



August 2012

Afghanistan: Proposed Revision of Post-Conflict Assistance Phaseout

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
FY	–	fiscal year
IDA	–	International Development Association
PBA	–	performance-based allocation
SDR	–	special drawing right

NOTE

In this report, "\$" refers to US dollars.

Director General	K. Sakai, Strategy and Policy Department (SPD)
Director	Hong Wei, Operations Planning and Coordination Division, SPD
Team leader	Chongshan Liu, Principal Economist, SPD
Team members	Irish de Guzman, Associate Strategy and Policy Officer, SPD Rona Garibay, Strategy and Policy Assistant, SPD

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

Contents

Page

I.	INTRODUCTION	1
II.	ADB OPERATIONS IN AFGHANISTAN	1
III.	POST-CONFLICT ASSISTANCE TO AFGHANISTAN	2
	A. Approach to Post-Conflict Assistance	2
	B. Allocations of Post-Conflict Assistance to Afghanistan	3
	C. Proposed Revision of Post-Conflict Assistance Phaseout to Afghanistan	4
IV.	RECOMMENDATION	5

I. INTRODUCTION

1. Under the Asian Development Fund (ADF) X, 2009–2012, Afghanistan receives exceptional post-conflict assistance, with a plan to phase out post-conflict premiums over 6 years. However, the economic situation and operational conditions in Afghanistan worsened in 2010. To sustain the Asian Development Bank (ADB) operations and build on hard-won but still-precarious progress in post-conflict reconstruction and recovery, ADB suspended in June 2010 the phaseout of post-conflict assistance to Afghanistan for 2 years, 2011–2012.¹

2. During ADF XI replenishment, donors discussed post-conflict assistance phaseout to Afghanistan. Considering the need to continue supporting for the country's development and to follow the framework of exceptional post-conflict assistance to Afghanistan as defined in ADF X, donors agreed to a proposed revision of the original phaseout plan of post-conflict assistance to Afghanistan. The revision proposed that ADB resume in 2013 the phaseout of post-conflict assistance to Afghanistan and extend the phaseout period by 2 years, until 2018.

3. This paper seeks the approval of the Board of Directors of ADB of the proposed revision of post-conflict assistance phaseout to Afghanistan.

II. ADB OPERATIONS IN AFGHANISTAN

4. As a result of 3 decades of war and insurgency, Afghanistan is the poorest country in Asia and the Pacific.² It has been struggling with long-term deficits in human, infrastructure, institutional, governance, and security development. The lack of security remains a serious challenge to the country's development. The process of reconciliation, reconstruction, and development that began in 2002 is continuing with the inherent challenges, but much remains to be done through the transition period up to 2014 and beyond. The cycle of fragility and violence can only be broken through development. Continued instability in Afghanistan highlights the need for ADB to continue supporting the country's development and effectively coordinate with other international development partners in programming and implementing its operations.³

5. ADB is the fourth-largest development partner of the Government of Afghanistan, and has mainly focused its assistance on infrastructure development. ADB operations in Afghanistan have evolved over the decade and are now concentrated on three sectors (transport, energy, and water resource management) and six themes (governance, gender equity, climate change, capacity development, private sector development, and regional cooperation and integration). ADB has provided more than \$2.8 billion in concessional loans, equity investments, grants, and technical assistance since 2002. Despite the challenges of operating in a conflict-affected country like Afghanistan, ADB's investments are delivering tangible outputs and outcomes. The projects being funded are essential for the economic viability of the country today and in the

¹ ADB. 2010. *Afghanistan: Proposed Suspension of the Post-Conflict Assistance Phaseout*. Manila.

² ADB. 2011. *Fragile and Conflict-Affected Situations*. Paper prepared for the first ADF XI replenishment meeting, Manila, 8–9 September.

³ ADB has financed its development operations in Afghanistan primarily from ADF resources set aside for exceptional assistance to the country. The recently approved Afghanistan Infrastructure Trust Fund, managed by ADB, will help pool donor resources to cofinance ADB-assisted infrastructure projects. The trust fund provides a financing and implementation window, particularly to donors with a smaller development footprint in Afghanistan that wish to contribute to the provision of infrastructure development by leveraging ADB's competitive advantage, technical expertise, and sound fiduciary arrangements in implementing large infrastructure projects. The size of the fund is expected to be limited to complementing, but not substituting for, ADB's exceptional post-conflict assistance to Afghanistan.

long run. ADB projects are making a difference to the quality of life of ordinary citizens through (i) the provision of power to major cities; (ii) the development of the telecommunication system; (iii) regional connectivity through railways, the ring road, and other regional highways; and (iv) the development of water and agribusiness infrastructure.

