FISCAL POLICY DIRECTORATE

FISCAL STRATEGY PAPER

Medium Term Fiscal Framework

1395

MINISTRY OF FINANCE
GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN

Fiscal Strategy Paper Contents

Key Acronyms

ADB	Asian Development Bank
ANDS	Afghan National Development Strategy
COFOG	Classification of Functions of Government
CPI	Consumer Price Index
FDI	Foreign Direct Investment
FPD	Fiscal Policy Directorate
FPF	Financial Programming Framework
FSI	Financial Sustainability Indicators
FSP	Fiscal Strategy Paper
GDP	Gross Domestic Product
GIROA	Government of the Islamic Republic of Afghanistan
IDA	International Development Association
IMF	International Monetary Fund
IsDB	Islamic Development Bank
MFM	Macro Framework Model
MOF	Ministry of Finance
MTBF	Medium Term Budget Framework
MTEF	Medium Term Expenditure Framework
MTFF	Medium Term Fiscal Framework
NPP	National Priority Plan
PFEM	Public Expenditure and Financial Management Law
SOE	State Owned Enterprise

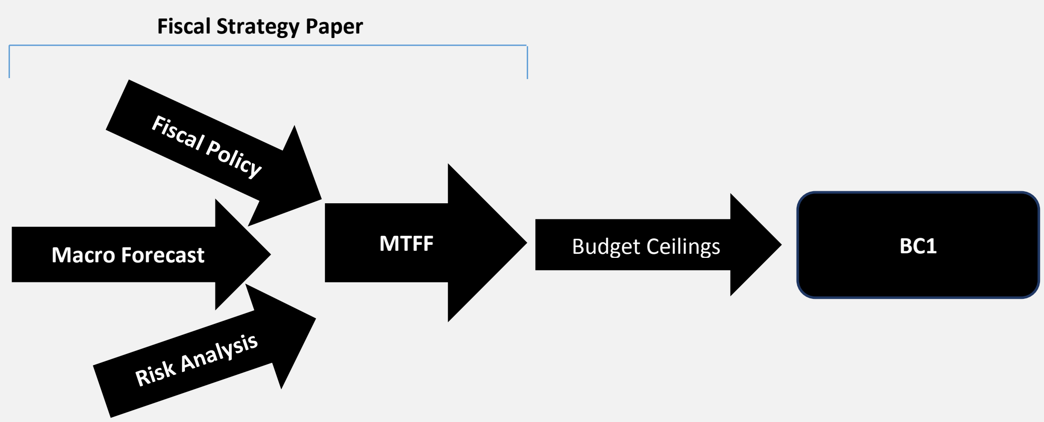
Introduction

This fiscal strategy paper (**FSP**) will set out the Government's medium term macro-fiscal framework, and provide guidance for the circumstances under which the 1395 budget will be set. It contains:

- The Afghanistan Macro Forecast for 1395, and outer years and the international context
- The broad fiscal policy framework under which the budget will operate, including rules the Government will adhere to.
- The medium term outlook for revenues, and broad categories of non-discretionary and discretionary expenditure, including aid forecasts and scenarios
- An overview of past performance in Government spending, and aid execution
- A discussion of the risks presented for the next fiscal year, including estimations of their impact
- A debt sustainability and fiscal sustainability analysis

This document is designed to inform the budget envelope: the international macroeconomic environment helps determine the Afghanistan macro forecast, and both the macro framework and the fiscal policy framework, past performance and donor data determine the Medium Term Fiscal Framework (**MTFF**). The MTFF is then supported by the analysis on debt and fiscal sustainability, and the risk and scenario analysis, in order to provide a fuller macro-fiscal picture.

Process of Preparing the Top-Down Budget:



Risks are compiled in order to determine scenarios for the macro-fiscal framework, some of these are set out in the ***Risks to the Macro-Fiscal Framework*** section, under Impacts; others are set out in the Scenarios portion of the ***Medium Term Fiscal Framework*** section. An overview of the macroeconomic and fiscal risks is set out in a Risk Matrix on page 27.

The Government produces the macro-fiscal forecasts using a financial programming framework (**FPF**), and uses multiple sources of information in order to inform these forecasts. The assumptions behind the macro forecasts are set out on page 14; the policy assumptions behind the fiscal forecasts are set out in the ***Fiscal Policy*** section (detailing the broad fiscal policy framework). These forecasts, and accompanying analysis, are produced by the Fiscal Policy Directorate (**FPD**), of the Ministry of Finance.

The macro-fiscal data set out in this document are the initial estimates for 1395 and onwards[1], these figures are indicative and may be adjusted during budget preparation as more information becomes available on the base year performance (1394) and on overall macro-fiscal conditions.

[1] Estimates have been generated for 1394 as a base year, as the final data is not available for this year at the time of production.

International Economic Outlook

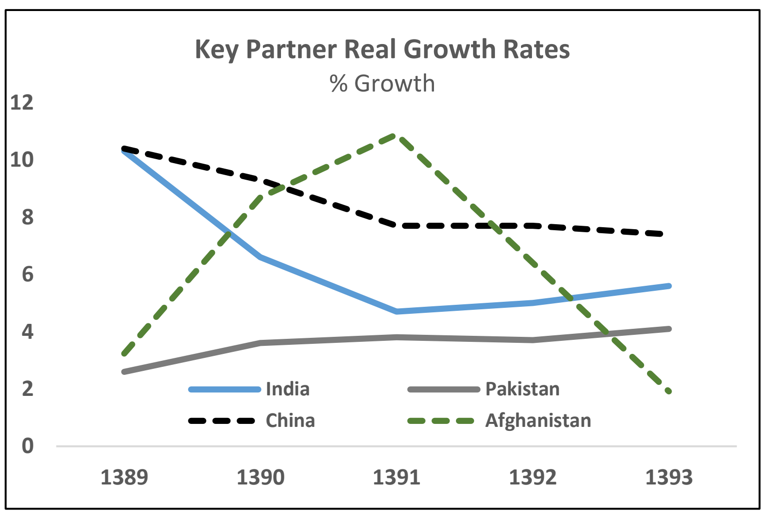
Overview of Economic Conditions

1393 saw the World economy continue to perform sluggishly, with a weaker than expected recovery (IMF growth forecasts for the year were revised down to 3.3 percent, from 4.0 percent in the April, 2013 WEO). Growth in the developing world was reduced by slowing growth in China, and overall world growth was pushed down by the reductions in the BRICS performance.

Partner Real GDP Growth	2010 1389	2011 1390	2012 1391	2013 1392	2014 1393
World Growth	**5.4**	**4.1**	**3.4**	**3.3**	**3.3**
India	10.3	6.6	4.7	5.0	5.6
China	10.4	9.3	7.7	7.7	7.4
United States	2.5	1.6	2.3	2.2	2.2
Pakistan	2.6	3.6	3.8	3.7	4.1
Iran	6.6	3.9	-6.6	-1.9	1.5
Turkmenistan	9.2	14.7	11.1	10.2	10.1
Tajikistan	6.5	7.4	7.5	7.4	6.0
Average	6.9	6.8	4.4	4.9	5.3

Source: IMF World Economic Outlook, October 2014

Falling growth rates in China and India are likely to mean possible reductions to Foreign Direct Investment (**FDI**) flows in to Afghanistan. FDI into Afghanistan has been focused on the extractive sector, which have in part been dominated by firms from China and India, and have fallen over the same time period (from a pre-2008 crisis average of US$ 233 million per year, 2005-2007, to around US$ 69 million in 2013[2]).



[2] UNCTAD Country Report

Afghanistan is in the following trade zones/agreements:

- **APTTA:** the Afghanistan-Pakistan Transit Trade Agreement, allows Afghanistan access to the ports in Pakistan for onward shipment of goods, with no duties or taxes on goods in transit. This agreement allows for mutual recognition of certain documentation, and simpler, standardized customs processes.
- **ECOTA:** the Economic Coordination Organisation Trade Agreement is a 10 member agreement, including many of Afghanistan's neighbours, to work towards the progressive removal of trade barriers and promote regional trade. It aims for the full removal of barriers and the creation of a free trade area for inter-regional trade.
- **SAFTA:** the South Asian Free Trade Agreement is an eight member trade organization with the aim of reducing inter-regional tariffs on non-sensitive goods.
- **WTO:** Afghanistan is working to join the World Trade Organisation, and as part of this effort has formed a working party to discuss the foreign trade regime.

World Economic Outlook for 1394 and 1395

World growth is expected to improve but remain moderate. China is expected to remain at growth of between 6 and 7 percent, below its recent historic performance, and reflecting the impact of falls in demand in the developed world. The growth in regional trading partners is expected to remain high, and as a result there is potential within the region for exports from Afghanistan.

The table below shows the forecasted economic growth over the medium term for the World, and our partner countries. Growth in Afghanistan is projected to be in line with the regional average, and slightly above in the outer years. The growth in 1393 was depressed below regional performance, and growth in 1394 is still in recovery from that slowdown. In general, while growth is slowing in the region, performance remains fundamentally strong and much of the slowdown among partners is the results of the reductions in Chinese and Turkmenistan growth.

The growth in Turkmenistan has been driven in part by sizable oil extraction, and public investment. While the growth in China has slowed as a result of decreased demand in the developed economies. The United States is expected to see continued strong growth following on from the recovery after the 2008 Financial Crisis.

Partner Real GDP Growth	2014	2015	2016	2017	2018
	1393	1394	1395	1396	1397
World Growth	**3.3**	**3.5**	**3.7**	**4.1**	**4.0**
India	5.6	6.4	6.5	6.6	6.7
China	7.4	7.1	6.8	6.6	6.4
United States	2.2	3.1	3.0	3.0	2.7
Pakistan	4.1	4.3	4.4	4.8	5.0
Iran	1.5	2.2	2.2	2.2	2.2
Turkmenistan	10.1	11.5	9.9	8.1	8.0
Tajikistan	6.0	6.0	5.8	5.8	5.8
Average	5.3	5.8	5.5	5.3	5.3

Source: IMF World Economic Outlook, October 2014, January 2015

World

The IMF has projected that growth around the World will reach 3.5 percent in 2015, and rise to 3.7 percent in 2016[3]. The decrease in oil prices towards the end of 2014, and early 2015, as a result of increased supply, will likely have some positive effect on world growth – particularly in manufacturing economies.

[3] This represents a slight downward revision on the last IMF forecast, the result of weaker activity in the Eurozone, China and Russia, and lower growth prospects for oil exporting economies.

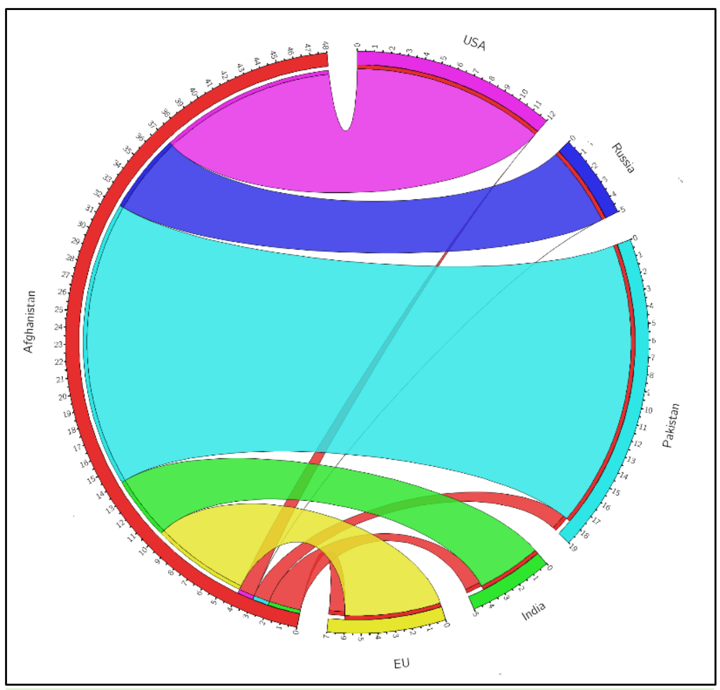
The Organisation of Petroleum Exporting Countries (**OPEC**), took the decision to maintain levels of supply, despite increases in production by the United States. This increase in overall global supply, alongside some weakness in demand in oil consuming economies, led to a precipitous decline in the price of oil. Prices are not expected to dramatically recover (see Commodity Performance and Forecasts, below), however there is expected to be a small, steady increase over the coming years[4].

Growth in the United States has been stronger than expected, and the US is forecast now to see growth of around 3 percent into the near future. This has been helped by an expansion of oil extraction in the US, as well as a loose monetary policy by the Federal Reserve.

European economies have seen a resurgence of the problems from the 2008 Financial Crisis, with an attempt by Greece to renegotiate debt, including the bailout support from the IMF-EU-ECB group. The European Central Bank (**ECB**) has expanded its use of unconventional monetary policy increasing purchases of instruments to include multiple types of bonds issued in the zone. The Swiss Central Bank removed the cap on the value of the Swiss Franc leading to a dramatic rise in the value of the Franc.

Regional

The October, 2014 WEO has reduced the expected performance of the Middle East, North Africa, Afghanistan and Pakistan region in response to a worsening security situation in many countries across the region. The growth in 2015 is expected to improve on 2014, however this is dependent largely on improved security and increasing oil production in some members.



Trade flows between 5 major trade partners (in 100 million Euros). Data from Eurostat, and IMF, calculations by FPD. Red ribbons are exports, coloured ribbons are imports.

A number of our key partner countries in the region face economic changes this year, including:

Iran: while Iranian growth prospects remain good, uncertainty remains over the impact of falls in international oil prices, which could put at risk growth in Iran.

Pakistan: Pakistan operates an IMF (Extended Fund Facility) program, as part of an effort to improve fiscal controls. In general cautious fiscal policies have improved the budget deficit, and growth is expected to be robust, with low inflation.

India: growth in India has slowed over time, as a result of global concerns. While this situation is expected to improve the

[4] At the time of writing oil price futures for December 2019 were priced at 69.5 USD per barrel, above the current spot price of 52.

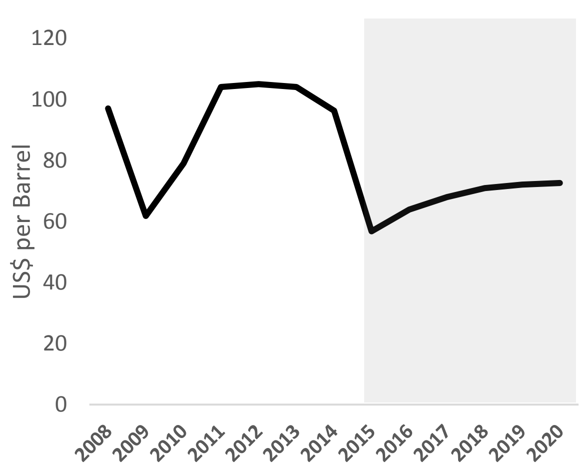
risk remains that falls in investment will lead to longer run growth reductions. Inflation has remained relatively high, although falling food prices will help reduce this; and the economy remains vulnerable, given its international trade connections, to a withdrawal of loose monetary policy in the developed world.

