VOLUME 1 ISSUE 2

Afghanistan Economic Outlook

July 25, 2020

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Key Highlights:

- COVID-19 pandemic has strongly affected economic activities in the country. The economy is projected to contract by 8.2 percent in 2020, before embarking on a recovery phase by Spring 2021.
- Exports dropped to merely US$ 32.7 million (Afs 2.5 billion) in the second quarter of 2020, compared to $204 million in Q1-2020 or compared to $143 million in Q2-2019.
- Inflation increased from 3.8 percent in January 2020 to 6.4 percent in June 2020. This was mainly driven by food prices inflation which increased from 6 percent to 12.6 percent over the period.
- Revenues in the first half of the year were nearly 17 percent lower than in the same period in previous year. This has opened up a budget deficit of Afs 40 billion (about $525 million) for this year, despite frontloading of donor resources.
- An 8-percent economic contraction increases unemployment rate from 23.9 percent in 2017 to 37.9 percent in 2020. If "underemployment" is also taken into consideration, the figure would be as much as 53.5 percent. In nominal terms, this means that nearly 4.8 million people will be either unemployed or under-employed by the end of 2020, which is an increase of 1.5 million people compared to the 2017 levels.
- The need for an emergency support program to households is enormous, and the government's approach to mobilize $300 million required for the REACH project by reallocating resources from the existing development portfolio is justified. However, the type and the structure of the program, which currently relies on in-kind distribution of food, needs to be seriously reconsidered for the reasons of efficiency, effectiveness, value-for-money, and transparency.

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1. Background

The COVID-19 pandemic has reportedly affected more than 35,000 individuals with nearly 1,250 deaths in Afghanistan. According to a survey, however, conducted in Kabul by a local media outlet ('Etlaat Roz'), the actual number of cases could be as much as ten times the officially recorded numbers.

According to the officially reported numbers, the COVID-19 incidence curve is now on a downward trend since the end of June. Kabul and other major cities have returned to regular activities after observing around eight weeks of semi-lockdown in April and May. However, schools and universities still remain closed.

On the political front, the political impasse over Presidential elections came to an end as President Ghani and Dr. Abdullah, the two leading candidates, entered into a political agreement on May 17, 2020 after around seven months of contention and negotiations.

However, recent surge in conflict and violence in a number of provinces and failure to observe the peace process by the Taliban have not allowed public confidence to rebound since the peace deal signed between the United States and the Taliban in February 2020.

Given persistent uncertainties around the peace process, projections and forecasts in this report assume that some level of violence and conflict will continue to sustain throughout the year, and that the potential gains of the peace process will not materialize for at least another year.

2. Economic Growth

The COVID-19 pandemic has plunged the Afghan economy into a deep recession. The economy is projected to contract by 8.2 percent in 2020, driven by a fall in output as a result of disruptions to supply chains and exports, and a drop in consumption due to an income shock borne by the households. The –8.2-percent growth forecast represents a slightly upward revision to the AEO's April projections for the 'Acute COVID-19' scenario (see Table 1).

Table 1: Revisions to 2020 Growth Projections since Spring 2020

	Spring 2020	Summer 2020
World Bank ADU (March 17 release)	[0.4% ; 1.7%]	
Biruni AEO (April 2 release)	*[–3.3% ; –9.9%]*	
IMF WEO (April 14 release)	–3.0%	
World Bank ADU (July 15 release)		[–5.5% ; –7.4%]
Biruni AEO (July 25 release)		*–8.2%*

Anecdotal reports indicate widespread suspensions in the production activities of manufacturing firms in the second quarter of the year, with production gradually resuming in the third quarter. Manufacturing, construction, restaurants & hotels, and transportation sectors have been severely affected. However, information and communications sector are expected to have performed well.

Agriculture is projected to post a positive growth in 2020, as this year's harvest is expected to be slightly above the average. Precipitation levels in the 2019/20 wet season was satisfactory.

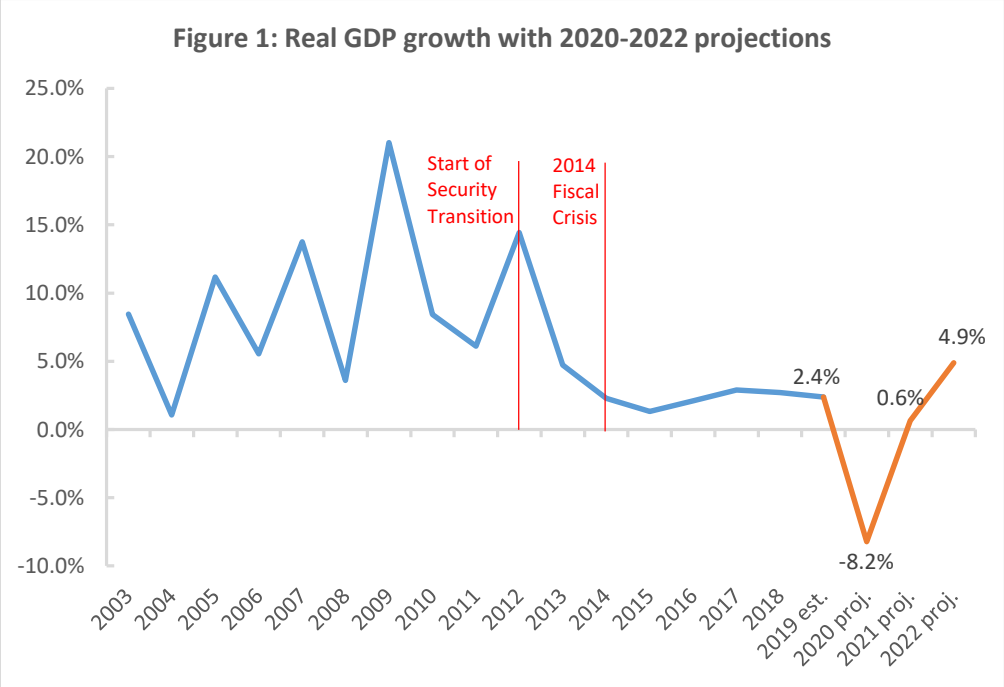
Despite reports of diseases to wheat crops in some parts of the country, overall wheat harvest in 2020 is expected to be near average.[1]

Table 2: Real GDP Growth and Nominal GDP, with Projections for 2020 & 2021

	2018	2019 proj.	2020 proj.	2021 proj.	2022 proj.
Real GDP Growth	2.7%	2.4%	-8.2%	0.6%	4.9%
Agriculture	-0.9%	2.4%	2.6%	-0.5%	2.5%
Industries	7.6%	1.8%	-12.5%	0.6%	4.8%
Services	1.8%	2.8%	-9.6%	1.0%	5.7%
Nominal GDP (Billion Afs)	1,412	1,539	1,517	1,534	1,685
Nominal GDP (Billion USD)	$19.5	$19.8	$19.8	$19.6	$21.1