6. During ADF XI, the post-conflict assistance for Afghanistan will focus on selected areas considered vital for post-conflict reconstruction and development. These include (i) expanding the provision of and access to energy; (ii) expanding transport facilities through railway development and road construction and rehabilitation; (iii) improving irrigation and agricultural productivity; and (iv) strengthening governance, capacity, and institutions. ADB will work closely with the Afghanistan authorities to ensure that the country's infrastructure projects are operated and maintained properly.

III. POST-CONFLICT ASSISTANCE TO AFGHANISTAN

A. Approach to Post-Conflict Assistance

7. The 2001 performance-based allocation (PBA) policy recognized the need for flexibility in ADF allocations to post-conflict countries, in line with the approach of the International Development Association (IDA).⁴ Under the disaster and emergency relief policy approved in 2004,⁵ ADB committed to using the IDA13 framework for post-conflict assistance as a reference for planning ADF assistance to post-conflict countries.⁶ The 2004 review of the PBA policy⁷ reiterated the commitment to use the IDA framework.⁸ ADB has aligned with IDA's approach to determining country's eligibility for exceptional treatment. ADB has also been involved in the preparation of the post-conflict needs assessments for the eligible countries in the region.

8. The framework for post-conflict assistance was modified during subsequent IDA14 and IDA15 replenishments, but the allocation principles remain the same. During IDA14, the phaseout period was 3 years, for a total of 7 years of exceptional treatment.⁹ During IDA15, the duration of exceptional assistance was extended to 10 years by doubling the phaseout period from 3 to 6 years. During ADF X negotiations, donors agreed that ADF post-conflict country allocation arrangements would generally follow those of IDA. The ADB 2008 refinements of the PBA policy provided a 6-year post-conflict phaseout.¹⁰

⁴ ADB. 2001. *Policy on Performance-Based Allocation for Asian Development Fund Resources*. Manila.

⁵ ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila.

⁶ IDA. 2001. *Adapting IDA's Performance-Based Allocations to Post-Conflict Countries*. Washington, DC. See also IDA. 2002. *Additions to IDA Resources: 13th Replenishment. Supporting Poverty Reduction Strategies*. Washington, DC.

⁷ ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

⁸ The IDA framework provides exceptional post-conflict assistance to eligible countries in three stages: (i) an initial allocation, (ii) exceptional allocations linked to performance norms, and (iii) a phased return to regular PBA. In the third stage, the country receives a declining portion of a post-conflict premium every year until the premium is fully phased out.

⁹ When the system was established in IDA13, it was envisaged to provide 5 years of total exceptional assistance, including a 2-year phaseout period. This was extended to 7 years of total exceptional assistance with a 3-year phaseout at the IDA13 midterm review.

¹⁰ ADB. 2008. *Refining the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

9. Under the IDA16, fiscal year (FY) 2012–FY2014, IDA decided to take a flexible, case-by-case approach to the treatment of the phaseout for post-conflict assistance.¹¹ Based on the agreed criteria, IDA extended the phaseout period of post-conflict premiums to those countries judged eligible for extensions. As such, IDA extended Afghanistan's post-conflict phaseout from FY2013 to FY2014, the end of IDA16.

B. Allocations of Post-Conflict Assistance to Afghanistan

10. ADB began its post-conflict reengagement in 2002 with a disaster and emergency relief program in Afghanistan.¹² During ADF IX, ADB set aside \$400 million for each of the two biennial periods for post-conflict assistance to Afghanistan, 2005–2006 and 2007–2008. Under ADF X, Afghanistan continues to receive exceptional post-conflict assistance. Donors also agreed,¹³ and the ADB's Board of Directors approved, the phaseout of the exceptional post-conflict assistance to Afghanistan over 6 years starting in 2009 (footnote 8).¹⁴

11. ADB started implementing the Afghanistan post-conflict phaseout in 2009. Under ADF X, the size of the ADF allocation to Afghanistan is the sum of the formula-based PBA and a portion of post-conflict premiums. The post-conflict premium for each biennium under ADF X was determined based on the following formula:

$$(\text{post-conflict premium}) = (\$670 \text{ million}) - (\text{PBA formula-based allocation})$$