China: growth in China is expected to reduce, in line with reduced demand for exports. The Chinese authorities continue to make efforts to promote internal demand, and the slowdown in growth has begun to impact international prices for resources. While China is also a key trading partner for Afghanistan their main intervention in the country remains through investments in concessions and other projects. A reduced resource demand within China puts these at risk.

Commodity Performance and Forecasts

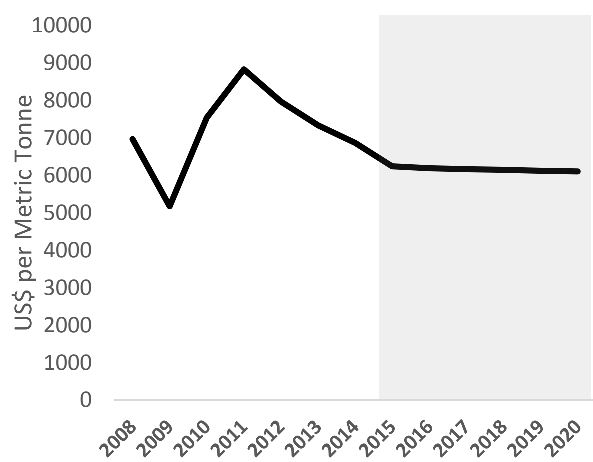
The below show the key commodities for Afghanistan and the likely future movements of their prices. The reduced growth expectations for China are likely to keep commodity prices steady over the coming years.

Crude Oil Prices Forecast



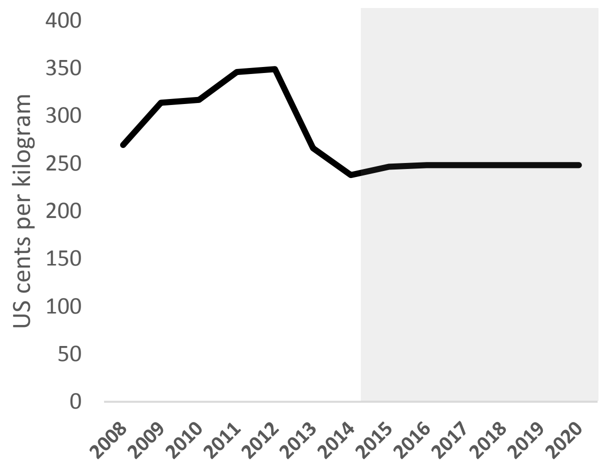
Afghanistan relies on imports of imported fuel, and fuel prices locally tend to move in line with international prices. Prices dropped considerably in late 2014/early 2015, pushing down local fuel prices by 13 percent. They are expected to recover slightly heading towards 1395, however futures prices indicate that prices are expected to remain lower for some time.

Copper Prices Forecast



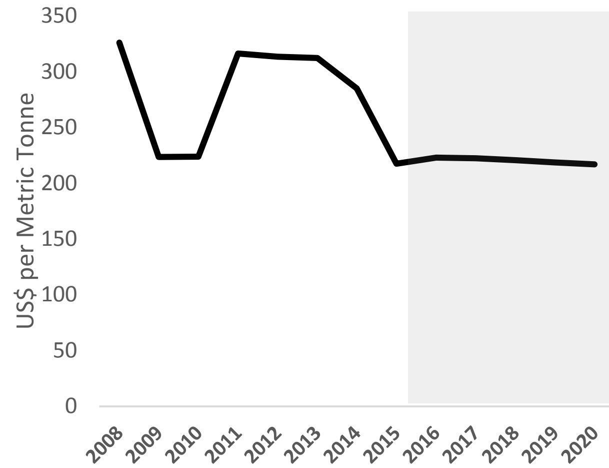
Copper prices have declined dramatically from a peak in 2011, unfortunately this has made copper a less attractive investment around the world, including in Afghanistan. Prices are expected to stabilise over the medium term, meaning we cannot rely on an increase in copper prices to make mining investments more appealing here.

Tea Prices Forecast



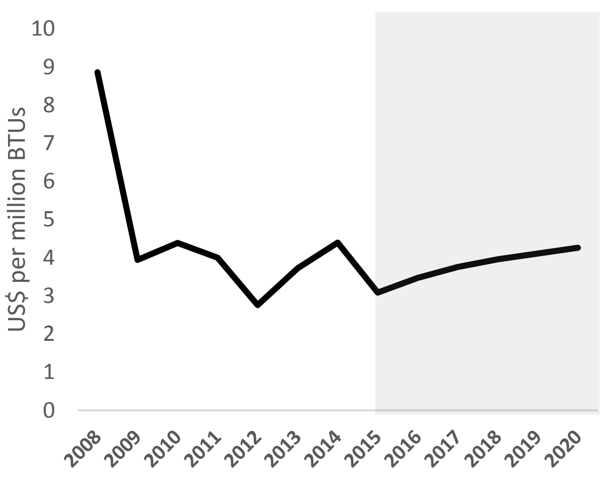
Afghanistan relies mostly on imported Tea and the tea price in international market has a huge impact on local prices which move with the price fluctuation in international prices. The tea prices trend over past few years was high. However, the prices gradually declined since first half of 2012 up to the end of 2014. Meanwhile, the forecast for the medium term is not predicted to be very high, the price might remain moderate**.**

Wheat Prices Forecast



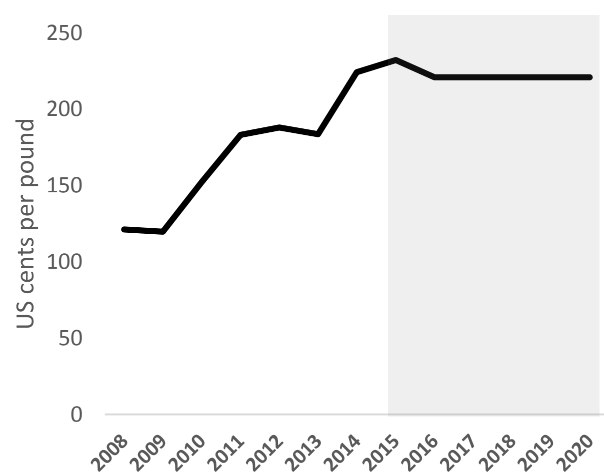
Wheat is main staple food item consumed in Afghanistan. Despite the huge potential and reasonable climate, Afghanistan still relies on wheat imports from our neighboring countries. The prices in International markets has positive and negative impacts on wheat flour prices in the local market. Wheat prices fell during 2013 and 2014 and it's expected to remain lower over the medium term**.**

Natural Gas Prices Forecast



Afghanistan is dependent on imported Natural Gas over the past 13 years. Generally gas prices have been high in Afghan markets due to the higher transportation cost and limited competition. However, still the changes in gas prices in global markets affect the gas prices in Afghanistan, as recently we observed about 38 percent decline in the retail gas prices during December 2014 and January 2015. But over the medium term the prices in international market expected to trend upwards slightly from 2016 onwards.

Beef Prices Forecast



Afghanistan imports Beef from other countries but not in large volume, as local suppliers also fulfill partial demand for beef in the market. Looking to the beef price in above chart, this has increased dramatically over the past eight years, but the outlook for the prices seems to be relatively lower in the coming years, probably due to change in international demand.

Risks in the World Economy

The major risks in the World economy include:

- Continued slowdown in Japan, leading to lower overall world growth, and an exacerbation of the problems in the Eurozone, caused by Greek debt renegotiations.
- An increasing of borrowing costs in developing countries, as more investors move to safe havens.
- There is uncertainty over the likely future movement of oil prices. While futures prices reflect a steady increase, this is likely the result of a general assumption that reduced prices will reduce investment in the sector, tightening production and raising prices in the future. In the medium term the prices are likely to be dependent strongly on both political factors, and the level of production in the United States.
- Reduced growth in the United States as a result of tightening monetary policy. A tightening of the Federal Reserve's monetary policy could reduce the growth levels in the US, and risk an overall world slowdown.

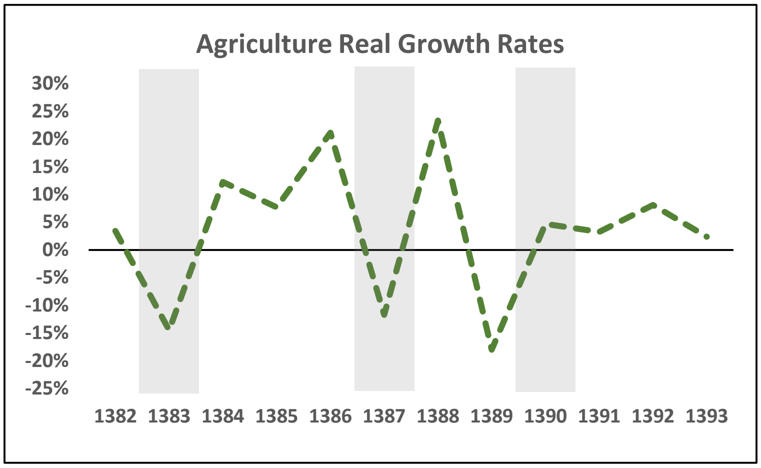
Regional Risks:

- Efforts in China to curb the expansion of credit could reduce likely demand in the region
- Reduced growth in China, leading to lower commodity prices, or stagnant prices for likely major export commodities for Afghanistan.
- Low tax collection relative to GDP remains a concern in the region, and efforts to improve the ratio may slip in many countries.
- Security concerns in the region risk damaging growth and increasing fiscal pressures on Governments.

Macroeconomic Performance and Outlook

Historic Performance

During fiscal year 1393 the macro-economic environment was marked by a prolonged slowdown which was the result of the elections. 1393 saw both a presidential election, which went through to a second round, and a security transition; both of these events together created an uncertainty which reduced business and economic activities, reduced imports, and reduced FDI and donor support. The complicated election process during March and June 2014 created uncertainty in the political environment which is the core determinant of economic activities, and foreign and domestic investment in Afghanistan. Unrest in the political climate has caused a reduction in potential economic growth over the past 10 years. Real economic growth remains close to two percent by end of 1393, while economic grown during fiscal year 1392 was above three percent.



Gross Domestic Product (**GDP**) was affected by slowing growth in the manufacturing and services sector. Agriculture growth had slow, but not negative performance. The slowdown in manufacturing and services was led by reductions in retail activity, and falling rental prices.

Agriculture growth has been historically volatile, varying in line with changes in the climate and prices. In recent years this has stabilized, in part due to efforts to irrigate, and in part the result of a more favourable climate.

Historic GDP	**2010** 1389	**2011** 1390	**2012** 1391	**2013** 1392	**2014** 1393
Nominal GDP (Afs Bn)	**719.6**	**863.7**	**1044.7**	**1149.9**	**1215.9**
Nominal GDP (US$ bn)	**15.0**	**19.2**	**20.9**	**22.1**	**21.7**
Agriculture (% Nominal GDP)	28.8	28.0	26.4	25.6	23.7
Maufacturing (% Nominal GDP)	21.3	22.4	21.3	20.5	20.5
Services (% Nominal GDP)	49.8	49.6	52.3	53.9	55.8
Real GDP Growth (%)	**3.2**	**8.7**	**10.9**	**6.4**	**1.9**
Agriculture Real Growth (%)	-18.0	4.7	3.3	8.1	2.4
Manufacturing Real Growth (%)	6.3	9.8	7.8	4.9	0.7
Services Real Growth (%)	18.1	10.3	16.0	6.3	2.2

Source: Central Statistics Office, and FPD Staff Estimates

Outlook

1394 and 1395 are expected to be years of recovery, with an improvement in activity, however economic performance is expected to remain below that of recent history. Growth in Afghanistan is expected to be led through a recovery in the services sector in 1394 and 1395, with growth levels returning to a moderated trend. Price changes have moderated over time, but are expected to rise slightly above the 1393 figure this year and in 1395, as the low inflation was in large part the result of large falls in rental prices at the start of 1393, and moderate international prices.

In percentage change	Historic	Current	Budget	Outer Years	
Unless otherwise noted	**1393**	**1394**	**1395**	**1396**	**1397**
Real GDP Growth	1.9%	4.0%	6.1%	6.6%	6.7%
Nominal GDP Level (Afs bn**)**	1215.9	1292.0	1434.5	1591.9	1775.8
NGDP by Sector (Afs bn**)**					
Primary	288.2	292.5	330.0	368.0	412.0
Secondary	249.4	266.2	294.0	328.3	368.6
Tertiary	678.3	733.4	810.5	895.7	995.1
GDP Deflator	3.8%	2.1%	4.6%	4.1%	4.5%
CPI Inflation	1.3%	4.3%	4.3%	4.1%	4.3%

Source: FPD Staff Estimates

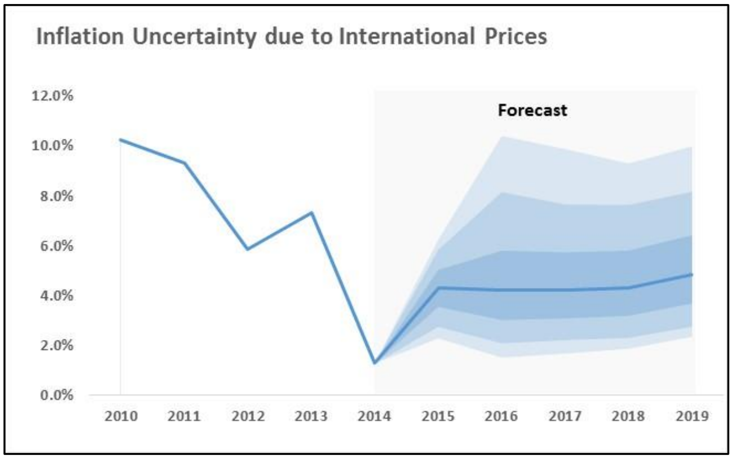
We have assumed that:

- Growth in construction is expected to remain high, despite a slowdown in imports in 1393. Construction activity however seemed to remain stable in 1393.
- Retail trade is expected to improve following the end of the election, and transition.
- Telecoms is expected to grow robustly, particularly with the start of operations of Salaam, and a likely expansion of internet services.

GDP is being led by growth in services, however agriculture, as a large component of household incomes and occupational activity. Recovery in the secondary sector is forecast to be a little slower because of conservative assumptions on the expansion of the manufacturing sector. Values in the table above are given in *Basic Prices*.

GDP Per Capita: The GDP per capita is expected to grow slowly over time, recovering to the pre-2014 level by next year.

