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Foreword

It gives me great pleasure to present volume 2, third edition of the Quarterly Economic and Statistical Bulletin of Da Afghanistan Bank for the second quarter of 1383(20 June - 20 September 2004). The Bulletin reviews overall economic development, as well as progress in financial sector reform, fiscal issues and monetary policy developments in the Afghan economy during this period under review.

On this occasion, I would like to express my thanks and appreciation to the Macroeconomic/Statistical Unit of the Monetary Policy Department of Da Afghanistan Bank in general and to Dr. Neil McMullen and Mr. Asadullah Ashraf Mojaddidi in particular for the continued high quality of the Quarterly Economic and statistical Bulletin. Dr. Andrew Hook prepared the analysis of the banking sector that appears as section 2 and I want to thank him for this important contribution. In addition I would like to thank Mr. Asadullah Ashraf Mojaddidi for this contribution on poverty in developing countries, article which appears as section 6.

This edition of the Bulletin is richer and broader than our previous editions and in future issues we will aim to continue improving the quality of our publication. To this end, I would like to invite non-DAB experts and scholars to submit their scholarly articles analyzing economic issues pertaining to Afghanistan, to be considered for publication in our future editions of the Quarterly Economic and Statistical Bulletin.

Noorullah Delawari
Governor & President
Da Afghanistan Bank

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GOA	Government of Afghanistan
FEMA	Foreign Exchange Market in Afghanistan
LCs	Letters of Credit
DAB	Da Afghanistan Bank
CPI	Consumer Price Index
AFs	Afghani (the national currency)
MOF	Ministry of Finance
CMEA	Ex-Soviet Trading Block
ARTF	Afghanistan Reconstruction Trust Fund
LOTFA	Law and Order Trust Fund for Afghanistan

1.0 Macroeconomic Overview

As reported in the last Quarterly Bulletin, the Afghan Economy has turned in a strong performance over the last two years with economic growth estimated at about 28.6 percent and 15.7 percent in the fiscal years of 1381 (2002-03) and 1382 (2003-04), respectively, albeit from a depressed base. The main contributing factor in the growth of the economy was recovery of agricultural production after years of drought, the construction and service boom in urban centres, a substantial amount of donor inflows from grants and aid, a return of émigrés, private sector expansion and also improvements in security situation. Apart from the growth story fiscal, monetary and exchange rate policies contributed on the stabilization front. The stabilization policy is supplemented by a wide range of structural reform measures which are needed to enhance economic incentives and improve resource allocation, as well as to remove impediments to private sector development. These developments have contributed to improving the overall macroeconomic environment in the country.

1.1 Economic Growth

Afghanistan's growth performance during the current fiscal year 1383 (2004-05) is a matter of concern which was adversely affected by a recurrence of the drought in the country. Although some parts of the country, especially the southern-western regions, have been facing drought like conditions for the last 4-5 years, the situation not only deteriorated there but spread to engulf most of the rest of the country during the second quarter of fiscal year 1383. This caused severe damage to agriculture and to overall economic growth. Real GDP growth in the current fiscal year 1383 (2004-05) is now estimated at 8.0 percent. Estimates are that agriculture declined by 5.8 percent while the rest of the economy expanded by 18 to 20 percent during the current fiscal year. The shortage of water adversely affected the performance of the major crops and consequently reversed the previously rising trend in agriculture output. Land resources were also diverted from traditional agriculture base to the illegal drug economy. As a result the poppy production was some 17 percent higher than last year, while the cereal yield (especially wheat) was reduced by 25 percent.

The pursuit of a judicious mix of monetary, fiscal and exchange rate policies have enabled the economy to sustain moderate growth despite the economic losses from drought. One positive development is the 15.1 percent rise in currency growth which was accompanied by moderating inflation and an appreciation of the exchange rate of about 17 percent during the quarter under review from 50.5 Afs per dollar to a high of 42 Afs per dollar. Later on the exchange rate depreciated moderately and stabilized in the range of 45 Afs per dollar.

In the second quarter of 1383, a total of $61.6 million domestic revenue was collected compared to $52.9 million in first quarter, which indicates an increase of 16 percent over the first quarter. The total amount of domestic revenue generated during the first half of the fiscal year is $114.5 million which represents 37 percent of the projected domestic revenue. So far $136.5 million has been spent as part of government's operating expenditures in second quarter as against $104.61 million in first quarter with a total of $241.11 million in the first half of year representing 40 percent of total operating expenditures. The government runs a budget deficit of almost 50 percent of total expenditure which is financed by the donor inflows particularly through ARTF and LOTFA accounts.

The overall inflation rate was recorded at 1.3 percent in second quarter as against 6.9 percent in first quarter of 1383 (2004-05). In recent quarters the main factor responsible for a relatively stable inflation has been the upward adjustment in rents and housing. However, that is now slowing down. Once adjusted for real estate price increases, core inflation declined by about one percent. Food inflation was down 4 percent as compared to an upward increase of 3.8 percent in first quarter of 1383. Prudent fiscal management and monetary policy plus an appreciating exchange rate succeeded in maintaining price stability during the second quarter as part of the country's stabilization efforts.

On the external side, the trade account has shown a deficit of $732.9 million during the first half of 1383. The foreign exchange reserves, including gold rose to over one billion Dollars by the end of second quarter. This level is sufficient to avoid major exchange rate disruptions in the event of an adverse external shock.

1.2 Agriculture

As shown in Table 1, agriculture is the dominant sector of Afghanistan's economy employing 80 percent of its labour force and producing almost half of its GDP. The decline in agriculture's share in GDP indicates that growth in this sector is lower as compared with the growth in other sectors of the economy, especially the manufacturing and trade sectors. Agriculture's performance has been unsatisfactory mainly due to dependence on traditional methods of cultivation, lack of motivation on the part of unskilled farmers and most importantly due to natural disasters like drought and pest attacks.

Table 1: Sectoral shares of GDP

Sector	2003	2004
Agriculture	49.7	48.5
Industry	20.1	21.3
Services	30.2	30.2
Total	100.0	100.0

Sources: IMF, CSO

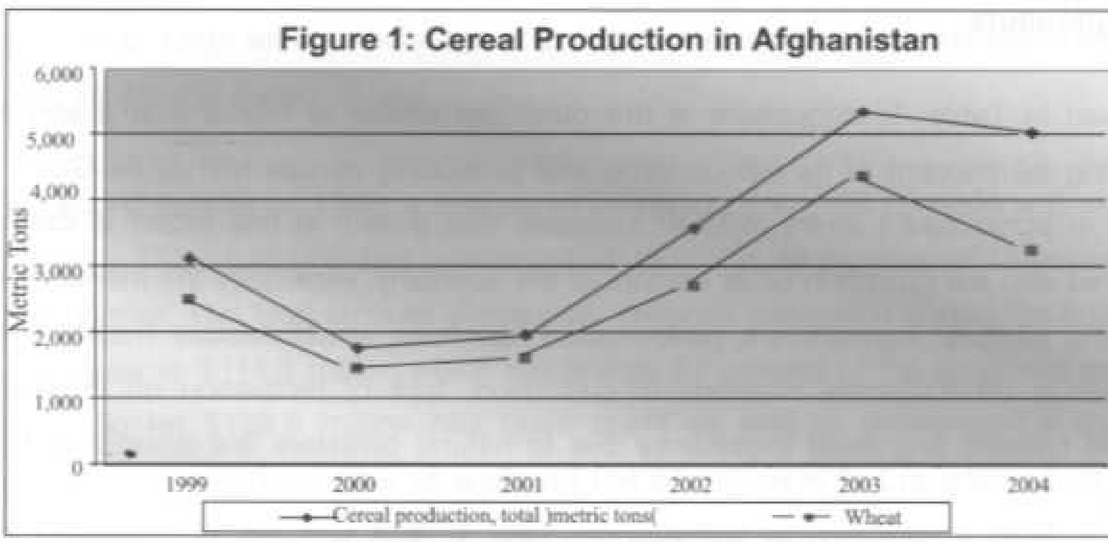
The overall agriculture growth suffered a severe setback during 1383 due to drought and shortages of irrigation water; eventually resulting in a decline of almost 6 percent as against an impressive growth of 50 percent last year. Among the major crops, wheat production was limited to 3.25 million MT against 4.36 million MT in 1382 (2003-04) which indicates a lower yield by more than 25 percent, as against a 62 percent rise in

1382 while the rest of crop shows a moderate rate of increase with a 61 percent increase in rice production, albeit from low levels initially.

Table 2: Selected Economic indicator

MTs	2003	2004	Percent change
Agriculture	5,372,000	5,061,000	-5.8%
Wheat	4,361,000	3,248,000	-25.5%
Rice	291,000	470,000	61.5%

Sources: MAAH, DAB, CSO



The table and chart above shows estimated outputs by crop, and clearly demonstrate the effect of the drought in the recent year, particularly on wheat production.

2.0 A Strong Start for Banking in Afghanistan

2.1 Introduction

It has been almost two years since the Government of Afghanistan introduced its new currency and just over one year since the Central Bank and Banking Laws were approved. The banking sector in Afghanistan, starting from a very low point two years ago, is now growing at a fairly rapid pace. Eight new and three old re-licensed banking institutions have been established and are active. A range of banking services is now available from different competing banks. This article reviews briefly the background of the financial sector in Afghanistan and the quite substantial progress that has occurred over the last two years.

Several points are worth underscoring. The establishment of several diverse new banking institutions so quickly has surpassed many people's expectations. Certainly, the rate of economic growth, the relative stability of the currency, the serious and real commitment of the international donors have all played a major part in the introduction of new institutions. All have indicated their long term commitment to the country, even as they have dealt with remaining security concerns. As indicated below, there are different markets for the banks in Afghanistan, and different banks are seeking first mover advantage, leading to the acquisition of significant market share.

To date most of the progress has been achieved by the new banks. The relatively slow reform of the existing domestic banks has meant that they remain in the background in terms of market development. These banks started the period in very poor condition but, until the new banking laws were passed little could be done in terms of reform. Given the importance of these banks to the financial sector, the time is right for a vigorous restructuring and reorganization. If these banks do poorly over the coming years, this will certainly slow the growth of banking in Afghanistan.

As the new banks commence operations, it is clear that within the formal financial sector the US dollar is being used much more than the Afghani. Two general reasons can be offered for this result: 1(a continuing lack of confidence by the public and businesses in the Afghani, based on the previous 25 years experience, and 2) the lack of an adequately supportive infrastructure for the banks to manage their liquidity in Afghani. Some measures to promote more use of the Afghani are under consideration and are presented below.

In many ways the financial sector has gotten off to a surprisingly strong start. There appears to be a critical mass of institutions to move ahead in developing the sector, but there are important issues that will need to be addressed in 2005 to maintain this momentum. One of those is the use of the Afghani, as noted above. Measures need to be taken if the Afghani is to take its rightful primary position in the financial markets in Afghanistan. Further legal and accounting measures are needed to provide banks with reasonable protection so that they can lend without undue risk. Finally, measures are needed to extend the banking sector throughout the country, to all provinces.

2.2 The Background: Banking in Afghanistan

Afghanistan's formal banking sector is relatively new, with the first commercial bank, Bank Millie, being established in 1933. Although this bank had 72 percent private ownership, it undertook some central bank functions until 1939, when Da Afghanistan Bank was established. Bank Millie was heavily focused on trade finance and in the early years opened six overseas branches and 10 branches in the provinces. The bank often took ownership shares in the companies that it lent to and still has ownership in a number of industrial companies as well as in Pashtany Terjaraty Bank (PTB).

The next commercial bank to be established was Pashtany Tejaraty Bank, opened in 1955 with government ownership of some 60 percent. In the first decade of operations it also focused on trade financing and opened branches in several countries, including Iran, France, Japan and Pakistan.

In the 1970's the Daoud government nationalized both banks and established two new development banks, Industrial Development Bank and Export Promotion Bank. These development banks joined the Agricultural Development bank, which had been established at the same time as PTB. Under the Daoud regime, Soviet style banking was introduced, moving the banks away from market-oriented banking to centrally controlled banking.

The start up period of the banking sector in Afghanistan, from the mid 1930's to 1970 was relatively short and did not benefit from strong foreign investment, focusing mostly on trade. Foreign bank activity in Afghanistan was at best very limited and no formal capital markets were established. People had, however, developed some confidence in the banks, as a customer deposit base was established. The development of the formal sector, nonetheless, remained limited while the informal sector, with the hawalas, remained active.

From the 1970's until 2002 the formal banking sector underwent a drastic deterioration. Sound banking policies disappeared in the face of political and military force. Banks were looted at various times. Until 2002, there was little point for depositors to try to get their funds from the banks, the bank recording systems were hopelessly out of date, and overseas funds were frozen. After 2002, many depositors found that they could get only a fraction of what they deposited, due to the depreciation of the Afghani from around 50 to the Dollar to 50,000 in 2002. What confidence had been built up in the banking sector in Afghanistan prior to the 1970's was definitely lost by 2002.

There is little information on the detailed operations of the hawalas during the period from the mid-1930's to 2002, but it is clear that as the formal sector collapsed, these operators provided financial services that were no longer available through the formal sector. During the time of the civil war and the Taliban, the hawalas remained active. They offered transfer services into and out of Afghanistan, as well as to and from the provinces. They provided foreign currency exchange, microfinance, trade finance and deposit taking. As unregulated operators, they also were active in non-financial activities, such as telephone and fax service and regional and international trade.