Source: NSIA for 2018; Biruni Institute staff estimates and projections for 2019-2022

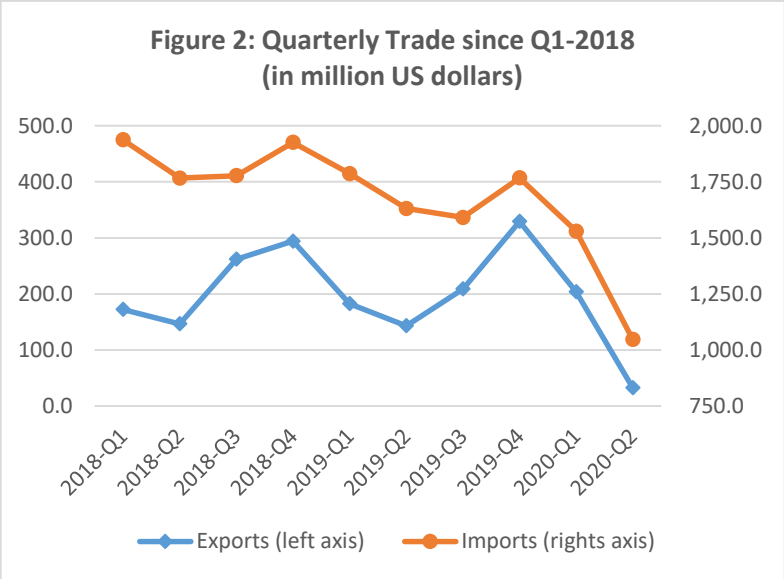
However, the positive growth in agriculture output in 2020, which is forecast at 2.6 percent, is insufficient to offset the projected negative growth of –12.5 percent and –9.6 percent respectively for industries and services sectors. Given the significant size of the informal economy, absence of insurance mechanisms, and lack of fiscal space to provide stimulus packages to small & medium enterprises (SMEs) as well as to poor households, the economic impact of COVID-19 in Afghanistan has been devastating. Nonetheless, Afghanistan has not been unique in posting a sharp economic contraction. According to the International Monetary Fund's (IMF) June 2020 World Economic Outlook, advanced economies are projected to contract by an average 8 percent in 2020, while countries in the region such as India (-4.5%) or Iran (-6%) are also expected to experience sharp contractions.



Note: Excludes opium value added.
Source: NSIA and World Bank for actual historical data, Biruni Institute staff estimates/forecasts for 2019-22.

[1] "Food Security Outlook, June 2020", FEWS NET.

Exports dropped to merely US$ 32.7 million (Afs 2.5 billion) in the second quarter of 2020, compared to $204 million in the first quarter of 2020 or compared to $143 million in the second quarter of 2019. This is an historically low level of quarterly exports ever recorded since 2005 when the National Statistics & Information Authority (then, Central Statistics Office) started to publish quarterly trade statistics. Given that the export basket of Afghanistan is primarily composed of agriculture commodities (incl. fruits), the fall in exports principally reflect a drop in global demand and disruptions in international shipment[2] rather than a fall in agriculture output in the country. However, the fall in exports does drag heavily on the gross domestic product (GDP) of Afghanistan, and on the income of producers in the agriculture sector who failed to export their products. Imports, too, dropped to $1 billion in Q2-2020, compared to $1.5 billion in Q1-2020 or compared to $1.6 billion in Q2-2019, reflecting a weakening domestic demand.



Source: NSIA and Customs Department (MoF)

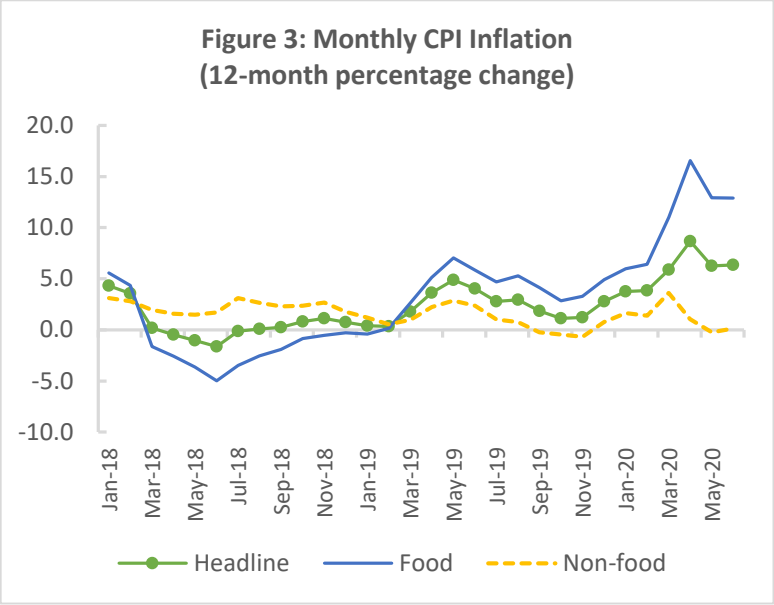
Assuming that the COVID-19 pandemic is past its peak in Afghanistan and that a second wave will not materialize, the economy will embark on a recovery trajectory only in Spring 2021. The economy is projected to continue to contract in the second half of 2020, while posting a stagnant growth in the first quarter of 2021.

3. Inflation

Given Afghanistan's high dependence on imported food and non-food products, disruption in trade as a result of border closures can have strong impact on domestic inflation. In early March, with the closure of Torkham border with Pakistan, wheat flour prices increased by 80-100 percent in Kabul within 2-3 days as the panic burst, despite the fact that the Pakistani wheat flour represents only a small portion of the flour imports in the country. After President Ghani's statement in which he reassured the people of sufficient wheat flour stocks in the country and imposition of price controls, flour prices dropped close to previous levels. In the past, previous

[2] Between March and May 2020, almost all border points with neighbouring countries remained closed for Afghan exports transportation. The border points of Torkham, Speen Boldak, and Ghulam Khan with Pakistan, and Sher Khan Bandar border with Tajikistan were entirely closed. At Aqina border with Turkmenistan, there was a cap of up to 15 trucks per day entering the country. Four other border points (two with Iran, one with Uzbekistan, and one another with Turkmenistan) was open for in-coming shipments only, while out-going cargos for exports were restricted. By the end of June 2020, most border points re-opened for in-coming and out-going cargos.

instances of border closure (for instance closure of Torkham border in 2011-12) has often had significant pressure on domestic prices.