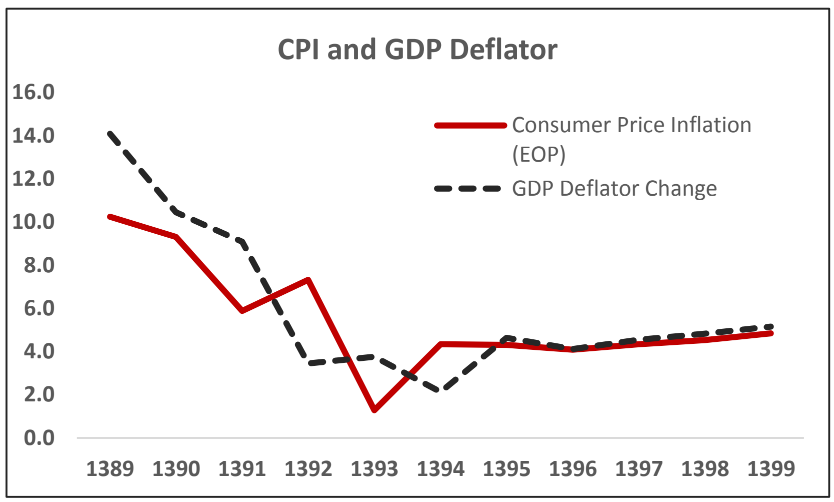
US$	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
GDP Per Capita	714.9	741.6	713.6	730.2	754.5	781.0	810.5	842.9	878.9



Inflation in 1393 was driven by falls in the prices of rental properties, particularly in Kabul. International prices moderated towards the end of the year, particularly fuel, which has also helped reduce inflationary pressures. In 1394 and 1395 we expect international price pressure to remain low, with a small rise in fuel prices. In general the inflation levels are expected to remain around 4 percent, in line with a substantial moderation in prices growth over recent years.

The above shows the forecast for next 5 years. It shows the variance in domestic inflation as a result of uncertainty in international prices. The prices examined include fuel, wheat and liquid gas prices, all of which make a substantial components of consumer expenditures. Any changes among these three commodities can cause considerable variation in inflation for future years. With 50 percent certainty, the inflation is expected to lie in the range of 3 percent to 6 percent for the fiscal year 2016.

Both the consumer price inflation and overall GDP deflator have moderated over time, and are expected to see further moderation going forward, a testament to the success of the Government's economic stabilization policies. Inflation over the last 3 years have averaged 4.8 percent, with a significant moderation in international food and fuel prices in 1393 responsible for the very low rate in that year.



Imports are expected to increase slowly over time as a result of low levels of local production of goods, creating a continued demand for international imports; this may moderate depending on the level of aid flows, and FDI, as well as the income from concessions.

Exports are expected to recover partially in 1394 from the downturn in 1393, and remain on this trend through 1395 and the medium term. The main components impacted during the 1393 downturn were construction material imports and the imports of fuel – while some of this may be related to the drawdown of international forces and some international organisations, and thus will not recover, it is also likely (particularly for construction materials), that it was partially the result of reduced investment during the elections, and reduced business activity. Retail sales fell during 1393, hence 1394 forecasts and beyond have remained conservative in case firms are reducing excess stock rather than importing additional goods.

Exchange Rate: we are assuming a 5 percent depreciation in the currency over the period 1395 – 1399, based on the base assumption that the exchange rate for 1393 Afs 57/dollar.

This forecast is based on internally developed econometric models linking exchange rate expectations (i.e. historic exchange rates) and historic inflation rates to movements in the exchange rate over time[5].

The table below sets out the Afghanistan's estimated and forecast balance of payments:

Balance of Payments – *Afs Millions*	**1393**	**1394**	**1395**	**1396**	**1397**
Current Account	**145117**	**87846**	**53107**	**19432**	**-15910**
Goods Balance	-368520	-428281	-443233	-458788	-475027
Imports	-472997	-538395	-559502	-581794	-605358
Exports	104476	110114	116269	123006	130331
Services Balance	37277	37495	31841	25546	17293
Payments	-121206	-128485	-142305	-157523	-175444
Receipts	158483	165980	174146	183069	192737
Net Income and Transfers	476360	478632	464499	452674	441824
Capital Account	**17549**	**19825**	**19221**	**11986**	**21547**
Capital Transfers	2468	2145	2043	-4821	1964
Foreign Direct Investment	20990	22040	23142	24299	25514
Other	-5909	-4359	-5964	-7492	-5931
Changes in Reserves	**162666**	**107671**	**72327**	**31418**	**5636**

Source: FPD Staff Estimates

Population Forecast:

Population forecast figures are based on the UN Economic and Social Affairs (**ESA**) Population Division estimates for the overall Afghan population growth. This assumes that the population increases at a rate of 2 percent per annum.

[5] Percentage changes in the exchange rate are a function of $\%\Delta ER_t = -0.003ER_{t-1} + 0.001INF_{t-1} - 0.221\%\Delta \mathrm{INF}_{t-1} - 0.211\%\Delta \mathrm{INF}_{t-4}$

Fiscal Performance

Last Year's Performance (1393)

Collection fell particularly in imports and sales taxes, as a result of the fall in imported goods during the year. This fall was concentrated in construction materials, and fuel imports. While construction material imports have fallen general construction activity has not (construction withholding grew year-on-year). The Government also used financing from the Afs 20 billion carry forward from 1392.

The Government introduced no new major tax policy changes in 1393. The figures below are preliminary and may change after reconciliation.

Afs Millions	**1392** Actual	**1393** Budget	**1393** Preliminary	% Change on 1392
Revenues Including Grants	**306105**	**-**	**278975**	-9%
Revenues Excluding Grants	**109732**	**133800**	**99278**	-10%
Revenue (without customs)	**81427**	**97726**	**75019**	-8%
Tax Revenues (without customs)	52392	62352	47745	-9%
Fixed Taxes	11972	13807	9921	-17%
Income Taxes	16610	19741	16803	1%
Property Taxes	295	399	633	115%
Sales Taxes	17809	23246	15739	-12%
Other Taxes	5110	4482	4649	-9%
Tax Penalties and Fines	596	676	0	-100%
Customs Duty, Import Taxes	28305	36074	24260	-14%
Non Tax Revenue	**21881**	**27593**	**16015**	-27%
Income from Capital Property	1739	3315	1383	-21%
Sales of Goods and Services	8127	10746	3342	-59%
Administrative Fees	10567	11996	9501	-10%
Royalties	318	360	429	35%
Non Tax Fines and Penalties	630	774	713	13%
Extractive Industry	499	402	647	30%
Miscellaneous Revenue	**3407**	**3560**	**7451**	119%
Social Contributions	**3747**	**4221**	**3808**	2%
Grants	**196373**	**-**	**179697**	-8%
Foreign Governments	140082	-	119263	-15%
International Organisation	56291	-	60434	7%
Other Government Units	0	-	0	-

Source: FPD, and AFMIS

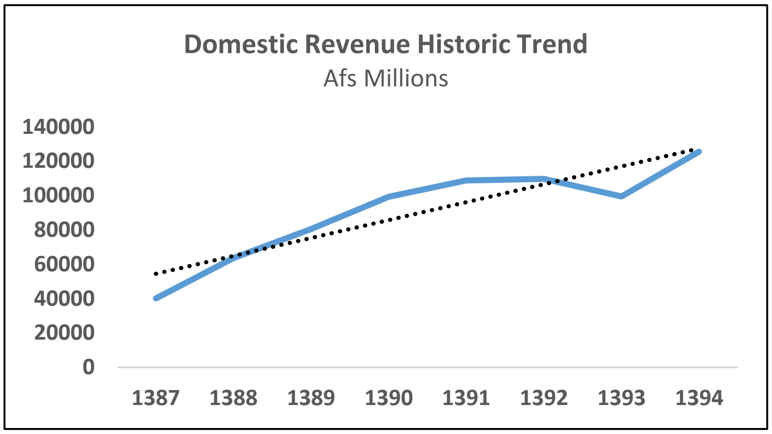
Expenditure has reduced in the development budget in line with the reduced resources available. The Government made particular cuts to the G+S and Capital expenditures, as they were the ones most easily adjusted throughout the year, and as a result fell most below budget. However the Government made savings where possible in expenditures less detrimental to growth – including travel and communication costs; and additional areas like overtime costs.

Afs Millions	**1392** Actual	**1393** Budget	**1393** Allocated	**1393** Actual	% Change on 1392
TOTAL GROSS EXPENDITURES	277947	428379	422844	304095	9%
Operating Budget	197746	280473	276810	227891	15%
Development Budget	80201	147906	146034	76204	-5%
Discretionary Budget	18903	0	46424	9422	-50%
Non-discretionary Budget	61298	147906	99610	66781	9%
TOTAL NET EXPENDITURES	277911			304062	9%
RECURRENT EXPENDITURES	228821	N/A	321258	255800	12%
Compensation of Employees	139475	162603	156013	150157	8%
Wages and Salaries	133718			144207	8%
Social Benefits	5757			5950	3%
Use of Goods and Services	77642	N/A	143145	85531	10%
Travel	2192			1993	-9%
Communications	3992			3955	-1%
Contracted Services	25283			27810	10%
Repairs and Maintenance	9605			15620	63%
Utilities	3220			5710	77%
Fuel	5809			10524	81%
Other Use of Goods and Services	27541			19919	-28%
Interest	268	2400	2400	349	30%
Social Transfers	11436	19700	19700	19763	73%
Subsidies	900			453	-50%
Grants	233			411	76%
Social Security	10299			18731	82%
Other Social Transfers	3			168	4887%
ACQUISITION OF ASSETS	0				
Gross Acquisition of NFA	49126	N/A	101586	48295	-2%
Net Acquisition of NFA 1	49090			48262	-2%
Sale of Land and Buildings	-36			-33	-9%
Buildings and Structures	36886			22203	-40%
Machinery / Equipment	8118			6135	-24%
Valuables	1			0	-100%
Land	606			571	-6%
Capital Advance Payments	3514			19384	452%

Source: FPD, and AFMIS

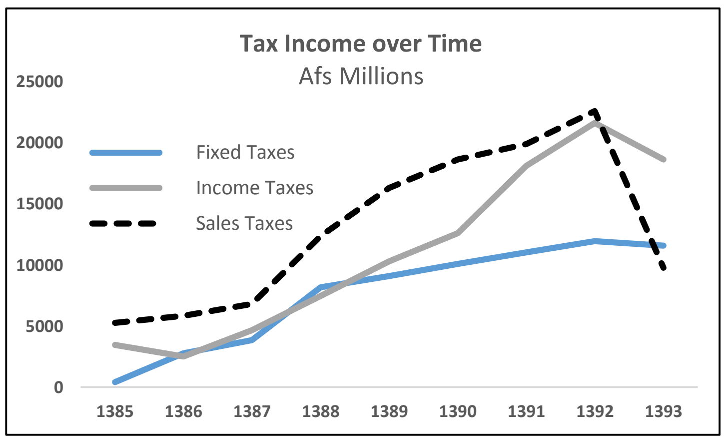
Historic Performance

Historically we have seen periods of dramatic revenue growth, however in recent years this has moderated with growth in revenues declining and eventually falling negative. The falls in imports last year have dramatically reduced revenue below trend. However even prior to that point the growth of domestic revenue collection was moderating. During 1388 to 1390 growth was an average of 28 percent, from 1391[6] to 1392 this fell to 7 percent, with a decline following in 1393.



The collection under Income Taxes has grown by 150 percent over the past 5 years, however royalties have grown at over 2000 percent, reflecting the potential importance of this sector once mining projects come underway.

The majority of revenue lines have moderated in a similar fashion to the overall during the same time period, possibly reflected the limited room for easy gains in terms of large amounts of additional revenues.



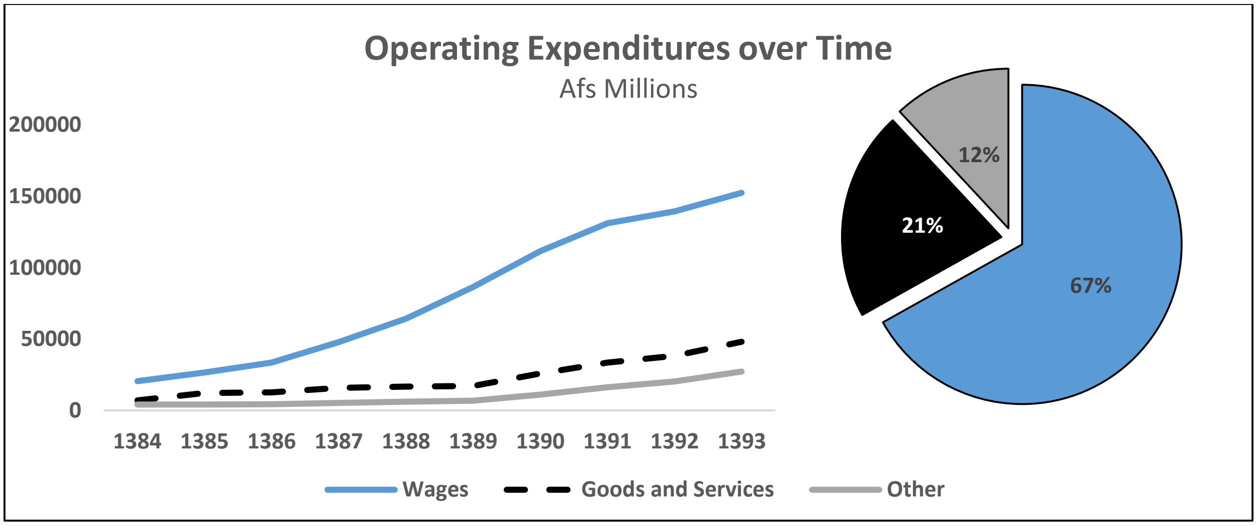
The dramatic fall in sales taxes is the result of a general slowdown in retail activity. The Government plans the introduction of VAT in the near future, in part to help the enforcement of the collection of these types of taxes which should improve the yield.

The increase in domestic revenue resources over time has allowed the Government to expand expenditures. The overall aim of the Government (see ***Fiscal Sustainability*** section) is to improve the coverage of the budget by domestic resources. Over time this has steadily increased – the change in the last two years is reflective of an increase in donor support coming on budget.

	1384	1385	1386	1387	1388	1389	1390	1391	1392	1393
Domestic Revenue/Total	22.1%	37.6%	35.6%	43.6%	46.7%	45.8%	49.3%	50.7%	34.1%	37.1%

Source: FPD Staff Calculations

[6] 1391 was only a 9 month fiscal year, in order to allow the adjustment of the fiscal year; the figures given here show the collection annualized as though it was for a 12 month year for ease of comparison.



Expenditures have grown consistently over time, with a slowing in 1391 to 1393 as a result of revenue constraints, and controls. The operating expenditures are primarily related to salaries, with a smaller portion to Goods and Services – as some of the G+S expenditure falls under the development budget. The slowing expenditures, even prior to the 1393 slowdown, indicates that the Government is achieving more control over expenditures and costs.

Historic Debt:

Afghanistan went through the Heavily Indebted Poor Countries Initiative (**HIPC**) debt write down, which significant reduced the debt between Decision Point (**DP**) and Completion Point (**CP**). Since that point debt has been largely concentrated in remaining debt from the Russian Federation, and debt to the multilateral organisations (our only source of borrowed funds at the moment).