2.3 Banking and Financial Sector in 2002

All of the banks suffered serious and continued financial and physical damage during the war and Taliban periods. During this long period there was heavy political interference in bank management and operations. Modern banking practice and policy were totally lacking, as political appointees with little or no experience in banking operated the banks. Management and staff with good experience either left of their own volition or were forced out. Under the Taliban, all qualified managers were terminated and all women, who at that time composed up to 30 percent of the staff at PTB, were terminated. Meanwhile, the banks with branches abroad had their funds frozen.

The civil war and role of the Taliban had created a legal limbo. The only legal framework for the financial sector, the 1994 Law on Money and Banking, was fundamentally flawed. It reflected central planning, where the only monetary policy is to direct credit. In light of the recent defeat of the Taliban, people were uncertain which laws applied in which conditions. This made decisive action to reforming the existing banks impossible in the short term.

In 2002 when the Taliban fell and the Interim Government was introduced under President Karzai, the formal financial sector was no longer functioning and all transactions were in cash. Only the informal sector, was providing financial services, such as money transfer, foreign exchange transactions, deposits and loans. None of the seven Afghan banks, including the central bank, had up to date record-keeping or financial reports. Controls were focused on cash alone.

The hawalas were still functioning in 2002. In the period immediately after the defeat of the Taliban, the only way to bring money into Afghanistan, besides the suitcase, was the hawalas. However, the lack of transparency, the lack of reliable reporting, the lack of well-defined enforcement powers, and the general vulnerability of the hawalas system to financial abuse meant that changes were also needed in the activities and the regulation of the money changers.

Although there was some activity in microfinance in 2002, this was limited. Microfinance is a new development in Afghanistan, at least in the context of the many microfinance programs that have been developed world wide in other countries over the last twenty years. The World Bank reports that in mid 2002, NGOs in Afghanistan had total outstanding loan portfolios of only US$1 million, with 12,000 clients.[1] NGOs, until 2002, viewed their activity more as charitable and were not concerned with repayments on with the sustainability of financial services for the Afghan poor.

2.4 Reform and Legislative Actions

Building a financial sector in a post-conflict economy presents many challenges. Some of the typical problems are: 1) lack of trained personnel; 2) inaccurate and lagging financial reporting; 3) absence of accounting standards; 4) the lack of a solid and efficient legal framework; 5) poor corporate governance; 6) macroeconomic instability; 7(lack of an effective monetary policy; and 8) a general lack of infrastructure for the public and private sectors. In addition, there are many stakeholders, ranging from government officials, officials in the different Ministries, the Central Bank and, fortunately for Afghanistan, many bilateral and multilateral donors, who have valid interests in the entire process. For these reasons, and because of the dynamism of Afghanistan's economy a realistic strategy for developing the financial sector must be flexible, to take into account changing conditions.

From an economic perspective, a sound and well-designed macro-economic framework is a precondition for developing a financial sector, and to date this has been achieved with rapid growth, moderate inflation, and a stable exchange rate. Financial sectors are built on confidence. Without a stable economy and sound monetary and fiscal policies, such confidence will not be forthcoming. This is especially so in the case of Afghanistan where depositors have lost great sums of money due to the large depreciation of the currency and the abuse of the banking sector as a whole.

In fact, the early reform efforts in Afghanistan focused on the government infrastructure, to develop a sound base that, in turn, could provide a supportive environment for private

[1] The Financial Sector in Afghanistan, Managing the Postconflict Reform Process, Joseph Del Mar Pernia, Simon Bell and Samuel Munzele Maimbo. 2004. Finance and Private Sector, South Asian Region, World Bank

sector investment and growth. Attention was given to key Ministries, such as the Ministry of Finance and to the Central Bank, so that they could become operational.

The most immediate priority for developing a new market economy was to introduce a new currency. At the start of October 2002, there were several types of bank notes in circulation in Afghanistan: one official bank note, one issued by one of the Northern warlords and one with high serial numbers. There had been no recent experience with the implementation of monetary policy and existing statistics were unreliable. The introduction of a new currency, with modern security features, took place between October 7th, 2002 and January 2nd 2003. This successfully set he stage for the implementation of monetary policy and for the development of the new financial sector in Afghanistan.

The beginning of the reform of the banking sector depended on the establishment of a legal framework for both the central bank and the commercial banks. Without such a law, managers, advisors and donors would have to work in an uncertain legal environment. Actions would be subject to challenge, due to the legal uncertainty and progress could only be slow and uncertain. So the next step forward on the financial sector was the passing of two presidential decrees, the Law on Da Afghanistan Bank and the Banking Law of Afghanistan, approved on September 16, 2003. The signing of these documents was the culmination of more than one year of intensive effort by the central bank, in cooperation with the IMF. USAID advisors and other organizations also participated in the drafting process.

The adoption of the Central Bank and Banking Laws opened the door for substantive action in a number of areas. Some of the key actions that are called for by the laws are listed below. It should be realized that every one of these actions required considerable planning and effort, particularly on the part of DAB, which did not have any supervision capability in 2002. All of these activities have been developing on parallel tracks since September 2003.

1) Re-licensing of existing banks
2) Treatment of failing and/or bankrupt banks
3) Establishment of bank supervision, capability, including hiring and training staff,
4) Establishment of a regulatory framework based on the rule of law,
5) Licensing of new banks, and,
6) Supervision and regulation of new and old banks,
7) Restructuring DAB in line with appropriate central bank functions (See the previous article financial sector outlook in Afghanistan on page 30 in the December 2003 issue of the Economic Quarterly Bulletin)

The development of regulations implementing the DAB Law and Banking Law has been particularly intense. Under the DAB Law, regulations have been introduced setting higher standards of entry and operations for foreign exchange dealers (formerly known as moneychangers or hawalas) and money service providers (money transmission, check cashing, and safekeeping), and establishing reserve requirements for monetary policy purposes. Under the Banking Law, regulations have already been adopted governing bank licensing/branch permitting, regulatory capital, liquidity measurement and management, limitations on large exposures, and credit extended to related persons. Soon to be finalized and adopted are regulations on enforcement, prohibited activities, and limitations on foreign exchange positions; additional regulations on change in control, corporate governance, and consolidated supervision of a bank and its affiliates are planned for 2005.

Monitoring for compliance with these laws and regulations, as well as conformance with best banking practices, is DAB's newly-created Financial Supervision Department which has already conducted eight on-site examinations and is receiving monthly data from all banking organizations enabling off-site monitoring of individual banks and aggregate statistics for the banking sector.

2.5 The Composition of the Banking sector

At least three types of institutions are playing a role in the establishment of the financial sector in Afghanistan: 1) pre-existing domestic banks; 2) newly established Afghan banks; and 3) new foreign banks. The weak condition of the old domestic banks indicates that without rapid and strong reorganization and modernization, it will take considerable additional time before they are operating at international standards. A vigorous restructuring and capacity building should be urgently considered for these domestic banks. The treatment of the pre-existing domestic banks is important because it sends a signal to the market of the priorities and intentions of the authorities. An orderly process, for re-licensing, liquidation or sales is essential to start rebuilding confidence in public policies.

Three long-established domestic banks, Bank Millie, Pashtany Tejaraty Bank, and Export Promotion Bank applied for re-licensing and are in the process of starting up again. The first two banks prepared documentation, including a business plan, for their proposed continued operation by March 15, 2004, while the Export Promotion Bank applied and received its re-license later in 2004. These banks are currently operating under a special regime, until their financial condition improves. The status of the three remaining domestic banks is in the process of being resolved.

In contrast to earlier periods, there has been strong interest by foreign banks to establish branches in Afghanistan, as well as interest by Afghans to start their own banks. In late 2004, there are seven new banking institutions operating in Afghanistan, including branches of the National Bank of Pakistan, Habib Bank (from Pakistan), one branch of the Punjab National Bank, (an Indian bank), and Standard Chartered. The First Microfinance Bank, FMFB, is focusing on microfinance, in Kabul and throughout the country. It is owned by the Aga Khan Fund for Economic Development (AKFED) and the International Finance Corporation. The Afghanistan International Bank, AIB, is another locally established bank owned by four entities, including the Asian

Development Bank. Habib Bank [2], a Pakistani Bank with a majority ownership by the Aga Khan, also opened a branch in Kabul in the summer of 2004. In mid 2004, another locally established bank, Kabul Bank started operations. This bank has majority Afghan ownership and is interested in moving toward nation-wide banking.

2.6 Initial Activities of Commercial Banks

The banks have reported balance sheet positions to the DAB for the four months from June to September 2004 and, based on these, some initial comments can be made on their activities. It is prudent, however, to treat these reports with some care, as the banking system is just starting up and four months is a limited period of time. Total assets have risen by 11 percent over the period to Afs15.7 billion. This has been funded by a 42 percent increase in deposits at banks, although from a relatively low starting point of Afs 3.7 billion. Capital has remained about the same at around Afs 9 billion.

The aggregate totals are dominated by the two domestic banks, Bank Millie and Pashtany Tejaraty Bank, but the new institutions are responsible for virtually all of the increases in deposits and lending over this period. Total assets of the two domestic banks actually fell by Afs 100 million over the period, but they still accounted for 57 percent of total assets. There was relatively little change for the Export Promotion Bank, and for the three other domestic development banks that are still reporting. Thus, all of the increases in deposits and loans were all registered by the new banks.

Of the 42 percent increase in deposits, Afghani deposits rose by 13 percent and Dollar deposits were up 66 percent. In September total US Dollar deposits totaled Afs 3.6 billion compared with Afs 1.5 billion for Afghani. Possible reasons for the slower growth in Afghani will be reviewed later, but generally individuals and businesses still appear to prefer to hold Dollar deposits in the formal banking sector.

[2] Habib Bank was formerly a State Bank. In 2004 the Aga Khan purchased 26 percent ownership, with a commitment to increase this share to 51 percent.

The picture is similar in the case of lending, with a total increase in lending of 40 percent over the four month period, to Afs 1.5 billion in September, with the Dollar-denominated lending accounting for virtually all of the increase. The largest percentage increase was for US Dollar denominated loans by banks other than Bank Millie and Pashtany Tejaraty Bank. This Dollar lending rose by 125 percent to Afs 649 million. Afghani loans did increase, by 23 percent, but this was entirely accounted for by the two domestic banks.

By contrast the deposit and lending activities of the domestic banks have not been growing rapidly. The domestic banks clearly are at a disadvantage compared to the new banks. The former are overstaffed in terms of numbers but lack many critical skills. They had no computers until recently and do not have reliable historical reports. They still have only a few computers and required special assistance from DAB in order to participate in DAB's electronic payments systems, the Afghanistan unds Transfer System and the Afghanistan Clearing and Settlement System. Finally, they are owned by the government and as yet do not have a mandate to proceed with a thorough reform of their operations.

Although the growth of the financial sector is being driven by the new banks, the role of the three domestic banks should not be underestimated. These banks had countrywide experience in banking, as well as international experience. Unfortunately, to date very little in the way of financial or technical assistance has been provided to these banks. The domestic banks have an advantage in their operations in Afghani, and measures to promote the use of the Afghani in the financial sector should be coordinated with effective action to strengthen the domestic banks.

The new banks generally have different strategies, but they all have advantages compared to the domestic banks. They started with significant experience in banking, either in this part of the world, or generally. Their management can assist in developing realistic business plans that have been tested in other countries. They can leverage from existing expatriate staff and hire only those local staff that they can train. All of the new banks are computerized and were so from early days. In addition, some have powerful foreign or international owners, who are providing needed financial and technical assistance.

The new banks, particularly those with international owners, are seeking to build on their international strengths and connections. Thus, trade financing is a target area for many, as well as business with NGOs and various donor projects. Payments into and out of Afghanistan are another important area, as well as transfers within Afghanistan. Several banks have been active users f DAB's new Afghanistan Funds Transfer System, AFTS, which was developed with USAID assistance. Many of the new banks have interest in opening branches in the main provincial centers, and even beyond. The new banks are focusing on Dollar deposits, although they do offer current accounts in Afghani.

Lending appears to be primarily short term, one or two months or even less. The longer term lending is basically one year, except for construction loans. This reflects the high risk in lending in a location where there is no strong legal framework with which creditors can protect themselves. The degree of legal certainty regarding collateral is seen by many as unsatisfactory. These problems favor the international companies that have offices in other countries, where the legal framework is more reliable and there are good financial reports.

As indicated above, lending is occurring, and some of this is for local businesses. Different banks take different measures to protect themselves. In all cases, there is a strong "know your custcmer" orientation. Some banks will visit borrowers and spend time with them to obtain information about their cash flow, business plans, etc. In most cases, the banks cannot expect borrowers to have any published financial reports, or indeed much in terms of written reports.

Another approach is to require the testimony of the head of a municipality or recognized authority before a loan can be granted. In still other cases the owner of some of the new Afghani banks may have had many prior relationships with businesses and this serves as a basis for the lending. Other approaches include very short term loans, credit lines that must be "cleaned" regularly and relatively high interest rates to compensate for the risk.

2.7 The Use of the Afghani: Formal and Informal Sectors

Since the introduction of the new Afghani in late 2002, there has been a pronounced divergence in its use in the informal sector and in the formal sector. Increases in the use of the Afghani above and beyond the rate of real growth and of price increases, both of which are reasonably well known, can be taken as a measure of the increased use of the currency outside the formal financial sector. This demand reflects a structural change, as the currency penetrates different parts of the economy. The rate of this penetration, also known as Afghanization, since the introduction of the new currency in mid 1381 (Oct-Dec. 2002) has been consistently high. In 1382, the rate of Afghanization was 8 to 10 percent, while the rate so far in 1383 has been 10 to 12 percent.