Source: NSIA

Consumer prices inflation started to surge in March 2020, when the COVID-19 pandemic started to disrupt international trade. Inflation (year-on-year) increased from 3.8 percent in January 2020 to 8.7 percent in April 2020, before moderating to 6.4 percent in June 2020. Food prices inflation increased from 6 percent in January to 16.6 percent in April, before curbing to 12.6 percent in June. Non-food prices inflation, however, has had a disinflationary trend, falling from 1.6 percent in January to 0.1 percent in June 2020.[3]

Our forecasts show that inflation will maintain an upward, but steady, trend for the remainder of the year, with headline inflation reaching 8.8 percent by end-year. This means a 'period-average' headline inflation of 6.8 percent for the full year. Most inflationary pressures will be coming from food prices inflation, which is forecast to reach 17.5 percent by end-2020 (with its period-average rate projected at 13.3 percent for the full year).

Table 3: Period-average Inflation for 2018-2021

	2018	2019	2020 proj.	2021 proj.
Headline	0.6%	2.3%	6.8%	0.5%
Food	-0.3%	4.9%	13.3%	-3.4%
Non-food	1.8	0.8%	0.1%	4.8%

Source: NSIA for actual figures, and Biruni Institute staff projections.

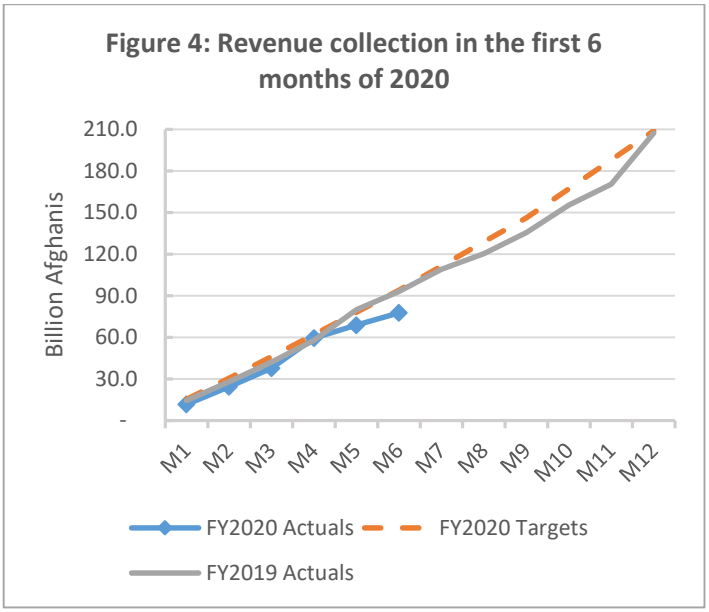
4. Fiscal Sector

With falling production and investment activities in the second quarter of 2020, domestic revenues in the first six months of the year were nearly 17 percent lower than in the same period in previous year. Revenue collection by the end of the sixth month (June 21st) stood at Afs 77.7 billion, as compared to the actual revenues of Afs 93.2 billion in the first half of previous year or as compared to the revenue target of Afs 94 billion for June 2020.

At this trend, domestic revenues are projected to reach Afs 144 billion by the end of the fiscal year, which is about 30 percent below the levels of revenues collected last year. In percentage of GDP, this shows a 4-percentage point drop in domestic revenues, declining from 13.5 percent of GDP in 2019 to 9.5 percent of GDP this year.

[3] June inflation numbers are preliminary figures by the National Statistics & Information Authority (NSIA), and might be subject to slight revisions.

The projected revenue shortfall of Afs 65 billion (about US$ 850 million) by end-year is expected to be partially addressed by recent reallocation and restructuring of donors' project portfolios, as well as front-loading of grant disbursements through the ARTF (Afghanistan Reconstruction Trust Fund). In total, about $500 million have been reallocated under the ARTF to COVID response projects,[4] and an additional $420 million of discretionary resources (including ARTF grants and a concessional long-term credit by the IMF) are mobilized to finance government's civilian recurrent expenditures. However, except for the $100 million grant through the World Bank's global emergency operation ('Fast Track Facility'), and the $220 million long-term concessional credit by the IMF's emergency financing ('Rapid Credit Facility'), no other 'new' grants are committed to Afghanistan.



Source: ARD, Ministry of Finance

Table 3: Domestic Revenues (in million Afghanis, unless otherwise indicated)

	2016	2017	2018	2019	2020 proj.	2021 proj.
Domestic Revenues	143,238	169,564	190,723	207,748	144,093	180,974
Tax revenue	69,498	69,692	83,485	81,945	61,759	77,249
Customs duty	31,265	32,597	35,192	34,137	27,003	33,776
Non-tax revenue	42,475	67,275	72,046	91,666	55,331	69,949
Domestic Revenues (in % of GDP)	10.8%	12.7%	13.5%	13.5%	9.5%	11.8%

Source: Ministry of Finance for actuals, and Biruni Institute staff estimates for 2020-21 projections.

In sum, with the reversal of the United States' initial decision to reduce their aid to Afghanistan by $1 billion this year, and with the provision of additional discretionary resources by the donors which is primarily the outcome of frontloading fund disbursements in the ARTF and the World Bank's IDA-19 commitments for 2020-2023, the budgetary financing gap in 2020 is partially addressed. This has allowed the government to adequately manage the fiscal crisis so far.

However, frontloading of ARTF resources has significantly raised medium-term financing risks, especially if the donor pledging conference in Geneva in November 2020 fails to secure new aid pledges (for 2021-2025) at a level close to the pledging levels of 2016 Brussels Conference (i.e. US$ 3.8 billion per year for the civilian sector) and if the donors fail to replenish the ARTF to adequate levels for the next few years. ARTF is the principal facility through which the donors provide discretionary resources to the Government for budgetary support.

[4] Including the $300 million REACH Project ("COVID Relief Effort for Afghan Communities and Households").

Despite reduced government operations in the 2nd quarter of 2020, total expenditures in the first half of the year (i.e. Afs 162 billion) were just below the levels of expenditure in the same period last year (Afs 164 billion). While spending on wages and capital expenditures were lower this year, spending on operations & maintenance (O&M) and social transfers were slightly higher. In terms of budget breakdown, development budget spending in the first half of 2020 was Afs 43 billion as compared to Afs 50 billion in the same period in 2019, while operating expenditures were Afs 118 billion as compared to Afs 114 billion in the first half of 2019.