12. The amount of \$670 million was determined based on the exceptional biennial allocation to Afghanistan under ADF IX, scaled up in proportion to the increase in the overall size of the ADF from ADF IX to ADF X. As the PBA formula-based allocation to Afghanistan for 2009–2010 (the first biennial period of ADF X) was \$102 million, the above formula gave \$568 million as the post-conflict premium in 2009–2010. The exceptional post-conflict assistance to Afghanistan for 2009–2010 included \$446 million (11/14 of the post-conflict premium of \$568 million) and \$102 million (from the PBA formula-based allocation).¹⁵

13. With Afghanistan continuing to face strong development needs, ADB suspended the phaseout for 2011–2012 following the agreement by donors in May 2010 and approval by the ADB Board of Directors in July 2010. It was estimated that Afghanistan would receive \$162 million more of ADF resources than it would have received without the suspension. Donors agreed on the partial and temporary utilization of the remaining usable liquidity of the ADF to finance this incremental allocation to Afghanistan. This was confirmed at the ADF X midterm

¹¹ If the decision is made to extend a country's phaseout period, the extension will cover the next replenishment period (for both post-conflict and reengaging countries), subject to the condition that the cumulative support does not exceed 20 years for a post-conflict country and 10 years for a reengaging country. The financial benefit to the country judged eligible for further extension will be limited to that arising from a longer phaseout, with no other changes to its level of allocation.

¹² Following the pledge made at the 2002 Tokyo Conference, ADB provided \$167 million in ADF assistance to Afghanistan in 2002, followed by \$150 million in 2003 and \$170 million in 2004.

¹³ ADB. 2008. *Asian Development Fund X Donors' Report: Towards an Asia and Pacific Region Free of Poverty*. Manila (para. 71).

¹⁴ IDA began its post-conflict phaseout for Afghanistan in FY2008.

¹⁵ The first biennium allocation formula in 2009–2010 was: (PBA formula-based allocation) + (6/7) x (half of the post-conflict premium) + (5/7) x (half of the post-conflict premium); or (PBA formula-based allocation) + (11/14) x (the post-conflict premium). The proportion of grant assistance to Afghanistan will be based on its risk of debt distress, in accordance with the ADF grant framework. Afghanistan has been receiving 100% ADF grants as it was assessed to be at high risk of debt distress. No volume discount is applied because of the country's post-conflict status.

review meeting in November 2010. Donors also agreed to discuss the approach to and financing of future exceptional post-conflict assistance to Afghanistan during the ADF XI replenishment exercise.

C. Proposed Revision of Post-Conflict Assistance Phaseout to Afghanistan

14. During ADF XI replenishment exercise, donors discussed post-conflict assistance phaseout to Afghanistan. Considering the need for continuing support for the country's development and following the framework of exceptional post-conflict assistance to Afghanistan as defined in ADF X, donors agreed to a proposed revision of the original phaseout plan of post-conflict assistance to Afghanistan. The revision proposed that ADB resume in 2013 the phaseout of post-conflict assistance to Afghanistan and extend the phaseout period by 2 years, until 2018.

15. Following the approach in ADF X, donors also agreed to scale up the exceptional biennial allocation in proportion to the increase in replenishment size from ADF X to ADF XI. This means that the exceptional biennial allocation would amount to about \$734 million.¹⁶ The post-conflict premium during the ADF XI period would be calculated as follows:

$$(\text{Post-Conflict Premium}) = (\$734 \text{ million}) - (\text{PBA Formula-Based Allocation}).$$

16. In line with the IDA's post-conflict framework, Afghanistan would receive its PBA formula-based allocation plus a declining portion of post-conflict premiums. For the biennial period 2013–2014, the country will receive its PBA formula-based allocation plus 11/18 of the post-conflict premium. For the biennial period 2015–2016, the country will receive its PBA formula-based allocation plus 7/18 of the post-conflict premium. For the biennial period 2017–2018, the country will receive its PBA formula-based allocation plus 3/18 of the post-conflict premium.¹⁷ ADB will prepare post-conflict performance indicators and the regular country performance assessment for Afghanistan during the 2013–2018 phaseout period. In the biennium following the post-conflict phaseout, Afghanistan would receive its allocation through regular PBA.