Turning to the use of the Afghani in the financial sector, it is clear that growth so far has been less dynamic than the Dollar. The rate of growth in nominal Afghani deposits was only 13 percent during the four months leading to September 2004. Ninety percent of the deposits are with Bank Millie and Pashtany Tejaraty Bank, and many of these are inactive accounts. A recent survey of the banks indicates that although a number of banks are seeking to take Afghani deposits, the public remains uninterested. The situation is similar for lending in Afghani, with only a Afs 100 million increase in the reporting period, with very little of the increase for the new banks.

The financial sector infrastructure is still not in place to support the financial sector's expanding liquidity management needs in Afghani. A Capital Note Facility was introduced by DAB in September and it marks an important step towards a more market oriented system with the introduction of an Afghani interest rate. This facility allows banks to invest their Afghani in an overnight or thirty day capital notes and, when the need arises, 90 and 180 day notes can be issued. The size of this market remains limited, and experience with this facility is being reviewed. Banks currently do not have a reliable source of Afghanis, if they run short of cash due to large withdrawals. Although the banks could invest Afghani in the capital notes, strong demand has not yet developed. The loan market is still in a nascent stage and presents a fairly high level of risk. In these circumstances focusing on the US Dollar is the path of least resistance for the new banks at this time.

A policy issue arises concerning the Dollarization of the financial sector and what measures could be taken to promote the use of the Afghani in the formal financial sector. The position of the Government of Afghanistan is clear: the Afghani is the national currency and its use should be promoted. The challenge is to find market-friendly ways of doing this in the next year or two, so that the Afghani begins to play a larger role in the formal financial sector.

A complete analysis of this topic lies beyond the scope of this article, but several points are relevant in regards to the financial sector. Within the formal financial sector there is a wide-spread perception that the Afghani is potentially a weak and unreliable currency. This is what the banks hear, even though the currency has appreciated by 15 percent since the end of the currency conversion. People explain this by the drastic losses that they sustained when the banking sector went into crisis, and the currency depreciated by some 10,000%. One or two years of positive experience are apparently not enough to change this perception, so measures that increase confidence in the currency could assist in encouraging the use of the Afghani in the financial sector, and more widely.

Such changes center on improved legal and institutional reforms to support lenders in efforts to collect loans and a deeper Afghani based domestic market to utilize deposits which are not immediately lent to investors.

A key set of measures that should be implemented concern the encouragement of genuine foreign exchange and money markets that the banks could use to manage their liquidity in Afghani. It should be obvious that the banks will expand the usage of the Afghani very slowly in the current situation. With the exception of the Capital Notes, the nascent loan market presents high risks for the banks.

V. Next Steps:

In order for the financial sector to maintain and increase its recent rate of growth, action is needed in a number of areas. The use of the Afghani in the formal financial sector needs to be increased, on both the deposit and loan side. The Capital Note, providing a facility of $25 million equivalent in Afghani for investment is a start. In addition, a legislative and/or regulatory platform should be established to assure equality of rights between creditor and debtor. Lending in Afghani is occurring, but the rates of interest are quite high, from 15 to 30 percent for short term loans. Clearly, this reflects the high level of risk in the market.

The adoption and implementation of the two banking laws and the opening of new banking institutions are moving the financial sector in the right direction. However, without strong and rapid reorganization of the two older domestic banks, further growth will be constrained and directed primarily to international and Dollar business. The domestic banks make up some 60 percent of assets and liabilities, and currently they are not moving forward.

Developing the foreign exchange market for the Afghani will help meet some of the needs noted above, at least on the use of the Afghani in the financial sector. With an active spot and forward market, banks will be able to operate with more flexibility. One way to develop the foreign exchange market could be to bring some of the most active money changers into the formal sector, as foreign exchange dealers. Admittedly, there is a significant distance between the current operations of the money changers and a formal sector foreign exchange dealer, but it may be possible to structure a new hybrid type of institution in uch a way as to attract the money changers and to meet the supervisory and regulatory requirements of a modern central bank.

An additional part of the financial sector infrastructure that has been started and will be brought up the standards of 2005, is the National Payment System. The DAB has launched the Afghanistan Funds Transfer System, AFTS, and the Afghanistan Clearing and Settlement System. The plan is to follow up in the next year with a Real Time Gross Settlement System. These systems will support the rapid growth of the Afghani, particularly for transactions purposes.

3.0 Monetary Aggregates

3.1 Money Supply

Money supply M1- currency in circulation plus demand deposits - increased by 51.4% during the last year, from Afs 25.26 billion at the end of Sonbola 1382)September 03(to Afs 38.26 billion at the end of Sonbola 1383 (Sept. 04) with an increase of 17.5% during the quarter under review (June. 04 to Sept. 04). This increase in M1 was largely due to the rise in currency in circulation, which grew by 51.1% during the full year with an increase of 16.5% during the final quarter. At the same time demand deposits finally began to rise, increasing by 54.13% over the last 12-months ending Sept 2004, with an increase of 26.6% during quarter from June to Sept. 2004.

The accounts of Da Afghanistan Bank (DAB) showed an annual increase of currency in circulation at the rate of 51.1% from Afs. 22.77 billion, at the end of Sonbola 1382 (Sept. 2003) to Afs. 34.42 billion by the end of Sonbola 1383 (Sept. 2004). Using current data for GDP this yields a ratio of currency to GDP of 12.85% for Sonbola 1383 (Sept. 2004).

Demand deposits in Afghanistan at the end of Sonbola 1383 Sept. 2004) totalled Afs. 3.84 billion, which came to about 1.43 percent of GDP. This represents growth of 26.7%-percent from the June 2004 level of Afs 0.8 billion. Thus M1 in Afghanistan is made up of about 89.96 percent currency and 10.04 percent notional demand deposits. The redevelopment of a system of genuine, active demand deposits is a task that has begun as communications are improving and as new, fully functional commercial banks are being established under the new banking law.

To arrive at a broader definition of money that reflects a more developed and diversified financial sector, quasi money is added to M1 to yield M2. Quasi-money includes mainly time, savings and foreign currency deposits held by non-government residents and organizations in banks and other financial institutions. Reflecting the low level of financial development in Afghanistan the existing data shows quasi-money to be almost nonexistent. Excluding demand deposits, quasi-money in Afghanistan increased from Afs 260.8 million as of the end of Sonbola 1382 (Sept. 2003) to Afs 413.3 million at the end of Sonbola 1383 (Sept. 2004) an increase of 58.5 percent during the last year, which came to about 0.16 percent of GDP. By comparison quasi-money in Pakistan averaged about 25% of GDP at some point in the last six months, implying that Afghanistan is clearly undeveloped financially compared to Pakistan.

Money supply M2, increased during the quarter by 17.3% from Afs 32.96 billion as at the end of Jawza 1383 (June 04) to Afs 38.67 billion at the end of Sonbola 1383 (September. 2004). M2 increased by 52.19% over the last year with the bulk of the growth in currency and national demand deposits. The low levels of demand deposits and the very low levels of time and savings deposits emphasize the lack of financial development currently prevailing in Afghanistan. Table 3: below shows monthly summary data for the M1 and M2 monetary aggregates and their components during the six month period of the year 2004 (April 04 to Sept. 04).

Currency in circulation grew by 16.5 percent during the last quarter. Given a sharp appreciation of the exchange rate in end August 2004 and improving reserve position of the country, combined with moderate pick up in inflation in the year 2004, a significant share of the effect of monetary growth appears to be on growth in real GDP.

Table -3: Monetary indicators (In million of Afs)

	Mar-04	Apr-04	May-04	Jun-04	Jul-04	Aug-04	Sep-04
	Hoot	Hamal 83	Saur	Jawza	Saratan	Asad	Sunbola
Money Supply, M1	**30705.1**	**29990.9**	**30905.4**	**32566.1**	**33863.6**	**36176.6**	**38259.5**
Currency in circulation)Out side DAB(	28272.0	27455.1	28186.6	29532.5	30674.4	32443.7	34417.5
Demand Deposit	**2433.2**	**2535.8**	**2718.8**	**3033.5**	**3189.2**	**3732.9**	**3842.0**
Central Bank	645.8	716.0	714.1	891.9	1047.5	1162.3	1069.8
Branches	943.7	993.5	1181.7	1169.0	1136.8	1510.1	1670.0
Commercial Bank	843.7	826.4	823.0	972.7	1004.8	1060.5	1102.3
Money Supply, M2	**31093.8**	**30383.9**	**31300.1**	**32964.4**	**34288.7**	**36597.0**	**38673.4**
Time Deposit	**39.9**	**32.8**	**32.8**	**32.8**	**33.7**	**33.1**	**33.3**
Central Bank	7.4	0.3	0.2	0.3	0.3	0.4	0.4
Branches	-	-	-	-	-	-	-
Commercial Bank	32.5	32.5	32.6	32.5	33.3	32.7	32.9
Savings	**348.7**	**360.3**	**361.9**	**365.6**	**391.5**	**387.4**	**380.6**
Central Bank	41.4	41.5	41.6	42.7	42.9	43.0	42.0
Branches	6.7	6.8	6.6	6.6	6.4	6.1	6.3
Commercial Bank	300.6	312.0	313.8	316.3	342.3	338.2	332.3
Monetary Base	**28507.2**	**27704.4**	**28431.4**	**29833.2**	**30931.8**	**32776.6**	**34663.4**
Currency in Circulation	28272.0	27455.1	28186.6	29532.5	30674.4	32443.7	34417.5
Commercial Bank's Operational Reserves	125.8	175.6	175.4	198.2	207.1	214.7	220.1
Excess Reserve	109.5	73.7	69.4	102.4	50.4	118.2	25.8

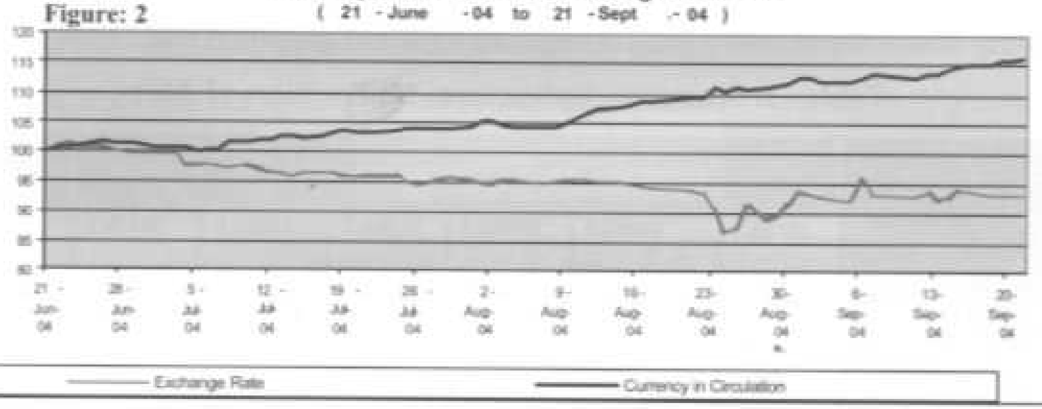
Source: Monetary policy department, DAB

3.2 Currency in Circulation and the Exchange Rate

A daily time series for currency and the exchange rate are shown for the quarter in Figure 2 below. In general the monetary aggregates are showing strong trending growth while there is a moderate appreciation in exchange rate during the quarter under review. Currency in circulation grew by 16.5% during the last quarter under review.

Figure: 2

Currency in Circulation & Exchange Rate from
(21 -June -04 to 21 -Sept .- 04)

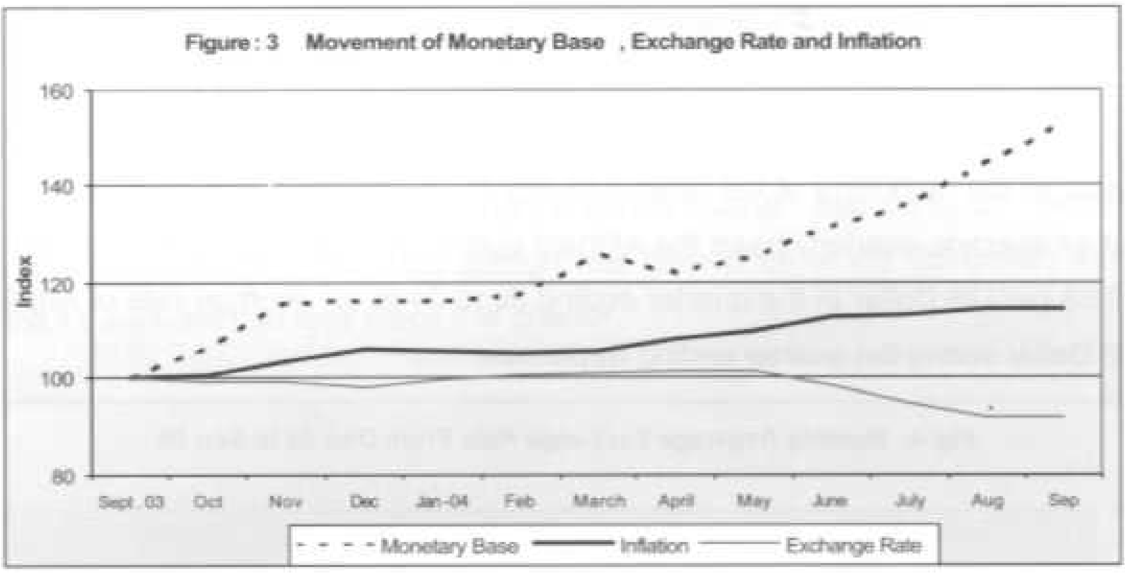


Daily reports of Currency in Circulation do not include Currency in the treasuries of DAB branches or commercial banks.

3.3 Monetary Base

The Monetary base is defined as currency in circulation outside the central bank, plus reserves of the commercial banking system plus commercial banks' investment in central bank instruments. At present, base money in Afghanistan can be defined as currency in circulation plus actual reserves. The monetary base increased by about 51.9 % during the 12-months from Afs 22.82 billion at end of Sonbola 1382 (September 03) to Afs 34.66 billion at end of Sonbola 1383 (Sept. 04) with the increase of 16.2% during the last quarter.