Table 4: Expenditures in the first halves of 2019 and 2020 (in million Afghanis)

	2019 H1	2020 H1
Total Expenditures	**164,388**	**161,808**
Operating	114,204	118,340
Development	50,184	43,468
By economic classification:		
Wages & salaries	88,470	86,798
Operations & Maintenance	28,016	30,399
Capital expenditure	35,053	30,003
Social transfers	11,766	13,774
Interest payments	1,083	835

Source: Ministry of Finance

The budget amendment for 2020, which was approved by the Parliament on July 1, increased the overall budget from the initial level of Afs 428 billion to Afs 449 billion for 2020. This comes from a Afs 6.5-billion increase in the operating budget and a Afs 14.5-billion increase in the development budget. However, it opens up a fiscal deficit of Afs 40 billion (about $525 million), even after accounting for the IMF's $220 million credit and the frontloading of discretionary grants through the ARTF (see Table 5). While the Government is planning to finance this deficit through its cash reserves that were sitting in the Treasury account at the start of the fiscal year, there is however limited room to fully cover the deficit by the treasury funds because some of those are restricted to the security sector only (i.e. funds disbursed by the CSTC-A security trust fund). Hence, the Government may have to accumulate arrears this year to cover the shortfall, and this will increase Government's liabilities which have to be met in the next fiscal year.

Table 5: Revenues and Expenditures in 2018-2020 (in million Afghanis)

	2018	2019	2020 proj.
Total Revenues	**397,217**	**405,848**	**394,484**
Domestic revenues	190,723	207,748	144,093
Donor grants	206,495	198,100	250,391
Total Expenditures	**388,642**	**417,970**	**434,584**
Operating	262,257	275,163	288,922
Development	126,385	142,806	145,663
By economic classification:			
Wages & salaries	185,990	199,389	201,383
Operations & Maintenance	80,886	84,415	91,590
Capital expenditure	89,714	102,756	97,618
Social transfers	30,050	29,207	42,120
Interest payments	2,003	2,203	1,873
Budget deficit	**8,575**	**-12,122**	**-40,100**

Source: Ministry of Finance for 2018-2019, and Biruni Institute staff projections for 2020.

Nonetheless, there is likelihood of under-execution and under-spending in both the operating and the development budgets. Actual total expenditures are projected to reach Afs 435 billion by the end of 2020, which is nearly 4 percent higher than the actual expenditures in 2019

(i.e. Afs 418 billion). Total *on-budget* grants (including discretionary and non-discretionary, and including security and civilian grants) are forecast at Afs 250.4 billion (or US$ 3.3 billion) for this year.

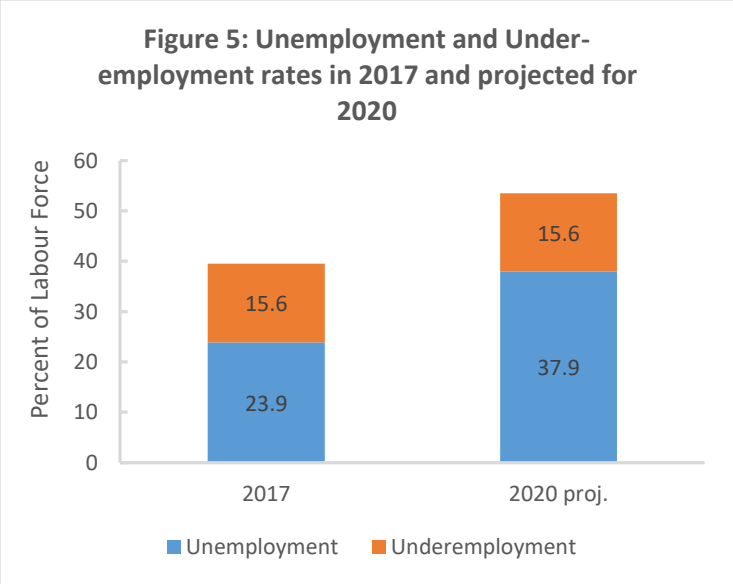
5. Poverty and Unemployment

In 2017, unemployment rate was estimated at 23.9 percent (and if combined with the 15.6-percent rate of "under-employment", then the figure would increase to 39.5 percent), while poverty headcount rate stood at 54.5 percent. It is expected that both unemployment and poverty rates have increased over 2017-2019 period.

The World Bank projects poverty rate (which is based on the national poverty line of Afs 3,004 per person per month at 2017 prices, equivalent to about $1.5 per day per person) to increase to 72 percent by end-2020. This projection is based on the assumption where income from remittances, which make only a small proportion of household income in Afghanistan, would fall by 75 percent in April-June and by 50 percent in the rest of the year. It also assumes that income and consumption remained stable between 2017 and 2019. These seem rather conservative assumptions, because: (1) the COVID-19-triggered crisis has introduced shocks to all sources of income, and not only to the remittances channel, and (2) household income – if proxied by GDP per capita – has constantly declined over the 2017-2019 period.

Biruni Institute staff uphold that if more realistic assumptions are taken into consideration, the poverty rate forecast could increase to as much as 80 percent for 2020. This means that around 8 million additional people would fall below the poverty line, adding to the number of 16 million people who were poor in 2017.

The unemployment impact of COVID-19-triggered economic crisis has also been significant. According to the simulation results of the Biruni Institute's "SAM-based multiplier model",[5] an 8-percent economic contraction – as projected in this report – increases unemployment rate by 14 percentage points. This forecast assumes that the economic shock passes entirely through the investment and exports channels, and that unemployment remained stable over the 2017-2019 period – which is a rather conservative



Source: ALCS 2016/17, and Biruni Institute staff projections

[5] The multiplier model is based on the Social Accounting Matrix (SAM) for Afghanistan, that is developed by the Biruni Institute with the 2017-2018 annual data. The SAM consists of 38 production sectors, and the institutional accounts for labour, capital, household (disaggregated by income quintiles), firm, government, tax, savings-investment, and rest of the world.

assumption. The model also assumes 'fixed prices' (meaning that demand shocks translate into changes in output rather than changes in prices) and 'unconstrained supply capacity' (meaning that changes in demand are matched by changes in output, without adjustments in the imports).

Based on this conservative forecast, unemployment rate is projected to increase from 23.9 percent in 2017 to 37.9 percent by the end of 2020. If "under-employment"[6] is added on top of it (assuming that the underemployment rate has remained constant over the period), the figure would be as much as 53.5 percent of the labour force. In nominal terms, this means that nearly 4.8 million people will be either unemployed or under-employed by the end of 2020,[7] as compared to only 3.3 million in 2017 – that is, an increase of 1.5 million people.

6. In-Depth Topics Section

Topic # 1: COVID-19 Response Programs: Food versus Cash

A typical fiscal policy response at times of economic recession is to undertake an expansionary fiscal policy (such as rolling out fiscal stimulus programs) to help revive the economy by boosting domestic demand. Fiscal stimulus includes a wide range of instruments, such as tax reduction, increase in government consumption, or expanding social transfers. For fiscal stimulus to generate sizeable aggregate impact, it must be additional to the existing levels of budget spending. If the fiscal initiatives or interventions do not increase the overall level of public spending during a recession, they are normally not perceived as a fiscal stimulus.