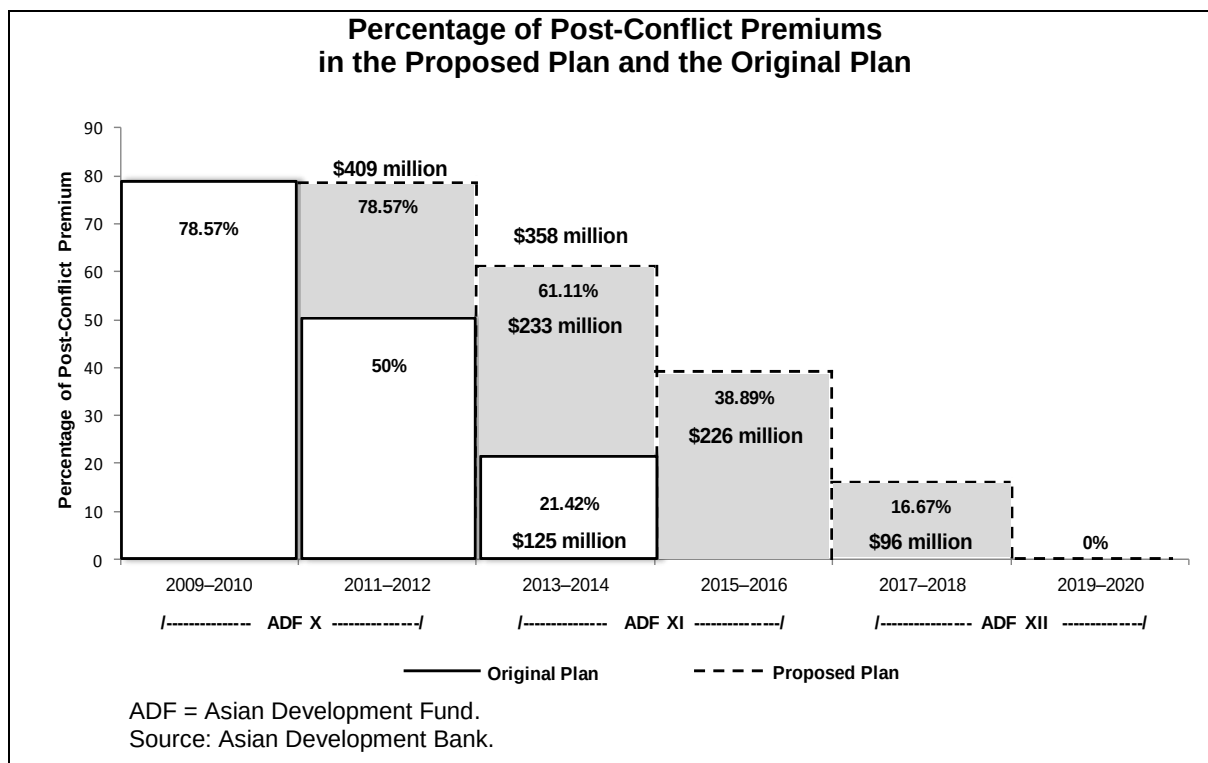
17. Following the approach in ADF X, the proportion of grant assistance to Afghanistan will continue to be based on its risk of debt distress, in accordance with the ADF grant framework. As stipulated in the grant framework, no volume discount will be applied because of the country's post-conflict status.

18. Under the proposed post-conflict phaseout to Afghanistan, ADF provisions to Afghanistan in ADF XI will be greater than those envisaged under the original phaseout plan during ADF X. Compared with the original phaseout plan, the proposed phaseout plan will provide an additional 39.7% of the post-conflict premium to Afghanistan in 2013–2014 and an additional 38.9% of the post-conflict premium in 2015–2016. Further, an additional 16.1% of the

¹⁶ Following the approach in ADF X, the exceptional biennial allocation of \$670 million in ADF X was converted into SDR422.3 million using the ADF X SDR dollar exchange rate. Then this amount of SDR422.3 million was scaled up in proportion to the increase in the overall size of the ADF from ADF IX to ADF X. The exceptional biennial allocation in ADF XI would then be SDR469.35 million. Using the ADF XI SDR dollar exchange rate, the exceptional biennial allocation in ADF XI would be \$734 million.

¹⁷ The exceptional post-conflict allocation used to calculate the post-conflict premium for the biennial period 2017–2018 will depend on the outcome of ADF XII replenishment discussions and may differ from the \$734 million used during ADF XI.

post-conflict premium will be provided to Afghanistan in 2017–2018. The amount of additional ADF provision to Afghanistan under proposed phaseout plan is estimated at around \$459 million in ADF XI.¹⁸ The figure below illustrates the effects of the proposed phaseout plan as compared with the original phaseout plan (footnote 17).



IV. RECOMMENDATION

19. The President recommends that the Board approve the proposed revision of post-conflict assistance phaseout to Afghanistan following the framework as discussed in paras. 14–16.

¹⁸ This estimate uses the latest available 2011 country performance assessment ratings and derived PBA allocation to Afghanistan and assumes the PBA allocation will remain constant throughout the rest of period.