Figure 3 illustrates the movements of monetary base, exchange rate and the price level in the economy for the period Sept 2003 to Sept 2004. After a period of slow growth up to January 2004, the money base accelerated; especially during the 5-month period (from Apr. 04 to Sept 04). This was consistent with increased demand for money(i.e. Afghanistan of the money supply) and with sustaining continued rapid economic growth. The exchange rate showed low volatility over the past year with notable appreciation during the quarter under review. The general price level trended upward over the last year, driven mainly by rent and housing costs in the Kabul area. This series will be monitored very closely in the coming months to see if there is any change in the existing trend patterns of strong economic growth with relative stability in the exchange rate and moderate increases in non-rent domestic prices.



4.0 Foreign Exchange Market

4.1 Foreign Exchange Rates

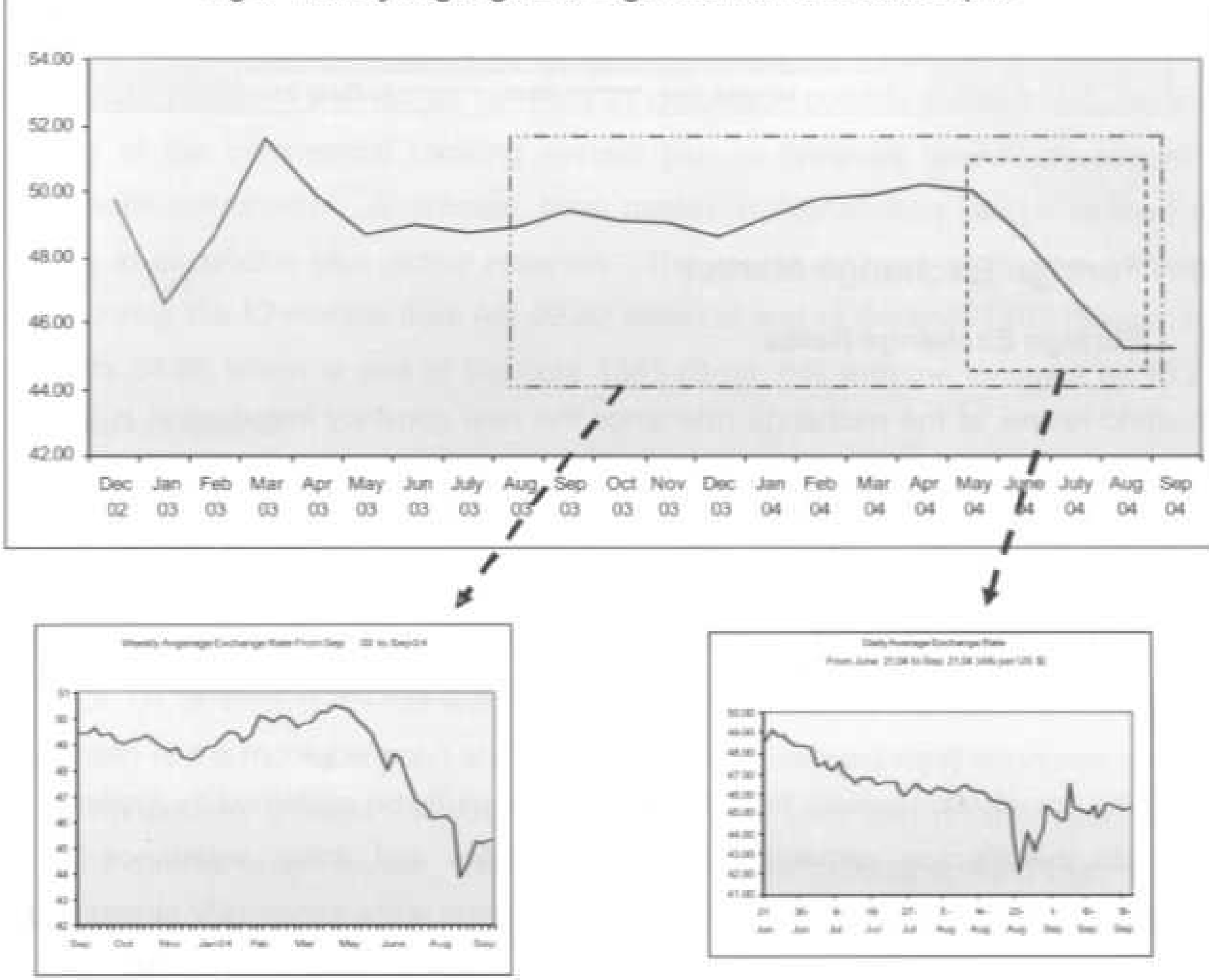
A historic review of the exchange rate since the new currency introduction is given in Fig 3. At the beginning there is a cycle of appreciation and depreciation lasting from Dec 02 to May 03. Then, it is relatively stable for about 12 months from May 03 to May 04 depreciating gradually in the range of 48 to 50 Afghan, per US Dollar. From the middle of April 04 to late August 04 a sharp appreciation took place. Then after August the exchange rate moved back to the range of about 45 Afghani per US Dollar.

During the pre-election period, the appreciation can partly be explained by expenditures related to the election campaign by the candidates and donor assistance for the election. This is also harvest time and Afghani exports were seasonally strong. At the same time demand for Afghani was high relating to the period before Ramadan.

To observe the in-depth scenario, the weekly exchange rate and daily exchange rate are shown in Fig 4 . The daily figure shows the fluctuations that occurred during the quarter. The Afghani appreciated from June 04 to late Aug 04 with a high of 42 Afghani per Dollar on August 24th. Thereafter Afghani depreciated somewhat from late Aug 04 to the middle of Sep 04.

On end of quarter period basis, the rate appreciated by about 6.8% from Afg 48.55 per US Dollar at the beginning of the quarter to Afg 45.26 per US Dollar at the end of Sep 04. On an average quarterly basis the Afghani appreciated by 7.023% from an average Afg 49.68 per US Dollar in the quarter ending June 04 to an average rate of Afg 46.19 per US Dollar during the quarter ending September

Fig 4: Monthly Avgerage Exchange Rate From Dec 02 to Sep 04



4.2 Foreign Exchange Auction (Sterilization Process)

To maintain the relative stability in the exchange rate the DAB continued its policy of periodic intervention in the market to smooth fluctuation in exchange rate and in the growth of the money supply. Overall, net intervention in the foreign exchange market in Afghanistan by DAB amounted to US$ 73.15 million in the most recent quarter, which was 11.9% of the currency at the beginning of the period. Table 4 summarizes the results of DAB foreign auctions during the period from 8th Sep 03 to 28th Sep 04. The *weighted average of the awarded auction rate (sale price of the US Dollar) was 46.07* for the 11 auctions that took place this quarter.

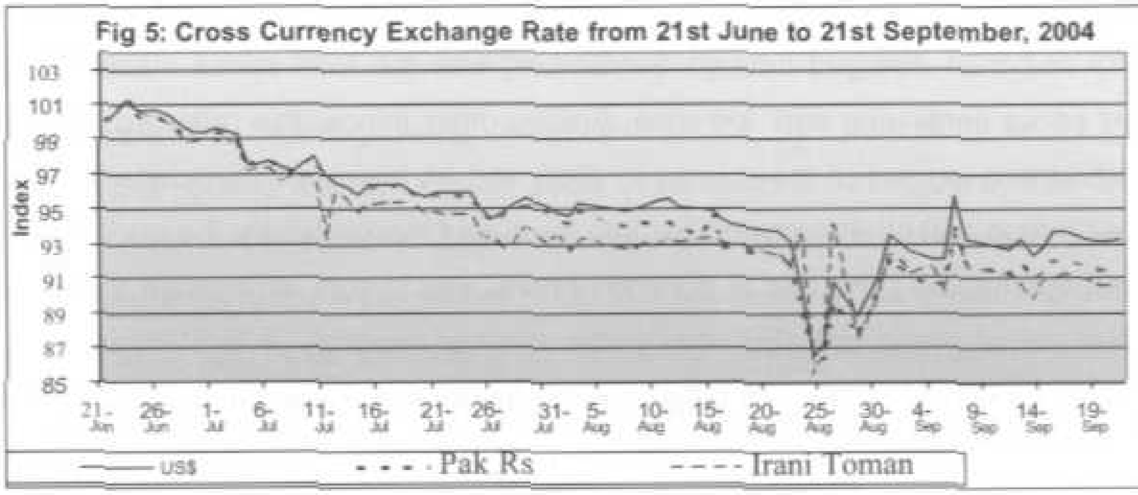
Table 4: Foreign Exchange Auction During The Period Dec 28, 02 to Sep 28, 04

Auction Date	No.of Bidders	Price Offered High	Price Offered Low	Price Sold	Amount Awarded in Million US $	No. of Awarded Bidders
8-Sep-03	36	49.12	48.80	49.12	5.00	20
16-Sep-03	40	49.43	49.10	49.43	5.00	20
20-Oct-03	20	48.40	48.28	48.55	5.00	20
30-Oct-03	39	49.25	48.90	49.10	5.00	20
5-Nov-03	43	48.65	48.60	48.75	5.00	39
17-Nov-03	42	48.18	48.15	48.60	3.25	9
2-Dec-03	35	48.68	48.50	48.63	5.00	20
9-Dec-03	38	48.05	47.85	47.95	5.79	38
6-Jan-04	32	48.66	48.40	48.61	5.00	18
13-Jan-04	37	48.92	48.70	48.90	5.00	20
20-Jan-04	40	49.41	49.20	49.41	7.00	23
27-Jan-04	38	49.23	48.80	49.05	8.85	26
29-Jan-04	28	48.55	48.00	48.55	4.60	8
9-Feb-04	35	49.06	48.50	49.06	5.00	23
17-Feb-04	37	49.91	49.76	49.91	4.99	20
24-Feb-04	37	49.90	49.70	49.88	8.87	19
2-Mar-04	37	49.90	49.75	49.88	9.90	33
9-Mar-04	39	50.11	49.97	50.11	15.00	29
16-Mar-04	38	49.85	49.96	49.96	11.55	33
23-Mar-04	26	49.33	49.00	49.33	7.32	25
28-Mar-04	30	49.62	49.40	49.70	10.00	26
6-Apr-04	33	50.00	49.85	50.00	7.00	17
13-Apr-04	29	50.35	50.15	50.35	5.00	24
20-Apr-04	30	50.23	50.00	50.24	5.00	14
26-Apr-04	30	50.61	50.48	50.62	5.15	20
4-May-04	23	50.38	50.10	50.30	4.25	19
11-May-04	27	50.31	50.00	50.25	5.15	22
18-May-04	29	50.00	49.80	49.95	9.04	28
25-May-04	26	49.60	49.40	49.50	5.70	25
1-Jun-04	28	49.45	49.20	49.35	9.75	28
7-Jun-04	19	49.00	48.50	48.76	7.15	18
12-Jun-04	21	48.13	47.90	48.00	6.95	21
28-Jun-04	21	48.15	48.00	48.25	12.00	20
12-Jul-04	23	46.75	46.60	46.80	10.00	21
20-Jul-04	17	46.50	46.20	46.60	8.00	5
27-Jul-04	22	46.03	45.84	46.00	4.99	22
3-Aug-04	23	46.30	46.10	46.30	5.00	7
17-Aug-04	21	45.80	45.50	45.65	5.20	20
24-Aug-04	14	41.15	41.00	41.45	3.05	14
7-Sep-04	18	45.30	45.10	45.30	7.30	18
13-Sep-04	14	44.55	44.47	44.65	4.95	13
21-Sep-04	21	45.48	45.30	45.48	7.55	15
28-Sep-04	20	45.00	44.87	45.10	5.10	18
Total Amount Sold in US Dollars					285.41	

Source: Da Afghanistan Bank, Monetary Policy Department.

4.3 Cross Currency Exchange Rates

During the quarter under review the Afghani initially appreciated against the Iranian Toman, Pakistani Rupee and US Dollar from June 04 to 25 Aug 04, by about 7.5%; then it started to depreciate from 25th Aug 04 to 10th Sep 04 by about 2.5%. Figure 5 illustrates the daily movements of the exchange rate of the Afghani per unit of the other currencies. In sum the Afghani appreciated by 8.4 percent relative to the Pak Rupee and 9.2 percent relative to the Toman during the June 04 to Sep 04 period.