For Afghanistan, however, the fiscal space to undertake such expansionary policies is limited, and the Government does not have many choices in terms of stimulus programs. The current COVID-19-triggered recession has further reduced the available policy options for the government as domestic revenues were immediately and abruptly affected by the crisis in the second quarter of 2020. Donor funding commitments which were pledged in the 2016 Brussels Conference for a four-year period also ended this year.

The Afghan Government has therefore started reviewing its development portfolio, by re-allocating resources across the development projects, restructuring some of the existing projects (which may mean canceling or suspending some of the projects), and introducing new projects that are better targeted to the poor and to the sectors that increase resilience at times of crisis (such as the agriculture sector).

Such exercise, however, requires a careful understanding of the economic growth elasticities and fiscal multiplier impact of various sectors and projects, in order to ensure that the aggregate economic growth is not hurt. When fiscal space is limited, the rule is to decrease spending in sectors with insignificant (or even negative) fiscal multipliers and increase spending in sectors with higher multiplier impact.

[6] Based on the national definition, a person is underemployed if s/he has worked less than 40 hours in a reference period of one week. This basically means that anyone who works for less than 6.6 hours a day is considered 'underemployed'.

[7] This assumes that the labour force which was estimated at 8.5 million in 2017 has increased to an estimated 8.9 million by 2020, based on a 2.5 percent annual population growth.

Among the new development projects that are being designed to address the impact of COVID-19 is the "COVID Relief Effort for Afghan Communities and Households" (REACH) project, which was introduced by the President on July 19, 2020. The $300-million project, labelled as *"destarkhwan-e milli"* (Farsi: دسترخوان ملی), is funded by the ARTF donors ($125 million) and the World Bank ($175 million). The allocated funds for this project do not constitute new grant commitments, but are rather reallocated from other ARTF projects and front-loaded from the existing ARTF and IDA commitments.

Despite the fact that the details of ARTF portfolio restructuring are not yet available (in order to assess its overall growth impact), the REACH project is still justified in the sense that it addresses a crucial needed for an emergency support to poor households and communities. However, the nature of the project (i.e., distribution of in-kind food staples) needs to be seriously reconsidered.

Given higher propensity of projects that consist of delivery of in-kind benefits to corruption, fraud and misuse, and an unsuccessful experience with recent smaller projects of wheat and bread distribution in Kabul city, the REACH project should have been designed to primarily include digital cash transfers. Along these reasons, the Parliament unanimously rejected the project on July 21st. In fact, lower implementation and logistic costs, greater effectiveness in terms of poverty alleviation (as it gives the poor the choice in terms of procuring their needs), and – more importantly – lower fiduciary risks and better transparency and accountability are some of the reasons why an electronic money transfer program should have been opted for.

Afghanistan has made tremendous progress in the development 'mobile money' (also called, 'electronic money' or 'digital cash') and its associated technological infrastructures over the past two decades. Major donor countries have spent enormous amounts of grants (out of their funding commitments to Afghanistan) to help with the development of this technology, amounting to hundreds of millions of dollars. Several telecom companies, including Roshan ("M-Paisa"), AWCC ("My-Money"), Etisalat ("M-Hawala"), and recently MTN ("MoMo"), have invested enormously in these platforms. A breakthrough in this sector was realized very recently when the national e-payment

Key Facts on "REACH" Project

"COVID Relief Effort for Afghan Communities and Households"

« دسترخوان ملی »

Project Development Objective:

To provide emergency support to selected households through communities in project areas during the COVID-19 outbreak.

Total Project Cost:

US$ 300 million

Financing:

- World Bank IDA ($175m)
- ARTF ($125)

Project Components:

1) REACH Rural - Household support in rural and peri-urban areas ($158 million)
2) REACH Urban: Household Support in Provincial Capital Cities ($56 million)
3) REACH Kabul: Household Support in Kabul City ($78.5 million)
4) Project management, communications and monitoring ($7.5 million)

Implementing Agencies:

- Ministry of Rural Rehabilitation and Development (MRRD)
- Independent Directorate of Local Governance (IDLG)
- Kabul Municipality

switch, "Afghanistan Payment System" (APS), was operationalized. The APS allows for real-time settlement of financial transactions across various commercial banks, as well as across electronic money institutions (EMIs), in Afghanistan.

With the telecom coverage standing at 90 percent of the population in Afghanistan, electronic money transfer could have been a better alternative to in-kind food distribution. Electronic money applications can function with any traditional GSM mobile phone, and do not necessarily require a person to have a smartphone. A concern that is raised in the Project Information Document (PID)[8] of the REACH project is that the network of mobile money agents is currently limited in the country. However, this is not a substantive concern because the number of agents can be immediately scaled up within a matter of one to two months, as soon as retail merchants and money dealers (or *hawala* providers) are informed by the government that a $300-million digital cash transfer would be rolled out within a given timeframe. According to an exploratory research by the Biruni Institute, the technological prerequisites are fully in place in the country that could have supported a digital cash transfer program at such scale.

The PID does however acknowledge that "*experience from other countries and a few small-scale pilots in Afghanistan indicate that potential benefits of direct mobile-based cash transfer include reduction of program delivery costs; minimization of fraud and leakage risks; financial inclusion for the most vulnerable who would otherwise not have access to the formal financial services; and, from a welfare perspective, improved flexibility and choice for [households] to use relief for their most pressing needs. In terms of viability, small-scale efforts by humanitarian agencies to transfer cash to their beneficiaries using mobile money in Afghanistan have proven generally reliable, targeted, secure, and cost-effective.*"[9] Despite this acknowledgement, it is unfortunate that the project failed to consider digital cash payment as the primary instrument.

Nonetheless, even a hybrid project without necessarily comprising electronic money transfers could have been a better option than the in-kind food distribution. For instance, the $300-million funds could have been transferred to households using: (1) the current payroll system for civil servants and the national security forces (which include more than one million payroll accounts), but primarily to those whose monthly salaries are less than Afs 12,000 per month; (2) the biometric system for pension transfers, and for payment of social benefits to registered individuals under the Martyrs & Disabled scheme; (3) supplemented with a cash-for-work program; and finally (4) complemented by in-kind food distribution ***only*** to remote communities where markets are premature.