Afs Millions	At DP	2008/09	Post-CP	Current	Change	
					On DP	On CP
Total	**11939**	**2104**	**2313**	**2374**	**-80%**	**3%**
Multilateral	**557**	**1001**	**1177**	**1285**	**131%**	**9%**
IDA	301	433	418	423	41%	1%
Asian Development Bank	255	478	628	693	172%	10%
IMF	0	87	119	131	-	10%
IsDB	0	1	12	38	-	225%
OFID	2	2	0	0	-100%	-
OPEC	0	0	0	2	-	-
Bilateral	**11382**	**1103**	**1136**	**1089**	**-90%**	**-4%**
Russia	11128	851	1003	956	-91%	-5%
Germany	44	17	0	0	-100%	-
United States	112	108	0	0	-100%	-
Other Official Bilateral	99	127	0	0	-100%	-
Bulgaria	48	49	52	53	11%	1%
Iraq	9	0	0	0	-100%	-
Kuwait	19	21	23	23	17%	1%
Saudi Arabia	22	0	0	0	-100%	-
Saudi Fund	0	47	47	47	-	-1%
Slovak Republic	0	0	0	0	-	-
Croatia	0	0	0	0	-100%	-
Iran	0	10	10	10	-	1%
Commercial	0	1	0	0	-	-
Bulgaria	0	1	0	0	-	-

Source: FPD Staff Calculations, World Bank, IMF and Debt Management Unit, Ministry of Finance

Fiscal Policy

Fiscal Framework

The fiscal policy of the Government of Afghanistan helps set the framework for the medium term fiscal scenarios. The fiscal policy outlined in this section is the result of international agreements the Government has committed, as well as statements of the Government's fiscal objectives over the medium term. In general the Government has adopted a contractionary fiscal policy, reducing the level of spending in order to meet resource availability. As Afghanistan does not borrow and has limited reserve funds, the fiscal policy is pro-cyclical, with falls in expenditure occurring alongside falls in economic activity.

Fiscal policy in Afghanistan is heavily influenced by both the 1393 cash crisis, and the large donor support to Government. 1393 saw a downturn in revenues, as a result of events surrounding the elections, and security transition. This downturn in revenues led to the use of the Government's funds held in the Treasury Single Account (**TSA**). As a result of these events, the fiscal policy over the medium term is tied to ensuring fiscal recovery from the downturn, and building the Government's domestic resources.

The Government proposes to slowly phase out donor support to key Government operations, bringing more on budget, and ensuring that the domestic revenues grow at a rate fast enough to cover operational expenditure in the long term. Over the medium term the Government proposes to increase the coverage of operational spending by domestic revenues from 8 to 9% to a figure more in line with the regional collection[7]. This is in line with the long run aim of covering the security expenditure fully by 2024.

The re-integration of government operations within the budget and government systems is a key aim of the government, in order to ensure that the Government controls more of the operational aspects of running the state – including on security, policy making, audit and oversight and budget preparation. In the medium term framework therefore, the Government's key fiscal policy aims can be stated as:-

- The reduction over the medium of the portion of the operational budget funded externally, and an improvement in the domestic revenue/operational spending ratio.
- The Government intends to ensure a build-up of cash reserves over the medium term in the Treasury Single Account, in order to provide a cushion of funds for future downturns. Given our commitment to avoid borrowing, we must ensure we are able to manage liquidity through a reserve of funds, and close management of cash.

[7] Collection in India and Pakistan is between 10-12%

Fiscal Policy from IMF Agreement:

These include:-

- Ceiling on short term borrowing set to zero
- Ceiling on non-concessional[8] borrowing set to zero
- Ceiling on government guaranteed borrowing set to zero
- Ceiling on arrears set to zero

The Government had an agreement with the IMF, under the Extended Credit Facility (**ECF**) program, to adhere to a restricted borrowing plan, including no short term, or non-concessional borrowing. As a result borrowing from local markets is unlikely to be allowed, and borrowing is primarily sourced from the main concessional lenders (the World Bank IDA facility, the Asian Development Bank and the Islamic Development Bank). While the ECF program came to an end in 1393 (2014), a likely future Staff Monitored Program (**SMP**) would most probably include a similar commitment to restrict borrowing.

Terms and Conditions of Loans under Historic IMF Agreements

Term	Long Term	Short Term
Concessionality	Non-Concessional	Concessional
Borrower	Central Government	Guaranteed SOE

A long term, concessional loan to central Government would be uncapped under the agreement with the IMF; however any other variant is subject to a zero cap (for example, a short term loan by the central government, regardless of conditions, would be not within the terms of the agreement).

As a result, in the MTFF we have restricted borrowing to the identified concessional borrowing in the medium term. This includes borrowing from the ADB, IsDM and World Bank IDA (as well as the funds from the IMF agreement – see ***Debt and Fiscal Sustainability*** *Section*).

Fiscal Policy from PFEM Law:

The Public Finances and Expenditure Management Law (**PFEM**) Law sets out the conditions under which guarantees may be given by the Central Government. In only two circumstances can the Government give a guarantee for a loan, these are:

- Where a law is in place authorizing the value of the guarantee
- Where the budget law includes appropriation for the value of the guarantee

As a result, we are not assuming that the framework contains any commitments to give guarantees throughout the year. Therefore the Government will not acquire new contingent liabilities throughout the medium term.

[8] For the purposes of this rule, non-concessionality is defined as a grant element of less than 35 percent, typically we are aiming for a grant element of 60 percent.

The PEFM sets out rules on the preparation of the budget, including timelines and reporting requirements after the fact, as part of this it sets out a rule on the appropriation for contingencies, which will guide the contingency appropriation in the MTFF.: “An appropriation not exceeding 3% of total program expenditures for contingencies”.

Fiscal Policy from the Minerals Law:

At the moment all minerals revenue goes through the general Government budget and the Treasury Single Account (**TSA**), the Government does not operate a separate fund to save minerals revenue as either a revenue stabilization or wealth fund.

Fiscal Policy from Other Agreements:

- The Government has made a commitment to phase out external support to the security sector by 2024, starting with financing for meals for soldiers being brought on budget, and with increasing salary payments being made by the Government instead of through donor support. The Government committed to ensuring that operation and maintenance spending was slowly phased on to budget. [linear assumption about phasing in, in MTFF]
- Afs 500 million of domestic revenue is committed to security sector spending (ANSF - Ministry of Defense and Ministry of Interior – Chicago Conference Agreement) (NSC and NDS – the Government contributes more in previous years, because we have a wider definition of the security sector.)
- The Government earmarks around 10% of domestic revenue each year as a contribution to the development budget. The Government maintains discretion over how this money is spent within the development budget.

Government Debt Strategy:

The Government set out, in 2005, a series of debt policies which determines the constraints on debt acquisition by the Government. These are in line with the policies agreed under the programs with the IMF, and are intended to elaborate further the Government’s continued commitment to debt sustainability. Among these are:

- Debt is the total of Government borrowed funds, guarantees and contingent liabilities, and as a result fall under these constraints.
- The Government will only acquire debt from the International Financial Institutions (**IFIs**), and that debt should be at concessional rates: with repayment terms, service charges and other fees and charges below market.
- The Government sets an annual limit on borrowed funds and guarantees, set out in the Budget book, however there is no longer term limit set out.
- The Government will only issue domestic debt when circumstances support it, and policies, procedures and processes have been established.
- The Ministry of Finance, in consultation with the Budget Committee, will determine if a specific project should be financed through borrowing, dependent on the economic rationale of the

project, the number of beneficiaries and any other criteria the Government deems to be important.

In line with the commitments under previous IMF programs, the Government will not borrow, other than concessionally.

Policy Objectives Affecting Aggregate Ceilings:

- The Government aims to ensure that operation and maintenance of new capital is accounted for the in the expenditure plans of Budgetary Units through the medium term, ensuring that the cost of capital expenditure projects are fully realized at the decision time.

Earmarked Operational Budget:

Portions of the operational budget are earmarked towards specific expenditures. The donor support to the operational budget cannot be used generally within the operational expenditures, and is instead focused on the security sector (within that sector there is some room for some small variety of uses within the codes agreed with donors). These areas of support are:-

- LOTFA: is earmarked to the security sector, it is to be used for salary payments.
- CSTC-A: is earmarked to the security sector, however there is discretion within that where the money may be spent (MoD and MoI)
- NATFO (National Army Trust Fund Office): is earmarked to the security sector, primarily training and development expenditure.

Tax Policy Changes

In 1394 the Government is introducing a number of new tax policy measures, these will continue in to 1395, and have influenced the baseline forecasts for revenue. These new measures are estimated to be raising an addition Afs 8 billion in revenue; the forecast prior to these new additions was Afs 114 billion, for the 1394.

The new measures include:-

- An increase in the overflight fees charged to airlines, pending agreement on the increase with the International Air Transport Association (**IATA**).
- An increase in the rate of Business Rate Tax (**BRT**) charged on sales of goods
- An increase in certain tariff duties paid at the border
- An increase in the fee placed on the import of a liter of fuel.
- The introduction of taxes on the top-up credit for mobile phones

The collection from these lines relies upon falls in compliance and changes in demand not being too dramatic. The total value at risk for changes in demand and compliance is Afs 1.4 billion. On top of this there is an introduction risk (many of these new measures require either international agreement or passage by the legislature[9]); and a requirement to ensure the administrative mechanisms are in place in order to collect the taxes (particularly in the case of the top-up fees). If these fees are not introduced the collection this year is likely to fall below Afs 123 billion, which will reduce forecasts for collection in 1395.

Tax Expenditures: tax expenditures are tax incentives that the Government provides for particular types of provision of services, or goods, or to encourage a particular activity in line with policy goals (they can be provided through deductions, exemptions or differential rates of taxation). These are so called because the policy goal could also be achieved through a direct expenditure rather than through revenue foregone. As part of the commitment to full policy transparency some of these are set out here, and the Government will develop a more comprehensive listing and costing over time:

- An exemption on BRT for the provision of non-profit health services
- An exemption on BRT for the provision of non-profit education services
- There are BRT exemptions for financial and insurance services (in line with Article 65 of the Income Tax Law)
- Income received from renting a residential property to a natural person for more than 6 months of the tax year is exempt from BRT.
- Each of: religious services, humanitarian aid, G+S to the Government for natural disaster reconstruction, and physical education and sports are all exempt from BRT providing they are non-profit entities.

Box 1. Background to the Value Added Tax (VAT)

VAT was planned to be implemented in FY 1394, however due to the complexity of the tax system, the ARD wasn't ready to roll out this tax in 1394. Hence, it is now planned to be implemented in FY 1395.

VAT is a tax on consumption levied whenever the value of goods and services increases as they change hands in the course of production, distribution, and final sale to the consumer. The VAT has two concepts in VAT – zero-rating and exemption of goods and services. The VAT law has provided special provisions in this regard for certain goods and services which are exempted and zero-rated.

With the VAT introduction, the entire 2% BRT levied in border will be exempted along with partial replacement of 2% BRT collected by LTO office. Hence, the introduction of VAT will not be a huge burden in the market and should not adversely affect the price level as well. The overall effect of price level would be an increase of around 1.4% to 2% only. Manufacturing and Equipment will be affected the most, however the price level of telecommunication will fall by around 1% or higher. Similarly the effect on food and beverages will be very minimum.

VAT has a major advantage over the BRT: VAT prevents tax on tax and further exempts and zero-rates tax on certain essential goods and services. However there are still caveats to it, such the intricacy of tax calculation and compliance.

[9] The current forecasts for collection assume introduction in 6 months.

Risks to the Macro-Fiscal Framework

Risk Matrix

The below table sets out the key risks to the Government's macro-fiscal forecasts.

Risk	Likelihood	Impact	Details
Fiscal: continued low imports (either a result of volume decreases, or continued reductions in fuel and other prices) suppress earnings from import taxes	MEDIUM	HIGH	The current macro-framework assumes recovery in imports revenue through the year 1394; should this not occur and imports remain permanently lowered, it will reduce the forecasts for 1395 as well. (See ***MTFF section,*** Scenarios).
Fiscal: mismatches between revenue collection and expenditure could cause a cash shortfall.	HIGH	HIGH	A cash shortfall in 1394 could occur as a result of the low bank account balance, should a mismatch between expenditures and revenue occur, or revenue underperform. This could continue into 1395 if balances do not improve through this year.
Fiscal: the introduction of new measures in 1393 may be delayed	MEDIUM	MEDIUM	The introduction of new measures could be delayed for legal reasons (agreement with international bodies or passage by the legislature), or the implementation of some could be delayed (particularly top-up fees, for which a collection method would have to be determined).
Macroeconomic: Low agriculture growth due to low snowfall	MEDIUM	MEDIUM	Performance in the agriculture sector is reliant on the good season (level of snowfall), this year was low snowfall compare to last year.
Fiscal: Exchange rate depreciation causes cost increase for Government imports	LOW	MEDIUM	The exchange rate is assumed to see a continued, slight, depreciation over time in the macro-framework. An accelerated depreciation would slightly reduce debt sustainability (although the impact would be small), and increase the cost of imports.
Fiscal: Interest rate increase creates additional debt costs	LOW	LOW	Debt levels remain low, as a result the risk of this is slight. An increase in debt costs would likely be caused mainly as the result of a movement away from concessional borrowing.
Fiscal: Aid slowdown (commitments don't materialize)	MEDIUM	HIGH	In previous years execution on development has only been around 50% of the forecasted commitments, and donors may increasingly add conditionality to aid.

Risk	Likelihood	Impact	Details
Macroeconomic: continued uncertainty reduces FDI	MEDIUM	LOW	FDI reduced during the election period, with general domestic investment down as well. A continuation of economic and security uncertainty will likely suppress this further, particularly in the mining sector.
Fiscal: O&M costs are calculated as higher than anticipated	LOW	MEDIUM	O&M costs are assumed to be a function of capital expenditure. However, higher than expected costs of maintaining or operating new capital projects will create a large pressure on the Government budget in the long run[10].
Macroeconomic: lower execution in the development budget will increase unemployment.	MEDIUM	HIGH	The development budget has typically seen lower than desired execution rates. A lower development expenditure will likely reduce GDP growth below potential, and reduce employment growth.
Fiscal: reduced retail activity causes underperformance to target in BRT collection	LOW	LOW	1393 saw reduced collection from sales taxes, a continued low retail performance, would likely reduce BRT collection.
Fiscal: pension payments are exceeded by pension collections in the medium term	MEDIUM	LOW	The pension scheme in Afghanistan operates on budget. To date this has yielded a surplus for the budget, however demographic pressures leading to increasing costs are likely to lead to a deficit which requires financing from budgetary resources.
Macroeconomic: international commodity and food prices rise again after the slowdown this year.	LOW	LOW	An increase in the international commodity and food prices could push up local prices, increasing inflationary pressures in Afghanistan.
Macroeconomic: inflation and reduction in the external dollar flow cause a depreciation in the value of the Afghani.	LOW	HIGH	In the medium term the likelihood of a large decrease in dollar inflow is low, or spike in inflation is low. However, if they occur their impacts are likely to be high on the value of the Afghani.