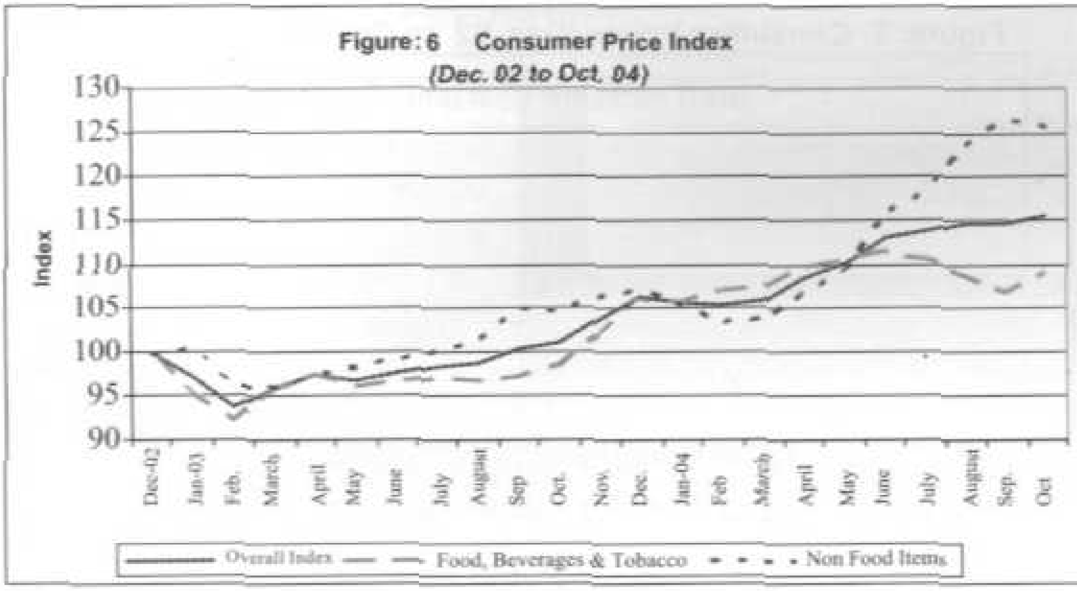


5.0 Price Movements

The quarterly inflation for the overall CPI at the end of Sonbola 1383 (Sept. 2004) fell to 1.32% compared to the rate of 6.9% registered during the previous quarter ending Jawza 1383 (June 2004). During the 3-months period Jawza 1383 (June 04) to Sonbola 1383 (Sept. 04) the food component of the CPI declined by 4.0% while the non-food prices rose by *9.05 %. Most of this rise was due to higher rents and housing.* Excluding rents prices fell by about 1% during the recent quarter.

The most current data available is for October 2004 (Meezan 1383) and the overall price indices recorded an increase of 14.5% during the 12-month period October 2003, to October 2004. Both food and non-food inflation were major factors behind the up tick in the overall CPI with food rising by 10.6% and non-food by 20% during the twelve months period ending October 2004. Note that most of rise was secured in the first half of 2004 and was heavily influenced by the rent component. During the 22 months since the new currency was introduced in Dec. 02 the average annualized rate of inflation works out to be 8.56%.

Figure 7 illustrates the movement of consumer prices over the last 22-months ending with October 2004, for both the composite CPI and for its two main components)food and non-food items(. Both of these components moved together until the end of April 2003 and then diverged through September, with the food prices stabilizing but non-food prices continuing their increase. Among other things, this reflected good crops in the northern regions of the country in 2003 and an improved transportation system for moving food and other commodities into the Kabul market where the price surveys were taken for the CPI. The rise in non-food prices was in part attributable to the seasonal rise in rental prices in Kabul during the summer months. In September 2003 these patterns reversed with food prices rising during the Ramadan period and non-food stabilizing and then declining in early 2004. After March 2004 the food prices remained stable while the non-food components indicated a sharp increase. The major contribution to this increase came from rents which rose by 61.8% during the six months period ending October 2004.



Rental prices were the fastest growing component of the CPI increasing by 94.7% during the 22-month period ending October 2004. This is shown in figure 8. The CPI without rents recorded an increase of only 9.9% from Dec. 02 to Oct. 04, which works out to annual rate of 5.4% since December of 2002. About 35% of the overall increase in general CPI came from rents, which rose by 61.8% during the 6-month period ending October 2004 with an increase of about 26.2% during the quarter under review. This increase in rental prices reflects partly on the secular repatriation of Afghan refugees from neighbouring countries and partly on the seasonal inflow of Afghans to Kabul from Jalalabad, Kandahar and other hot areas of the country during the summer season. The problematic security situation in the rural areas also results in migration of Afghan citizens to Kabul. All these factors have contributed to the increased demand for housing and accommodation in Kabul. Moreover, in a rapidly growing economy like Afghanistan the marked increase in real estate prices and rentals is part of a secular trend and not at all unusual. It is a reflection of the successful expansion of Afghani incomes over the last two years.

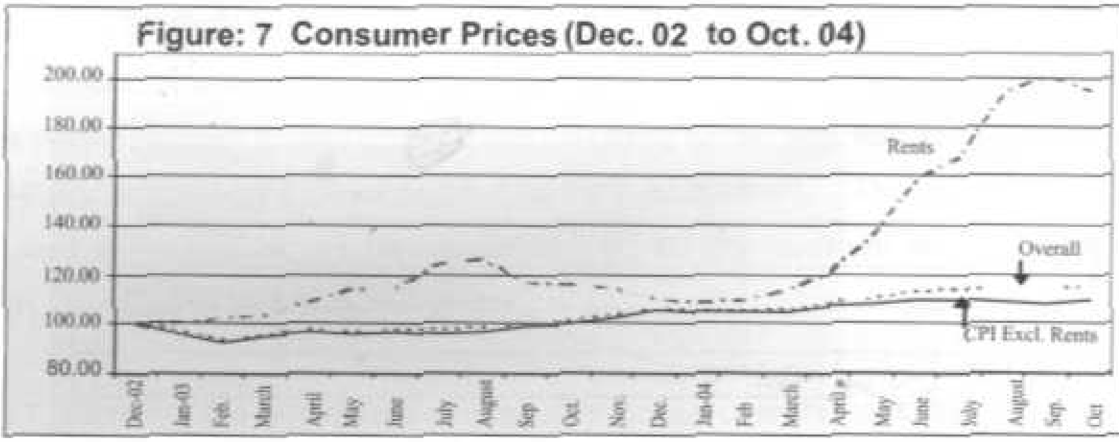


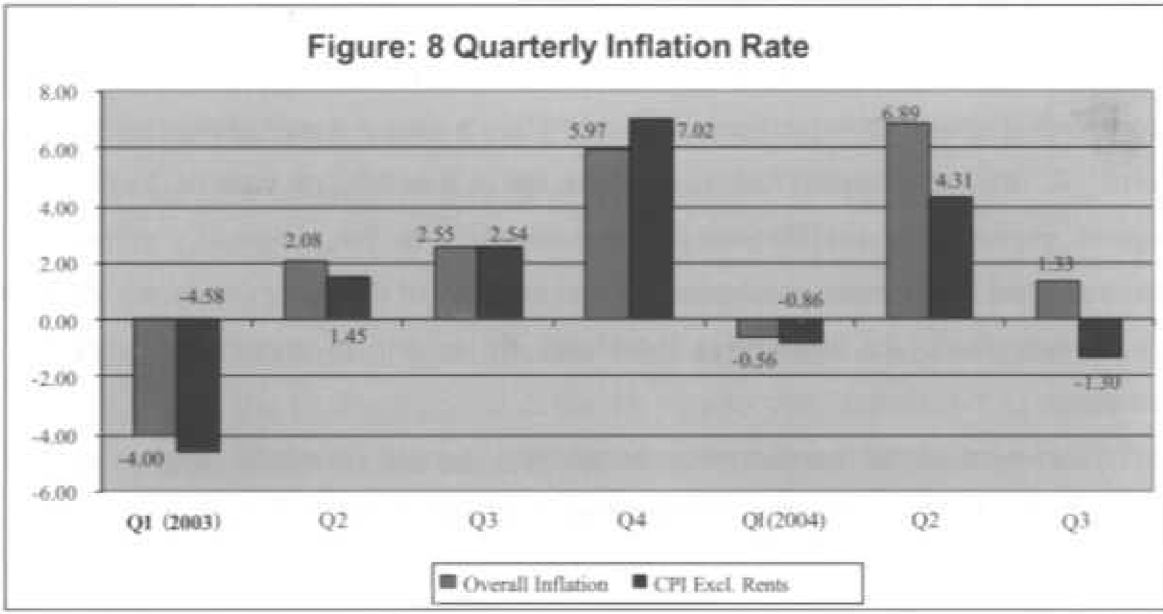
Table 5 shows the index levels for food and non-food prices from late 2002 through October 2004. Rent, a component of prices, is also including.

Table: 5 Consumer Price Index (Dec. 02 = 100)

S. #	Period	Overall Index	Food, Beverages & Tobacco	Non Food Items	Rent	Monthly % Change (Overall CPI)
1	Sep	75.8	78.5	71.0		
2	Oct	85.2	85.9	84.0	NA	12.5
3	Nov	104.6	108.7	97.4	NA	22.7
4	Dec-02	100.0	100.0	100.0	100	-4.4
5	Jan 03	97.3	95.3	100.5	NA	-2.7
6	Feb	93.9	92.3	96.3	102.3	-3.5
7	Mar	96.0	95.9	96.3	104	2.2
8	Apr	97.7	97.7	97.7	108.7	1.8
9	May	97.0	96.2	98.3	113.8	-0.7
10	June	97.9	97.0	99.3	114.4	0.9
11	July	98.3	97.1	100.2	123.9	0.4
12	Aug	98.7	97.0	101.4	125.9	0.4
13	Sep	100.5	97.5	105.1	117.4	1.8
14	Oct	101.0	98.6	104.7	115.9	0.5
15	Nov	103.8	102.1	106.5	114.3	2.8
16	Dec	106.5	106.1	107.3	110.1	2.6
17	Jan-04	105.7	105.8	105.5	108.8	-0.8
18	Feb	105.6	107.1	103.3	109.1	-0.1
19	March	105.9	107.3	103.9	113.8	0.3
20	April	108.5	109.8	106.6	120.3	2.5
21	May	110.3	110.9	109.4	136.3	1.7
22	June	113.2	111.4	116.0	159	2.6
23	July	113.7	110.8	118.3	168.2	0.4
24	August	114.7	108.7	123.8	193.6	0.9
25	Sep	114.7	106.9	126.5	200.6	0.0
26	Oct	115.7	109.1	125.7	194.7	0.9

Source: Central Statistics Office, Kabul Afghanistan.

Figure 8 shows the quarterly rate of inflation.



Quarterly inflation rates extending back to the beginning of 2003 are shown in figure 8. Prices tended to accelerate through 2003, but have not shown a clear pattern in 2004. Inflation was low in the first and third quarters and high in the second quarter. Under these circumstances DAB's goal is to gradually reduce inflation to less than 10 percent in 1283 (2004-05), and even lower in 1384, assuming moderate to low inflation continues the world economy.

6.0 Poverty in Developing Countries, Measurement and Analysis

6.1 Introduction and Definition

Poverty researchers should first make sure they have a clear and accurate idea of what they mean by "poverty". There are many different definitions of this social phenomenon, and according to the definitions chosen, widely varying indicators can end up being used for analysis.

Typically, the poverty line is the consumption level that is required to achieve the minimum acceptable standard of living in a given society. This minimum standard may be defined in absolute or relative terms. The absolute poverty line is often defined as the threshold that allows minimum calorie requirements plus a small allowance for non-food items. A relative poverty line is defined as a function of various income (or consumption expenditure) distribution parameters, such as the mean or median. (For example, a relative poverty line could be defined as 50% of the mean income). When a person's consumption falls below this threshold, he or she is considered poor in a relative sense.

Since minimum acceptable consumption levels vary across countries, and over time, poverty lines also tend to vary across countries and over time. However, difference in the definitions and methodologies used for computing poverty lines tend to vary far more across countries than over time in the same country, especially when the time periods are not too far apart. Thus, national methodologies should not be used for making international comparison of poverty because of the divergent standards.

In current prices the $1-a-day poverty line represents the $1.08 per person per day consumption level in 1993 purchasing power parity prices. The threshold stands as an internationally accepted minimum level of private consumption and its use seeks to provide a more meaningful comparison of poverty across countries.

There are of course other definitions and concepts of poverty, among them:

1) Poverty incidence is the proportion of individuals, whose income or expenditure falls below the poverty threshold, among the total population.
2) The poverty gap index, unlike poverty incidence, gives a sense of how poor the poor are and reflects the depth of poverty.
3) The squared poverty gap index adds the dimension of inequality among the poor to poverty to the gap index and is said to reflect the severity of poverty.

4) The transient poor are those who are poor for a short period of time. These individuals are usually poor because of economic distortions of market imperfections.
5) The permanent portion of the chronically poor are those people who are poor for a long time because of they have few assets or skills.
6) The Lorenz curve is a curve that represents the relationship between the cumulative proportion of income and cumulative proportion of the population.
7) The Gini coefficient, another commonly used measure of inequality, is the area between the Lorenz curve and the 45 degree line, expressed as a percentage of the area under the 45 degree line, showing numerically how skewed the overall income distribution is in a given country.

6.2 Data and other Indicators

The primary sources of income/consumption data to judge poverty levels are household income and expenditure surveys that should be conducted more or less regularly within countries. In much of the developing world, these surveys are not conducted yearly and, for this reason, time series are not available or have large gaps.
Income/consumption poverty measures ought to be complemented by the analysis of a series of social indicators such as health, education, employment, gender, housing, water and sanitation and many others. The indicators chosen to monitor the Millennium Development Goals provide a good example of the kind of data needed to analyze poverty and human development.

A somewhat different approach has been followed by UNDP, the agency that has created indices such as the Human Development Index and Human Poverty Index. These indices add up several indicators and attempt to give a single concise measure of the multi dimensionality of poverty.

Researchers should also try to complement poverty statistics with qualitative data from participatory poverty assessments such as those conducted for the study "Voices of the poor."

Multi dimensional quantitative and qualitative data helps in fact to gain a clearer and more nuanced picture of the poverty situation in a certain country or region. Listening to poor people is fundamental if we want to understand the challenges they face in their lives[3].

The measurement and analysis of poverty, inequality, and vulnerability are crucial for cognitive purposes, to know what the size and nature of the poverty problem is, to know where and how progress has been made, and ultimately to know what the solution is. Better data is needed for analytical purposes, to understand the factors determining this situation, for policymaking purposes, to design interventions best adapted to the issues, for monitoring and evaluation purposes, to assess the effectiveness of current policies, and to determine whether and in what ways the solution is changing[4].