Such a scheme could have been way more efficient than a full-scale food distribution. While there might be concern for redundant beneficiaries in such a program (for instance, a person might be receiving benefits under the M&D scheme but also participate in the cash-for-work program), any such leakage to the poor segment of the population is still preferable – and has positive welfare impact – than a potential leakage to corrupt senior officials in Kabul or in

[8] Project Information Document - COVID-19 Relief Effort for Afghan Communities and Households (REACH) - P174119 (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/418271594295664016/Project-Information-Document-COVID-19-Relief-Effort-for-Afghan-Communities-and-Households-REACH-P174119

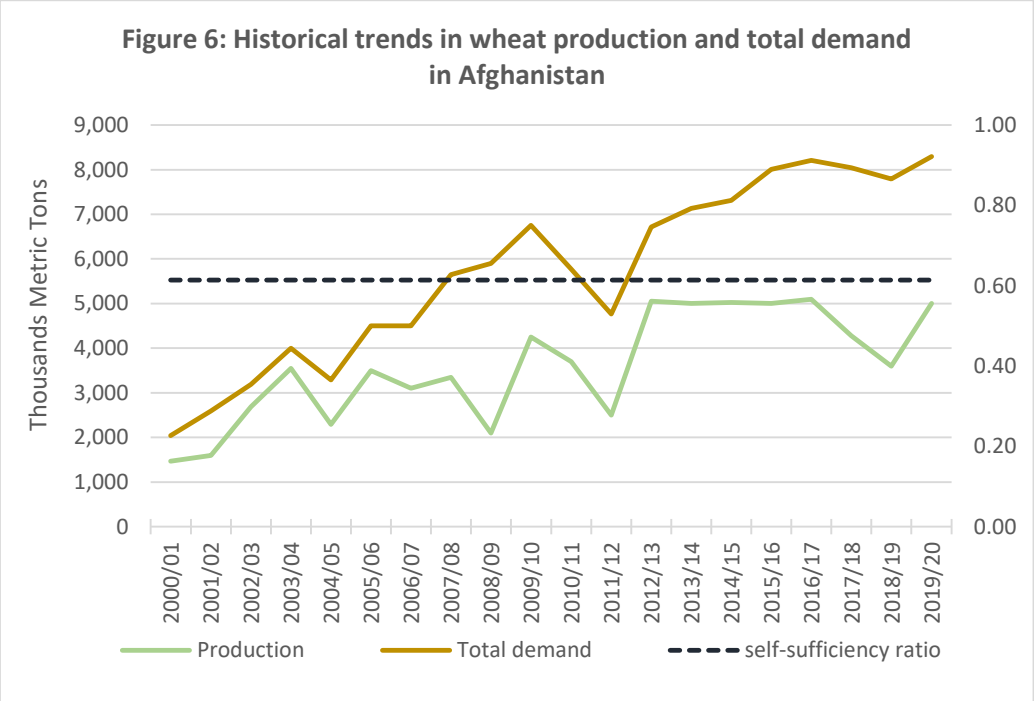
[9] Idem, page 19.

provincial capitals involved in the oversight and implementation of the program, or to those providing the food supplies as contractors to the government.

In sum, the need for such an emergency support program to households and communities is enormous, and the government's approach to mobilize the required funding of $300 million by reallocating resources from the existing development portfolio is also justified. However, the type and the structure of the program needs to be seriously reconsidered for the reasons of efficiency, effectiveness, value-for-money, and transparency.

Topic # 2: Wheat Prices Vulnerability to Trade Shocks

Afghanistan requires around 7,000 thousand metric tons of wheat on average for domestic consumption every year, while domestic wheat production stands at an average of 4,500 thousand tons. The remaining requirement is met by importing wheat from Central Asian countries, mainly Kazakhstan and Uzbekistan, and from Pakistan. Afghanistan currently records a self-sufficiency ratio of 0.61 in a normal year (see Figure 6). This makes wheat prices in Afghanistan to be more dependent on the wheat market of exporting countries.



Source: U.S. Department of Agriculture's Production, Supply, and Distribution Database

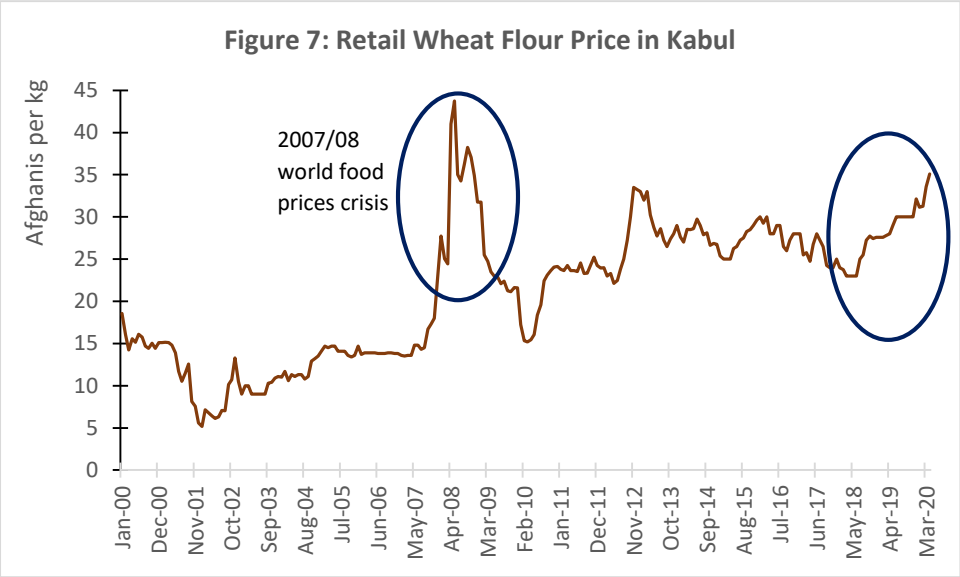
What has been the impact of COVID-19 on wheat prices?

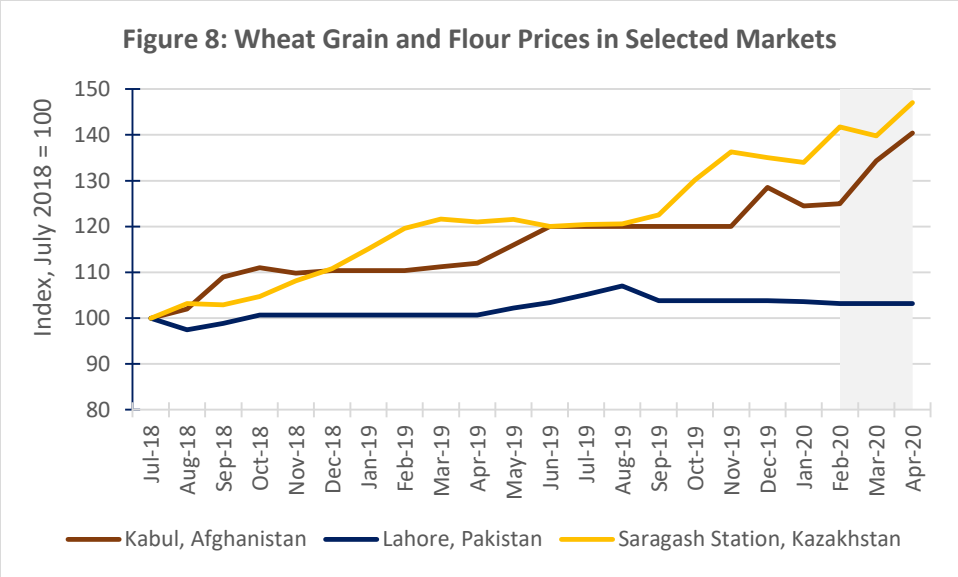
Wheat flour prices were already high since 2018 when Afghanistan recorded a poor wheat harvest. Wheat prices did not ease during 2019/20 marketing year[1] despite a good harvest. The main reason was that Kazakhstan, the biggest wheat exporting country to Afghanistan, had a poor harvest in 2019/20, and therefore wheat and wheat flour were imported to Afghanistan at higher parity prices.