Source: Ministry of Finance and FPD Staff Research

[10] In order to take into account in the medium term, the Government has begun estimating O&M costs for projects.

Impact

In order to judge the scale of the impact of these risks we run some simulations (set out below), to estimate the likely effect. Details on how some of these are conducted are set out in the ***Technical Annex***.

Delayed Introduction of New Measures

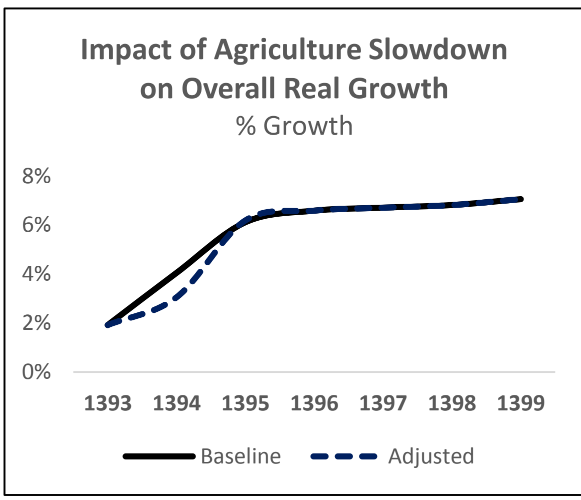
The delayed introduction of new measures could have a large effect on the revenue collection this year. New measures in total are responsible for Afs 8 billion in revenue collection. Assuming they are not introduced at all this would lower the forecast for 1395 to the base Afs 114 billion. The more risky measures, including the introduction of high overflight fees, and the tax on top-ups, are estimated to generate around half of the revenue for the Government.

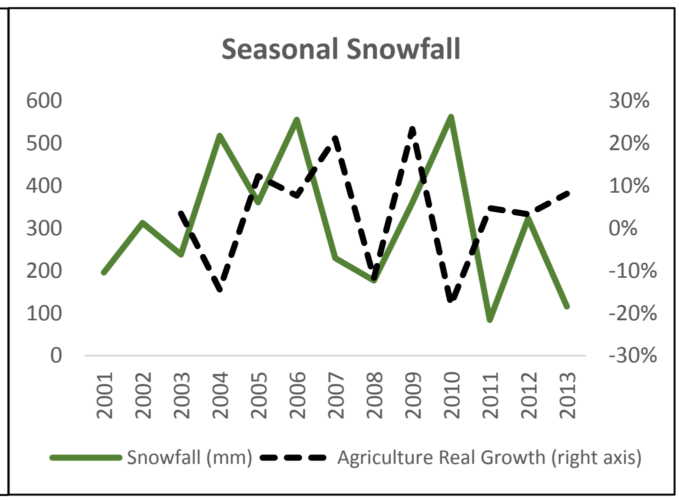
Reduced Aid

A reduction by 50% in aid expenditure on budget will reduce dramatically Government's impact on the overall economy. The estimated overall impact on value-added within the year is a loss of as much as 2.1% of growth. The longer run impact on growth, as a result of reduced investment, will also be significant, reducing growth slightly below the long run trend.

Reduced Agriculture growth

A large negative agriculture growth is unlikely at this stage given that it would take a longer period of low precipitation, however it possible that low snowfall[11] could lower agriculture output or reduce that growth to zero. Below is a chart showing overall GDP growth with zero agriculture growth, and the over-time relationship between snowfall and growth:



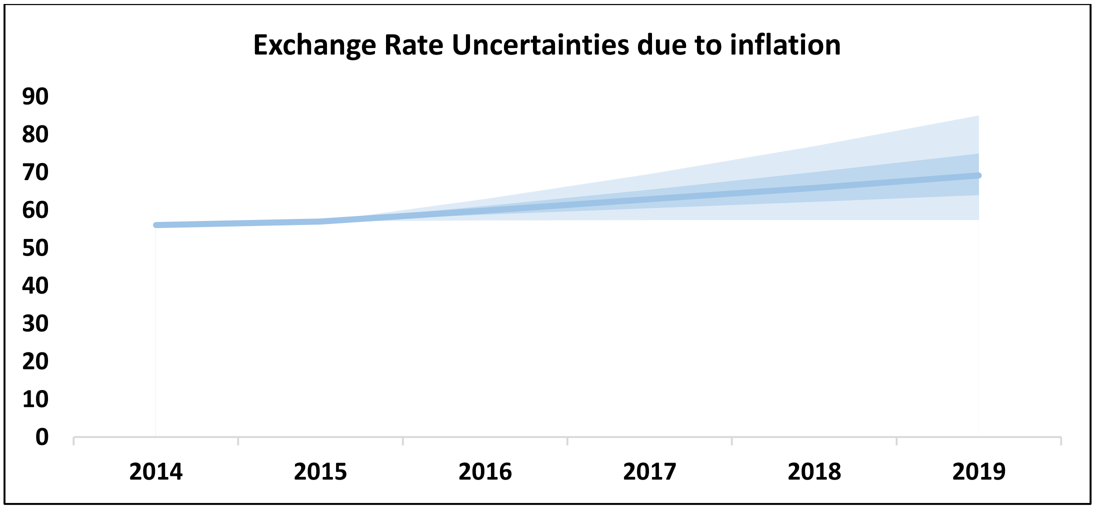


[11] Ministry of Agriculture, Irrigation and Livestock snowfall reports: http://mail.gov.af/Content/files/weekly%2018%20Jan%202015_pub4(5).pdf

Depreciation of the Afghani

While there is a risk that the depreciation of the Afghani could cause inflationary pressures in certain goods in Afghanistan, there has historically been little relationship between depreciation of the Afghani and inflation. Inflation in Afghanistan is more driven by movements in international prices, and the economic cycle here. As a result we have not included this as a risk.

The Afghani could continue to depreciate as a result of inflationary pressures. The below chart shows the range of likely outcomes for the value of Afghani over time, with most of the risk towards depreciation[12].



International Prices Increase

The diagram in the ***Macroeconomic Performance and Outlook*** section shows the impact of changes in international prices on local inflation. The high reliance on imports makes us particularly vulnerable to changes in international prices. As was outlined in the commodity section of the ***International Economic Outlook*** most international commodity prices are expected to remain fairly stable over the near term, hence the likelihood of this risk is categorized as low. However, at the most extreme a dramatic rise in prices could push inflation to between 8-10%. Inflation in Afghanistan however has moderated over time, and the increase in local production of many items, and increase in the number of trading partners, has reduced the volatility of the prices of imports.

Reduced Retail Activity

The table below shows the current forecast growth rates for different retail sectors, alongside the simulated rates under a less optimistic scenario:

GDP Growth	**1394**	**1395**	**1396**	**1397**	**1398**
Baseline	4.0%	6.1%	6.6%	6.7%	6.8%
Reduced Retail	3.8%	5.7%	6.1%	6.3%	6.4%

Source: FPD Staff Estimates

[12] The chart is generated using the regressed relationship between exchange rates and inflation.

The impact of these changes on the collection of BRT is set out in the scenarios under the ***Medium Term Fiscal Framework*** section.

Pensions Scheme

A number of changes have been made to the Government's pension scheme:

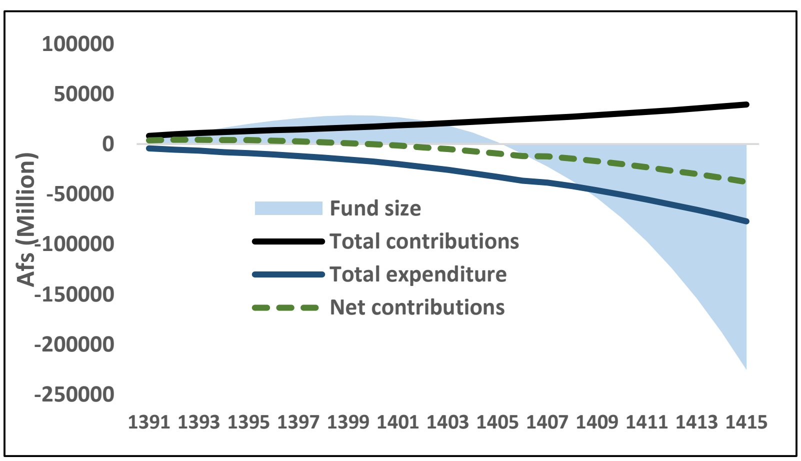
- The new pension scheme increased employer and employee contributions (for those who were admitted on the new scales of the *Pay and Grading* reform), and decreased the generosity of pensions to retirees.
- The reforms also eliminated continuous payments to survivors replacing them with a lump sum benefit.

However the old age pensions remained as a function of the final salary and length of service in the public sector. Benefits of the retirees under the old scheme (those who retired prior to the *Pay and Grading* reforms) stayed the same.

It is expected that contributions will exceed expenditures to the Civil Sector and Security funds by 1402 and 1401 respectively. Following 1402/1401, expenditures will increasingly exceed contributions. The surpluses built up in the early years of both funds (if such cash funds were actually set up on the Treasury system[13]) are expected to be entirely offset by 1409 for both funds. In the years following, additional contributions or reductions in the value of benefits will have to be undertaken to ensure the sustainability of the scheme.

Moreover, the early growth in the two new funds is dependent on the Government meeting its contribution obligations. This is particularly so for the Security Sector fund where the Government is responsible for 11 percent of the 16 percent salary contributions. Where the Government does not consistently meet its obligations, both funds will quickly run significant deficits. This will place considerable additional strain on the Government's long term financial resources.

Ensuring the two funds are kept in balance (contributions equal to expenditure) may require increase in contribution rates, for example beginning from the year when the funds go out of balance (1401/1402). By the year 1415, assuming all other parameters stay the same, contributions may need to double.



If the Government offsets the early surpluses from the Civil Sector and the Security schemes to fund the deficit from the old scheme, total contributions will exceed total expenditures from 1391 through to

[13] Currently, as part of the reform, the separate funds have been established as virtual book entries, while the actual collected contributions flow into the general budget.

1399. The surplus built up in the early years (assuming it is saved and is available for future pensions) will be entirely spent by 1405. From 1406 onwards, the Government will have to meet the shortfall between expenditures and contributions.

The, pooling financing of the old and the new schemes will mean reaching the break-even point much sooner.

Over the 25 years from 1391 to 1415, total expenditure for the three funds combined will be Afs 777 billion, while total contributions will be Afs 551 billion, leaving a shortfall of Afs 226 billion. The Government's component of the contributions will be Afs 313 billion. Total Government payments over from 1391 to 1415 are Afs 539 billion, comprising of the Afs 313 billion contributions and the Afs 226 shortfall.

Mitigation Strategies

Risk	Mitigation Plan	Measurement
Reduced imports reduces performance under the customs collection	The Government has introduced a number of new tax collection measures in 1394, and these will continue through the 1395. In addition VAT has passed through the Parliament, and will be implemented by 1395.	The Government continues to monitor macro-economic indicators throughout the year, and update the macro-fiscal framework to give an indication of the like scale of impact. The overall revenue will be reforecast throughout the year in order to determine if it seems to be performing overall.
In the long run the pension schemes are likely to face funding difficulties.	An increase in the contribution rate, an increase in the retirement age from 65 to 67, a review of the formula for calculating pensions, or the setting up of a dedicated fund (or funds) for pensions could prolong the sustainability of the funds.	The Government monitors the contribution levels to the funds, and undertakes sustainability analysis regularly (see above).
Cash Shortfall	The Government is targeting a year end carry forward to 1395 of Afs 10 billion, which should provide more liquidity against shocks. During 1394 the Government will ensure expenditures are managed in order to avoid depleting cash reserves.	The Government monitors account balances throughout the year and prepares cash plans.
Reduced retail activity causes under-performance in BRT	The Government is planning an increase in the rate of basic BRT from 2% to 4%, although this will likely not come into place until the second half of the year.	The Government monitors performance against targets for each revenue line throughout the year.

Indicators

State Owned Enterprises (**SOEs**) Profit and Loss:

Afghanistan has multiple SOEs, publically owned companies providing a market service or goods, including ones operating in the airline industry, construction, printing, finance and insurance and multiple other areas. These companies, while helping achieve Government policy in their areas of operation, also create a potential cost risk for the Government, as a result the Government has undertaken to monitor the ongoing profitability of the SOEs as a whole, in order to determine whether or not they are likely to create a drain or a gain to public resources over the long term. Over the long term the Government is committed to the privatization of the SOEs, and has separated them into those which are to be divested into private ownership and those which can remain part of the Government.

Afs Millions	**1388**	**1389**	**1390**	**1391[1]**	**1392[1]**
Total Revenue	11690.1	11408.1	11384.9	3208.0	3990.7
Total Expenditure	9983.5	10099.3	8650.0	1705.7	2155.1
Balance	1706.5	1308.8	2734.9	1502.3	1835.6

1/ Information on all SOEs was not available
Source: SOE Unit, FPD calculations based on information available

Non-Compliance in Revenue:

Non-compliance is difficult to measure accurately, given the constraints in getting information of the eligible for tax goods, companies and individuals. However, estimates for non-compliance among two key sectors show that:-

- Current non-compliance for BRT is estimated at 80%; that is 80% of business eligible for BRT are not making payments
- Non-compliance under imports is less, amounting to around 9%; with most imports captured at the border.

Revenue to Target:

During the year the Government monitors the Revenue collection to target, and this year will particularly monitor the BRT collection, and the collection of import tax revenues; in order to determine whether or not there is likely to be an underperformance in overall revenue by the end of the year. In recent years the most underperforming general revenue lines have been: royalties' collections, sales taxes, property taxes and administrative fees; with the exception of 1393 customs revenue had generally performed well.