6.3 Share of People living on less than US$ 1/Day

Looking at economic growth, Sub-Sahara Africa has performed very badly for much of the period since 1980)with the notable exceptions of Botswana and Mauritius(and many African countries today have a level of per capita GDP below that of 1980 period. GDP per capita is below the level of 1960s in some African countries that have experienced civil war. At the other extreme, the growth of some East Asian countries has been at rates, which are historically unprecedented where it took Hong Kong, Singapore and Taiwan one generation to achieve middle-income status. China is presently growing at 9 per cent a year and this is having a strong poverty reduction effect. Latin America achieved steady if unspectacular growth in the period up to the

[3] Source: Article by Simone Cecchini, February 17, 2004, Key Indicators 2004, Asian Development Bank Special Chapter, Poverty in Asia
[4] **Source: World Bank**

late 1970s but then went into deep recession as the debt crisis erupted in the 1980s (years which Latin Americas describe as the "lost decade"). Latin America recovered in the 1990s, but the region has had mixed results, with a spectacular economic collapse in Argentina, which was the star reformer of the early-to-mid 1990s and continued strong growth in Brazil and Mexico. The Middle East and North African countries raised their standard of living using their oil wealth, but have largely failed to achieve economic *diversification and provide employment for their growing and young populations.*

In summary, the developing world today presents a very mixed picture, very fast growth and poverty reduction in much of Asia; slow or negative per capita GDP growth in Sub-*Sahara Africa (SSA) combined with rising poverty; high volatility in Latin America's* economic performance; and widespread stagnation in North Africa and the Middle East, despite often abundant natural resources.

Table

Extent of Poverty, 1990-2015

	Share of people living on less than U.S $ 1/day (%)		
	1990	1999	2015
East Asia and Pacific	30.5	15.6	3.9
Excluding China	24.2	10.6	1.1
Europe and Central Asia	1.4	5.1	1.4
Latin American & Caribbean	11	11.1	7.5
Middle East and North Africa	2.1	2.2	2.1
South Asia	45	36.6	15.7
Sub-Saharan Africa	47.4	49	46
Total	**29.6**	**23.2**	**13.3**
Excluding China	28.4	25	15.7

Source: World Bank (2003:05)

6.4 Conclusion, Policies to Eradicate Poverty

To eradicate poverty, there is a need for national and international policy formulation. There are many factors that affect distribution and economic growth. Demography changes, agricultural policies, trade and industrial policies, labor market policies, taxation, and social expenditure policies all play a role. Large proportion of unskilled workers due to a combination of demographic changes and underperforming educational system, for example, would tend to put downward pressure on wages that unskilled workers can secure for themselves as the supply of unskilled labor rises (other things, including the demand for such workers, remaining equal). Conversely, if trade and industrial policies raise the relative profitability of producing labor-intensive goods, then the demand for labor should increase. This could lead to a rise in wages of labor and thus lower inequality if, the labor were provided by individuals belonging to lower-income groups. Indeed such a process is believed to have taken place in the Republic of Korea and Taipei, China from the 1960s to the early 1980s (Quibria 2002) .

To reduce poverty countries should adopt policy formulations for strengthening the financial institutions, generate high levels of savings to support national and international investments, improve education systems, increase exports and have meaningful legal institutions. Experience shows that rapid economic growth is the best way to reduce poverty.

Eradication of poverty is central to global stability and peace, World Bank Group President James D. Wolfensohn recently issued an urgent call to action to make the planet more equitable and safe, through the three pillars of poverty reduction, environmental stewardship, education of the youth of the world and develop a global partnership for development. The World Bank and United Nations poverty researchers and expert recommendations support these ideas.

United Nations Millennium Declaration (September 2002) emphasizes on these issues declaring that

"We will spare no effort to free our fellow men, women, and children from the abject and dehumanizing conditions of extreme poverty, to which more than a *billion of them are currently subjected*".

Millennium Development Goals are as follows:

- Eradicate extreme poverty and hunger
- Achieve universal primary education
- Promote gender equality and empower women
- Reduce child mortality
- Improve maternal health
- Combat HIV/AIDS, malaria, and other diseases
- Ensure environment sustainability
- Develop a global partnership for development

The Millennium Development Goals calls for reducing the proportion of people living on less than $1 a day to half the 1990 level by 2015-from 27.9 percent of all people in low and middle income economies to 14.0 percent.

However, to do this, the developing countries have to take appropriate actions and formulate policies to eradicate poverty by 2015, as indicated above[5].

[5] World Bank Group, Development Goals and, ADB Key Indicators 2004 "Poverty in Asia"

7.0 Fiscal trends

7.1 Introduction

Budgets are plans dealing with the acquisition and use of resources over a specified time period. The fiscal year for Afghanistan is the Solar Hijri Year which normally starts on March 21 and ends by March 20 of the following year. The government plans its expenditures according to the anticipated revenues from provinces and other sources, including the grants and loans from abroad. The total combined (development & operating) expenditure of government during 1383 is projected to be $1,378.6 million, of this the operating expenditure is projected to be $608.6 million and the projected development expenditure is targeted to be $770 million.

According to the Berlin Conference declarations there are multiyear donor commitments totaling $8.2 billion (during the fiscal years 1383-85), including $4.4 billion of commitments for FY 1383. Part of this will go to support the operating and development budgets and part will be spent independently by donors.

7.2 Operating Budget Overview

The operating budget funds the day to day operations of the government ministries and agencies. In 1382 expenditure totaled $456.7 million or about 10% of GDP. In 1383 this is projected to rise to $608.6 which will be 11% of GDP. The expenditure gap (donor financing) is projected to shrink by 7% from 56% of total actual expenditure in 1382 to projected 49% of total expenditure in 1383. This reduced dependency scenario will continue until the government achieves its long run goal of covering all its operating current expenses through domestic revenue.

The operating budget for FY 1383 is based on the following revenue side estimations and assumptions:

1. Continued strong GDP growth of roughly 15% for the upcoming year, supported by the increasing flow of reconstruction aid and inflows of private investment.
2. Continued reforms at customs border posts and high resulting revenues.
3. Implementation of tax reform measures by the Government.
4. Continued improvement in collection performance due to capacity development activities and technical assistance for tax and customs administration.

Based on the above reforms, domestic revenue is projected to rise from $200 million in 1382 to $308 million during 1383, a projected increase of 54%.

7.2.1 Operating Expenditure

Looking at operating expenditures during fiscal year 1383, more than half (52%) of the total $608.6 million expenditure is projected to be allocated to the wages and salaries of public employees, comprising a total of $314.7 million. Projected operating expenditure can be traced by economic classifications, which is shown in the Table XI. In this breakdown of the operating budget, $77.4 million has been allocated to unforeseen events, or a contingency reserve.

Table 6:

Afghanistan Operating Budget, SY 1383
(March 21, 2004-March 20, 2005)
(In million of US Dollars)

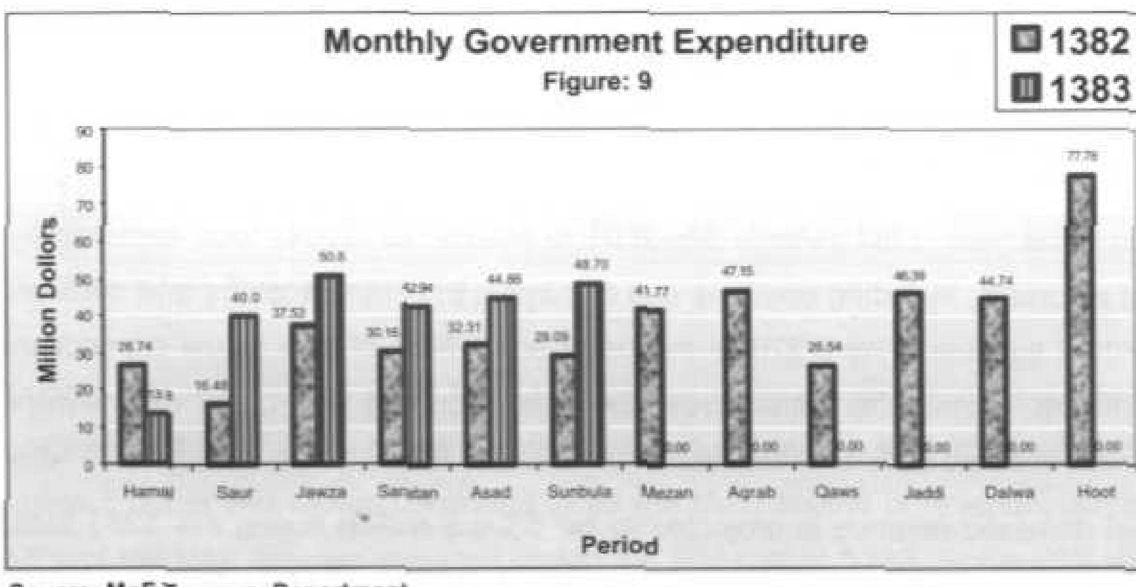
	Annual Budget	Months)Actuals(			Q1	Months)Actuals(			Q2	YTD	% of Annual Budget
		Hamal	Saur	Jawza		Saratan	Asad	Sonbula			
		Mar-Apr	Apr-May	May-Jun		Jun-Jul	Jul-Aug	Aug-Sep			
Domestic revenue	308.59	11.26	20.16	21.50	52.91	20.10	24.59	16.89	61.58	114.49	37%
Center		0.49	0.57	1.22	**2.29**	1.94	1.51	1.30	**4.75**	**7.04**	
Provinces		8.72	15.30	15.57	**39.59**	15.29	16.35	13.03	**44.67**	**84.26**	
All other Government organizations		2.04	4.28	4.71	**11.03**	2.87	6.73	2.56	**12.16**	**23.19**	
Expenditure	**608.5**	**13.78**	**40.05**	**50.78**	**104.61**	**42.94**	**44.86**	**48.70**	**136.50**	**241.11**	**40%**
Center-provinces	**608.5**	**13.78**	**40.05**	**50.78**	**104.61**	**42.94**	**44.86**	**48.70**	**136.50**	**241.11**	**40%**
Central government		12.03	28.74	27.58	**68.35**	28.16	23.79	28.20	**80.15**	**148.50**	
Provinces		1.75	11.31	23.20	**36.26**	14.78	21.08	20.50	**56.36**	**92.61**	
Economic classification	**608.5**	**13.78**	**40.05**	**50.78**	**104.61**	**42.94**	**44.86**	**48.70**	**136.50**	**241.11**	**40%**
Wages and salaries	314.7	4.27	19.83	30.07	**54.17**	24.85	26.82	28.11	**79.78**	**133.95**	**43%**
Purchase of goods and services	28.7	1.12	2.58	1.45	**5.16**	2.80	1.26	0.69	**4.75**	**9.91**	**35%**
Tools and Materials	98	6.73	10.76	9.60	**27.09**	9.54	10.43	8.24	**28.22**	**55.31**	**56%**
Repairs and Maintenance	17.6	0.93	0.78	1.23	**2.95**	1.15	1.69	1.86	**4.70**	**7.65**	**43%**
Capital Expenditure	35.1	0.56	5.41	2.03	**7.99**	3.15	4.24	3.23	**10.62**	**18.60**	**53%**
Investments	0	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	**0.00**	
Subsidies, Grants etc	37	0.16	0.68	4.89	**5.74**	0.88	0.42	6.21	**7.51**	**13.25**	**36%**
Contingency Reserve	77.4	0.00	0.00	1.52	**1.52**	0.57	0.00	0.35	**0.93**	**2.44**	**3%**
Functional classification	**608.5**	**13.78**	**40.05**	**50.78**	**104.61**	**42.94**	**44.86**	**48.70**	**136.50**	**241.11**	**40%**
General public services		1.05	4.01	4.51	**9.57**	5.27	3.02	3.74	**12.03**	**21.61**	
Defense		3.11	14.24	8.52	**25.87**	12.03	10.04	8.48	**30.55**	**56.42**	
Public order and safety		5.22	10.41	14.12	**29.76**	10.01	13.13	13.88	**37.02**	**66.78**	
Economic affairs		1.20	2.97	6.66	**10.83**	3.55	3.67	3.88	**11.09**	**21.92**	
Housing and communal services		0.04	0.10	0.07	**0.21**	0.16	0.07	0.10	**0.33**	**0.55**	
Health		1.89	2.08	1.80	**5.77**	1.70	2.23	1.39	**5.32**	**11.09**	
Recreation and culture		0.33	0.78	0.89	**2.00**	1.04	0.92	1.06	**3.02**	**5.02**	
Education		0.68	4.21	12.51	**17.39**	8.18	10.91	9.83	**28.93**	**46.32**	
Social protection		0.25	1.25	1.70	**3.20**	1.01	0.87	6.32	**8.20**	**11.40**	
Balance MOF	**-299.91**	**-2.52**	**-19.89**	**-29.28**	**-51.70**	**-22.84**	**-20.27**	**-31.81**	**-74.92**	**-126.62**	
Float and adjustment 1/	**0.00**	**-9.03**	**-9.91**	**5.95**	**-12.99**	**4.24**	**8.05**	**-13.97**	**-1.69**	**-14.67**	
Balance Da Afghanistan Bank	**-299.91**	**-11.55**	**-29.80**	**-23.34**	**-64.69**	**-18.60**	**-12.22**	**-45.78**	**-76.61**	**-141.29**	
Donor assistance grants and loans	**300.00**	**20.05**	**16.77**	**8.00**	**44.82**	**9.56**	**14.60**	**39.15**	**63.31**	**108.13**	
ARTF	252.30	20.05	16.77	8.00	**44.82**	9.56	14.60	30.15	**54.31**	**99.13**	39%
LOTFA and Army Trust Fund	47.70	0.00	0.00	0.00	**0.00**	0.00	0.00	9.00	**9.00**	**9.00**	19%
Other	0.00	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	**0.00**	
Banking financing 2/	**-0.09**	**-8.50**	**13.03**	**15.34**	**19.86**	**9.04**	**-2.38**	**6.64**	**13.30**	**33.16**	

Source: Ministry of Finance and Da Afghanistan Bank accounts

1/ Variation between the fiscal positions recorded at MOF and DAB . This discrepancy is due to the difference ("float") between checks issued and checks cashed.