In March 2020, when the COVID-19 was declared a global emergency, prices of wheat and flour started to increase in major cities in Afghanistan. In April 2020, wheat flour price in Kabul was 25 percent higher than in the same month last year, and 36 percent higher than the five-year average. As shown in Figure 8, wheat prices in the early outbreak of COVID-19 increased in Kazakhstan too. Data from recent years suggest that wheat prices in Afghanistan are strongly correlated with Kazakh wheat prices with a correlation coefficient of 0.92. However, they are not

[1] Marketing year is a 12-month period for a crop that starts with its harvest and used in that period. For Afghanistan, the wheat marketing year is July-June.

strongly correlated with the wheat prices in Pakistan, with which the correlation coefficient stands at 0.61.





Sources: VAM, WFP for Pakistan and Afghanistan. APK Inform Agency for Kazakhstan

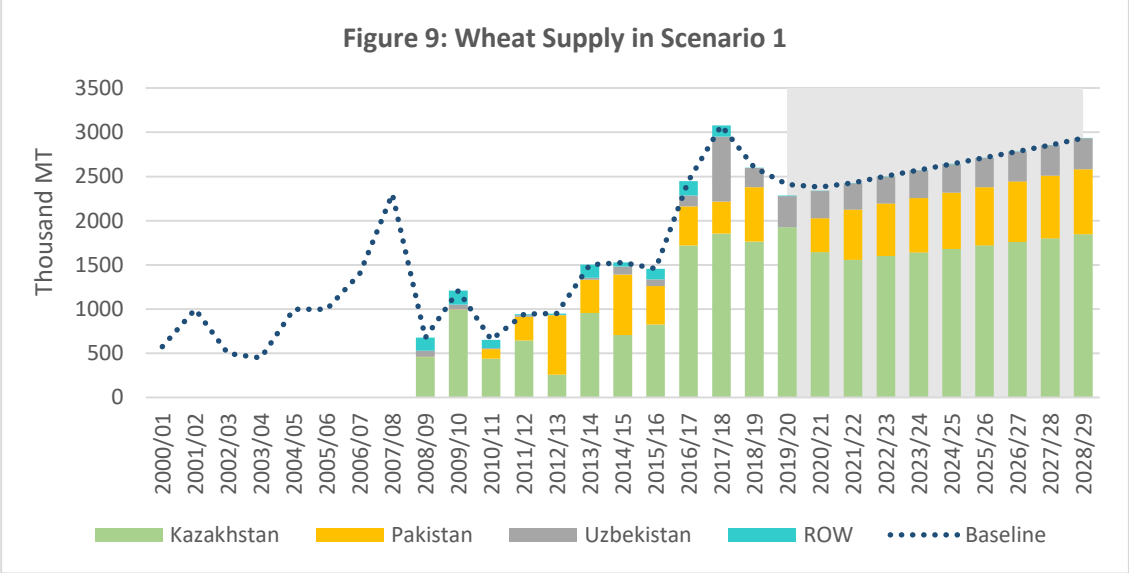
Wheat Outlook in Afghanistan:

When the COVID-19 was declared a pandemic, most countries imposed strict measures to fight the virus. Pakistan closed its borders with Afghanistan to constrain the spread of virus, before re-opening them in June 2020. Given possibilities of a second wave of the COVID-19 pandemic as it has been the case in some parts of the world, and recent resurgence of protectionist policies in many countries, as well as increasing food security risks in 2020 and 2021, this section presents a number of scenarios using a partial equilibrium model to assess the impact of potential trade restrictions on Afghanistan's wheat market. This helps the policymakers and other stakeholders to be better prepared for future economic shocks.

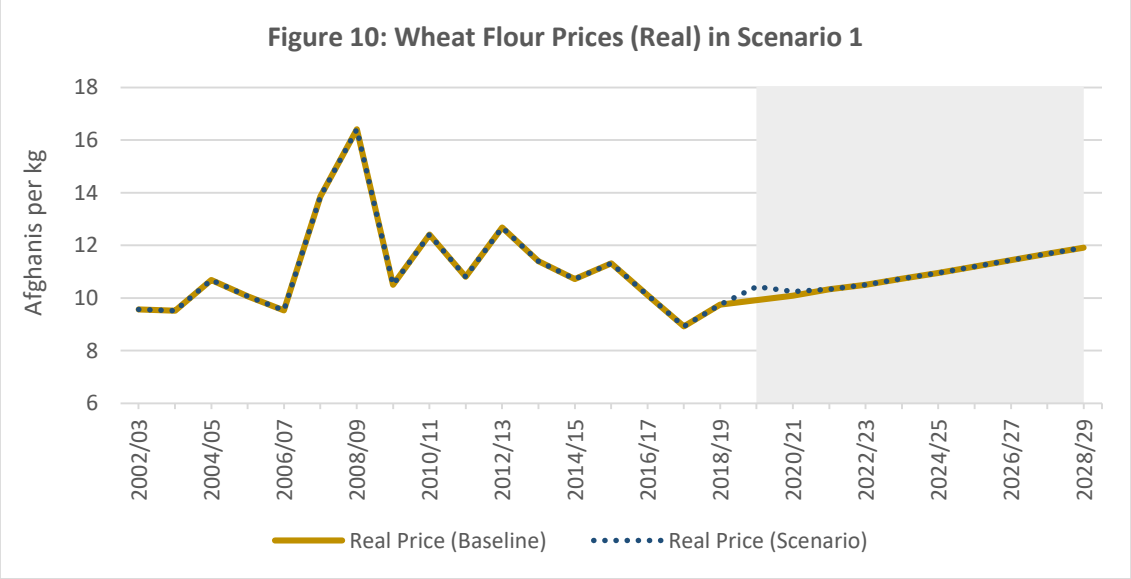
Analyzing the trade data for recent years reveals that Kazakhstan is by far the largest trade partner for wheat to Afghanistan, as it represents around 61 percent of Afghanistan's wheat imports, followed by Pakistan (23 percent), Uzbekistan (11 percent), and rest of the world (5 percent).