Medium Term Fiscal Framework

Medium Term Fiscal Framework Afs Millions	**Historic**	**Current Budget**	**Proposed Budget**	**Outer Years**		
Preliminary	**1393**	**1394**	**1395**	**1396**	**1397**	**1398**
TOTAL REVENUE AND GRANTS	**279739.6**	**425480.8**	**393639.8**	**395409.2**	**399004.5**	**399156.2**
Domestic Revenue	99487.6	123922.8	127094.2	137540.9	149429.6	162060.0
Tax Revenue	77566.5	98995.9	100102.5	107924.8	116971.9	127223.6
Taxes on Income and Profits	28809.1	34927.4	37024.2	40699.6	44984.7	49917.7
Taxes on Property	781.9	901.5	779.1	803.0	827.6	853.0
Taxes on Goods and Services	16672.6	26373.6	25539.7	27712.1	30205.6	33025.8
Taxes on Trade	26292.4	30818.7	30187.6	31462.8	32923.7	34492.6
Other Taxes	5010.5	5974.7	6571.9	7247.3	8030.3	8934.4
Non-Tax Revenue	21921.1	24926.9	26991.7	29616.0	32457.6	34836.5
Grants	180252	301558	266545.7	257868.4	249574.9	237096.2
Operational	139383	161627	153545.7	145868.4	138574.9	131646.2
Development	40869	139931	113000	112000	111000	105450
TOTAL EXPENDITURE	**322366.3**	**424538.3**	**393058.3**	**392335.6**	**396019.9**	**396417.9**
Discretionary	88091.3	108543.4	84283.3	76005.4	71202.6	67990.4
Non-Discretionary	74696.0	155515.5	141441.8	142009.2	142750.8	137934.7
Pensions	18762.0	16536.0	23832.4	25016.3	26369.9	26369.9
Interest Expenses	349.0	489.0	570.9	618.3	634.7	615.3
Ongoing Projects	0.0	2646.3	4581.5	5392.6	5623.2	5821.5
Earmarked (Project) Aid	40869.0	124140.3	101700.0	100800.0	99900.0	94905.0
Matching Funds	0.0	0.0	0.0	0.0	0.0	0.0
Earmarked (Other Codes)	14716.0	11704.0	10757.0	10182.0	10223.0	10223.0
Policy Determined	159579.0	160479.4	167333.3	174321.1	182066.5	190492.8
Employees Compensation	150157.0	156669.4	163425.8	170092.4	177472.3	185510.3
Govt. portion of Dev. Budget	9422.0	3810.0	3907.5	4228.7	4594.2	4982.5
Sale of Assets	36.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	-42590.7	942.6	581.5	3073.6	2984.6	2738.3
Primary Balance	-42277.7	1431.5	1152.4	3691.9	3619.3	3353.6
NET FINANCING	23829.0	-942.6	-581.5	-3073.6	-2984.6	-2738.3
Bank Account	22685.0	-1400.0	0.0	0.0	0.0	0.0
Loans	2936.1	2962.2	2263.4	4.3	0.0	0.0
External [1]	2936.1	2962.2	2263.4	4.3	0.0	0.0
Domestic	0.0	0.0	0.0	0.0	0.0	0.0
Principal Repayments	1792.1	2504.7	2844.9	3077.9	2984.6	2738.3
External	1792.1	2504.7	2844.9	3077.9	2984.6	2738.3
Domestic	0.0	0.0	0.0	0.0	0.0	0.0

1/ Excluding disbursement of IMF loan in 1394

Source: FPD Staff Forecasts

Assumptions

The framework has been built under the following key policy assumptions, among others, set out in the ***Fiscal Policy*** section:

- The Government will not borrow non-concessionally through the medium term.
- The Government will increase the funding for the security sector over time, in line with an aim to reduce operational donor support (LOTFA and CSTC-A) down to zero by 2024.
- The Government aims to improve the ratio of domestic revenue to the budget, in line with fiscal sustainability objectives.

The macro-framework provides the basis for forecasting individual revenue lines (this is set out in detail in the Annex). In general, tax lines are forecast using components from the macro framework model.

The other assumptions include:

- 1394 assumes a high growth in tax efficiency, this has been agreed with the IMF in order to close the gap between the macro-framework and revenue projections. However for 1395 we have assumed a much lower rate of efficiency growth in order to exercise caution over the likely collection in 1394.
- We have assumed no revenue generation from VAT in the current forecast, once an implementation plan for VAT becomes clear we will incorporate it into forecasts.
- Salaries are assumed to grow overall in line with the consumer price inflation.
- An initial financing for the operations and maintenance of new capital is included under the ongoing costs of projects (a non-discretionary item), however this fades out quickly under the assumption that generally O&M costs of capital are a discretionary item.

Revenue Forecast

GFS Revenue – Afs Millions	1393	1394	1395	1396	1397	1398
Tax Revenue	**77566.5**	**98995.9**	**100102.5**	**107924.8**	**116971.9**	**127223.6**
Taxes on Income and Profits	28809.1	34927.4	37024.2	40699.6	44984.7	49917.7
Taxes on Property	781.9	901.5	779.1	803.0	827.6	853.0
Taxes on Goods and Services	16672.6	26373.6	25539.7	27712.1	30205.6	33025.8
Taxes on International Trade	26292.4	30818.7	30187.6	31462.8	32923.7	34492.6
Other Taxes	5010.5	5974.7	6571.9	7247.3	8030.3	8934.4
Grants	**180252.0**	**301558.0**	**266545.7**	**257868.4**	**249574.9**	**237096.2**
Other Revenue	**21921.1**	**24926.9**	**26991.7**	**29616.0**	**32457.6**	**34836.5**
Property Income	1528.0	1781.1	1904.3	2031.3	2174.8	2336.3
Sales of Goods and Services	3516.4	3688.6	3955.3	4248.1	4587.4	4978.1
Fines & Penalties	10209.8	11671.3	12511.7	13808.0	15137.1	16729.0
Other	6666.9	7785.9	8620.4	9528.6	10558.3	10793.1
Sale of Non-Financial Assets	**36.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Source: FPD Staff Forecasts

The revenue is expected to be generated from a number of sources including:

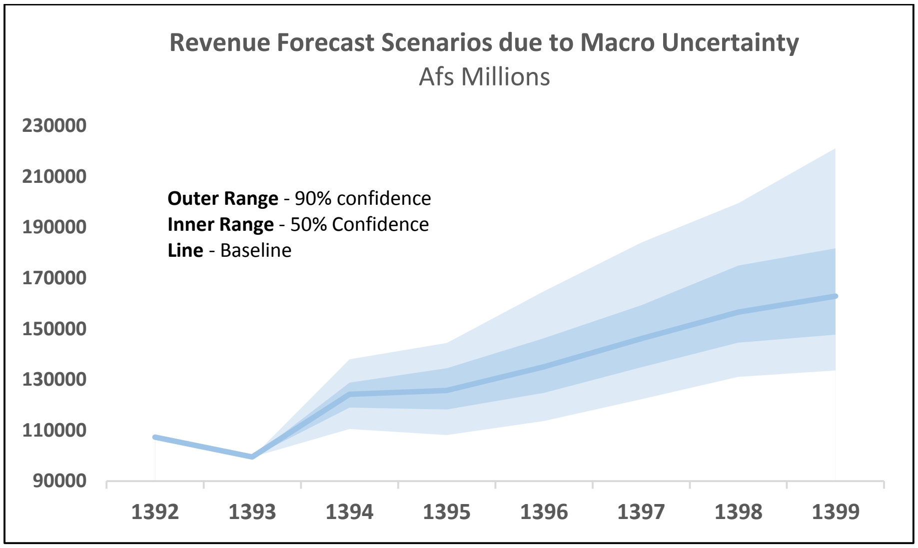
Extractive Industry Revenue: the extractive sector is assumed to generate only small returns in the medium term. This is the result of the uncertainty surrounding the implementation of large contracts, and historic delays in project initiations in the sector. The returns are forecast using the past base values, and are grown by the sectoral GDP.

Sales Taxes: the sales taxes are assumed to grow in line with consumer activity in the economy, and the retail sector (see scenarios below for a circumstance where the retail sector does not recover). VAT is not incorporated into these estimates, as it is uncertain the implementation timeline and the impact at the moment, given the rate of 5 percent.

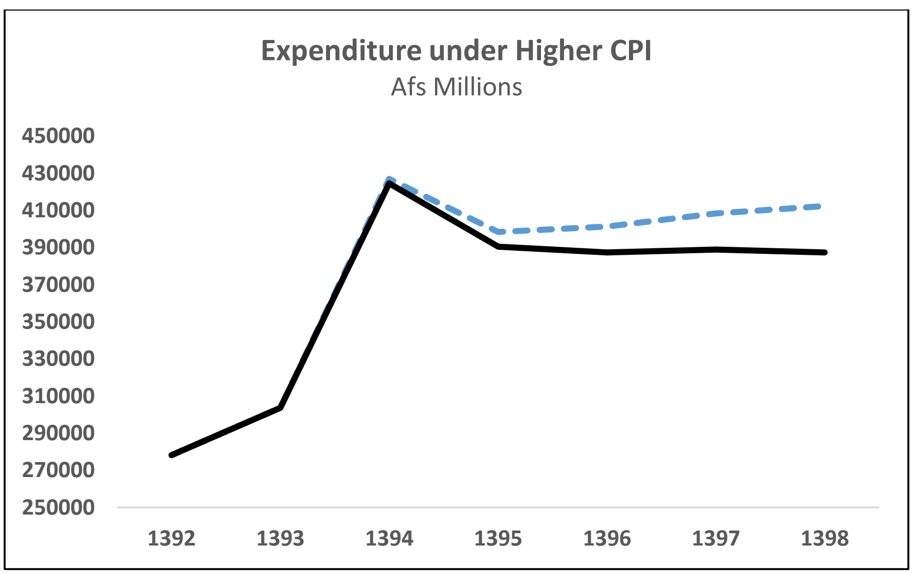
Trade Taxes: the trade tax forecast assumes that imports recover to a reasonable degree in 1394 (see Scenarios below for the forecast if imports remain stagnant). The fall in imports in 1393 was concentrated in areas which would have been impacted severely by the uncertain around the election, as a result it is likely there will be a recovery to some degree in 1394. The introduction of higher tariffs in 1394 should also improve the collection, and feed through into greater collection for 1395.

Donor Support: operational donor support is based on the assumption that the funds will phase out in an increasing fashion towards 2024; in the immediate future the Government will adopt responsibility for more security spending as additional items like NATFO come on to budget support. As a result the impact in the medium term is smaller than over the longer term.

The macro-framework forecast is inherently uncertain, the below chart shows the likely outcomes of revenue given uncertain in both the GDP and the import forecasts. We expect the revenue collected over the medium term to fall somewhere within the inner (50 percent) range of certainty, and the baseline forecast is the one used in the MTFF. (See Annex for details on the Stochastic forecasting).



The chart below shows the impact of a higher rate of CPI on costs (a 6 percent rate is assumed from 1395 onwards). Naturally increases in CPI may also push up revenue collection, but at the same time will create pressures on the demands for wages.



Non-Discretionary Expenditure

Non-discretionary expenditure (**NDE**) includes [list items in NDE]. In addition to NDE we also examine policy determine expenditure (**PDE**) which is not non-discretionary but determined by general policy objectives and would be difficult to change dramatically (including salaries, and core-budget financed capital).

Afs Millions	1393	1394	1395	1396	1397	1398
Discretionary Spending	88091	108543	84283	76005	71203	67990
Non-Discretionary Spending	74696	155516	141442	142009	142751	137935
Policy Determined Spending	159579	160479	167333	174321	182067	190493
Salaries	150157	156669	163426	170092	177472	185510
Total Available Resource	322366	424538	393058	392336	396020	396418

Source: FPD Staff Forecasts

Each of these expenditure lines is determined by agreements or policy, and is influenced in part by the macro environment, and changes to policy, and the assumptions built into the model:-

Wages and Salaries**:** Salaries are not typically non-discretionary expenditure, however there is limited scope for dramatic changes in the allocation to salaries, given the large portion of salaries which are funded through earmarked funds to salaries (LOTFA and CSTC-A), and are thus non-discretionary; and the difficulty in making large reductions to the overall size of the workforce. As a result we consider wages and salaries "*policy determined expenditure*", an expenditure line determined by a broad Government objective (a salary growth, and labour force growth or reduction plan).

Salaries are assumed to grow in line with inflationary pressures in the economy – as a result, while the overall size of the civil service is not projected to expand on a net basis over the medium term, there is expected to be an upward pressure on salary costs. Security improvements would reduce the requirement for salary costs and increase fiscal space.

Pensions: Pensions are a legally required expenditure by the Government, set out in the Pension Regulations. As part of this law the Government makes payments to former civil servants who have historically contributed into the pension scheme. At the moment this is approximately 120,000 pensioners. We expect pension costs to grow by significantly each year. (For more detail on the costs of pensions and the risks see the ***Risks to the Macro-Fiscal Framework*** Section). The pension figures in the main MTFF table shows the total pensions for retirees and martyrs. The latter is a non-contributory pension, and so is not included in the sustainability analysis, as it always presents a cost to the budget.

Ongoing Project Costs: In the framework we assume an increasing rate of O&M costs which have to be set aside based on capital spending. This has been phased out rapidly as O&M costs are typically considered discretionary – however after the immediate investment in capital it is unlikely that they will not be financed.

Matching Funds: no data on matching funds has been incorporated at the moment, however this could also be considered a non-discretionary expenditure, where the Government has agreed to provide these.

Membership Fees: the government has limited membership fees costs during the year, however these are captured under the earmarked other codes and are considered to be legally required (as a result of international agreements) and thus non-discretionary.

Earmarked Project Aid: donor support which is specifically set for particular projects, rather than whichever projects the Government chooses to allocate it to. That is, projects where the decision to not expend on the particular project would reduce the revenue by an equivalent amount.

Earmarked Other Codes: these are the contingency budgetary funds the Government sets aside in case of emergency need.

Discretionary Envelope

The discretionary envelope sets out the amount of funds the Government has allocative power over during the budget process. The total envelope, minus the non-discretionary (or already committed) funds above, and minus the policy determined spending gives the remaining discretionary envelope which can be allocated in the budget based on policy priorities, planned projects and past performance.

The discretionary enveloped is expected to diminish largely as a result of the expected decrease in aid towards 2024. Assuming that expenditure cuts cannot be made to the security sector in the medium term, as seems likely, the Government will have to finance more of the expenditures for security salaries through domestic revenue.

Bank Accounts**:** the Government has agreed with the IMF this year to ensure Afs 10 billion are left in the account by the end of the year 1394 to act as a cushion against future revenue shortfalls. This is in line with the Government's policy to ensure a cash reserve is available to help managed liquidity. As a result a surplus of Afs 1.4 billion is targeted for the end of the fiscal year, which alongside the Afs 8.6 billion carry forward from 1393, will help ensure that entering 1395 we have some funds to help manage liquidity. The medium term scenario assumes an attempt to maintain this account balance at, at least Afs 10 billion, unless emergency funds are needed.

Donor Support to the Budget

There is a lot of off-budget support to the security sector, incorporating spending on goods and services, and other areas. We have captured here the on-budget support through LOTFA, CSTC-A and others.

Funds from ARTF and DPG are discretionary development funds along with the government's contribution to the development funds (and we have incorporated a portion of donor support under discretionary funds in order to reflect this). DPG disburses upon the satisfactory performance of the government in certain predetermined areas.

Figures for the donor support to the budget are given through a rules based estimate, and will be updated to reflect actual commitments once these are available. The operational donor support is based on the assumption that support will be phased out towards 2024.