2/ Changes in the government accounts with DAB . A positive sign corresponds to a decline of balances and a negative sign to an increase in balances Government accounts are not allowed to go into overdraft.

The seasonal pattern of increased government expenditure near the end of the fiscal year recurred in 1382. Approximately 37% ($169 million) of total expenditure was processed during the last quarter of 1382. Figure 9 shows the expenditure level of the government by month. Monthly average expenditure was $38.06 million for the year 1382, compared to the budgeted amount of $45.8 million average monthly projected expenditure during the same period. The increase in the government expenditure during the last quarter, especially during the last month of the year, caused some depreciation in the exchange rate, but this was temporary. As we see in the Figure 9 the government expenditures jumped to almost $78 million (18% of total expenditure) during the last month of the fiscal year.



Source: MoF Treasury Department

During 1383 the projected average monthly expenditure is $51 million. However at the end of the second quarter the total expenditure has reached $241.1 million recording an average monthly expenditure of $40 million per month, which is about 21% lower than projected levels.

Continuing monthly variability in public expenditure may cause some fluctuations in the macroeconomic variables and could create challenges for macroeconomic management. In general, it would be desirable if the monthly expenditures did not deviate much from projected average at the beginning of the year and, in any event, should follow projected quarterly expenditure plans. So far monthly average expenditure hasn't exceeded the monthly projected revenue. Again there are fears that expenditure will peak at the end of the fiscal year 1383.

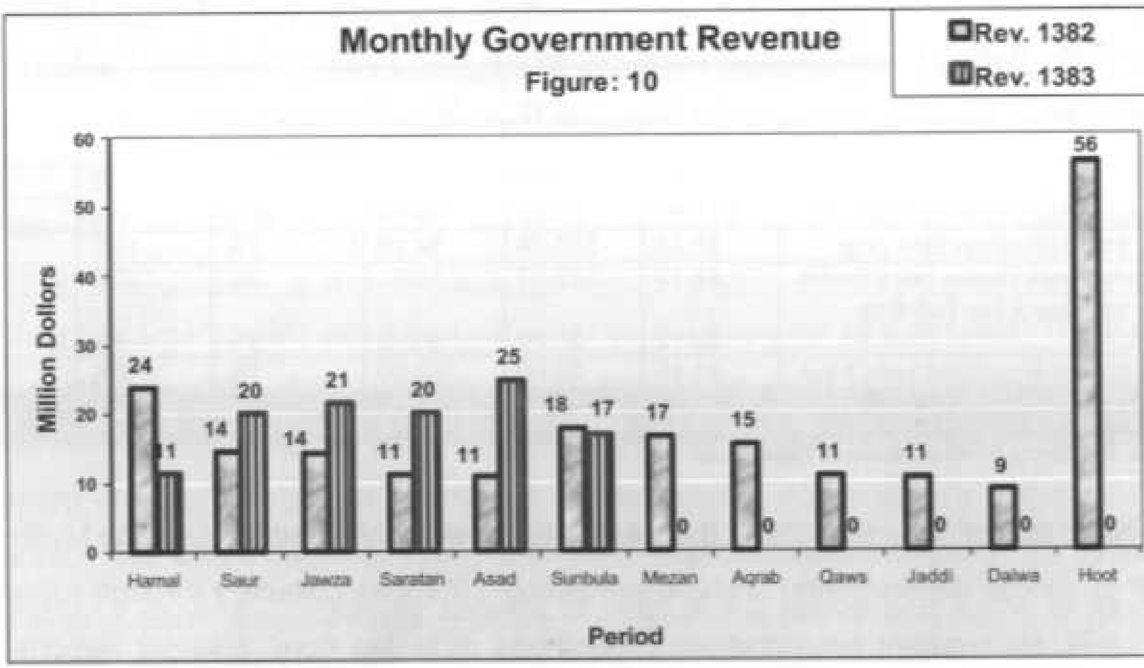
Uncertainties, about the future of the new government structure, after establishment of new cabinet is another reason, the concerned authorities could spend less. Considerable expenditure may not take place during this period until the elected government announces its cabinet. This is another reason why at the end of the year expenditures could increase to the recorded level of previous year.

7.2.2 Domestic Revenue and Grants

During the fiscal year 1382 (March 21, 2003 to March 20, 2004) total domestically generated revenues, including one time use of surplus in central account and transfers from provincial surpluses, were $260.4 million or some 57% of total actual expenditure ($456.7 million). During this period, revenue from recurring taxes and duties were $107.2 million or some 23% of total actual expenditure.

Anticipated domestic revenue is projected to be $308.6 million during the 1383 fiscal year. The foreign assistance through two accounts of (ARTF and LOTFA) is anticipated to be $300 million; specifically $252.3 million through ARTF (Recurrent Window) and $47.7 million through LOTFA (Police Salaries). According to MoF accounts at DAB, $99.1 million has been charged to the records of ARTF and only $9 million to the records of LOTFA.

The pattern of revenue flow from provinces to center has significantly changed compared to previous year. Partly this is because of developments in revenue collection methods and partly because of political events which accelerated this movement. As shown in the figure 10, the revenue reported at the end of the fiscal year 1383 was only $56 million. This is mainly because some of the provinces were not able to report their revenue on time.



Source: MoF, Revenue Department

During the first half of FY 1383, 37% of the targeted ($308 million) revenue was collected. This is a significant increase over the previous rate of revenue collection. Indirect Taxes and Duties continued to be the main source of revenue, accounting for 55% of the total revenue reported during the first half of 1383. Some 20% of the total reported revenue during the first half of 1383 was collected through direct taxes, which shows improvement overtime and demonstrates satisfactory signs of tax reform implementation.

Domestic Revenue by source

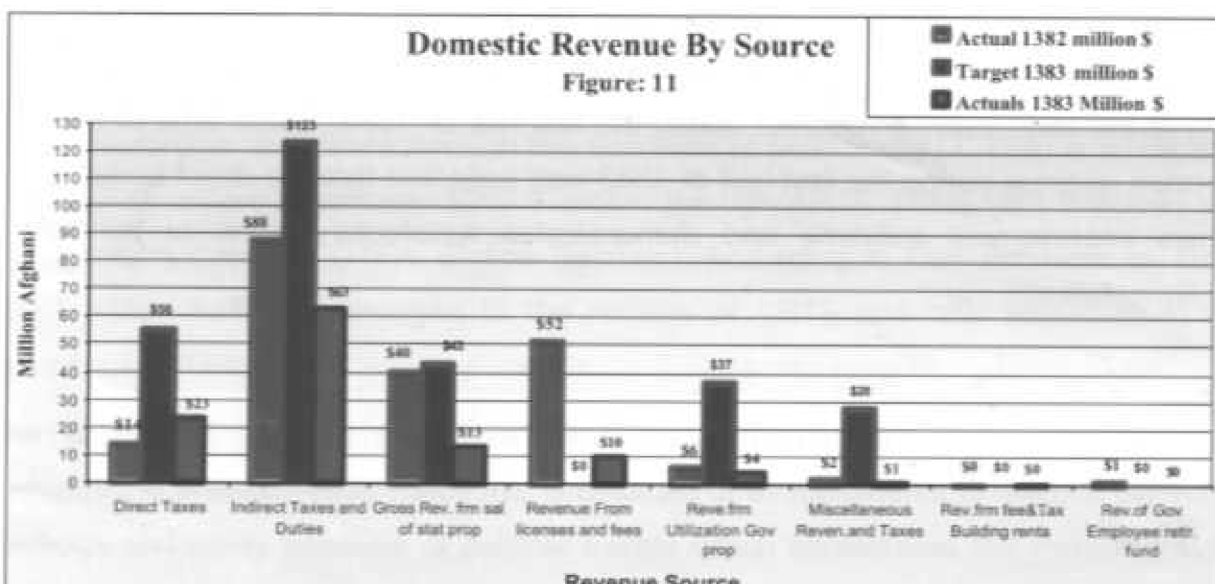
Table: 7 **First Six Months of 1383 (March 21- 04 to June 20- 04)**

Data received: November 8, 2004

Revenue Source	Actual 1382 million $	Target 1383 million $	Actuals 1383 Million $	1382 Actuals as % of Total	1383 Targets as % of Total	1383 Actuals as % of Total
Direct Taxes	$14.35	$55.56	$23.08	7%	19%	20%
Indirect Taxes and Duties	$87.65	$123.43	$63.39	43%	43%	55%
Gross Rev. from sale of stat prop	$40.42	$43.20	$13.35	20%	15%	12%
Revenue From licenses and fees	$51.68	$0.02	$9.60	25%	0%	8%
Rev. from Utilization Gov prop	$6.33	$37.04	$4.28	3%	13%	4%
Miscellaneous Reven. and Taxes	$2.13	$27.77	$0.71	1%	10%	1%
Rev. from fee &Tax Building rental	$0.15	$0.00	$0.09	0%	0%	0%
Rev. of Gov Employee retir. fund	$1.45	$0.00	$0.00	1%	0%	0%
Total	**$204.15**	**$287.02**	**$114.49**	**100%**	**100%**	**100%**

Source: Ministry of Finance, Revenue Department

According to MoF figures, 80% of the total revenue was collected through the Mustofiats (MoF provincial departments) and the remaining 20% was collected through ministries and other government organizations. Revenues collected from 6 major regions and Kabul contributed 72% ($82.1 million) of the total reported revenue ($114.5 million). The major contributor was Herat accounting for 34% ($38.8 million) of the total reported revenue.



Domestic Revenue By Source
Figure: 11

Source: Ministry of Finance, Revenue Department

8.0 External Sector Developments

8.1 Merchandise Trade

As stated in the previous issue, the trade data for Afghanistan is in the middle of a process of re-adjustment and re-estimation after decades of neglect. Currently there are three different approaches being followed to try to improve the accuracy of the trade statistics, namely: the traditional CSO approach, the IMF partner country data approach, and the DAB approach. The CSO is the official compiler of the merchandise trade statistic in Afghanistan. It utilizes data from the customs offices all over the country regarding the amounts imported and exported as the basis for its estimates. The IMF is using partner country data with some adjustment to estimate merchandise trade. Partner country data involves using export data from other countries (such as Pakistan or Japan) to Afghanistan as a means of estimating Afghanistan's imports. And, conversely the other country's imports from Afghanistan are used to estimate Afghanistan's exports. Combining aspects of both of the above plus some of its own survey work, the DAB statistics unit is making further adjustments in estimating the trade statistics. These adjustments are based on the assumption that a substantial share of the country's imports and exports are not passing through the customs offices, and that even the amounts that pass through customs and get enumerated are underestimated. Although the CSO figure understates the sum of Afghan trade, it is believed that the reported figure the CSO gets from the customs administration does reflect the underlying trends. One key problem with the partner country data is that the import figures generated are actually showing lower levels of imports than the CSO. This is probably due to the fact that some of our trading partners are also facing the understatement problems which Afghanistan is facing, and that the partners' data may not be completely enumerating their actual levels of trade.

Based on the unrecorded trade survey conducted by the DAB statistical unit and based on discussions held with recent IMF mission to Afghanistan regarding closing the gap in the estimation of trade, the DAB statistical unit attempted to estimate re-exports, unrecorded exports, and imports, and also estimated a number for drug exports for the first half of 1383 (3/04 to 9/04). The CSO and IMF do not take these activities into consideration in their data. Comparisons of the three results are shown for 1382 and the first half of 1383 is shown in Table 8.

Table 8: Comparison of trade statistics in million of US$

	1382			First Half year 1383		
Items	IMF	CSO	DAB	IMF	CSO	DAB
Trade balance	-1159.3	-562.4	-1,600.4	-697.1	-54.9	-732.9
Exports of goods	1248.3	2216.6	942.2	1015.9	1113.7	1113.7
Recorded	276.8	144.0	144.0	270.9	77.4	77.4
Unrecorded	971.5	2072.6	798.2	744.9	1036.3	1036.3
Imports of goods	2407.6	2779.0	2,542.6	1712.9	1168.6	1846.6
Recorded		2101.0	1,864.6	947.8	829.6	1507.6
unrecorded		678.0	678.0	765.2	339.0	339.0

The three sets of figures above reflect the current status of the three approaches being used to estimate Afghanistan's trade flows. Efforts are now underway to improve the capacity of the CSO through the implementation of an ambitious statistical master plan and through more intensive communication between the three institutions. Clearly, improving the CSO is the best long term solution for getting the correct numbers regarding the trade and other economic and social data. As time passes, the DAB statistical unit will continue working closely with CSO and the IMF, trying to improve the trade data of the country. Progress along these lines will be reported in future issues of this bulletin. However, the trade data still has many unresolved problems, and therefore one must be very careful about analyzing the trade account of Afghanistan on the basis of currently available statistics.

The data reported by CSO for the first quarter of 1383 (March -September 2004) with some adjustments by DAB, shows that imports rose to a level of $1846.6 million. Total recorded exports were estimated to be approximately US $77.4 million. The trade deficit for the first half of 1383 (March- September /2004) estimated by DAB, excluding opium exports, works out to be roughly US $732.9 million or about 25 % of GDP (see Table 9 for detailed trade data).