Scenario 1: Pakistan imposes trade restrictions for wheat exports to Afghanistan:

In a scenario where Pakistan restricts its wheat exports to Afghanistan for a period of one year, wheat flour prices in Afghanistan increase (in real terms) by five percent from the baseline during that year. In the following years when the restriction is removed, import levels and prices move back to the initial level . As expected, with the weak correlation between Pakistan and Afghanistan's wheat prices, a complete export ban by Pakistan can only marginally affect wheat prices in the country.



Note: Export restriction is imposed in 2019/20. Years shadowed in gray indicate scenario results.

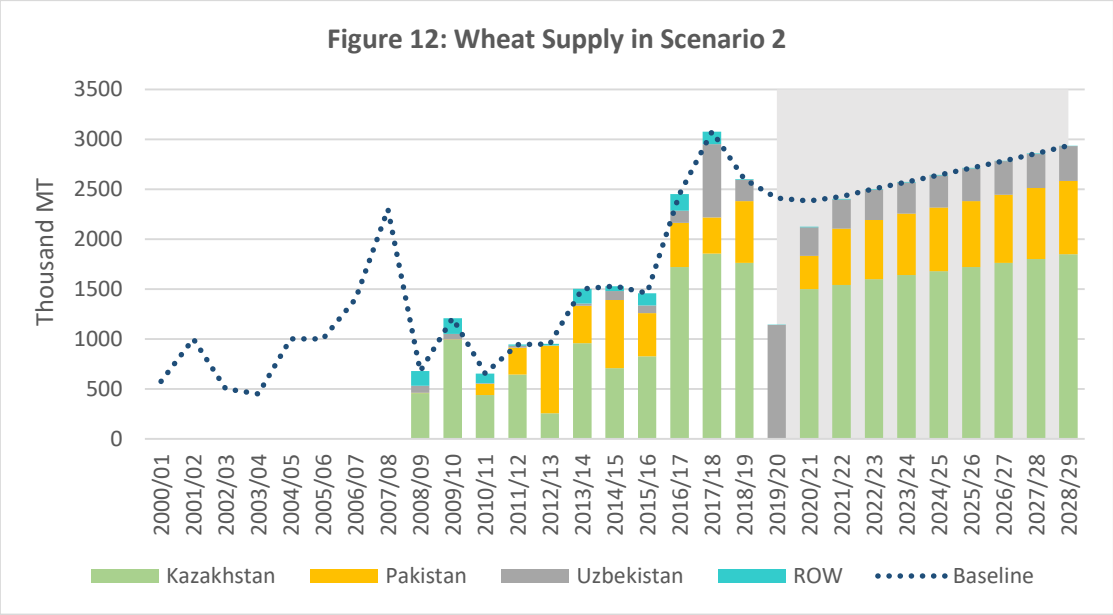


Note: Export restriction is imposed in 2019/20. Years shadowed in gray indicate scenario results.

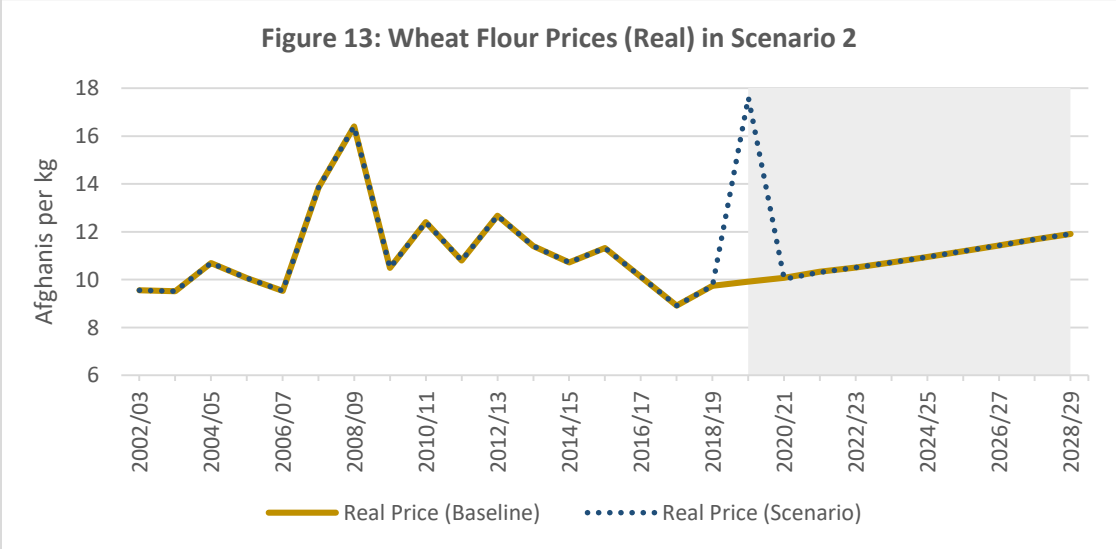
Scenario 2: Kazakhstan and Pakistan impose restrictions on wheat exports to Afghanistan

In this scenario we assume that both Pakistan and Kazakhstan restrict their wheat exports to Afghanistan for a period of one year, while Uzbekistan and the rest of the world continue trading with Afghanistan. Given the strong link between Afghanistan's and Kazakhstan's wheat markets, such a scenario has strong implications on prices in Afghanistan.

In a scenario where wheat imports from Pakistan and Kazakhstan are suspended, wheat imports from Uzbekistan can increase to partially fill the gap. Due to supply constraints, Uzbekistan cannot fully respond to Afghanistan's requirements. As a result, wheat flour prices increase by 78 percent compared to the baseline. As shown in Figure 12, wheat prices soar to unprecedented levels, even higher than the prices recorded in the 2007/08 world food prices crisis.



Note: Export restriction is imposed in 2019/20. Years shadowed in gray indicate scenario results.



Note: Export restriction is imposed in 2019/20. Years shadowed in gray indicate scenario results.

Conclusion:

Wheat imports structure in Afghanistan is highly concentrated, with imports from Kazakhstan representing 61 percent of Afghanistan's total wheat imports. Disruptions to wheat imports from Kazakhstan can have strong impact on domestic wheat prices in the country. Therefore, for the reasons of food security, as well as macroeconomic stability, it is important to diversify the markets for wheat imports, and at the same time increase wheat productivity in the country.

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