Fund	Discretionary/Non-Discretionary
LOTFA	No discretion, must be used for largely salaries, in the security sector. All salaries captured under policy determined spending in the MTFF.
CSTC-A	Limited discretion, must be used for salaries and other expenditures including fuel, in the security sector. All salaries captured under policy determined spending in the MTFF.
ARTF O&M	Discretion over how it is used, providing it is used on O&M. Falls under the discretionary development budget. Estimated value included under discretionary envelope in MTFF (i.e. not all development grants are counted as earmarked).
ARTF Ad Hoc	Discretion over the use of this within the operational budget, however this is a one-off support and will not be extended in 1395.
NATFO	No discretion, must be used for largely for pre-determined training, in the security sector.
ARTF Incentive	Discretion over which projects it can be used for, however it must fall under development. Estimated value included under discretionary envelope in MTFF (i.e. not all development grants are counted as earmarked).
World Bank (DPG)	Discretion over which projects it can be used for, however it must fall under development. Estimated value included under discretionary envelope in MTFF (i.e. not all development grants are counted as earmarked).
ARTF (Operations)	Discretion, however must be used within the operation budget.
Donor Project Support	No discretion, support for specific development projects must be used on those project areas it has been agreed. This falls under earmarked codes in the MTFF.

Discretion within the MTFF is determined on an expenditure basis – expenditures are identified which are non-discretionary for the Government (i.e. agreed donor projects etc) and then resources are split among them. All the items with no-discretion are put as either non-discretionary earmarked expenditures in the MTFF, or linked to policy determined expenditures anyway.

Mining Revenue

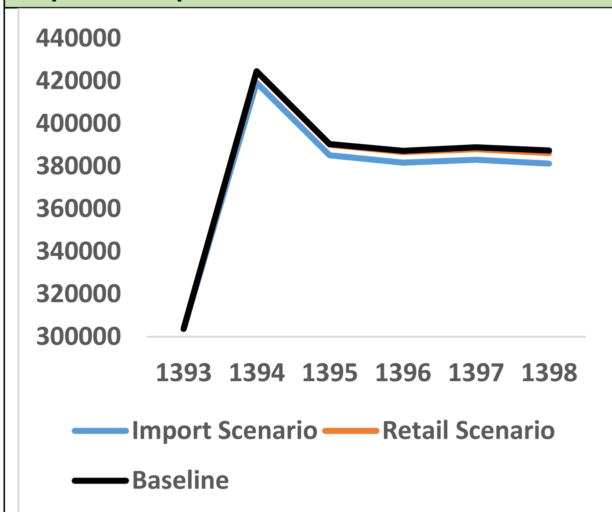
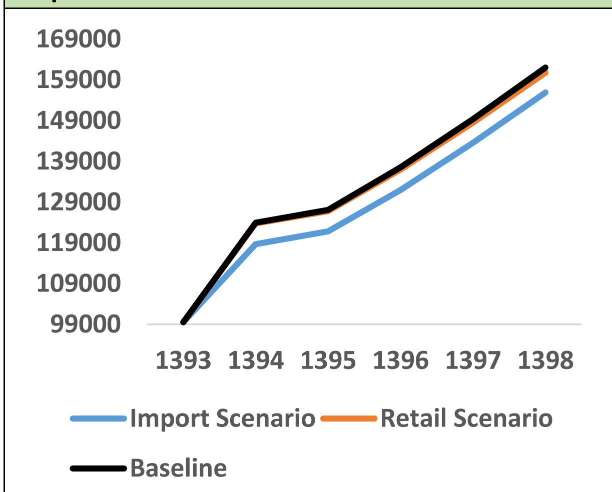
The forecast assumptions for mining revenue remain conservative. The Government's policies and objectives around the management of the Mining sector are in the process of being revised with the new Government, as a result it is difficult to set a timeline for the beginning of operations of most projects. In 1394 it is expected that mining revenue will come from the premium payment from Aynak, and the beginning of some operations under the Afghan-Tajik mining operations. These however have a degree of uncertainty attached to them and so were not included in the Afs 123 billion budget figure.

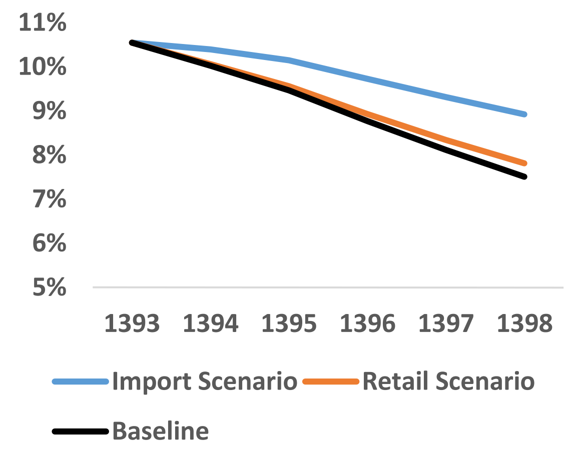
For 1395 the estimate uses the base collection of 1393, and grows in line with the expected growth in the mining sector; with an increase in growth in 1396 reflecting the likely start of some mining projects, however this is subject to revision

Scenarios

The scenarios were set up in the following ways:

- Import Scenario: We assume instead of an increase that petroleum imports will further diminish by 20 percent; this change is just considered for 1394.
- Retail Scenario: We assume zero growth in the retail sector and the hotels and restaurants sector for the whole of the medium term (1393-1398).

All figures are in millions of Afs unless noted otherwise	
Impact on Expenditure[1]	
	There is a limited impact on the expenditure from the changes in the growth in retail, that is because of the small overall revenue portion derived from the retail businesses and the large portion of expenditure is financed by the donors. There is a more pronounced decreased in the expenditures in the import scenario because of the large portion in the domestic revenue.
Impact on Revenues	
	The impact of revenue is similarly small for the retail scenario and higher for the import scenario. This again reflect importance of import revenue as a portion of domestic revenue, this remains pronounced through all of the medium term because the import revenue won't diminish in importance.

Impact on Debt[2]	
	Assuming that the expenditure cuts are not made in line with revenue then the debt would be higher in the import scenario but is still expected to fall.

1/ Assuming the Government maintains zero borrowing
2/ Assuming the Government maintains the same level of expenditures

Debt and Fiscal Sustainability

Debt Sustainability

The Public Financial and Expenditure Management (**PFEM**) Law sets out the rules under which the Government must operate borrowing. The Government is required to ensure that the borrowing undertaken through the fiscal year is used for developmental purposes. This includes building infrastructure, creating industrial parks and other alike activities which will help boost foreign investment in Afghanistan.

Currently Afghanistan is not in the dire situation of debt crisis like many other countries and debt can still be considered as a financing strategy to fund in investment projects in sectors of the economy. Below is a brief overview of the baseline debt, debt sustainability, shocks and scenarios, and what factors affect the debt sustainability of Afghanistan.

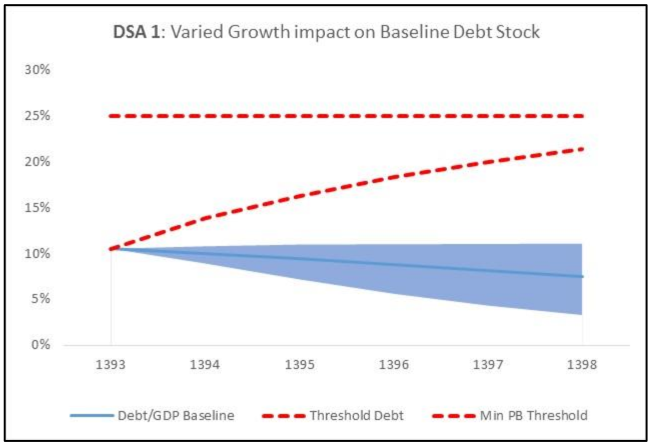
The Government's debt policy and framework is set out in the ***Fiscal Policy*** section.

DSA Table	**1393**	**1394**	**1395**	**1396**	**1397**
Baseline Debt/GDP	10.5%	10.0%	9.5%	8.8%	8.1%
Growth Shock Debt/GDP	10.5%	10.8%	11.0%	11.0%	11.1%
Portion Loans below Min. Grant Element [1]	0.0%	0.0%	0.0%	0.0%	0.0%
External Debt Service/Exports	1.1%	1.4%	1.6%	1.6%	1.5%
External Debt Service/Reserves	0.4%	0.4%	0.4%	0.4%	0.4%
Total Debt Service/Revenues exc rollover	2.1%	2.4%	2.7%	2.7%	2.4%

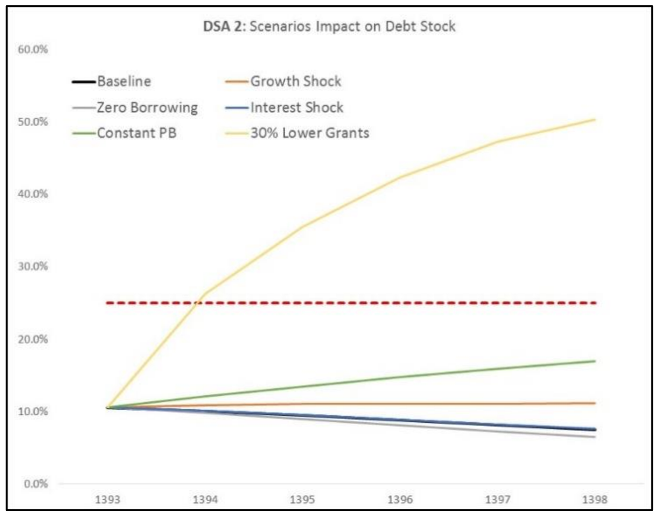
1/ Threshold for the minimum Grant element is 35%

Most of the debt indicators are well within acceptable bounds compared to international standards. The Debt to GDP ratio is currently 10% and is expected to decline further in future years as we repay the loans. However, a mere shock of 7% decline in nominal GDP growth could distort the outlook of debt to GDP and increase it to 11.1% in 1397. This still remains stable given the international threshold of 30% debt to GDP proposed by HIPC (Heavily Indebted Poor Countries) initiative.

Debt service-to-exports ratio currently stands at 1.4% and is expected to increase to 1.6% in 1395 and 1396 and will decline to 1.5% in 1397. Based on HIPC initiative, this should not exceed from 15%. It remain low for other indicators as well such debt service to reserves and debt service to revenues ratio. Similarly, the debt service-to-revenue ration remains well below at 2.4% compared to the threshold of 25% as per the HIPC initiative.

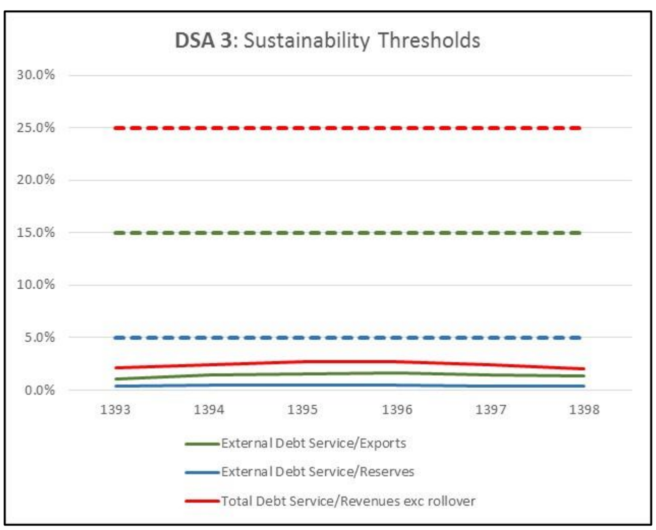


The debt in the medium term fiscal framework remains low, and within reasonable boundaries for sustainability (the red lines reflect an upper boundary of 25%, and a boundary given through a 4% of GDP deficit each year, the blue shaded area is the result of GDP uncertainty). The Government has adopted neither a balance rule nor a rule on the debt ceiling, as a result these are just shown for illustrative purposes.

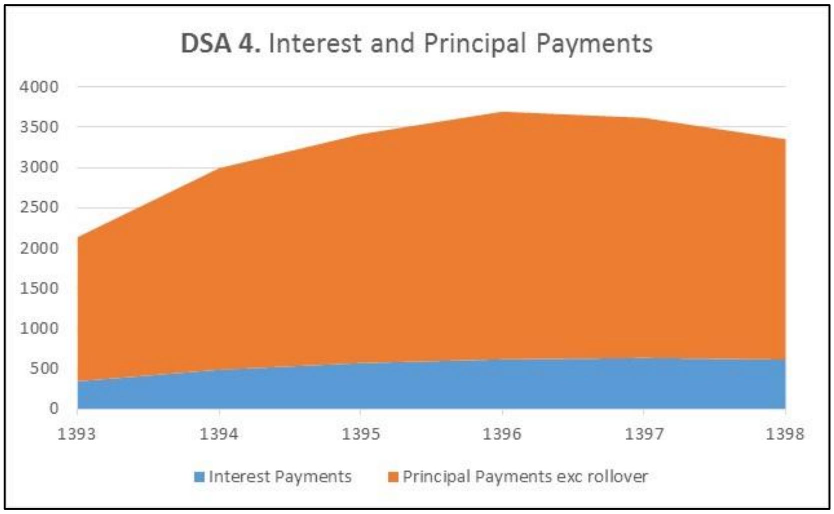


The fiscal framework set out in the MTFF operates under the Government's rules about borrowing (i.e. only concessional, long term debt to the Government can be undertaken). As a result this DSA sets out the impact, in the medium term, of any debt planned through agreements with the International Financial Institutions (**IFIs**) or similar, on concessional terms. There is no borrowing in the medium term to cover a general budget deficit, and all borrowing is for specific projects.

The primary risk to debt sustainability remains the high dependency on aid. Any reduction in aid support (particularly through operational aid) would lead to either a large cutback in expenditure, or a sudden and unsustainable increase in debt.

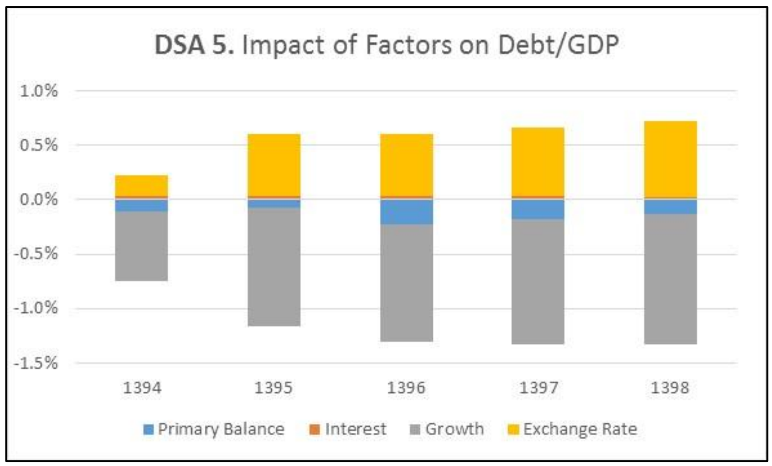


A high level of debt forgiveness and concessional interest rates means that Afghanistan does not have any likely fiscal risk from debt service payments. Afghanistan received a large amount of debt forgiveness through the HIPC process, reducing the cost of debt, and removing most of the high interest rate debt. In the medium term borrowing will be undertaken on concessional terms, which most likely means a service fee below 1% - further ensuring costs remain low.