As long as donor support continues this should be a manageable and appropriate deficit given the magnitude of the country's reconstruction requirements, particularly in the area of infrastructure. However, as noted above the unknowns are still so large that it is not possible to speak with real certainty about Afghanistan's external balance. According to the DAB survey the revenue from the exports of opium was around US $509.7 million in the first half of 1383, as the price of opium increased in the second quarter from the low level prevailing earlier in the year, and therefore revenue increased during this quarter. If this is added to the total exports of Afghanistan as estimated by DAB then the trade deficit would be down to a level much lower.

The DAB and CSO, hopefully, with advisory support from the IMF, will be working together to improve the underlying balance of payment statistics in the coming year. In forthcoming issues of this bulletin progress on improving the statistical base of the external sector will be reported and data revisions explained as they are introduced.

Table 9: Merchandise Trade

(in US$ million)

				1382		1383 1st half	
		1380	1381	CSO	DAB*	CSO	DAB Adj
Imports:	(from previous period)	1695.89	2321.9	2779.0	2542.6	1168.6	1846.6
	Consumer goods	872.4	767.5	903.4	801.8	391.3	668.0
	Industrial supplies & materials	245.0	807.8	399.2	354.3	145.3	251.6
	Capital goods and others	562.3	724.4	777.4	689.9	285.5	572.9
	Fuel and lubricants	16.0	22.4	21.0	18.6	7.5	15.0
	Unrecorded			678.0	678.0	339	339
Exports:		1657.2	2290.1	2216.6	942.2	1113.7	1113.7
	Domestic	68.2	100.1	144.0	144.0	77.4	77.4
	Re-exports and shuttle trade	1589.0	2190.0	2072.6	798.2	1036.3	1036.6
Trade balance:		-38.6	-31.9	-562.4	-1600.5	-54.9	-732.9

Source: CSO and DAB

A deficit in the trade balance is present but this is to be expected for a post-conflict developing economy that is in the process of rebuilding its productive capacity after decades of war and destruction. Sizeable trade deficits should be expected to continue for the next few years as the global community continues to support Afghanistan's efforts to reconstruct and develop the economy and country.

Estimates for unrecorded import data are subject to a considerable degree of uncertainty, but were reckoned to be on the order of magnitude of $750 million in 1380 (2001/02), $1,150 million in 1381 (2002/03), and about $678 million in 1382 (March 2003 to March 2004).

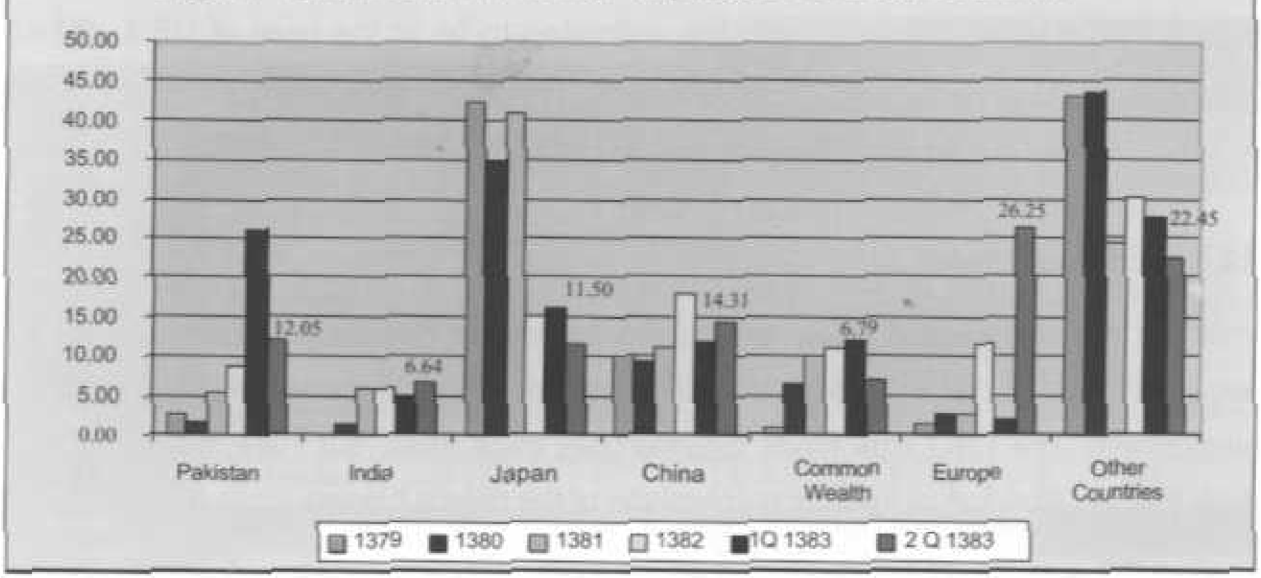
The 1382 result is based on the survey which was recently conducted by the DAB statistical unit in cooperation with CSO. Assuming the same level of unrecorded imports in each quarter; it follows that unrecorded imports were in the range of US$ 339 million during the first half of 1383 (March – September/2004). For exports, according to the survey conducted among traders in Kabul city, the total amount of the unrecorded exports including exports of opium was estimated to be at the level of US $ 1614.3 million in 1382. Total unrecorded exports together with re exports are estimated to be around US$ 953 million in the first half of 1383 (March – September/2004).

8.2 Direction of Trade

This and the next section utilize unadjusted CSO trade data, which clearly need to be upgraded, but is the only data available with direction of trade and compositional breakdowns. The CSO data tends to understate trade flows, but there is no reason to think that the direction of trade or composition of the data is biased.

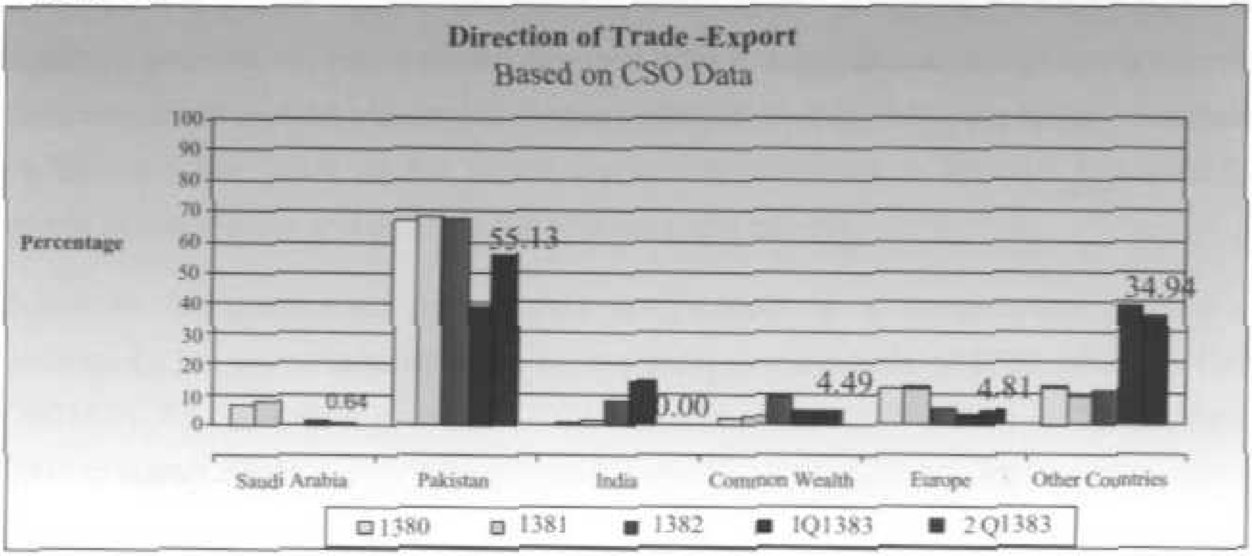
Figures 12 and 13 show the direction of trade, for both imports and exports, for Afghanistan during the period 1379 to first quarter of 1383 (March 2000 to Jun 2004). The statistics reported by CSO, in the second quarter of 1383 (6- 9/04) shows that the direction of trade changed. Imports from Europe grew sharply and replaced Pakistan as the top import source. In this quarter Europe's share of total imports to Afghanistan stood at about 26.3 %, up sharply from the second quarter of the previous year. Europe's leading role in the share of total imports of the economy is followed by "Other countries" which provided 22.5 % of total imports, china with 14.3, and Pakistan with 12.05%.

Figure 12: Direction of Trade - Imports Based on CSO Data



the export side, Pakistan remained On A fghanistan's largest customer by a large margin. Pakistan's share of total exports to Afghanistan increased during the second quarter of 1383 (July to September 2004) to 55 %, next at 35% with the other countries.

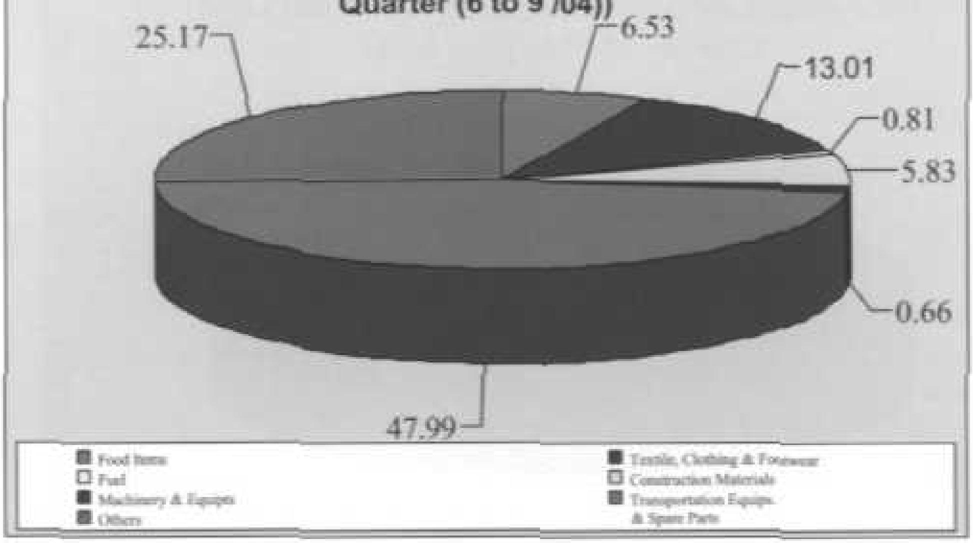
Figure 13:



8.3 Composition of Trade

The composition of imports during the second Quarter of 1383 (July – September/ 2004) indicates that the import of transportation and other equipment have increased to the largest share of total imports, at 48%, "Other Imports" were second at 25%, and textiles clothing and footwear next at 13%. (See figure 14).

Figure 14: Composition of Imports 1383 (2end Quarter (6 to 9 /04))



Breaking down total exports for the second quarter of 1383 (July to September /04) by the main commodities and products, Figure 15 shows carpet and rugs constituted some 46 % of total exports, followed by food items with 31.4 %, and medical seeds at 10 %. Leather was ranked fourth at 4.2 % of total Afghan exports.

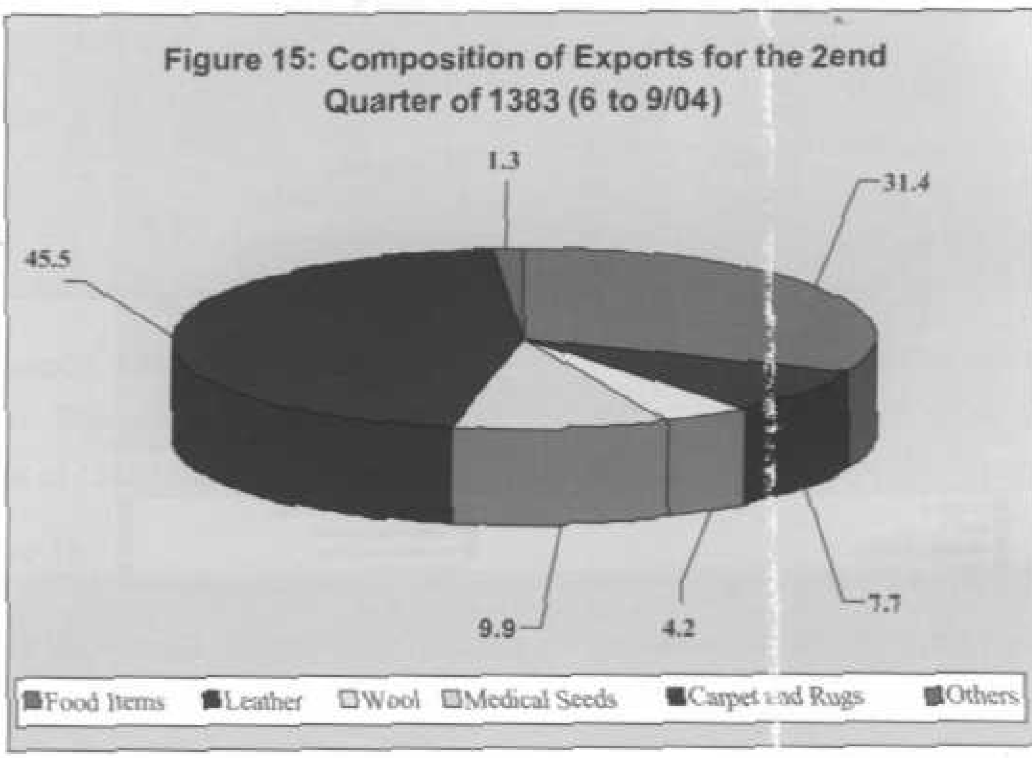


Figure 15: Composition of Exports for the 2end Quarter of 1383 (6 to 9/04)
1.3
31.4
45.5
9.9
4.2
7.7
Food Items
Leather
Wool
Medical Seeds
Carpet and Rugs
Others