The principal payments increase as a result of the forecast depreciation over time of the Afghani. This increases our cost of payments in the local currency, even though the cost of payments in the contracted currency does not increase. The high portion of foreign currency debt leaves us at risk of currency changes creating higher costs for payments.

The debt stock as a portion of GDP is reduced over time as a result of economic growth. Even though there is planned borrowing, which will increase the absolute amount of debt, the acquisition of debt remains low enough to be smaller than the impact of the growing economy. Given our debt is denominated in foreign currencies, the depreciation of the Afghani will increase debt stock.



The Government also holds outstanding promissory note with the central bank for the amount of increased capitalization of Kabul bank required to meet solvency ratios following the loan losses. Primarily however the Government holds external debt, from the multilaterals.

Fiscal Sustainability

The major fiscal sustainability indicator is the portion of the Budget covered by domestic revenue. The Government's medium term objective is to increase this proportion (which, as can be seen in the table below has been achieved). The drop between 1393 and 1394 is the result of the low execution of grants revenue in 1393.

Fiscal Sustainability Indicators	**1393**	**1394**	**1395**	**1396**	**1397**
Domestic Revenue/Budget	32.8%	29.2%	32.3%	35.1%	37.7%
Employee Compensation/Domestic Revenue	150.9%	150.9%	126.4%	128.6%	123.7%
Spending minus Development Grants/Revenue	264.1%	264.1%	229.7%	220.4%	203.8%
Revenue minus Grants/GDP	8.2%	9.6%	8.9%	8.6%	8.4%
Grants/Revenue	181.2%	243.3%	209.7%	187.5%	167.0%
Improvement Index	**100.0**	**100.4**	**107.9**	**119.0**	**130.8**

In general we expect to see an improvement in overall fiscal sustainability. The primary measure of domestic revenue to budget is increasing steadily, and the overall portion of Government spending on employee compensation is expected to reduce in line with the Government's efforts to bring expenditures under greater control. Revenue/GDP remains a concern, however efforts by the Government to close the tax gap through audits, and reforms should help improve this closer in line to regional countries (around 11-13 percent).

Technical Annexes

Pension Modelling

Year	Old Scheme			Civil Sector Fund			Security Sector Fund			*Aggregate for the three funds*			
	Employee contribution	Government contribution	Expenditure	Employee contribution	Government contribution	Expenditure	Employee contribution	Government contribution	Expenditure	*Total contributions*	*Total expenditure*	*Annual deficit (surplus)*	*As % of wage costs (for all 3 funds)*
	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Percent
1391	0.1		2.2	2.2	2.2	1.3	1.1	2.5	1.0	8.1	4.5	***-3.6***	*-7%*
1392			2.3	2.9	2.9	1.9	1.2	2.7	1.3	9.8	5.5	***-4.2***	*-7%*
1393			2.4	3.4	3.4	2.7	1.3	2.9	1.5	11.0	6.7	***-4.3***	*-6%*
1394			2.8	3.8	3.8	3.4	1.4	3.1	1.9	12.0	8.1	***-3.9***	*-5%*
1395			2.7	4.1	4.1	4.1	1.5	3.3	2.2	12.9	9.0	***-3.8***	*-5%*
1396			2.8	4.3	4.3	4.9	1.6	3.5	2.6	13.7	10.4	***-3.3***	*-4%*
1397			2.9	4.6	4.6	5.8	1.7	3.7	3.1	14.5	11.9	***-2.6***	*-3%*
1398			3.1	4.9	4.9	6.8	1.8	3.9	3.7	15.4	13.6	***-1.8***	*-2%*
1399			3.2	5.2	5.2	7.9	1.9	4.2	4.3	16.4	15.5	***-0.9***	*-1%*
1400			3.4	5.5	5.5	9.2	2.0	4.4	5.0	17.4	17.6	***0.2***	*0%*
1401			3.1	5.9	5.9	10.5	2.1	4.7	6.4	18.5	20.1	***1.6***	*1%*
1402			3.3	6.2	6.2	12.4	2.2	4.9	7.3	19.6	22.9	***3.3***	*3%*
1403			3.4	6.6	6.6	14.1	2.4	5.2	8.3	20.8	25.8	***5.1***	*4%*
1404			3.6	7.0	7.0	16.1	2.5	5.5	9.5	22.0	29.1	***7.1***	*5%*
1405			3.8	7.4	7.4	18.1	2.6	5.8	10.8	23.3	32.7	***9.4***	*6%*
1406			4.0	7.9	7.9	20.3	2.8	6.1	12.4	24.6	36.6	***12.0***	*8%*
1407			2.3	8.3	8.3	22.1	2.9	6.4	14.0	26.0	38.4	***12.4***	*8%*
1408			2.4	8.8	8.8	23.8	3.1	6.8	15.7	27.4	41.9	***14.5***	*8%*
1409			2.5	9.3	9.3	26.0	3.2	7.1	17.5	28.9	46.1	***17.2***	*9%*
1410			2.6	9.8	9.8	28.4	3.4	7.5	19.6	30.5	50.6	***20.1***	*11%*
1411			2.8	10.4	10.4	30.8	3.6	7.8	21.7	32.1	55.3	***23.2***	*12%*
1412			2.9	10.9	10.9	33.4	3.7	8.2	24.0	33.8	60.4	***26.6***	*13%*
1413			2.7	11.5	11.5	36.3	3.9	8.6	26.6	35.6	65.6	***30.0***	*13%*
1414			2.6	12.1	12.1	39.4	4.1	9.1	29.1	37.4	71.2	***33.8***	*14%*
1415			2.6	12.7	12.7	42.7	4.3	9.5	31.8	39.3	77.1	***37.8***	*15%*
Total		**0**			**176**			**137**		**551**	**777**	***226***	

Year						Government payments when the surplus is NOT saved				Government payments when the surplus is saved			
	Employee contributions	Government contributions	Total contribution	Total expenditure	Annual deficit (surplus)	Government contributions	Annual deficit (surplus)	Accumulated surplus	Total Government cost	Government contributions	Annual shortfall	Accumulated surplus	Total Government cost
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)
						= B	= E	= 0	= F + G	= B	= E – L t – 1	= - ∑ E	= J + K
	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)	Afs (billions)
1391	3.5	4.7	8.1	4.5	-3.6	4.7	-3.6		1.1	4.7		3.6	4.7
1392	4.2	5.6	9.8	5.5	-4.2	5.6	-4.2		1.4	5.6		7.9	5.6
1393	4.7	6.3	11.0	6.7	-4.3	6.3	-4.3		2.0	6.3		12.2	6.3
1394	5.2	6.8	12.0	8.1	-3.9	6.8	-3.9		3.0	6.8		16.1	6.8
1395	5.5	7.3	12.9	9.0	-3.8	7.3	-3.8		3.5	7.3		19.9	7.3
1396	5.9	7.8	13.7	10.4	-3.3	7.8	-3.3		4.5	7.8		23.2	7.8
1397	6.3	8.3	14.5	11.9	-2.6	8.3	-2.6		5.6	8.3		25.9	8.3
1398	6.7	8.8	15.4	13.6	-1.8	8.8	-1.8		6.9	8.8		27.7	8.8
1399	7.1	9.3	16.4	15.5	-0.9	9.3	-0.9		8.4	9.3		28.6	9.3
1400	7.5	9.9	17.4	17.6	0.2	9.9	0.2		10.1	9.9		28.4	9.9
1401	8.0	10.5	18.5	20.1	1.6	10.5	1.6		12.1	10.5		26.8	10.5
1402	8.5	11.2	19.6	22.9	3.3	11.2	3.3		14.5	11.2		23.5	11.2
1403	9.0	11.8	20.8	25.8	5.1	11.8	5.1		16.9	11.8		18.5	11.8
1404	9.5	12.5	22.0	29.1	7.1	12.5	7.1		19.6	12.5		11.3	12.5
1405	10.1	13.2	23.3	32.7	9.4	13.2	9.4		22.7	13.2		1.9	13.2
1406	10.6	14.0	24.6	36.6	12.0	14.0	12.0		26.0	14.0	10.1	0	24.1
1407	11.2	14.8	26.0	38.4	12.4	14.8	12.4		27.1	14.8	12.4		27.1
1408	11.9	15.6	27.4	41.9	14.5	15.6	14.5		30.0	15.6	14.5		30.0
1409	12.5	16.4	28.9	46.1	17.2	16.4	17.2		33.6	16.4	17.2		33.6
1410	13.2	17.3	30.5	50.6	20.1	17.3	20.1		37.4	17.3	20.1		37.4
1411	13.9	18.2	32.1	55.3	23.2	18.2	23.2		41.4	18.2	23.2		41.4
1412	14.7	19.2	33.8	60.4	26.6	19.2	26.6		45.7	19.2	26.6		45.7
1413	15.4	20.1	35.6	65.6	30.0	20.1	30.0		50.1	20.1	30.0		50.1
1414	16.2	21.2	37.4	71.2	33.8	21.2	33.8		54.9	21.2	33.8		54.9
1415	17.1	22.3	39.3	77.1	37.8	22.3	37.8		60.0	22.3	37.8		60.0
Total	238	313	551	777	226	313	226		539	313	226		539

CGE Simulations

The Government conducts some internal modelling using a computation general equilibrium model – to estimate the impact of tax policy changes, and changes to aid flows, and household and government investment. This is used to inform the forecasting in the macro-framework model, and for simulations under the risk section.

The CGE model is an Excel based model, using a few simple identities to balance three production markets (Agriculture, Manufacturing and Services), as well as the Labour market, and household spendings. The Government is included and must run a balanced budget in the model, matching taxation and spending; and decisions on household spending are made based on a utility function.

Stochastic Modelling

The fan charts in this paper are generated through the stochastic generation of input variables (e.g. GDP), and from this the creation of multiple scenarios given the random changes of input variables within certain parameters.   For each stochastic simulation we generate at least 1000 scenarios, assuming changing input variables. The parameters for input variables are typically based on past performance – for example, the historic standard deviation of real GDP growth rates is used in order to determine the likely uncertainty around future growth rates. The simulations are anchored around the baseline determined in the MFM.

DSA

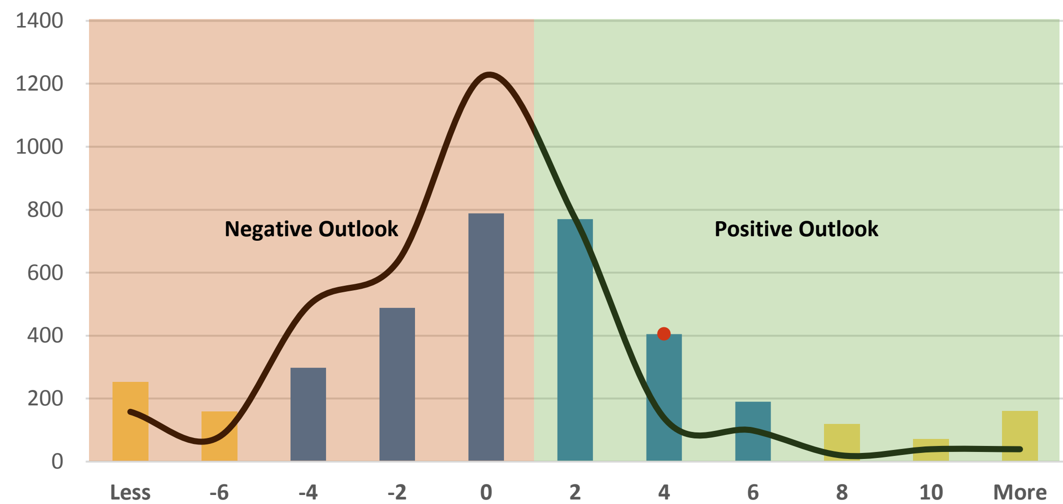
The DSA thresholds are:

- 25% upper threshold for debt in the medium term – this is based purely on a reasonable threshold for debt for a country at this stage, and is not stated Government policy.
- A 4% primary balance deficit – this shows the debt acquisition which would occur with a 4% primary deficit.

Realism of Forecasts

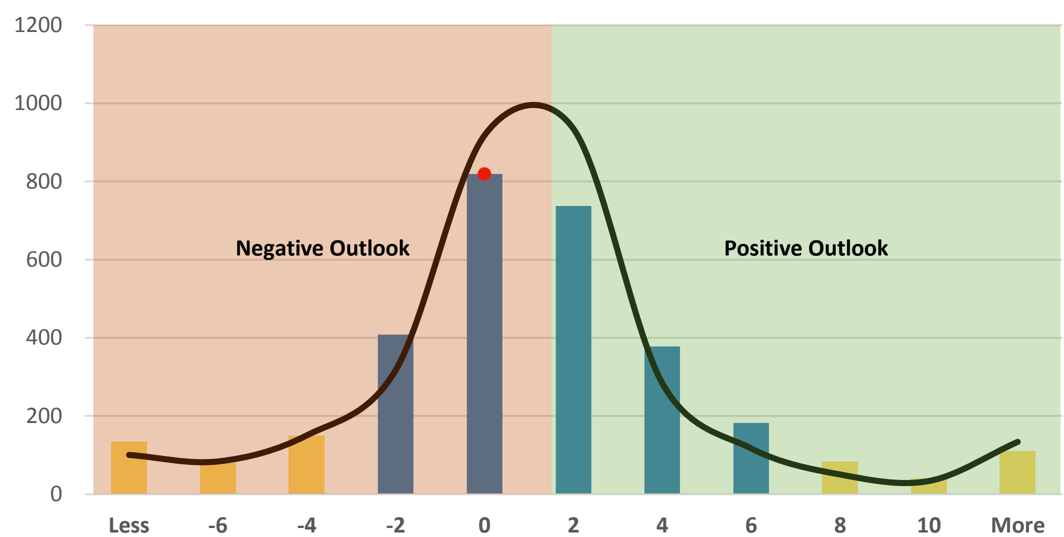
The distributions in the below reflect the changes that countries around the world have seen during a 3-year period. The figures are taken from the IMF WEO, for the time period between 1980 and 2014. The black line represents the scaled distribution for just the most recent year (in order to see if the change is realistic given the changes that other countries are seeing in the same period). The red dot represents Afghanistan, the shaded yellow areas are the unlikely areas.

Realism of the GDP Forecast:



The change the in real GDP growth forecast is on the more positive side, with a change in the forecast between 1393 and 1396 (a 3 year change) in the framework of around 4%. However, given the circumstances surrounding performance in 1393 this is not deemed to be unrealistic.

Realism of the Revenue Forecast:



Assuming the GDP forecast performs as expected the change in the ratio of Revenue/GDP is realistic over the 3 year time horizon (between 1393 and 1396). This does however require that GDP grows as expected.

MINISTRY OF FINANCE
GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN