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Securing Durable Development in Afghanistan
POLICY NOTES FOR THE GOVERNMENT

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Economic Policy and Poverty Unit
South Asia Region

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OVERVIEW

I. INTRODUCTION

2. The government of Afghanistan has an opportunity in the coming months to turn the country around. It is now opportune to improve security, governance, and development. Unprecedented international military support, political attention and aid are available to Afghanistan.

The government is planning to match this attention with its own scaled up efforts. The success of the new International Security Assistance Force counter-insurgency operation is being enhanced by the government's concurrent commitment to reconcile with insurgents who opt for peaceful resettlement. In terms of governance, the authorities have built substantial social capital since 2002. A functional central government, the establishment of above-par public financial management systems, and the emergence of strong leadership in key economic ministries are a few notable achievements. The government is inheriting years of good economic performance, notable progress on social outcomes, and continuing strong support from the international community. GDP has grown at an average of 12 percent in the last five years with moderate inflation and a stable afghani. The National Solidarity Program is spurring community-driven rural development in nearly all districts of the country and the large opium economy is in retreat. Significant progress has been achieved in basic education and health. Gender indicators are improving.

3. The government and its development partners have an obligation to seize this opportunity for all Afghans. All donors made an explicit commitment at the London Conference in January 2010 to progressively cede leadership to the Afghan people. The donors agreed to route half of their development aid through the national budget – from the current one-fifth – in the next two years, as local capacity to execute development programs improves. Further, donors aim to work together to improve aid effectiveness by better alignment with Afghan priorities, minimize opportunities for corruption and improve aid predictability. The follow-up Kabul conference in the coming months is an opportunity for the government to announce concrete plans to implement its vision as set out in the Afghanistan National Development Strategy (ANDS).

4. This overview summarizes the view of the World Bank on priority development issues and policy actions. It is intended to be a useful reference for the government as it prepares for the Kabul conference. The issues and policy options proposed are consistent with the ANDS and the Bank's Interim Strategy Note of May 2009. It synthesizes the key findings and analyses of the detailed Policy Notes which draw upon the World Bank's past and ongoing work in Afghanistan, as well as wider experiences, including those from other countries experiencing conflict¹.

□ 1

They are also based on recent analytical writings on Afghanistan, including the Afghanistan

Public Expenditure Review (2010), Afghanistan Growth Diagnostics (2008), Afghanistan

Investment Climate Assessment (2008), and Bank staff analyses of individual sectors.

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II. KEY MESSAGES

5. The underlying storyline for the strategy for durable development in Afghanistan argues that

winning the peace and ensuring security requires creation of jobs, strengthening the role and functions

of the state as provider of services to deliver good governance, and laying the foundations for longer

term development with good macroeconomic management and enhanced capacity. Job opportunities

are needed to resettle combatants, unemployed youth (210,000 males aged 18-24 years), and new

entrants to the job market (320,000 a year)². Despite the plan to increase security forces (military and

police) to 400,000 over five years, most of the job-creation or income opportunities have to occur in

the private sector, both formal and informal. Expanding the private sector, including in agriculture

and mining – the two main drivers of future Afghan growth, requires vast improvements in public

infrastructure, sustaining and scaling up successful national programs and strengthening economic governance.

6. While there is an urgent need to expand jobs and income opportunities in order to secure peace, it

is equally important for the authorities to assuage the discontent of the majority of peaceful Afghans

by ensuring that government is seen to be clean and delivering public goods and services. At the same

time, the government must continue to nurture the drivers of long-term growth that will have to be

increasingly financed from own resources, non-concessional aid, and private inflows. Afghanistan's

long-term future will therefore depend on fostering a productive, skilled work force and invest in its

next generation of leaders, entrepreneurs, and workers. It will also reap strong social returns by

ensuring that young Afghans – including girls – are well educated and healthy. A medium-term goal

should be to strengthen the capacity of those currently employed so as to increase their productivity.

7. With these overarching objectives – given the wealth of development experience that the

government and development partners have accumulated, and based on analysis of

relevant studies

and the progress of reforms thus far – the development priorities for the government can be

summarized as follows:

- Winning the peace entails complementing security initiatives with job-creation by:
 - Expanding agriculture, shrinking opium production, and furthering rural development;
 - Relying on the private sector to lead in job-creation;
 - Relieving infrastructure bottlenecks and realizing mining potential.
- Good governance requires strengthening the function and role of the state by:
 - Reversing the growing perceptions of corruption;
 - Strengthening the rule of law and access to justice;
 - Improving public services.
- Building the foundations for longer-term durable development will need to focus on:
 - Maintaining macroeconomic stability and improving fiscal sustainability;
 - Emphasizing human capital development.

8. These key priorities accord well with the government's recently-endorsed "cluster approach"???.

This evolved out of the recognition that there was a problem with duplication and overlapping

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The numbers used are not precise but give the orders of magnitude based on analysis of the National Risk and Vulnerability Assessment (2008),

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responsibilities between many ministries, leading to weak and fragmented policy coordination. After considering the issues, the authorities and donors came up with the idea of grouping relevant ministries into four development clusters: agriculture and rural development; infrastructure and economic development; human resource development, and governance.

III. Creating Jobs

9. With one-third of the population below the poverty line and one-third of the youth unemployed or under-employed, the challenge of moving out of conflict and winning the peace becomes one of creating jobs and expanding income opportunities. Considering the rural and agrarian basis of the economy, the nascent and fragile private sector, huge infrastructure needs, and the landlocked position of the country, the strategy to create jobs and increase incomes in Afghanistan hinges on: (i) expanding agriculture and enhancing rural development; (ii) promoting the formal private

sector, and
 (iii) addressing infrastructure bottlenecks.

(i) Expanding Agricultural Production and Enhancing Rural Development

10. **Agricultural Production:** Most of the poor live in the rural areas. In order to get them out of poverty and out of the illegal opium economy, the strategy has to aim at increasing agricultural productivity and production (focusing on wheat, horticulture and livestock) while making it more costly to produce and trade opium. Being in an arid region, agricultural production in Afghanistan depends heavily on irrigation, yet less than one-third of the total arable area receives irrigation. Water resources are underdeveloped and much of the existing irrigation facilities are so seriously damaged that most irrigation schemes operate inefficiently. The total irrigated area (1.8 million ha in 2007) has shrunk dramatically from the pre-conflict extent of 3.2 million ha. In order to address water-related issues a three-track strategy is needed: (i) continuing the ongoing program of rehabilitating traditional irrigation systems to ultimately restore the pre-conflict irrigated area; (ii) identifying and prioritizing new investments for water-resource development based on a multi-sectoral and river basin approach (taking account of the needs for drinking water, irrigation, hydro-power, industry/mining and environmental protection), and (iii) building institutions and developing capacity for sustainable monitoring, planning, development, and management of water resources in the country. Besides water scarcity, lack of other inputs (such as seeds and knowledge) constrains agricultural productivity. Food staple yields for crops such as wheat are significantly lower than in other countries in the region. The livestock sector is a major source of income and food but, again, productivity is low. In general, agricultural research and extension systems in Afghanistan are very weak and the rural finance system is grossly underdeveloped. Incomes are below potential because of deficiencies in the transport network between growing areas and markets. Inconsistencies in the policies of some programs or donors regarding input subsidies are not conducive to sustainable development.

11. To expand agriculture and create jobs the government needs to: (i) increase yields by rehabilitating and expanding irrigation, and introduce consistent policies for input supply (for instance, in subsidies); (ii) strengthen food security by increasing production, broadening income-generating opportunities, and improving transport between areas of surplus and deficit production; (iii) develop a better legal and institutional framework for the use of water resources,

making clear distinctions in responsibilities between the various water-related institutions (such as in planning, infrastructure development, financing, etc.); (iv) continue developing the country's capacity to design and implement complex multi-purpose projects (for instance, resource coordination, resource or basin

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planning, project preparation and financing, and trans-boundary issues); (v) continue privatizing animal-health and veterinary services and introduce a system of sanitary mandates allowing private veterinary clinics to carry out services such as disease surveillance, vaccination, etc.

12. Opium Economy: In addition to bolstering the production of legal crops under agriculture, the authorities also need to implement the counter-narcotics strategy in order to discourage illegal, high-return opium cultivation. There has been modest but significant progress in reducing opium cultivation, and farm-gate prices have continued to decline with global market trends. However, revenues from the drug trade are large (over one-third of GDP) and there are indications that the drug economy is now consolidated around fewer, though powerful, well-connected actors. The preferred option would be to deepen the emphasis on interdiction of large growers and traders as opposed to crop eradication because the former approach has had better success.

13. Rural Growth: Development of agriculture-based downstream activities and provision of social services in the rural areas requires contextual knowledge and local support. Community-driven development (CDD) is an outstanding vehicle to delegate micro-level decision making to individual communities to identify and implement appropriate projects for community benefit. International experience shows that the CDD can be successful in post-conflict areas, allowing governments to quickly deliver services to rural poor. Afghanistan's CDCD model, the National Solidarity Program (NSP), has had considerable success. The government has used the NSP to develop social capital and institutions in rural communities, providing them with resources to identify and build infrastructure projects themselves. Since 2003, the program has established over 22,000 Community Development Councils (CDCs) through which over 50,000 community subprojects have been implemented. The priority is to support and extend the CDC program all of the approximately 10,000 remaining rural communities in the country and provide a second round of block grants to communities that have already utilized their first block grant. This second round will not only help communities meet additional infrastructure needs but will further build the capacity of the CDCs already created so that

they can continue to represent their communities and address development priorities. About US\$2 billion will be needed to achieve these commitments. At the same time, fiscal and administrative controls will have to be strengthened to ensure accountability and proper use of the funds, particularly in insecure areas. With CDCs already established in over 70% of the country, and considering the investments already made in building their capacity, there is a strong case to turn them into local governments at village level.

(ii) Promoting the Formal Private Sector

14. Private Sector Development: Although agriculture is still the mainstay of the economy, experience elsewhere suggests that the formal private sector (including micro-, small- and medium-enterprises arising from the informal sector) which develops in urban areas is usually the dynamic engine of growth, employment creation, and income generation, and offers the best way out of poverty.

15. The development of the formal private sector is stymied by a weak investment and business climate as was unambiguously revealed by the Investment Climate Assessment. With the high, 12 percent annual GDP growth of the past five years, the private sector has been growing rapidly, albeit from a very low base. Yet, stronger private-sector growth is constrained by poor governance, weak factor markets, and lack of innovation, competitiveness, and diversification (most industries are linked to agro-business). Instability of policies and weak enforcement severely burden the cost of doing business. Infrastructure bottlenecks further hinder the climate for investment and business, and

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service delivery is poor and often nonexistent. Given the current situation of insecurity and weak governance, Afghanistan needs to formulate a strong industrial policy that will give strategic support and executive confidence to the evolving formal private sector. It must also promote competition, encourage innovation, and help diversification to encourage competent local and foreign firms to expand into job-creating fields where global demand is rising fast. One priority would be to press for full implementation of the 2007 Roadmap for Private Sector Development, through regular dialogue with industry associations, investors, and entrepreneurs. Sixteen of the 50 recommendations set out in the roadmap still have to be initiated in order to secure access to land, establish a legal framework for firms and civil society, relieve human capacity constraints and encourage corporate social

responsibility. To improve governance for the private sector, the authorities will have to ensure property rights are made more predictable for investors, through mechanisms such as codes of conduct and investor grievance resolution systems.

16. Financial Sector: The private sector can develop only if there is a viable financial sector.

Valuable progress has been made in financial-sector development and financial deepening with the

entry of private banks. Despite the low level of non-performing loans (just 1 percent of loans are non-

performing), banks are still averse to lending because of the poor security situation, weak

enforcement of property rights, and insufficient provisions for recovery of collateral.

The World

Bank's recent Enterprise Survey shows that only 51 percent of enterprises reported having a bank

account and only 5 percent of Afghan enterprises have a loan with a financial institution.

As a

priority, the government could focus on developing a financial-sector development strategy to expand

financial services, and strengthening the supervision of commercial banks and non-bank

financial

institutions.

17. Trade and Regional Cooperation: Trade with neighbors and regional cooperation is vital for a

land-locked country like Afghanistan to ensure the foundations of economic development and curtail

terrorism and cross-border trafficking in illegal narcotics. Most-favored-nation tariff rates are low (6

percent on average) and the trade regime is open, with few non-tariff barriers. However, there are

serious problems in trade facilitation and logistics, and administrative measures are often

discretionary, creating vulnerabilities for corruption. Fostering regional cooperation must be a key

government objective, as cross-border projects offer excellent opportunities to bind the regional

partners in mutual prosperity and peace. Large irrigation projects in Afghanistan need to be

negotiated with the riparian states in accordance with international rules. The development of regional

transport and energy networks will help facilitate trade and redress regional imbalances in demand

and supply of goods. Policy options that would enhance the benefits of regional cooperation and trade

include: (i) developing a national trade policy with reliance on the private sector to lead growth and

create jobs; (ii) formulating a regional cooperation strategy with coordinating mechanisms to prevent

different government agencies from conducting their own negotiations and fragmenting the system,

and (iii) enhancing international cooperation through the South Asian Association for

Regional
Cooperation (SAARC) and other key regional forums.

18. Extractive Industries: The oil, gas and mining sector is an important source of economic growth in Afghanistan. It stimulates infrastructural development and offers direct and indirect employment, diverse economic linkages, royalties and taxes, and technological innovation. Moreover the sector supplies energy, industrial minerals, and construction materials for reconstruction and nation-building. Emerging new geological data have increased understanding of the potential for oil, gas and minerals production, and investors are responding. From 2009, the extractive industries have begun moving into larger-scale mining and gas development. While small- and medium-sized enterprises

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continue to provide construction materials, emerging larger operations are fostering the development of vital physical and social infrastructure, by providing shared-use road, rail, power and water systems. The Aynak copper mine is the first such development to serve as a catalyst for the development of resource corridors, following major infrastructure routes that are expected to stimulate economic growth, partly because policies and contractual obligations will lead to the development of secondary goods and service industries. Afghanistan's mineral commodities are linked to global markets, and there are expected to call for the opening of additional infrastructure from the Hajigak iron ore development, which is currently under tender, and possibly also from prospective gas deposits in Sherbegon. Both mines could bring fiscal revenues of between US\$400 million and US\$700 million per year (compared to domestic revenues from all sources of US\$670 million in 2007/08).

19. The enabling environment is nearly complete, with the legal framework operational, the regulatory framework nearing completion, and preparations for improved environmental and social performance and regulations underway. Significant attention needs to be given to economic, environmental, and social performance within the sector to ensure sustained growth. There is an immediate need to design and implement social and environmental safeguards for the Aynak project: clear policies and procedures to meet the contractual obligations and requirements under the Environment Law, and establish the roles and responsibilities of the National Environmental Protection Agency (NEPA), and the ministries of Agriculture and Mines. Also, to ensure that the mining operations create jobs for their local populations, it will be necessary to provide training for

employment in extractive industries and programs to build the capacity of SMEs to become suppliers to the operations during construction and exploitation. Donors are currently working on the above regulatory frameworks, together with delineation of potential resource corridors to inform and direct policy on development of ancillary infrastructure in a more integrated planning framework.

(iii) Relieving Infrastructure Bottlenecks

20. A top priority is to relieve infrastructural bottlenecks in order to create jobs through private sector development and lay the foundation for longer-term development. The post-conflict rehabilitation of much of the damaged major road and urban electricity networks is well advanced. Major cities have seen some improvement in urban services. Yet, connecting major road arteries to rural areas is necessary for rural development. Afghans – both corporate and individually – are already paying high prices for electricity because it is in short supply. Developing cheaper gas-based sources of indigenous power and building hydro-electric power stations where feasible will require lead time for preparation. The rapid penetration of mobile phones is good but internet access lags far behind. City dwellers are vastly underserved by the provision of urban services and the public service utilities are in poor financial state.

21. Transport: Increasing connectivity of Afghanistan through transport links to other countries and through a reliable, well-maintained road network that connects the rural areas is vital for spreading economic opportunities. At present, transportation of general-purpose freight by road carries clear advantages over rail in Afghanistan, but in the long term, as freight volumes rise, rail transport could become important. However, policy-making is hampered by undefined roles and responsibilities of the various government ministries involved in managing and regulating the transport sector. Measures to address these challenges could include: (i) formulating legal and institutional frameworks to develop the transport sector and clarify roles and responsibilities; (ii) developing a sustainable financing mechanism for maintenance of road assets; (iii) merging the ministries of Public Works and Transportation and Civil Aviation, as well as those units in the ministries of Rural Rehabilitation and Development, Interior, and Urban Development that deal with transport into a single Ministry of

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Transport, and (iv) conducting a comprehensive transport-demand study as a precursor to developing a credible long-term national transport strategy, with a separate railway-sector strategy

for transport
along main corridors.

22. **Power:** Electricity access is limited to major cities and towns, and reliability of supply has only recently started improving. For smaller towns and most of the villages, public investments in independent micro-grids and home solar systems, particularly those under the NSP, have begun to expand electricity access, but reliability remains a major concern. Access to electricity is estimated to be 20% nationally and only 6% in rural areas. Improving reliability to existing customers and access to the unserved population will require a quantum increase in the sector's institutional capacity. Improvements are needed in planning, construction, operation, and in commercial performance to lower costs, reduce losses, and enhance revenues. These are both short- and long-term challenges, and require attention also to the development and rehabilitation of indigenous generating resources, in particular gas, coal, hydro and wind. At the same time, small, basic electricity requirements – such as lighting, mobile phones, and other information or entertainment services – of the vast majority of the currently-unserved rural population can be met by promoting individually-owned solar-powered retail products. The near-term policy reform agenda should focus on a realistic plan, with clearly assigned institutional responsibilities, to: (i) adopt a legal and regulatory framework for investment promotion; (ii) draw up a priority-investment and capacity-building plan for the public utility, with specific performance targets aimed at improving commercial discipline; (iii) increase cost recovery via efficient pricing, and (iv) coordinate donor activities, including those for off-grid electricity investments. As the grid stabilizes and progress is made in providing "basic electricity services", the government should also support expansion of clean cooking- and heating-fuels and technologies.

23. **Information & Communication Technology (ICT):** Fueled by private investment, mobile penetration is affordable and has rapidly reached 40 percent of the population, but Internet usage is expensive, limiting the reach to barely 2 percent of the population. Inefficiency and inadequacy of backbone communication infrastructure has stymied the growth of the Internet in Afghanistan. The potential of the ICT sector in development can be unleashed by policies that include: (i) privatizing telecom assets while protecting competition; (ii) designing a policy and regulatory environment to promote access to, and use of, Internet services; (iii) addressing regulatory issues, such as convergence, licensing, radio-spectrum management, and interconnection, and at the same

time using the Telecommunications Development Fund to promote Internet services, and (iv) coordinating and implementing e-government services to further stimulate the demand side.

24. Urban Civic Infrastructure: Severe under provision of basic civic amenities (water, sanitation, roads, waste collection) and weak institutions for service delivery afflict vast areas of urban Afghanistan. Ninety percent of urban residents lack access to piped water, 60 percent use traditional, covered latrines, 80 percent must use unpaved roads to reach their homes and 70 percent do not have their waste collected. Several municipalities are characterized by corruption, inadequate capacity, and weak administration. These issues need to be tackled by integrating service-delivery systems of the municipalities and the utilities, strengthening of local finances and service delivery capacities, upgrading community-based infrastructure and housing, and scaling up and replicating successful community-based pilot schemes, such as in Kabul.

IV. Delivering Good Governance

25. Strengthening governance, rule of law and reining in the growing perception of widespread and pervasive corruption are fundamental to nation-building and rebuilding the legitimacy of the

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government. Restoring public trust in leaders and government institutions through attainable service improvements at the sector level would require initial implementation of meaningful yet feasible short-run measures. These would include curbing corruption, as identified at the London conference, improving the rule of law and access to justice, continuing reforms in public financial management and the civil service, and rapidly improving the capacity of key service agencies that interact most frequently with the public. Efforts to strengthen governance are hampered by the slow progress of civil service and justice-sector reforms, remaining weaknesses in the public financial management system, limited resources, poor accountability, and capacity breakdowns in provincial governments. Ultimately, it is about a shortage of local talent and sector-specific skills that lead to an over reliance on external technical assistance.

(i) Addressing Growing Perceptions of Corruption

26. Corruption is endemic and growing. Afghanistan's ranking in Transparency International's Corruption Perceptions Index slipped from 179th to 176th out of 180 countries surveyed in

2008 and 2009 (it was 117th out of 159 in 2005). There have been encouraging recent steps to address the issue, but much more needs to be done to show that there is the political commitment to tackle the issue, including the arrest and prosecution of senior officials suspected of corruption. Following the promulgation of the new Anti-Corruption Law in 2008, the High Office of Oversight (HOO) was established to coordinate and lead anti-corruption activities. The implementation of an asset declaration process for senior officials was one of its first tasks. The HOO has developed a strategy and other important time-bound milestones to fully operationalize and gradually roll it out. As part of this effort, steps can be taken to strengthen the authority of the HOO so that it has real powers to ensure that public officials declare their assets and allow for seizure in cases of corrupt practices. In this respect, the recent Presidential decree giving additional authority and weight to the HOO's role and mandate is welcome. In addition, the rules and procedures for disciplinary actions against misconduct and appointment process for senior appointments need to be reviewed. It is important to focus on public-service delivery sectors to prevent corruption and enforce zero tolerance for errant officials. Civil-service pay reforms and simplification of procedures would reduce incentives and opportunities for corruption. Excluding persons associated with the narcotics trade from government positions would be a telling step toward clean government.

(ii) Rule of Law

27. The government has taken steps, with the international community, to rehabilitate the justice system and improve the delivery of legal services. A challenge in the Afghan legal system is the need to reconcile and connect state law, sharia law and customary law so as to establish a unified legal system consistent with Islamic and human rights standards and Afghan legal traditions. Progress in justice reform has been slow. The justice institutions are seen as the most corrupt in government, and most people still choose traditional systems to resolve common disputes. The sector suffers from weak human capacity, a lack of basic physical infrastructure in the provinces, and the absence of uniform business operations. Previously, reforms focused on the formal justice institutions. But many stakeholders now agree that the challenges in the sector are bigger than originally thought, and that better results would be achieved by: (i) emphasizing service delivery through a unified system that combines state and informal institutions; (ii) improving accountability of public institutions, and (iii)

concentrating on legal empowerment. The three justice institutions themselves – the Supreme Court, Ministry of Justice and Attorney-General's Office – recognize the need for change and are working together with donors to improve the system.

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(iii) Improving Public Services

28. Public Financial Management: PFM is progressing satisfactorily and meeting acceptable standards, according to several studies and indicated by increasing on-budget development spending.

However, the sustainability of the current good performance in PFM is a concern, given the significant dependence on international advisors and local consultants who earn more than standard

civil service compensation rates. Also, there is limited independent oversight of public expenditures,

and parliament lacks a dedicated Public Accounts Committee to review financial statements and

compliance reports by the Control and Audit Office; follow-up is rare. Some options for strengthening PFM include: (i) ensuring continued technical assistance for PFM (possibly with

pooled donor support); (ii) continued implementation of Pay & Grading (P&G) and Civil Service

Reforms (CSR), and (iii) improving local governance.

29. Capacity Building: A major obstacle to civil service reform and, inter alia, reducing incentives

for public sector corruption, is the widespread practice by donors of engaging national consultants to

fill civil service positions in line ministries and paying salary top-ups to regular civil servants.

Nowadays, the public sector in Afghanistan hosts an array of remuneration and employment arrangements – some introduced by government and others implemented in a largely ad-hoc manner

by donors. This has become known as the problem of the "second civil service". These practices

undermine incentives and capacity-development objectives. Improving the capacity of the civil

service to deliver services and broadly meet its mandate will depend upon:

- The ability of government to develop the competence of existing staff, and a broader pool of

- individuals employable as civil servants over the longer term;

- Ensuring that the scope and size of the civil service, and the structure of individual

- organizations are consistent with the government's development priorities, overall mandate at

- national, and provincial or district levels, and fiscal capacity;

- The ability of the government to recruit, retain and support competent individuals as civil

- servants, and provide an appropriate incentive framework for performance;

- Political will to limit adverse practices and promote consistency across government, and

- The willingness of donors to engage in a balanced approach to progressively

address capacity
constraints.

V. Maintaining the Fundamentals of Longer-Term Durable Development

30. While the urgent objectives of winning the peace and ensuring security, as well as the imperatives of nation building and improving governance, overwhelmingly preoccupy the authorities and policymakers, the fundamental tasks of laying the foundations for longer-term sustainable and inclusive development are equally important. The two key elements of this essential aspect are prudent macroeconomic management as the foundation for growth and poverty reduction, and human capital development for building capacity and a productive, competitive work force.

(i) Maintaining Macroeconomic Stability and Improving Fiscal Sustainability

31. Despite the political and security problems, Afghanistan has accomplished high growth with macroeconomic stability in the last five years. Inflation has been moderate (under 10 percent), the exchange rate stable (Afs 49-51 per US\$), and foreign reserves adequate (above eight months of imports). This has been made possible by astute exercise of control by the Da Afghanistan Bank, with

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generous aid from donors filling in large budgetary and balance-of-payments gaps. The large inflows of foreign aid are managed outside the budget, and these have tended to raise the prices of non-traded goods and skilled labor, adversely affecting competitiveness. The extent of future donor support will depend on improvements in fiscal sustainability. The capacity of the government for paying for its operational expenditures, including security, must steadily improve. As the economy matures, monetary policy should reflect increasing sophistication in deploying a wider array of tools to target inflation and manage the exchange rate to preserve competitiveness.

32. Fiscal Policy: Policies in the fiscal arena are consistent with the goal of macroeconomic stability, but concerns about fiscal sustainability persist. The country remains highly dependent on grants to cover fiscal deficits and about three quarters of external assistance is channeled outside of the national budget through direct execution by donors, undermining sovereign fiscal policy. Fiscal sustainability – defined as the ratio between operating expenditures and domestic revenues – has declined from 68 percent in 2006/07 (after rising from the 2002/03 level of 67 percent) to 60 percent in 2008/09. In spite of improved revenue collection, the revenue effort at 7 percent of GDP is much lower

than countries with similar incomes. In the meantime, some current expenditure components related to security and civil service wages are expected to increase over the next couple of years. Operations & maintenance requirements of large development-budget capital investments are also worrisome. As for positive developments, core budget expenditures doubled in three years to US\$2.2 billion in 2008/09 and there is also potential for increased absorption of aid channeled through the operational budgets.

33. The government needs to focus on sustaining the momentum of revenue efforts to reach the goal of fiscal sustainability. Despite impressive revenue efforts, Afghanistan remains in the bottom tier of low-income countries, and able to pay for only 70 percent of its current consumption expenditure. On the expenditure side, policy steps can be taken to accommodate higher security spending, preserve pro-poor public spending, contain unanticipated increases in non-security wages and salaries, reflect semi-annual P&G-reform action plans in the budget & medium-term fiscal framework (MTFF), while initiating steps to move towards a medium-term expenditure framework (MTEF). Acceleration in the execution rates of core development budget expenditures can be achieved by improving budget formulation, aligning budget objectives better with those of the ANDS, and by developing performance monitoring and project evaluation. To better align the external budget with the core budget, the government can start using sector-wide approaches (SWAps) as a foundation for aligning the core operating and development budgets with the external budget. Finally, there is a need to analyze and estimate future recurrent costs associated with the core and external development budgets and incorporate results in the MTFF.

34. Improving Aid Effectiveness: The donor community plays a critical role in the current phase of Afghanistan's rebuilding and development, and it is imperative that the commitment continues. But, as is well known, much of the aid flows outside the budget, not necessarily aligned with the government's sectoral and spatial priorities. Aid delivered outside the budget, even in an environment of well-functioning public financial management and competent leadership, could undermine the very task of state-building which brought donors to Afghanistan. Steps to improve the effectiveness of the large volumes of aid inflows should: (i) allocate more aid through the budget to meet the goal of 50 percent in two years, and (ii) improve the predictability of aid in budget planning by formulating a

multi-year financing strategy, aligning financing decisions with the Afghan budget calendar, sharing information, and coordinating hiring policies to contain escalation in consulting costs.

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(ii) Emphasizing Human Capital Development

35. Human capital development is fundamental to poverty reduction, and indeed, to equip people to engage in and benefit from a dynamic private sector which can generate growth, employment, and income. The ANDS recognizes this and accords high priority to human development objectives. The delivery of social services at the current stage of Afghanistan's development and nation-building phase has special characteristics, as the country's social infrastructure has suffered considerable setbacks as it emerges from conflict.

36. Basic Education: Remarkable strides have been made in the primary and secondary education sectors. While fewer than 1 million children were in school in 2002, more than 6.3 million children are now (2008/09) enrolled in formal education (85 percent are primary school students). Despite progress, there are concerns about poor quality of learning, low primary completion rates and low quality of teaching at all levels. Enrollment in the higher grades is minimal. Some 5 million children remain outside the system. The literacy rate of women 15 years and older is only 12 percent compared to 39 percent for men. Also, Government must secure access to school for girls by stemming the violence directed against schools for girls. Policy options to improve access and quality of education include measures to: (i) implement flexible strategies to suit the heterogeneity of service contexts in Afghanistan (road access, security, climate, etc.) to increase education access and improve teaching and learning quality; (ii) integrate services for teachers (training, curricula, etc.) across different administrative levels, and (iii) implement school-based management and community participation as a flexible and pertinent mechanism.

37. Higher Education: In the higher education subsector, there is considerable unmet demand with more than 100,000 graduates from 12th grade opting for post-secondary studies annually. The priority now is to improve the quality of higher education programs and institutions, with most public and private universities requiring support in updating their professional fields, academic programs, and qualifications of the professors. Increasing university autonomy needs to be complemented

by greater accountability and a quality assurance system to be managed by normative institutions. The government's policy options can focus on operationalizing and executing the 2010-14 National Higher Education Strategic Plan, which is an important roadmap for the development, expansion, and quality of the higher-education sub-sector.

38. Health: There have been many improvements in the health sector. With able leadership from the government, the donor community could support sound health policies and innovative service-delivery models using NGOs and enhanced public services. Another important innovation has been third-party monitoring, which provided high-quality data on the performance of the sector. Between 2003 and 2006, infant and under-five mortality rates declined by 22-26 percent, use of antenatal care increased from 5 percent to 32 percent, and skilled birth-attendance from 6 percent to 19 percent. However, health indicators are still dismally low, despite the health care system increasing access to services and improving the quality of care considerably. Under-five mortality, at 191 per 1,000 live births, is 67 percent higher than the low-income country average, and maternal mortality, at 1,600 mothers per 100,000 live births, is the second-highest in the world. Physical access to health services remains an issue, with more than 60 percent of the population living further than one hour's walking distance from a health facility. The national health strategy provides the framework for support from all development partners, thus creating one of the most important conditions for moving towards a sector-wide approach (SWAp). The sector faces several key challenges, including: (i) how to further increase the coverage and enhance the content of the basic package of health services; (ii) enabling the public sector to deliver services other than through the contracting model, which has been

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successful so far; (iii) determining an essential package of hospital services to complement the basic package and provide more comprehensive services to the population, especially to reduce maternal mortality; (iv) improving coordination between the ministries of Public Health, Education and Agriculture in order to reduce the high level of malnutrition in the country, and (v) building a strong partnership with development partners for a sustainable and stable source of financing for the sector.

39. Gender: Both education and health have significant gender dimensions with vast inequities and

lagging human development indicators for women. While significant progress has been made in recent years (for example, primary enrollment for girls has risen from zero in 2001 to more than one-third of all primary students currently), the formulation of policies and implementing actions need to redress these inequities. The gains made since 2002 must be maintained and strengthened by the government giving more support to vulnerable girls and women. It could, for instance, improve the safety and appropriateness of school environments for girls and young women (for example, by having separate buildings, female-only dormitories for teachers and students, etc.), training local women in basic health care provision, training more women as extension workers in agriculture and livestock, and training women to manage micro-loans and businesses.

VI. CONCLUSION

40. No one has a definitive way for leading a country out of conflict and poverty into peace and prosperity. The analysis and recommendations put forward here represent the thinking and experience of the World Bank team working on Afghanistan, in conjunction with the government of Afghanistan and other development partners. The current window of opportunity should not be missed. Winning the peace, delivering good governance, and laying strong foundations for Afghanistan's long-term growth are mutually-supportive goals. In most cases, the recommended actions build on notable successes and efforts that are already under way in Afghanistan. While the prioritization implicitly takes account of sequencing, the mix of policy options includes both easily-implementable actions and difficult ones. We believe the current Afghan leadership has the willingness and capacity to take on these challenges to meet the expectations of its people and development partners. □

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AGRICULTURE AND RURAL DEVELOPMENT

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Agriculture

Priorities for Action

□ Sustainable productivity increases to achieve long-term food security. Wheat yields in Afghanistan are significantly lower than in Pakistan, Uzbekistan and Iran and there

exists ample scope for narrowing the yield gap. Improving wheat yields through continuing investments in irrigation and expanding supply of high-quality inputs would free up land for high value commodities.

□ Increase the livestock sector's productivity and sustainability. Since the continued growth of the Afghan economy will eventually result in a rising demand for meat and milk, a number of actions are required: (1) increasing pasture productivity; (2) developing a market for cattle feed; (3) developing a viable animal health system including national veterinary service coverage; (4) solving the increasing conflicts between Kuchi nomads and sedentary farmers; and (5) keeping the size of the herd to sustainable levels that are in line with pasture availability (especially during the winter).

□ Achieve food security. This requires looking beyond productivity and production increases to income generation and social protection. Widespread poverty greatly complicates access to food even when available in sufficient quantities. The latest estimates show that 36% of the population was below the poverty line in 2007/08. Earlier nutrition studies in 2004 revealed chronic malnutrition problems - 54 % of under-five children were malnourished in 2004. The issue of access to affordable nutritious food to the poor is just as important as food availability/production in the aggregate.

□ The Government is taking the first steps towards the establishment of a Strategic Grain Reserve (SGR) whose scope and size should be limited. The key objectives should be emergency food support for vulnerable households in case of man-made and/or natural calamities (i.e. helping to overcome transitory food insecurity); and assisting particular groups of households that are unable to achieve food security even in times of good harvests. In addition the SGR may play a role in smoothening out regional food imbalances in areas that are seasonally inaccessible. The Government should pay careful attention to the management of the SGR. The fiscal impacts of the SGR should be minimized.

□ Transportation between food surplus and food deficit provinces needs to become more efficient. There exist significant disparities in wheat balances across provinces, with most of northern Afghanistan being wheat-surplus and most of the southern regions being wheat-deficit.

Successful operation of a SGR requires solving infrastructure bottlenecks, especially road transportation. Since private traders play a major role in transportation, it is important to ensure that they can adequately carry out their functions.

□ Sustain the on-going institutional reform process in the agricultural sector. The agricultural sector in Afghanistan is currently undergoing a rigorous institutional reform process led by the restructuring of the Ministry of Agriculture, Irrigation and Livestock (MAIL). Improving national capacity in agricultural policy analysis is an important part of this process but no further steps

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have been taken so far. In the short run the aim is to have a legal and policy unit directly under the Minister's Office. In the medium term establishment of an independent and competent Agricultural Policy Institute (API) capable of delivering on-demand, high- quality policy advice deserves serious consideration.

Context

Agriculture is critical for promoting overall development and poverty reduction. Agriculture is the largest economic sector in Afghanistan and accounts for about half of GDP (licit), 90% of exports (licit) and two-thirds of employment (2002/03 data: numbers are likely to have decreased somewhat in recent years). Agriculture is the main livelihood in rural areas which hold 80% of the total population and where poverty is starkest. Historical evidence from other countries when they were in a similar development stage as Afghanistan is now suggests that the bulk of poverty reduction occurs because of the employment multiplier effects of rising farm incomes. Accelerating agricultural development is therefore extremely urgent for poverty reduction but also for food security and civil security reasons. Furthermore, improving rural incomes through agricultural development is a crucial element in the counter narcotics strategy.

However, the main drivers of agricultural growth and rural poverty reduction – irrigation, adoption of improved technologies, sustainable management of natural resources, education, roads – have all suffered extensive deterioration due to conflict, lack of maintenance, and frequent droughts which seem to hit about every other year (e.g. 2002, 2004, 2006, 2008). Between 1978 and 2001 agricultural production grew at only 0.2% per annum, compared to 2.2% per annum in the pre-conflict period of 1961-1978. To achieve increased pro-poor economic growth that makes a significant dent in rural poverty, agriculture

needs to grow at an average rate of at least 5% per annum over the next decade.

Wheat is the main food staple crop in Afghanistan but average yields are low. Wheat accounts for about 70% of total cereal consumption and 50% of total caloric intake. It is grown on a total of about 2.5 million ha of which about 40% (or about 1 million ha) is rainfed and the remainder is irrigated land (about 1.5 million ha). Most (75-80%) of the wheat production is from irrigated land. But average wheat yields in Afghanistan are low (about 2.7 tons/hectare on irrigated land and 1 ton/hectare on rainfed land). Average irrigated wheat yields in neighboring countries (Pakistan, Uzbekistan, Iran) range from 3.0 to 5.0 tons/hectare – a rough indicator of the potential that exists for increasing yields in Afghanistan given sufficient water, appropriate inputs and support services.

Besides wheat, livestock is a major source of food and income for Afghan farmers. Range land covering about 45% of total land area has traditionally supported a large livestock population. However, over time livestock rearing in Afghanistan has become increasingly problematic due to increasing human populations, higher frequency of droughts affecting pasture productivity and feed availability, insufficient attention to animal health, and rising conflicts between the traditional livestock nomads (Kuchis) and sedentary farmers. In addition, livestock management technologies hardly changed in 30 years. The current livestock population is estimated at about 34 million (including some 12 million heads of poultry), a decline of 30-40% compared to the 1990s. The total number of ruminants (mostly goats and sheep but also cattle) is currently estimated at about 15 million, less than half the number 25 years ago.

Issues and Challenges

Given its predominantly arid climate, agricultural production in Afghanistan is highly dependent on water, either from irrigation or rainfall. But rainfall is highly variable from year-to-year and only about 2.5 million ha (or less than one-third of total arable area) receives irrigation. As a result only half of the total arable area (about 4 million ha) is actually being cultivated. There is enormous scope for improving

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water productivity on 1.3 million hectares, for rehabilitating existing traditional and modern irrigation systems on up to 800,000 ha, and for expanding the irrigated area by several hundred thousands of hectares through both large and small-scale irrigation schemes.

Most existing irrigation facilities are seriously damaged and in urgent need of repair. As

a result of the prolonged conflict, damaging floods and neglected maintenance, the irrigation infrastructure is in a serious state of disrepair. Irrigation schemes are operating at about 25 percent efficiency, as compared to the norm of 40 to 60 percent in the region, and are irrigating only about one third of the pre-conflict area. Rehabilitation has higher and quicker economic returns than irrigation extension. Rehabilitation is the quickest and most cost-effective means of restoring irrigation supplies to areas that used to receive water before but are currently out of command because of the dilapidated state of the system. Rehabilitation also improves reliability of supplies to areas that currently do receive water.

The agricultural research and extension systems in Afghanistan are very weak. Gradual rebuilding of national institutional capacity for agricultural extension and research with a clear focus linked to the commodity production priorities (food crops, horticultural crops) would seem essential. The recently started Dutch-supported initiative in the area of vocational agricultural training is encouraging in this respect.

The rural finance system is grossly underdeveloped. A number of donors have developed micro credit systems for subsistence farmers but small commercial farmers and small rural enterprises lack credit access. It is urgent that the credit gap be filled. Current input vouchers are no substitute for credit in the longer run. Therefore, a National Agricultural Credit System should be implemented as soon as possible, preferably in the form of a private sector institution with an autonomous Board free from political pressure.

A census carried out in 2009 as part of the preparation of the Afghanistan Rural Enterprise Development Project (AREDP) among over 1,708 Small and Medium Enterprises (SMEs) in 33 provinces identifies amongst others two major obstacles to private sector enterprise growth: a shortage of business expertise and weak access to formal credit. More than 60% of the SMEs surveyed indicated a need for knowledge-based business training support, in particular technical (40%), business management (37%), and financial management (20%). Over 96% of the enterprises expressed an interest in accessing financial services. Of the 1,708 SMEs, only 13% had ever applied for loans, while 7% had received a formal loan. Women-owned firms are very few (8% in AREDP census and 3% in the WB survey).

Improving rural incomes through strengthening the rural production base is a crucial element in the counter narcotics strategy. While there is some anecdotal evidence that wheat may become competitive

with poppy at a wheat price of about US\$500/metric ton (which during the food crisis in 2007-08 made wheat a viable substitute for poppy) prices of wheat fluctuate too much for the crop to ever become a viable alternative to poppy in the long term without giving farmers similar support as they receive from opium buyers (inputs, credit etc). But an important lesson that can be derived from the high prices during the food crisis is that the eradication of poppy cultivation rests on improving the competitiveness of food crops, developing high-value crops, and fostering small rural enterprises.

The food staple sector alone cannot keep on driving agricultural and rural development beyond the short term. At least in the initial stages of agricultural development, increased food staple productivity has the largest multiplier effects for poverty reduction, far higher than non-food staple agricultural production. But in order to achieve broad-based agricultural and rural development in the medium to longer term, a three-pronged approach is needed: i) achieving sustained productivity increases in the food staple sector; ii) developing/restoring Afghanistan's high-value agricultural sectors especially livestock and horticulture; iii) development of rural enterprises.

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Role of the World Bank

In order to improve the sustainability of agricultural production in Afghanistan, the Bank has proposed to further increase its engagement in the sector. Both the Government and the Bank recognize that strengthening the agricultural production base is mandatory for improving the food security situation in the medium and longer term. The use of improved production technologies, continuing irrigation investments and rehabilitation of natural resources are crucial for achieving sustainable productivity increases. Both the Government and the Bank realize that building up a strong agricultural production base requires long-term investments and commitment from Afghanistan's development partners in the areas of improved technology development and transfer/extension services, capacity building, and rehabilitation of irrigation structures and the natural resources base. In addition to a series of significant investments in irrigation rehabilitation, the Bank is currently working with MAIL on the design of two new operations: (1) improving quality and reliability of input delivery systems (estimated financing requirement of US\$47 million); (2) improving the efficiency of on-farm water management (estimated financing requirement of US\$24 million). The Bank has also expressed its willingness to explore the possibilities for a sector-wide Adaptable Program Grant (APG) for possible IDA financing in FY11. The

implementation of the APG would follow a phased approach and would be fully consistent with the National Agricultural Development Framework covering agricultural research and extension, information systems and agricultural training & education, and community-based natural resource rehabilitation and management.

The Bank is also working with MAIL to improve the availability of protein and micro-nutrient rich foods. Since 2006 MAIL has been carrying out the Horticulture and Livestock Project (HLP) which is financed by a US\$ 20 million IDA grant plus US\$ 11 million co-financing from the ARTF. Recently the HLP went through a major restructuring including an extension of two years. In addition, in 2007 MAIL has received an US\$ 8 million IDA grant for the execution of Avian Flu project. The Bank is also supporting a Food Crisis Response Project in Afghanistan under the Global Food Crisis Response Program financed out of the Global Food Crisis Response Trust Fund. This Program is expected to enhance wheat production through increasing irrigated land by financing small scale community implemented and maintained irrigation schemes in provinces most affected by the food price increases.

But rural development cannot be based on agriculture alone. Recognizing the increasing importance of the non-farm rural sector for development, the Bank is currently preparing a new Rural Enterprise Development project (RED, initial budget US\$30 million). The RED aims to increase market participation of community-level rural enterprises and agri-businesses, build backward linkages to the rural economy and increase the endowment of productive assets, in this way reorganizing rural production systems around market-driven supply chain approaches. This is expected to result in increased production, incomes and sustainable employment opportunities. Together with developing high-value crops fostering small rural enterprises as advocated by the RED project are important elements in the counternarcotics strategy.

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Opium Economy

Priorities for Action:

- Continue and further deepen the emphasis on interdiction in the counter-narcotics strategy, including efforts to target medium-sized and larger drug traffickers and their

and should be prosecution positions in sponsors inside and outside the Afghan government; a variety of tools can used, including destruction of stockpiles and processing labs, arrest and (including extradition), and removing drug-related figures from their government which sends a powerful signal.

□ The progress achieved in eliminating opium poppy cultivation in a number of provinces should be sustained through continuing efforts by provincial and district authorities to persuade farmers not to cultivate opium poppy. However, massive eradication campaigns have been costly and ineffective, so the welcome de-emphasis on large-scale eradication should continue; the potentially explosively damaging option of aerial eradication must continue to be ruled out.

□ Rural development is critical for phasing out the opium economy over time. Hitherto most agricultural initiatives have been fragmented and inadequate. A 2008 World Bank – DFID joint report put forward a multi-faceted program for agricultural and rural development to reduce dependence on opium, but despite follow-up and support by the Bank, more financing will be required from other donors, as well as accelerated program development and implementation, to achieve success. Strong leadership in the Ministry of Agriculture and Ministry of Rural Rehabilitation and Development is needed to take forward this agenda.

□ Finally, there is a need not to be overly influenced (in a negative or positive direction) by short-term developments, but rather maintain a medium-term perspective and consistently take forward and implement the different elements of a sound, holistic counter-narcotics strategy

Context, Including Recent Quantitative Trends:

UNODC's most recent Afghanistan Opium Survey paints a picture of modest yet significant progress in reducing opium cultivation and, to a lesser extent, production over the past two years. Reductions in and progressive elimination of opium poppy cultivation have continued in all parts of the country other than the south, including in formerly major opium producing provinces such as Nangarhar and Badakhshan. (Helmand Province, the dominant producer of opium in Afghanistan and the world, saw a large reduction in cultivation in 2009, but there was a sharp increase in neighboring Kandahar Province)

However, these modestly positive trends provide no grounds for complacency: opium cultivation in 2009 is the fifth highest in Afghanistan's history, production the third greatest (due to higher yields), both well exceed peak levels of the 1990s, and Afghanistan remains the dominant global supplier of illicit opiates. Recent contraction of the opium economy appears to largely reflect market factors—oversupply, declining prices, and an apparent overhang of large opium stockpiles—so production could easily rebound if conditions change. By all indications drug-related corruption remains pervasive, along with the corrosive effects of the drug industry on governance, security, and the perceived credibility and

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legitimacy of the state. Growing links between the drug industry and the Taliban, and reports of criminalization of the latter, add to and complicate the challenges (although they should not detract from the importance of government involvement with the drug industry). Finally, year-to-year fluctuations are much less important than longer-term trends and the dynamic patterns whereby an entrenched drug industry contributes to keeping Afghanistan insecure, poor, and badly governed.

As can be seen from the table below, the estimated area devoted to opium cultivation in Afghanistan has declined substantially since the peak in 2007—by 19% in 2008 and 22% in 2009. Due to higher yields—as lower-yielding land is taken out of production, and probably also reflecting improving crop practices and good weather conditions—declines in estimated opium production were much less, 6% and 9% respectively in 2008 and 2009. Production in 2009 remains the third-largest in history and well exceeds peak levels of the 1990s under the Taliban regime. Moreover, it still most probably exceeds world demand for illicit opium. By all indications opium inventories have burgeoned in recent years and remain at historically very high levels. Finally, Afghanistan's longstanding status as the dominant, near-monopoly global producer of illicit opiates is based on devoting only a very small proportion of its total agricultural land to opium cultivation. This means that very large increases in opium production are always a possibility, as indeed occurred most dramatically in 2006 and 2007.

			1995	2000	2001	2002	2003	2004	2005
2006	2007	2008	2009						
			2,300	3,300	185	3,400	3,600	4,200	4,100
6,100	8,200	7,700	6,900						
Production (tons)									
			~52	70	11	74	76	87	87
92	93	93	n/a						

World Market share (%)

Number of provinces	8	22	11	24	28	34	26
28	21	16	14				
producing opium							
Area under opium	54	82	8	74	80	131	104
165	193	157	123				
poppy (thousand ha)							
As % of total	n/a	n/a	n/a	n/a	1.6	2.9	2.3
3.65	2.5	2.1	1.6				
agricultural land							
Area under poppy / Area	2.0	3.2	n/a	3.2	2.8	5.9	n/a
n/a	n/a	n/a	n/a				
under cereals (%)							
Gross farm income per	1,000	1,100	7,400	16,200	12,700	4,600	5,400
4,600	5,200	4,662	3,562				
ha (US\$)							
Gross potential value of	n/a	850	n/a	2,500	2,300	2,800	2,700
3,100	4,000	3,400	n/a				
opiate exports (US\$ million)							
Gross farm income from	50	90	60	1,200	1,000	600	560
760	1,000	730	438				
opium (US\$ million)							
Downstream income in	n/a	760	n/a	1,300	1,300	2,200	2,140
2,340	3,000	2,670	n/a				
Afghanistan (US\$ million)							

Note: The estimate of total agricultural land was sharply adjusted starting in 2007, so the figures for % of agricultural land are not comparable as between 2007-2009 and earlier years. Source: UNODC Afghanistan Opium Survey, various years.

Opium farm-gate prices have continued to decline, clearly reflecting the softness of the market. The estimated average farm-gate price at harvest time declined by 34% for fresh (wet) opium and 31% for dry opium in 2009, following declines of 19% and 22% respectively in 2008. Indeed, prices are now close to the levels seen in the 1990s, when opium was treated de-facto as a legal commodity by the Taliban regime and there most probably was little risk premium and much less extortion by power-holders from producers, although the Taliban in the 1990s taxed opium like other agricultural goods.

Falling farm-gate prices have resulted in a major decline in estimated farm income from opium—from \$1 billion in 2007 to less than half that in 2009. Even though representing only a small proportion of the total value of opium output nationally (most of which accrues to trading, transport, and processing), this

decline represents a substantial shock to Afghanistan's rural economy that was only partially offset in 2008 by higher wheat prices (which have since declined). Adverse impacts (compounded by

multiplier

effects) include lower household expenditures on education, health, and food; increased distress of poorer and more marginal households; labor and family migration in pursuit of livelihoods; and possible security and political fall-outs. This underlines the importance of economic and employment growth as well as effective rural development to reduce economic dependence on opium for rural households.

Turning to the spatial patterns of opium cultivation and production, the declining trend in the number of provinces producing significant amounts of opium (down to 14 out of a total of 34 provinces), and the increasing concentration of production in the southern provinces, continued in 2009. The nearly 33% fall in the area of opium cultivation in Helmand Province meant that its dominant role was slightly reduced, although this province still accounted for 57% of total national opium cultivation (down from close to 2/3 in 2008). Interestingly, there was a sharp 35% increase in the estimated area devoted to opium cultivation in neighboring Kandahar Province, which reached the highest level there in history.

Structural Developments and Key Issues/Challenges:

Anecdotal reports from a variety of sources suggest that the broad patterns which were emerging by 2006 have continued, including widespread and high-level drug-related corruption; linkages between government officials/politicians and drug interests; and consolidation of the drug industry around fewer, powerful, and well-connected actors. Counter-narcotics measures, implemented unevenly and in a corrupt manner, inadvertently contributed to consolidation of the drug industry as well as distortion of counter-narcotics efforts, with government actors protecting drug interests allied with them and often taking actions against other drug interests. Many observers in recent years have argued that parts of the Police and Ministry of Interior have been virtually "captured" by drug industry interests. Although the change in the leadership of MoI and subsequent reform efforts undoubtedly have resulted in substantial improvements, this progress may be fragile and will need to be deepened and sustained over a considerable period of time.

There have been clear signs of significant and more direct linkages between the drug industry and the Taliban insurgency as it has strengthened and expanded in the South, along with some signs of criminalization of the latter. To a large extent this is not surprising, as whoever has military and political power in major opium producing areas like the South would likely be involved with and benefiting from the drug industry. Key questions relate to the extent of this phenomenon; whether it interferes with the

Taliban's loose command and control and broad strategic direction; whether the Taliban's perceived legitimacy is thereby reduced; and the implications for counter-narcotics strategy and policies.

There have been some welcome changes in the counter-narcotics strategies and approaches of key international actors. The US administration has made a profound shift from an eradication-led or eradication-dominated strategy in the past to one which de-emphasizes eradication and instead focuses on interdiction efforts against drug traders, transporters, and processing labs. Senior US officials have publicly recognized that past large-scale eradication efforts achieved very little at great cost, and that this is not the way forward. NATO has also started to play a more active supporting role in counter-narcotics efforts (e.g. providing security in interdiction efforts when drug figures are associated with the Taliban). Although individual NATO countries may engage to varying degrees in counter-narcotics support, nevertheless this represents a significant shift.

The de-emphasis on large-scale eradication carries the challenge of sustaining and deepening past progress in reducing opium poppy cultivation in most parts of the country outside the south. These reductions were not achieved by massive eradication but rather by effective persuasion and threat of law enforcement actions (even if actually carried out only to a relatively small extent) helped further by the

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decline in world opium prices The increased emphasis on interdiction while most welcome does carry some risks and gives rise to further challenges, which need to be factored into the equation while implementing this approach. If not accompanied by meaningful efforts to root out major drug linkages in the government including at middle and higher levels, such efforts may inadvertently distort outcomes by seemingly focusing on those drug interests which are anti-government and not going after those associated with government figures.

Another positive change since 2008 has been in the leadership of the Ministry of Interior, followed by the initiation of meaningful reform in that agency and the Afghan National Police which MoI oversees. While the initial progress has been encouraging, this will need to be deepened and sustained over a considerable period of time, and it is still probably too early to ascertain the lasting impact on police and MoI officials' involvement in and benefiting from drug activities. While elements in the police and Ministry of Interior in recent years are widely considered to have played an important role in protecting

and "regulating" the drug industry, strong commitment to root out corruption from top leadership is essential for success in counter-narcotics. In the absence of strong actions and signals at these levels, there is a risk that improvements in MoI will affect the way drug-related corruption occurs and how associated funds are channeled, but may not sharply reduce let alone eliminate major drug-related corruption.

Provincial leaders and political figures in regions outside the south have been distancing themselves from the drug industry and sponsoring crackdowns against opium poppy cultivation. However, some of these figures may have been associated with the earlier expansion of opium poppy cultivation in their provinces, and moreover some "poppy-free" provinces remain important as lucrative transit routes for opiates. Also, in the provinces with more marginal production conditions, the phasing out of opium poppy cultivation very much reflects the progressive decline in farm-gate opium prices, which has rendered opium uneconomic on lower-yielding lands and with less skilled / efficient opium poppy cultivators and harvesters. Hence opium poppy cultivation could return to and expand in the "poppy-free" provinces if market conditions change and make this more lucrative.

Finally, there have been significant improvements in agriculture and rural development, critical for the economic sustainability of efforts to phase out opium poppy cultivation. These have been associated with a change in the leadership of the Ministry of Agriculture. However, and despite some very effective national rural development programs (NSP, NRAP, etc.), many interventions in the agricultural sector hitherto have been in the form of fragmented projects with weak engagement from the government side. In addition, many "alternative livelihoods" projects under the country-narcotics strategy have been of a short-term nature without sustainable results and carrying high costs. Agriculture and Rural Development programs currently being developed have great potential but must be well-designed, taken forward, and adequately funded.

Conclusions and Role of the World Bank:

As emphasized earlier, the modest progress in reducing the size of the opium economy during the past two years provides no grounds for complacency, and expectations for future progress need to be kept modest and setbacks expected. Some key recent changes in counter-narcotics strategy and policies are promising and should be continued and deepened. In other areas like rural development, a revitalized and larger effort is needed. And what happens at middle and higher levels of government in

relation to their links with the drug industry is of great importance; inaction in this regard would impose serious limits on overall progress and sustainability. As opium stockpiles start falling in the face of lower production, and/or global demand for illicit opiates increases and begins to catch up with supply, market conditions could change and become much less conducive to further reductions in opium poppy cultivation.

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In addition to its analytical work and policy advocacy (for example in continuing to disseminate the joint WB-DFID report on economic incentives and development interventions to reduce opium production, and continuing advocacy for implementation of the report's recommendations), the main role of the World Bank is in the sphere of agriculture and rural development. This will be critical for reducing the dependence of Afghanistan's rural economy on opium over time and thereby sustaining reductions in and eventual phasing out of opium production.

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Community Driven Development

Priorities for Action

□ Leverage community based institutions to deliver services. Mobilizing communities to lead local development programs will be vital. Extensive mobilization carried out under the National Solidarity Program (NSP) through the formation of Community Development Councils (CDCs) needs to be leveraged and these institutions used as gateways for village level development.

□ Complete national coverage of the NSP by providing a second round of grants. Going forward NSP needs to be rolled out to the remaining rural communities in the country (app.10,000); and a second round of block grants needs to be provided to CDCs to meet their infrastructure needs.

□ Maintain and enhance the quality of rural institutions. Moving forward it will be vital to ensure that the quality of the institutions, i.e. the CDCs created through the NSP continues to be maintained and further enhanced. This would include ensuring that CDCs are well governed, accountable, participatory, inclusive, legitimate and democratic institutions. Furthermore, they need to be linked to district and provincial levels of government and donor programs.

□ Activate CDCs in insecure areas as security returns. A large number of CDCs in the south and east were established when these areas were secure. NSP has started to implement a high risk strategy to remain engaged or re-engage in insecure areas. This strategy needs to be further operationalized to ensure that CDCs can be quickly activated when the situation becomes stable.

□ Increase jobs and incomes. To achieve long term stability and prosperity in Afghanistan, it is important that the successes in the community level institution building and village level infrastructure are matched with poverty reduction and sustainable job creation in the rural areas where most of the population lives and where the problems of poverty and unemployment are particularly severe. NSP constituents and members of CDCs have emphasized more needs to be done, especially in the area of job creation and livelihoods

□ Tackle the opium economy. Given past experience and the size of the opium economy, although there are no easy answers for tackling this challenge. Increasing productivity and growth in non-opium agriculture will be crucial to eventually eliminate the opium economy. However, because of the large profitability differences between opium and other crops, this will also require the promotion of alternative non-farm livelihoods.

Context

Country Context: Over 75% of the people of Afghanistan live in rural areas where agriculture is the primary activity and has contributed app. 40% of GDP (excluding the opium economy) over the 2002-2008 period. Years of conflict have left communities fragmented and poverty and vulnerability in the rural areas remains widespread. Key findings of the Government's 2007 National Risk and Vulnerability Assessment (NRVA) indicate that the poverty rate is 42 % (app. 12 million people), with per capita incomes of app. US\$ 14 per month. Furthermore, the NRVA estimates that food poverty affects 45 % of the total population and well over half of the rural population. These vulnerable people had food expenditures less than that required to purchase adequate calories (2100 calories/person/day). Furthermore, weak governance, poor infrastructure, some of the lowest human development indicators in the world continues to perpetuate poverty.

National Solidarity Program (NSP): The NSP is the flagship project of the GoA, helping the government deliver urgently needed services to its rural population. NSP was founded on

the principles of grassroots democracy and community-driven development and as such, NSP not only provides community-based infrastructure in a demand-driven manner, but also facilitates local governance. NSP follows a bottom-up community driven approach, whereby communities develop their own community development plans and prioritize their needs. Facilitating Partners ((FPs) national and international NGOs) are contracted by NSP for this work and they are crucial in this community development planning process, ensuring participatory rural appraisal techniques are used and that the voices of the poor and marginalized are taken into consideration. Separate women's groups are also formed to ensure that women's priorities are included. Since its inception in 2003, the NSP has established over 22,000 democratically elected CDCs at the village level reaching a rural population of 19 million. Approximately US\$ 700 million has been disbursed directly to communities through NSP for implementation of community prioritized projects. These CDCs have all developed Community Development Plans and submitted over 48,000 sub project proposals for funding. Of these nearly 35,000 have been completed and the rest are under implementation. Projects implemented by communities through NSP include: water supply and sanitation (24 percent); rural roads (25 percent); irrigation (18 percent); village electrification (13 percent); education facilities (12 percent); and others (8 percent). An economic analysis shows that the economic rate of returns (ERR) on these projects are high with an overall ERR of 18.9% for all sub-projects across the four main sectors. In addition, an independent randomized impact evaluation of NSP is currently being carried out and early results following a baseline and a follow-on survey reveal positive and substantial impact on several indicators of governance, access to services, gender and behavior, and legitimacy of the government.

Afghanistan Rural Enterprise Development Program (AREDP): AREDP is the Government of Afghanistan's response to tackling the issues of unemployment and opium production in the country and address market failures for business development and financial services for rural enterprises. It is planned to be a national program to jump start private sector growth in rural Afghanistan. It aims to strengthen community-based enterprises by supplying them with business knowledge and building their financial capacity, for private sector SME's to support them with business advisory services and to connect them to available credit and other financial services.

Issues and Challenges

Funding the next phase of NSP: The funding requirement to complete the national roll-out

and provide another block grant to qualifying communities, is estimated at \$2 billion. In the past, program implementation has suffered from over-commitments and lagging donor funding which has led to frustrations with the FPs and diminishing trust from the CDCs. Going forward, it is essential that more prudent financial planning is exercised. Currently, there are promising indications from donors, in particular the US, that they are interested to fund the program.

Agreement on sub-national governance arrangements: There have been counter-currents within the government and the donor community on the way forward for sub-national governance. Recently the Independent Directorate for Local Governance (IDLG) has agreed that until such time when village council elections can be held, the CDCs can be the governance and development platform in the communities. However there is still concern that the Afghanistan Social Outreach Program (ASOP) might undermine gains made on inclusiveness, transparency, and governance through its Community Councils which meet at district level and are made up of appointed representatives that receive a stipend and a small development budget.

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Alternative Arrangements for Working in Insecure Areas: Several FPs work in the more insecure parts of the country (South and East) and as a result have had to adapt their implementation strategy slightly to suit this context. In highly insecure provinces like Farrah and Kandahar, FPs have had to operate from provincial or district centers to ensure the safety of their staff and minimize travel. FPs also rely more on staff recruited from within the communities even though their capacities are well below what is required. This kind of flexibility in implementation has allowed NSP to cover a larger part of the country and to continue implementation even in an insecure environment. NSP has recently formalized the high risk strategy based on what was already being practiced by FPs working in insecure areas. This strategy is currently being tested in Kandahar and it is still too early to determine if it is effective.

Increasing Accountability through internal systems and external verification: The success and visibility of NSP makes it necessary for the program to develop reliable mechanisms to ensure accountability and proper use of funds. This can be achieved through stronger internal controls, a robust financial system and a regular external audits. In addition, and perhaps most reliable are social audits and

community participatory monitoring (CPM). Although this is not yet mainstreamed throughout NSP, social audits and CPM also help reinforce the idea of downward and horizontal accountability. Social audits allow communities to openly question and challenge the project expenses made by the CDC, allowing any doubts regarding project expenses to be cleared up openly. This process not only challenges the CDC members but also would expose any corruption on the part of the Provincial Management Unit of NSP or FP staff.

Bank's Role

□ Majority of the funding now comes through the ARTF but the donor community continues to regard the Bank as the lead donor for the NSP and instrumental during the design and supervision phases. The Bank has provided continuous leadership since the inception of the program and the team has always been led from the Kabul office which is an important factor in the program's success. The size, growing complexity, and increased scrutiny by the public and the donor community will place heavy demands on the team. The preparation of NSP-III is currently underway with appraisal scheduled for March 2010 and Board presentation in June 2010.

□ Through its support to the AREDP, the Bank will focus on improving employment, income of men and women in the rural areas, and sustainability of targeted local enterprises. These objectives are to be achieved by enhancing participation of the rural poor in economic activities, supporting them through business development services and access to finance, and improving market linkages and value chains. The project has been negotiated and is currently scheduled to go to the Bank's Board on March 2, 2010.

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INFRASTRUCTURE AND ECONOMIC DEVELOPMENT

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Water

Priorities for Action

□ Develop legal/institutional frameworks for clear division of roles and responsibilities among the several water-related institutions (e.g. as related to water planning; water infrastructure development, financing, implementation, and operation; demand management; applied research; irrigation and on-farm management; conjunctive use of surface and ground water resources; stakeholder participation; water rights, etc.).

□ Develop an appropriate knowledge base (e.g. GIS based) of river basin and projects, as well as analytical tools (e.g. models/ decision support systems) to help analyze projects in a multi-sectoral basin context.

□ Improve the capacity of GoA institutions on a number of aspects, including: Overall water resources coordination (strengthening Supreme Council for Water Management (SCWAM) and its secretariat); Water Resources Planning /Basin Planning (the Water Resources Planning Unit at MEW; emerging Basin Organizations); Water Project Preparation (the Project Planning Unit at MEW); Water Project Financing (MoF, MEW); international waters issues (proposed multi-disciplinary International Waters team that is critically needed). There will be a need to find the resources to hire and retain the best available young Afghan talent to be assigned to these teams and grow with the capacity-building experiences to be the water leaders of tomorrow.

□ Prepare to mobilize substantial investments that are essential for power and irrigation, especially backed by multi-purpose storage to ensure meaningful and sustainable growth. This will require the development of a good pipeline of well-conceived investments that have been analyzed in a multi-sectoral basin perspective and prepared to good quality standards. This will also require the GoA to have effective dialogues with development partners to ensure financing commitments for these long-lead projects and for developing a shared vision of the development priorities.

Context

Afghanistan is now at a critical juncture in its water resources development. Post-conflict reconstruction in the water sector has focused on rehabilitation of destroyed or dilapidated assets. Despite progress made on the institutional front, the Government of Afghanistan faces serious challenges to ensure an adequate

development in the Water Sector. New water resources development investments are needed for meeting increasing demands for domestic and industrial water supply, irrigation, hydropower, and other needs of its growing population and economy.

The GoA has started preparation of a number of small, medium, and large water projects (e.g. for much-needed new investments in storage, irrigation, hydropower) in all the major river basins of the country. However, unlike the successful program of small-scale asset rehabilitation in the water sector, there has not been significant progress in new water resources development. This is due to currently limited efforts at multi-sectoral basin planning to optimize investments, as well as a poor pipeline of well-prepared, bankable larger-scale projects.

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Inter-sectoral coordination has been enhanced with the establishment of SCWAM that incorporates the Ministers of key water-related ministries (Energy and Water; Agriculture, Irrigation, and Livestock; Agriculture and Animal Husbandry; Urban Development; Mining and Industry; and National Environment Protection Agency) and is headed by the First Vice-President of Afghanistan. The Afghanistan National Development Strategy (ANDS) is clear in its emphasis on developing an integrated water strategy and GoA has initiated the process of forming and mainstreaming basin organizations. GoA has also initiated the development of in-house multi-sector water planning capacity through the establishment of a Water Resources Planning Unit (WRPU) in the Ministry of Energy and Water (MEW).

Issues and Challenges

Afghanistan currently has a very low level of development of its water resources, and correspondingly low levels of water-related services, including urban and rural water supplies, irrigation, hydropower, and other uses. In Kabul, a major city and one of the fastest growing in Asia, the current water production per capita is approximately 16 liters per person per day and is declining – one of the lowest for any city in the world. About 80% of Afghanistan's population is rural, and about 80% of the country's population is engaged primarily in agriculture. The farmers' traditional irrigation schemes have suffered from social disruption and breakdown of established systems of maintenance and repair. Overall, irrigated area in Afghanistan has fallen from a peak of over 3 m ha to less than 1 m ha.

The fundamental constraint in the water sector is the limited capacity in GoA for

planning, managing and implementation of a multi-sectoral water investment program. New projects are often conceived and prepared in isolation by the different water-related ministries. Given the inter-linked nature of river basins, this fragmented approach could result in very sub-optimal development, where some of the planned investments could severely impact the viability of (or foreclose) other planned investments. Furthermore, progress has also been hampered by the lack of comprehensive basin plans with prioritized and costed investments. A major task for nation-building today is allocating the available development resources for water resources investment options in different provinces of the country, through a systematic consideration of provincial needs and opportunities in the basins and balancing them in the context of national development. The Afghanistan National Development Strategy (ANDS) emphasizes the need to focus strategically on addressing the capacity constraint at the two main levels – integrated water resources management and improving the quality of project preparation. This will require building up a shared knowledge base and analytical tools for basin planning and management, as well as improved project preparation from a multi-sectoral basin perspective.

A primary related issue confronting the water sector and the key stakeholders in Afghanistan is the lack of a common vision on how to develop and utilize water resources in the country across key stakeholders (e.g. government agencies, major types of water users, civil society, the Parliament, academia, development partners, etc.).

Another major challenge is the fact that all its rivers belong to trans-boundary basins. Water resource development in Afghanistan hinges critically on establishing cooperative agreements with other riparian countries. A concerted effort is required to build GoA capacity in trans-boundary water assessment, notification, negotiations, and treaty development. This will not only facilitate the preparation and financing of larger-scale projects in Afghanistan, but also improve regional cooperation.

Another challenge that looms ahead is that of climate change that threatens to accelerate glacial melt, reduce snow accumulation and melt, increase crop water requirements and evaporation, and exacerbate droughts and floods. There is a need to improve GoA capacity to address this challenge in a structured manner. Environmental issues of pollution (e.g. from the proposed Aynak mine) and groundwater management are also critical to the water sector in the country. There is a strong need for improved

hydro-meteorological systems throughout Afghanistan. Academia needs strengthening to produce a new generation of water professionals and improve targeted water research.

Bank's Role

The Bank already has a technical assistance program in support of key components of the recommendations under a 5 year Afghanistan Water Resources Development (AWARD) Technical Assistant Project. The first phase funded by ARTF has just started. This follows an AAA on Strategic Water Resources Planning in Afghanistan focused on the Kabul Basin that is completed and is now being disseminated. The AWARD TA is designed to help build GoA capacity in three areas: (i) Basin Planning with the Water Resources Planning Unit in MEW, (ii) Project Preparation with the Project Preparation Unit in MEW, and (iii) International Waters capacity building. In addition under the IDA program in the current fiscal year, Bank has provisioned a US \$ 35 million follow up project on Irrigation Rehabilitation. The Bank is ready to assist in advancing further on all recommendations in coordination with other development partners.

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Information and Communication Technologies (ICT)

Priorities for Action

Privatize state telecommunications assets while protecting competition. The Government should privatize Afghan Telecom, owner of the largest fiber optic backbone network, and its 20 percent stake in AWCC to strategic investors. Privatization will support Afghan Telecom's financial sustainability and realize the value of these assets. Simultaneously, it is critical to maintain a level playing field in the market and open access to the backbone network infrastructure at reasonable tariffs. This is important because Afghan Telecom is the only unified license holder, operates the only wireline network in the country, and will have control of the largest backbone network. Hence, privatization must take place alongside tariff regulation for the backbone network and equalization of the licenses.

Reform the regulatory regime and use the Telecommunications Development Fund (TDF) to promote Internet services. The Ministry of Communications and Information Technology (MCIT) and Afghanistan Telecommunications Regulatory Authority (ATRA) should design a policy and regulatory environment that promotes access to and use of Internet services. This will require addressing different regulatory issues such as convergence, licensing, radio spectrum management, and interconnection. The

regulatory regime should permit all services offered by a technology. Quick and transparent disbursements of the TDF should offer strategic support for network rollout. Internet policy should also include demand-facilitation measures to make Internet services more affordable and relevant to Afghans.

Coordinate and implement e-Government services. Given that ICT is a crosscutting enabler of government transformation, the National ICT Council should be more proactive as an e-Government coordinating body that works closely with the MCIT to identify and pilot services. These services could include both internal administrative tasks such as civil registries and citizen-facing services such as drivers' license applications or tax returns. These services should also be offered through various channels, including the Internet and mobile telephone. For this, regulation of mobile telephone based services such as mobile money transfer should be simplified. Moreover, these e-Government services should build on earlier MCIT initiatives including the e-Government interoperability framework and national data center, so that these resources are utilized fully and duplication is avoided.

Deepen the legal and regulatory capacity of MCIT and ATRA. Sufficient financial and technical resources for regulatory capacity building should be earmarked to train staff in international best practices. The Government should also simplify the administrative processes for appropriate staff of MCIT and ATRA to attend regional and international training and capacity building programs. This will allow Afghanistan to address the complex and fast-changing ICT sector to enable further private investment and sector growth.

Context

After initial successes, the Government has a key role in enabling the next stage of sector growth. The ICT sector has performed very well due to Government leadership and the creation of a policy and regulatory environment that enables competition and private investment. Now, Afghanistan has the opportunity to leverage the extensive mobile telephone platform for service delivery, promote Internet services, and implement electronic services.

Afghanistan has seen rapid growth in its telecommunications sector. There are now over 13 million telephone subscriptions, equal to about 43 percent of the population. This compares favorably with neighboring countries such as India (45 percent of population), Pakistan (58 percent), and Bangladesh (31

18

percent). Efforts by both the Government and private telecommunications firms have extended connectivity nationally. Private investments in the sector have crossed US\$1 billion; they are set to grow further as networks expand into previously un-covered areas.

There has been progress in developing the framework for e-Government scores

e-

0.42

Government services. The Government sees the potential for ICT to

0.41

Source: UNPAN, 2008

0.38

extend the reach and quality of public services. It also recognizes

0.32

0.29

0.27

the potential for improved government function through the

0.20

integration of ICT in internal business processes. To these ends, the MCIT has plans to introduce a range of e-services as part of its e-Afghanistan agenda. However, Afghanistan has more to do to catch

Sri Lanka

Iran

India

Pakistan

Bangladesh

Nepal

Afghanistan

up with regional peers: in the 2008 UN Public Administration Network (UNPAN) e-Government Survey Afghanistan ranked 167 of 182 countries, scoring less than its neighbors do (see Chart). The MCIT has put in place some important enablers, such as the data center and an e-Government interoperability framework. However, there is a need to better utilize these enablers.

The widespread mobile telephone network is a service delivery platform. Much of the population lives in areas covered by mobile telephone service. This platform can deliver services to the public and help monitor the progress of development projects. Such "m-applications" hold great promise because this is most widely spread platform in the country. Efforts have begun in this direction; one service provider has launched mobile-telephone based banking services that have been successful in the Philippines, Kenya, and South Africa. Other potential services include health information and educational services.

Issues and Challenges

Uncertainty about Afghan Telecom's future calls into question gains in national infrastructure development. State-owned Afghan Telecom remains in a precarious financial position with revenues only slowly recovering costs and long-standing debts. It remains bound by the procurement rules and operational terms of government agencies. Consequently, it is unable to compete effectively with the private companies. This matters because major national infrastructure such as the backbone network and the fixed line telephone network are under the care of Afghan Telecom. It cannot maintain these important networks without adequate resources, and privatization under stress will only

reduce the value of the public assets or force conditions that harm the competitive playing field in the market.

□ Ability of regulatory frameworks to respond to sector developments is limited. The telecommunications sector is continuously evolving in both its technology and business models. However, Afghanistan's regulatory frameworks are slow to respond. For instance, the convergence between telecommunications and data services can improve the reach and viability of both telephone and Internet services through technologies such as voice over Internet protocol (VoIP). But regulation does not permit this, cutting potential investments and missing growth opportunities.

Challenges remain in connecting the poorest Afghans. Telephone services remain out of reach for the poorest Afghans and for rural and remote areas. Afghanistan also lags in the use of Internet services. Internet users number only 2 percent of the population while the MDG target for 2015 is 20 percent. It is now technologically possible to provide telephone service over the Internet; Internet telephony reduces the costs of service while making the Internet business more viable due to the high demand for telephone

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service. The Government should strategically use resources available in the Telecommunications Development Fund (TDF) to cut the costs of network deployment and to make services more affordable. The Government should also consider simplifying the award process for TDF-financed programs, while maintaining transparency and accountability.

□ There are significant supply-side constraints to the growth of the Internet. A number of factors also hold back adoption of Internet services. These include supply-side constraints such as the: (1) high cost of connectivity to smaller cities and rural areas; (2) limited wireline telephone network; (3) near absence of cable television and wireless broadband networks; and (4) limited reach of electricity.

□ E-Government and other e-services face demand-side limitations. Demand-side constraints could hamper use of e-services even if networks are built. These include (1) low rates of literacy that limit the use of text-based services; (2) very low penetration of data-capable user devices such as smart phones (about 0.1 percent of the population) and computers; and (3) lack of relevant content and applications that make

Internet use

valuable and useful for Afghans. These demand-side constraints form a vicious circle and need to be resolved in order to spur the adoption of e-services and wider Internet services. The National ICT Council could act as a coordinating body to implement e-Government services through close collaboration with public, private, and civil society agencies. However, it has remained dormant.

World Bank's role

□ The World Bank Group has multi dimensional involvement in the Afghan ICT sector that is adapt to fit new priorities and focus areas. There is an ongoing policy dialogue with MCIT and ATRA on Internet policy, universal service, e-government and m-applications, and capacity building. The strategic objective is to help MCIT and ATRA design policies and programs to increase access to affordable Internet services. The World Bank is also working with a range of Ministries to mainstream the use of m-applications and improve rural livelihoods. The team is also identifying specific and strategic actions for the Government that support the development of m-applications in Afghanistan.

The World Bank's Emergency Communications Development Project (ECDP), which closed in September 2009, helped build vital communications infrastructure for government communications, supported policy reforms such as liberalization of the telecommunications market, and assisted in setting up the legal and regulatory frameworks. The ARTF supported the construction of a satellite earth station in Kabul. The IFC has also signed a deal with mobile telephone company MTN Afghanistan for a \$65-million loan and \$10-million in equity to support the expansion of the company's mobile telephone network and meet growing demand for affordable service. MIGA has also issued a guarantee of \$76.5 million to MTN that protects its investments against the risks of transfer restriction and expropriation.

Priorities for Action

□ A plan for environmental and social safeguards for Aynak mine and associated developments needs to be designed and then put in place before

construction on the mine
begins.

including ☐ Training programs to build capacity in mine and mine related employment,
provision of goods and services, is urgently required.

investments that will ☐ The new mine developments will result in very large infrastructure
are undertaken have economy wide repercussions. It is important that these investments
other in the context of local and regional development plans and complement
infrastructure investments underway or planned in the country.

needs updating and ☐ A plan for better understanding of gas reserves and their utilization
will require well logging to provide relevant data.

candidate ☐ The GoA has to fulfill the various obligations necessary to become an EITI
taxation and country and the Ministry of Finance needs to build capacity in sector
revenue management.

to be tackled— ☐ All of these developments and activities—completed, in progress, or soon
Afghanistan will prepare minerals and hydrocarbons to be among the leading sectors in
earnings, and for formal sector employment, fiscal revenue generation, foreign exchange
in leading the technical capacity building. Ultimately, they should play a critical role
growth process for the country.

Context

Afghanistan had made good progress in its extractive industries sector, particularly
mining. The regulatory framework is nearing completion, there has been significant progress in
institution building on the technical aspects of mining, and the first stages of the development of a world class
copper mine at Aynak are under way. Aynak and Hajigak—a world class iron ore deposit currently up for
tender—should make a very significant contribution to the fiscal revenues of the GoA. Estimates—
excluding the income or consumption taxes paid by mine workers or suppliers—are between US\$ 400 million
and US\$ 700 million per year compared to GoA domestic revenue of US\$ 670 million in 2007–08.

Nevertheless, if Afghanistan is going to fully benefit from this progress and use the
mining sector to propel growth rather than just as a source of fiscal revenues, further advances are
required. For the mining sector to make a sustainable contribution to the socio-economic development of the
country, it

will be necessary to undertake policies and programs (or implement existing ones) that will: (i) increase the participation of Afghani workers and businesses in the sector, and (ii) control possible negative environmental and socio-cultural externalities.

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Key mineral resources consist of:

- Two known world class deposits: Aynak copper and Hajigak iron ore.
- Several potential greenfield copper and iron ore sites.
- Extensive coal resources.
- Industrial minerals (limestone, aggregate, dimension).
- Artisanal, small-scale mining (gemstones, gold), which are a major employment creator in short-run with estimates of up to 100,000 jobs in this sub-sector.

The biggest development in the Afghanistan mineral sector has been the successful tender of the Aynak copper deposit, one of the largest in the world, by the GoA with support from the World Bank. Successful conclusion of the main agreement has already resulted in a payment of US\$ 80.8 million to GoA as the first tranche of a US\$ 808 million premium for the right to develop the deposit and a sliding scale of royalties, which peak at 19.5% at the relatively modest goal of \$2 per pound of copper. Due to the success of the Aynak tender, the GoA has begun the tender process for the Hajigak iron ore deposit, the largest in Asia, as well as three petroleum blocks. In addition, on March 16, 2009 the GoA has endorsed the principles of the Extractive Industries Transparency Initiative (EITI).

World Bank's Role

The Sustainable Development of Natural Resources Project (SDNRP) was launched by the Government of Afghanistan in 2006 to 1) provide financial and technical assistance to the Ministry of Mines (MoM), 2) improve its capacity to effectively regulate Afghanistan's minerals and hydrocarbon resources sector in a transparent manner, and 3) foster private investment in the sector. It was designed to support MoM in developing and implementing a plan for MoM's transition from being a producer of minerals and other commodities to a policy-maker and regulator. The IDA grant for this project, in the amount of US\$ 30 million was approved by the Board of the World Bank on June 20, 2006 and became effective on September 20, 2006 with additional financing of US\$ 10 million approved in 2009.

Most of the efforts of the SDNRP have been focused on developing the regulatory capacity of the MoM with respect to mining and preparing the tenders of, first, the Aynak copper deposit and, more recently, the Hajigak iron ore deposit. With respect to the first task, developing regulatory capacity, the project has helped to establish within MoM the regulatory functions necessary to supervise the sector, such as the cadastre, mining inspectorate, and environmental departments. Mining and petroleum regulations have been drafted and are waiting passage through the Ministry of Justice. The SDNRP project will continue until 2011. The main thrusts of this work will be the development of the Afghanistan Geological Survey and capacity building in the Ministry of Mines, particularly with respect to the cadastre and the mining inspectorate.

A new project is being prepared for the extractive industries sectors to go to the World Bank board in late spring 2010 (approximately US\$ 40-60 million). The objective of the proposed project (SDNRP-II) is to sustain achievements to date by further building sector governance, attracting additional FDI through new international offerings, and deepening economic linkages within resource corridors. An important part of the work will be to strengthen Aynak and Hajigak outcomes by enforcing regulatory monitoring and contractual compliance around Aynak and Hajigak, while strengthening linkages into the broader economy through public-private partnerships around ancillary infrastructure development.

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In parallel with the new project development is proposed mining sector economic and sector work (ESW). This ESW will analyze if and how the Afghanistan mining sector could be the main driver of economic growth for the country in the medium-term. The main strategic objective is to provide the GoA with the information required for the formulation and implementation of policies and programs in the MLS in order to maximize the potential of this sector. A complementary ESW is also being proposed by the private sector division for South Asia on private sector development in areas with large-scale industrial mining. This study would collect information on how large mining operations function, the types of goods and services they need, and the skill requirements. This would be followed by an analysis of what exists now in Afghanistan that could satisfy such needs (goods, services and skills), what could be fairly easily adapted, what could be developed with short-term training, and what needs to be, more or less, begun from scratch.

Finally, funding for EITI implementation will be partially available from the current

SDNRP project and partially from the EITI MDTF. The MoF is also taking some steps to secure more funding for EITI from other donors operating in Afghanistan

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Power Sector

Priorities for Action

- Expand Electricity Access. Government needs to develop a prioritized investment plan and implementation strategy to achieve the ANDS targets of electricity access, and to secure Donor support and funding for the strategy. A two-pronged strategy is recommended, with one prong aimed at stimulating industrial growth and commercial activity in the larger urban centers and the second prong to improve livelihoods and human development in rural areas. Achieving the objectives of the first prong will involve continued expansion of the electricity grid, alleviation of power shortages (by expanding power generation and imports), and lowering of supply cost (through substitution of high-cost imported oil-based generation with lower cost imports and generation based on indigenous energy resources). The second prong would support off-grid decentralized solutions for lighting and other productive activities, build upon the MRRD's community-based National Solidarity Program.
- Increase Electricity Supply and Improve Supply Security. Government needs to develop and prioritize a multi-pronged strategy, one which builds on Afghanistan's successful import of competitively-priced electricity from Iran, Turkmenistan and most recently from Uzbekistan, its rehabilitation of existing hydro plants, and the development of limited oil-based plants for back-up and emergency supply. Afghanistan needs to develop its indigenous energy resources. While its natural gas resources (at Sheberghan) are well suited to meet the country's winter needs as is surplus power from the coal-based plant being built by the developer of the Aynak copper mine, its water resources can contribute to food security and hydropower. Afghanistan can leverage its position as a transit country for Central Asia's energy resources to meet its and Pakistan's energy demand (the CASA-1300 project is a priority). Surplus electricity, in

future, may be

and its safe operation demonstrated.

□ Restore Financial Viability and Institute Demand-side energy efficiency measures.

Through a combination of better energy management systems (including metering), cost-recovery pricing and systematic strengthening of sector governance (including through the DABS corporatization process), the Government will need to restore the financial viability of the power sector (currently cost-recovery from end-user tariffs is about 65 %). In parallel, energy efficiency measures in large buildings, energy intensive industry, lighting, etc., need to be undertaken on a priority basis for both, lowering consumers' energy bills and allowing optimal utilization of scarce energy.

□ Institutional capacity building. The institutions involved in building, operating and managing the power infrastructure will need capable human resources and management/governance systems to achieve and sustain the ambitious sector goals. The strengthening of newly created national power utility (DABS), helping enhance its efficiency, accountability and commercial sustainability is most critical. In parallel, the Ministries of Energy and Water and Rural Rehabilitation and Development need to be strengthened to manage implementation of vast agenda.

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Context

□ The poor condition of Afghanistan's power supply infrastructure and institutions, combined with its underdeveloped primary energy resources, is a major impediment to the country's economic growth and the Government's efforts to alleviate poverty and establish its credibility. The World Bank enterprise survey 2008 cites electricity availability as one of the most pressing constraints hindering private sector businesses. Afghans have placed electricity as one of the top three concerns in the last four years, ahead of education and health in the surveys.

□ The Afghanistan National Development Strategy (ANDS) core targets over the medium-

term, for the power sector, is for the electricity supply to reach at least 65 percent of households and 90 percent of non-residential establishments in major urban areas and at least 25 percent of households in rural areas. However, as per the National Vulnerability Assessment data for the year 2008, only 20% of the total population and 6% of the rural population has access to grid electricity.

□ However, the system transmission and distribution losses (estimated by DABS around 44 % in Afghan year 1387 – ending March 2008) and the power generation costs with significant proportion from diesel based thermal plants are high (around USD 40 cents per kWh) and the collections are low. The tariffs for most of the Kabul consumers, which constitute about 40% of the total consumer base of DABS, do not cover the cost of power supply, even though tariffs, except for low end consumers³, are high – ranging from US 12 cents to 20 cents.

□ Sector Institutions need to be strengthened with leadership from nationals, who will provide continuity in implementing the vision and plans. It is critical for the success of the ongoing and new efforts to develop a strong national human resources team to strategize and perform at par with high quality international peers.

Issues and Challenges

□ Achieving electricity access goals in an effective and sustainable manner will require the coordinated strengthening of the state's institutional capacity (to plan, construct and operate energy investments) along with the financing of priority investments. Figure below shows the subcomponents of the improvements needed to meet the goals of the Afghanistan power sector strategy. In order to increase capacity on the grid, investments are needed in generation (local or imported), transmission and distribution infrastructure. Investments in energy efficiency programs will facilitate the optimal utilization of this capacity, especially since improvements in transmission and distribution networks will also increase the number of grid connections. These improvements should not be limited to building physical assets, but must also include analysis of delivery models and financing schemes. Similarly, development of off-grid access will require investment in off-grid power systems and also models for rural power service

delivery and its sustainability.

3

Low end consumers (up to 300 unit consumption) are charged at 3 US cents.

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GoA Target:
Improve electricity access

Increase	Increase	Increase
off-grid	electricity	grid
access	capacity	connections

Increase generation (local and imports)- fuel security & affordability	Energy efficiency measures	Expand/Improve T&D networks & services
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Subcomponents of strategy to improve electricity access in Afghanistan

Banks' Role

The Bank is leveraging its knowledge of Afghanistan's energy sector and challenges, and the continuous presence of sector specialists in the country over the last 5 years, to coordinate donor support, strengthen the Government's institutional capability in the sector, and finance the critical "missing links" on the investment side to ensure that country and donor supported efforts result in improved electricity services for betterment of lives and livelihoods. The rehabilitation of the largest hydro power project at Naghlu, linking North East Power System (NEPS) with Kabul city network, Rehabilitation of Medium and some low Voltage network in Kabul and community access through NSP is supported by the Bank, besides ARTF funded hydro generation plant at Mahipar and distribution rehabilitation and transmission augmentation projects of key urban centres located on NEPS. Shaping corporatization of DABS, assessment of energy efficiency opportunities and exploring options to complement DABS in increasing grid based access are some areas Bank has been supporting the Government.

The team would be working with IROA counterparts in selecting appropriate strategies for realizing the

ANDS outcomes in most cost effective and sustainable manner. The key areas to work will be on enabling Afghan National capacity to take key decisions rightly; and help them focus on achieving strategic outcomes.

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Transport

Priorities for Action

- ☐ Develop legal/institutional frameworks for clear division of roles and responsibilities among the several transport-related ministries with the possibility of merging ministries
- ☐ Consider the organization of the transport sector into authorities/agencies for the management of the sub-sectors: roads, aviation, railways
- ☐ Develop a sustainable financing mechanism for road maintenance
- ☐ Conduct a long-term study of transport demand and review the national transport strategy including one for railways before developing a national transport plan.
- ☐ Pursue regional integration of Afghanistan with its neighbors

Context

The legacy of conflict over the last 30 years left the country's transportation system in a very poor condition. Afghanistan's transport system comprises road, rail, air, and inland waterways. Since then, the donors have helped improve key infrastructure, especially roads. About 86% of the regional road network is scheduled to be operational by end 2009 with the remainder to be completed by 2010. Work is underway or funding has been obtained for the remaining regional roads, with the exception of a 50 km section east of Herat. The improved roads include almost 2,100 km (63%) of regional roads, 650 km (14%) of national roads, and 6,000 km of provincial and rural roads. Roads serve 90% of the national and regional travel demand. The total length of railways is 25 km, which are cross-border extensions from Turkmenistan and Uzbekistan to transshipment yards in Torghandi and Hairatan, respectively (about 10 km and 15 km from the respective borders). Inland waterways are limited to the Amu Darya and its tributaries although only the formal inland port at Shirkhan Bandar is operational at present. There are more than 60 airports and airfields spread across the country. There are two international and 22 domestic airports that meet International Civil Aviation Organization (ICAO) Class 4 categorization standards (runway length 1,800 m or greater). By 2010, the Kabul International Airport and Heart Airport are expected to achieve full international ICAO compliance while Mazar-e-Sharif, Jalalabad, and Kandahar

airports will be upgraded.

At the end of 2001, more than 90% of the transport system was unconnected and was in poor condition. Intraregional trade is growing but remains seriously constrained because of limited transport infrastructure and facilities. Trade is increasing between Afghanistan and Pakistan, Iran, and Central Asia. Annual growth rates exceed 10%. Total trade is now valued at \$3.5 billion, of which \$500 million are exports and \$3 billion imports. Afghanistan is the crucial link for Central Asia to access South Asian markets. It is also a conduit to access warm-water ports in Pakistan and on the Caspian Sea for trade with Europe and the Middle East. Fostering regional connectivity will help countries increase investment, trade, and employment.

Most border roads connecting Afghanistan with Uzbekistan, Iran, Pakistan, Tajikistan, and Turkmenistan are in bad shape. The Central Asia Regional Economic Cooperation Program (CAREC) has a strategy and action plan for six transport corridors across the region and the development of railway networks in selected countries. These rail networks will complement the road corridors and, in many instances, feed into port and airport networks. A priority railway network under CAREC is in Afghanistan. This has three main sections: (i) Hairatan to Mazar-e-Sharif, (ii) Mazar-e-Sharif to Herat, and (iii) Mazar-e-Sharif to Tajikistan. Later, other routes will include Chaman, border line between Pakistan and Afghanistan, to Kandahar. A railway line between Sangam in Iran and Herat is under construction with Iranian assistance. The first section of the northern network will be a new railway line from Afghanistan border town of

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Hairatan to Mazar-e-Sharif, to be financed by the Asian Development Bank (ADB). Automated customs and data systems (ASYCUDA) have been initiated that will reduce transit times and encourage promote trade, and aid in tracking customs collections.

Rail services at Hairatan move about 250 wagons a day, while in Torghandi it is about 50 wagons a day. The major imports are petroleum products and humanitarian food aid and at Torghandi, scrap metal is transshipped by truck to Pakistan. There is little reverse traffic except for some seasonal fruit. The Kabul International Airport handled approximately 0.5 million international and domestic passengers in 2005, and civil aviation generated about \$40 million from commercial over flights and airport taxes.

In 2007, registered vehicles included over 300,000 cars, 40,000 buses, 100,000 trucks,

100,000

motorcycles, and 5,000 rickshaws. Vehicle numbers increased rapidly, with annual growth over the past 3 years of 23% for cars, 15% for trucks, 48% for motorcycles, but only 2% for buses and rickshaws. Virtually all vehicles are second-hand imports from Japan and Europe.

Domestic air passenger and freight services are provided by the state carrier and several private carriers. At least daily flights are available between Kabul and most cities. International services between Kabul and several Asian destinations are provided by both national and international carriers. Airport facilities are limited and in a poor state of repair. Besides Kabul, Mazar-e-Sharif is the only main airport due for major reconstruction and expansion. A new 3,000 meter runway is being constructed. About 600 meters of the existing runway are being repaired, including new taxiways. This will increase capacity for the intermodal flow of commercial goods.

A private foundation operates a passenger ferry three to four times daily to Tajikistan. Tajikistan's state-owned barge service ferries trucks a few times per day, depending on traffic. A road bridge across the Pyanzh River near Shirkhan Bandar was completed in 2007 with funding from the United States Agency for International Development. The traffic potential through this border crossing is significant and plans are being made for full border facilities.

Two hundred and fifty-three private bus companies—135 based in Kabul and 118 in the provinces—with a fleet of 38,568 buses operate intercity services on the regional and national roads. The remaining buses are 8- to 12-seat vans owned by individuals providing informal passenger transport services in the cities and connections between rural areas and towns. The only cross-border bus service is between Jalalabad and Peshawar. An estimated 45 million passenger trips were made by bus transport in 2005.

More than 150 registered taxi companies operate in the country—53 in Kabul with a fleet of 16,309 taxis and 108 in the provinces with a fleet of 30,248. In 2007, the taxi fares varied from \$0.01/km to \$0.03/km depending on various classes of passenger vehicles and terrain types for paved roads, whereas it varied from \$0.015/km to \$0.03/km for unpaved roads. Operators pay a 3% commission to the Government at provincial or national borders and at the outskirts of major towns.

Freight is carried primarily in private owned trucks. At the current freight volume levels, railways are not competitive enough to develop as they require higher capital investment per kilometer and carry higher operational costs. The truck population is approximately 20% heavy articulated trucks with the remaining

80% divided equally into heavy, medium, and light or pickup classes. Freight charges are approximately \$0.07/ton-km on paved roads and \$0.08/ton-km on unpaved roads. A 5% commission per trip is levied by the Government. There are no special transit charges and foreign trucks transporting freight through Afghanistan are charged the 5% commission only.

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Institutional and Regulatory Frameworks

Multiple government ministries are involved in operating and regulating the transport sector: Ministry of Public Works (MPW), Ministry of Transportation and Civil Aviation, Ministry of Urban Development (MOUD), Ministry of Rural Rehabilitation and Development (MRRD), and the Ministry of Interior (MOI). Local authorities are also involved. In the road subsector, MPW is assigned the responsibility for planning, designing, constructing, and maintaining regional, national, and provincial roads. MRRD is responsible for rural roads, and MOUD and the local authorities administer the urban roads. There have been discussions at a high level about governance of the sector transitioning to international best practices within the Afghan context. This was expected to be achieved by merging the MPW and the Ministry of Transportation and Civil Aviation, plus those units in MRRD, MOI, and MOUD dealing with transport into a single Ministry of Transport by the end of 2009 but this has been delayed.

MPW has a workforce of approximately 200 engineers and administrative staff, as well as 2,000 laborers at the regional maintenance centers and provinces. At present, however, it serves as administrator for donor-financed projects and executor of budget-financed minor construction and maintenance works. MOTCA issues operating and transit permits, sets technical standards and tariffs, collects road-user fees, and enforces standards and tariffs. It also provides passenger and freight transport services using state-owned vehicles. Legislation in 2008 has authorized the Government to provide nationwide freight and passenger services. MOI carries out vehicle registration and administers driver training, testing, and driver licensing.

Policy and Legal Frameworks

Afghanistan is yet to formulate a transport policy. However, the Afghanistan National Development Strategy, which was launched in April 2008, guides investment and reforms in the sector. In the road subsector, the MPW Strategy under the ANDS calls for investments to upgrade and maintain

the Ring

Road and roads to neighboring countries by the end of 2009, as well as to establish a fiscally sustainable system for road maintenance using private contractors as much as possible by 2008. Also, it calls for 40% of all villages to be connected by all-weather roads to the national road system and 40% of all roads in municipalities to be improved to a good standard by 2010. The current situation is that 86% of the regional road network is scheduled for completion by end-2008 and the remaining length will be completed by 2009 or 2010.

In addition to the Civil Aviation Law, Law of Highway Traffic, Law on Regulating Movement and Function of Land Transportation Vehicles, Law for Punishment of Transport Violators, and Law for International Transit and Transport, which have direct relevance to the sector, much new legislation affecting its performance has been enacted or existing laws amended in the past 5 years. Among these are the Environment Law, Law on Preservation of Historic and Cultural Artifacts, Customs Law, Procurement Law, and the Law on Taxing Driving Permits for Motor Vehicles.

Issues and Challenges

Achieving regional and in-country connectivity in an efficient and sustainable manner will require a coordinated strengthening and rationalization of the government's ministries which are involved in the transport sector. This needs to be accompanied by the financing of prioritized investments and a sustainable funding mechanism for the maintenance of infrastructure, in particular roads.

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Despite significant investments in capacity building and institutional strengthening in the key ministries, especially MPW and MRRD, there remain severe human resource constraints and the ministries are still not able to implement development programs without significant technical assistance. To overcome this will require a targeted capacity building program for staff and a merit-based human resource management.

The national contractor and engineering industries are fragmented and have limited capacity. Government has found it difficult to attract international contractors to lead civil works contracts. Most bids attract less than three bidders and in many cases, this has led to inflated prices. For ADB-funded contracts, the average cost of constructing one kilometer of new two-lane road with 3.5-meter (m) lanes and 1.5 m shoulders rose from \$371,000 per kilometer in mid 2006 to \$534,000 in November

2007. The corresponding average cost of rehabilitating (milling the old pavement and resurfacing) one kilometer of new two-lane road with 3.5 m lanes and 1.5 m shoulders rose from \$251,000/km in 2004 to \$287,000 in March 2007. USAID has experienced an even larger increase in the cost of national roads, rising from \$326,000/km in 2004 to \$1 million/km in 2007, and the cost of provincial roads increased from \$53,000/km in 2004 to \$186,000/km in 2007. Not all high costs are because of insecurity. Some cost increases are a result of the rising material prices, weak oversight, increasing risk of implementation delays, and lack of competition due to the small pool of contractors willing and able to work in the prevailing conditions.

Bank's role

The Bank has been mainly involved with the roads sector, and in particular rural roads. In addition, the Bank is successfully involved in the improvement of the Afghan customs administration. For the last three years the Bank has had transport staff based in the Kabul office and the customs program is closely managed from Islamabad. We have been the lead donor in these two areas while ADB, USAID, and the EC have taken the lead in the other transport areas and are giving substantial but sometimes overlapping support for institutional development.

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Urban Sector

Priorities for Action

Moving from Reconstruction to Service Delivery and Governance is a priority in urban Afghanistan. As a start, this note recommends a dual approach for targeting the governance of municipalities and improving the delivery of municipal services. Several programs targeting municipal governance (including the UNDP and the World Bank program focusing on accounting changes) have been piloted in Kabul and other municipalities. However, these require consolidation to ensure a unified approach across municipalities. For this, the IDLG will remain a key partner for the urban sector. (See Annex 1).

Infrastructure provision is crucial in all urban areas of Afghanistan. Provision and management of power and water are tackled through CAWSS and the Minister of Power and Energy. Providing community based infrastructure, through urban upgrading (including street lighting, water

reticulation systems, roads, drains, latrines, and solid waste management bins), has proved extremely successful through donor financing and should be expanded, both by scaling up current successful experiences in Kabul and by replicating them in other municipalities across the country. However, such a system now requires increasing integration into the municipal and utility service delivery systems.

Need for an integrated approach to Urban Development. Achieving the above objectives would, therefore, require an integrated approach tackling infrastructure together with capacity building, changes in institutional structures of municipal and other service delivery departments, to allow for a move from infrastructure to service delivery.

Context

The delivery of urban services are the responsibility of municipalities (roads & drains, municipal solid waste, sanitation and groundwater) and utilities (power and water). The management of urban areas is the responsibility of the self financing municipality with the Ministry of Urban Development (MoUD) setting the urban policy context and the IDLG in setting the municipalities fiscal and administrative policy context. However, the urban sector requires strategic leadership and management to allow for urban areas and municipalities to play their crucial role in Afghanistan's development. This leadership has been unclear in the midst of the lack of clarity on the role of the MoUD, the municipalities (especially Kabul Municipality) and the IDLG.

The lack of clarity has contributed to slow donor engagement in the sector. As an example, Bank financed urban projects under supervision performed poorly during implementation with numerous delays in start-up, procurement and required restructurings. The Kabul Urban Waste Management Project was even dropped from the pipeline due to poor government ownership. This is in spite of the fact that over the years Bank financed urban projects have constituted the largest contributor – over 50% per year between 1384 and 1385 – to the MoUD's development budget⁴. Other Donors have also expressed concerns on the management of the urban sector, but suggest that engagement outside Kabul is easier. A USAID financed US\$145 m municipal support project targeting 40 municipalities over 3 years (Technical Assistance + limited investments) could provide impetus for engagement and interest in the municipal urban agenda.

(Note that in 1384, the Ministry was allocated a budget of US\$10,8m of which US\$8,4m was allocated from the KURP. In 1385, the Ministry was allocated USD28,3m, of which 10,27 m was allocated from KURP4. In 1386, the Ministry was allocated US\$40m, of which US\$ 16m was allocated from KURP and US\$10m from the ARTF-UWSS. Data taken from Afghanistan Budget for various years.

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Issues and Challenges

The urban sector faces four main challenges: (i) residents face poor access to infrastructure services, (ii) governance issues affect the institutions delivering services, (iii) widespread lack of investment in basic infrastructure services, and (iv) a tight control on the distribution of land.

(i) Limited Access to Infrastructure:

The data related to infrastructure access in urban areas speak by themselves:

☐ Water. 9 in 10 urban residents access water through a system other than piped water and, for the remaining resident, supply time is short.

☐ Sanitation. 6 in 10 urban residents use traditional covered latrines which currently do not have a viable collection system.

☐ Roads and Access. 8 in 10 urban residents access their homes through unpaved roads or footpaths

☐ Power. 7 in 10 Kabul residents have access to power through DABM but supply time is short.

☐ Waste. At least 7 in 10 residents in Kabul do not have access to a municipal primary collection system for waste.

☐ Businesses cite power (64%) as the largest overall challenge, followed by telecommunications (26%) and transport (25%) in 10th and 11th place.

(ii) Weak Institutions for Service Delivery:

Services are currently delivered by a mixture of small scale private sector providers, municipalities, utilities and NGOs/community delivery of services, with some Donor support. Key current 'gaps' in enhancing effectiveness include: i) no current interventions in building municipal service delivery capacity; ii) no consideration of interlinking disparate service delivery types to ensure a service delivery system; and iii) payments and financing of service delivery is also a key issue.

Municipalities are arguably the most important institutions for local service delivery.

Like all institutions in Afghanistan, inadequate capacity, poor administration and corruption hamper increased effectiveness in delivering services. Poor capacity is exacerbated by the fact that educational qualifications of employees do not always match skills required, low salaries – Afg2700 to Afg 5600 in Kabul Municipality – and a lack of formal HR system which drives nepotistic hiring practices.

Poor administration starts at the national level with vague/contradictory legal framework for municipalities which deliver several urban services and is further exacerbated by centralized control of municipalities (by Mayors or even by Governors) and lack of systems of administration.

Corruption is also an issue; rated #3 in business constraints and with 46% of individuals who has paid or knows someone who paid a bribe to a municipal official for services, Afghanistan also ranked no. 179 out of 180 countries in the 2009 Corruption Perception Index by Transparency International. Municipalities are not immune and this phenomenon greatly affects the capacity to effectively deliver municipal services and infrastructures.

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Municipalities also face serious challenges related to fiscal transfers. In fact, central transfers can occur, but they are unpredictable, as there is no framework for transfers. Therefore, municipalities are mostly self financing, but capital investments are rare. Budgeting occurs, but is unrealistic and controlled by the Mayors.

Current Service Delivery Framework Other Systems

NgOs	NATIONAL GOVERNMENT
Service, Action, Extent	
Water, stand-alone distribution, small	
Sanitation, Collection, small	
State Utilities	
MSW, Collection, small	
(CAWSS, DABM)	
Community Based	
water, sewerage,	
Service, Action, Extent	
power	
SWM, Collection, Medium	
Sanitation, Collection, Medium)	
Power, Generation, Small (Microrayan	
Private sector Organizations	MUNICIPALITIES
Service, Action, Extent	(SWM, sanitation, roads, drains,
SWM, collection, small	water quality
Regional Branches	

Sanitation, collection, large
(Power, Generation/distribution, small (Ghazni)

Individual
Service, Action, Extent
Individual Suppliers
Sanitation, emptying, large)
(power)
Water, wells, large)
Power, generators, medium)

(iii) Lack of Investment:

The Infrastructure Investment Gap for Kabul alone is US\$1,173 million over the next five years.

However, actual investment has been minimal. Urban areas have been allocated only 2,5% of the national

US\$4,7 b budget between 1383-6. Municipal budgets are small resulting in per capita overall allocation

of only US\$7 in Kabul down through US\$2,5 in Jalalabad.

But investments in infrastructure are also seriously hampered by the governance challenges of the

institutions that deliver services

(iv) Tight Control of Land Distribution:

With the massive urban growth, the management of land is crucial and poor land management hinders

economic growth and individual security. Access to land is ranked #2 in major challenges facing

businesses and 70% of Kabul residents live in informal settlements – a reflection of poor land

management policies and practices. Release of serviced land, which requires planning and policy, is needed.

Land distribution does occur and there are designated lots which conform to government requirements,

rights of ways are protected etc. However, land distribution is controlled by warlords, with complicity of

government officials. This militates against a re-investment of profits for service delivery as profit is

privately appropriated. Illegal land management interests stymied efforts at strategic development and a

transparent planning and development control process. Tenure and security for residents is poor as

addressing this issue means addressing warlord land grabbing – a 'not so safe' agenda.

Also housing is

already delivered privately and for the most informally.

1. Municipalities deliver vital urban services and many, particularly the larger municipalities, have the potential to meet their service delivery and management mandates. They are historically financially self-reliant public entities and have managed to survive and provide some measure of continued services and municipal management even in war and political turmoil. Services provided include sanitation, solid waste management, roads, and also management of urban and municipal areas through planning, land development and environmental health interventions. As such, they are, arguably, the most important institutions for local service delivery in Afghanistan's sub-national system.
2. However, the municipal sector requires intensive action and attention to allow it to live up to its mandate and potential, due to numerous challenges that it faces. Challenges include poor service delivery frameworks and capacity, inadequate revenue and expenditure assignments and subsequent poor access to and management of funds, poor municipal governance (i.e. centralized power resting with the Mayor in contradiction to the Municipal Electoral Law, no rules of operation, no voice), a contradictory and confusing legal and operational framework, which leads to ineffective upward accountability and reporting relationships.
3. The lack of service delivery strategies in the face of post war and growth challenges have left swathes of the city with no service delivery (e.g. in Kabul, no solid waste collection service is delivered to informal settlements that cover 70% of the city). This is compounded by lack of competency in human resources and an inability to recruit required skills due to uncompetitive recruitment processes and salaries. The traditional wakhil-i-gozar system and the newly introduced community development council system provide the basis for an accountable local governance system, but administration is currently centralized with little delegation from the Mayor, who is appointed, in contradiction to the Constitution.
4. Obsolete, confusing and absent expenditure assignments (e.g. the Soviet-era function of setting house prices, the absence of environmental sanitation) allow for poor service delivery. This is further exacerbated by vague revenue assignments that are unable to cover municipal expenditures. Municipalities do not have the resources to finance services, in spite of the introduction of a myriad of exotic taxes and fees that collect very little revenue. Subsequently, expenditure is extremely low (e.g. US\$1.12 per capita in Jalabad). Central government has funded this gap only selectively (i.e. only in Kabul) using opaque or indeterminate criteria that places financing at the risk of political interference.
5. The conflicting legal framework (laws contradict each other and the Constitution) results in a conflicting allocation of competencies, rules and procedures particularly between

municipalities and ministries, between ministries and, more worryingly, exacerbates a growing 'informal' provincial interference in municipal affairs. The latter, directly results in poor service delivery as the provinces often dictate investments that are not service delivery priorities.

6. A new municipal agenda is required to address the challenges but selectivity, prioritization and building on existing interventions at national and local levels are the keys to success. At the local level, geographic selectivity would ensure a more manageable municipal engagement. It should target Kabul and the a few major towns (Jalalabad, Mazar-i-Sharif, Herat) at first. High performing secondary municipalities with a demonstrated willingness for reform should be included at a later stage. Sectoral interventions should be based on principles of sustainability, and maximum impact and should build on existing successful pilots. Improving municipal finance and human resource systems (including capacity) are the building blocks of sustainability for any municipality – and should be a first priority intervention in any municipal program. Improved solid waste management systems and improved roads can show

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By Soraya Goga, Mihaly Kopanyi, Bappa Chakravarty, Wali Ibrahimi and Eliza Muzzini. Based on 'Municipalities in Afghanistan: A brief review of their operations' for the Public Administration Review.

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quick and demonstrable results – and for the former – can take lessons from a program at Kabul

Municipality. Municipal representation and accountability is also required.

7. At the national level, municipal issues can be inserted into a number of ongoing efforts (including a new local government, national tax policy, the Civil Service Commission reforms) as part of the National Policy Agenda. However, a national program to assist municipalities in accessing financing and capacity for sectoral interventions is also required

8. Management and Implementation of the Agenda: A role for the IDLG: The municipal terrain

is fraught with conflict between various ministries and between the ministries and the municipalities. The

management and implementation of the municipal agenda involves a number of national departments and

the municipalities themselves. The newly created IDLG provides an ideal forum for the management of

the agenda and the municipal agenda is part of its mandate. The IDLG should ensure that it draws on the

sectoral ministries in the design of its interventions.

9. The National Municipal Policy Agenda: In the short term municipal issues can be inserted into a

number of ongoing efforts, but new programs are also required. Interventions are:

□ The new Local Government Law (currently under formulation) should include a section on the

- municipal legal framework (Short Term)
- The National Tax Policy (currently under formulation) should also address municipal taxation and revenue issues (Short Term)
- The Civil Service Commission should examine the implementation of Priority Reform and Restructuring Program and pay and grade reforms at the municipal level. (Medium Term, but short term pilot possible with Kabul Municipality)
- The system of funding of municipalities should be rationalized. In the short term, the MoF can determine the extent to which municipalities can be funded in the next fiscal year and to formulate transparent criteria for such funding. In the medium-term, a transparent formula-based transfer system should be developed;
- Functions and expenditure assignments should be defined. However, an initial focus should be on the key functions of solid waste management, sanitation and roads that could make a difference in municipal service delivery. (Medium/Long Term)
- Guidelines should be developed for addressing accounting (including Chart of Accounts, financial rules etc) and for revenue generation. (Medium Term)
- Municipal elections and formation of Community Development Councils within municipal areas should be examined. (Medium/Long Term). In the short term, municipalities could attempt to allocate a development budget to each gozar.

10. A Municipal Support Program. Although several reforms should be implemented at the local level, municipalities in Afghanistan do not have the resources or the capacity to currently implement such activities. Consequently, the national government should lend assistance for investments and institutional development in key areas as follows:

- Make available financing that municipalities can access for technical assistance and for priority investment areas (sanitation, solid waste management and roads)
- Technical Assistance areas should be prioritized with a focus on (i) an accounting agenda (including introducing a new chart of accounts, improving internal controls etc), revenue generation (focus on the 4-5 most buoyant municipal revenues including safayi tax, rental properties and key fees and charges (e.g. business fees and sanitation fees) (ii) Development planning that prioritizes investments and Land Management; (iii) Implementation of HR program developed with IARCSS.

Annex 2: Bank Engagement in the Urban Sector

Bank engagement thus far has focused on a mix of infrastructure investments and some institutional change, policy dialogue and analytical work.

Institutional Change:

- Municipal Finance. The project focused on accounting systems changes in Kabul Municipality (under KURP). The program was to be expanded under the (dropped) Kabul Urban Waste Management Project.
- Urban Planning. Assisted in developing an initial plan for Kabul (though KURP). MSW/
- Sanitation. Technical Assistance to the Kabul's Sanitation Department (ARTF-UWSS).

Urban Service Delivery Investments: has focused on community/Government Service Delivery through urban Upgrading through the Kabul Urban Reconstruction Project and has provided support to the Kabul Municipality for closing the Chamtala dumpsite (through ARTF-UWSS).

Analytical work in the urban sector includes:

- Urban Sector Technical Annex for Securing Afghanistan's Future (December 2003) which outlined the financial and investment needs for service delivery in Afghanistan's urban areas;
- Fiscal Management for Provincial Municipalities for Reforming Fiscal and Economic Management in Afghanistan (2004) which outlined the fiscal status of provincial municipalities;
- Shaping Urban Futures: Challenges to Governing and Managing Afghan Cities (2005) provided a call to action for urban areas in Afghanistan;
- Municipal Finances and Management in Kabul for the Public Financial Management Review (September 2005) outlined the fiscal status of Kabul Municipality;
- Kabul Urban Land in Crisis: A Policy Note (June 2006); and Kabul Urban Policy Notes - 6 Short Notes on Land Management (July 2006) examined the causes of and outlined actions required to address the land management and distribution crisis in Kabul. ;
- Setting the Municipal Reform Agenda (2008) discussed a municipal reform agenda for Afghanistans municipalities;
- Kabul Urban Policy Notes included four long notes and three Short Notes on actions requires in the Cultural Heritage arena to safeguard and develop Afghanistan's cultural heritage

Priorities for Action

- Develop an Industrial Policy to strategically support emergence of promising areas of comparative advantage and alleviate rampant concerns over policy uncertainty and unpredictability.
- Launch a Diagnostic Trade Integration Study (DTIS) in order to identify barriers to realizing Afghanistan's trade potential and prepare an action plan to overcome these. This diagnostic should be used to develop a national export strategy.

□ Develop a national Trade Policy with a core focus on strong and sustainable private sector led growth leading to gainful job creation and poverty reduction.

□ Formulate a Regional Cooperation Strategy and formalize through coordinated institutional mechanisms to avoid fragmentation. Enhance the agenda through SAARC and other key regional forums.

□ Improve the capacity of GoA institutions including MoCI, MoF, AISA and EPAA to fully implement the 2007 Roadmap for PSD through regular dialogue with industry associations, investors and entrepreneurs.

Context

Private sector development, enhanced trade, and regional cooperation are all critical, interrelated components to helping Afghanistan integrate with the global economy while aiding its WTO accession efforts. The development and growth of the private sector as a key determinant of the country's overall trade capability is vital for economic development, especially in terms of job creation and overall economic growth.

In general, Afghanistan continues to rank the lowest in its region on the Doing Business Index and businesses are still constrained by the bureaucracy, lack of policy predictability and corruption plaguing the regulatory environment. In addition, access to land, power, finance and a skilled labor force is impeding the ability of companies to grow.

Afghanistan has managed to make significant progress in opening its trade regime in the recent years, allowing it to become one of the most open economies in South Asia. Afghanistan currently has a simple average MFN applied tariff rate of 5.6 percent which is significantly lower than the regional average for the South Asia at 13.5 percent. Despite Afghanistan's recent tariff reforms, Afghanistan still lacks an official trade policy and strategy on implementation of tariff reforms.

Afghanistan is a member of several key regional trade organizations including Central Asian Regional Economic Council (CAREC) and the South Asian Association for Regional Cooperation (SAARC), to potentially facilitate increased trade with neighbors and the broader region.

Issues and Challenges

The World Bank's recently published Afghanistan Investment Climate (2008) revealed that strong private sector growth is taking place despite poor governance, weak factor markets and a lack of innovation. However, success cannot be sustained without addressing the latter core issues that are severely affecting both the government and economy. The instability of policies and weak enforcement has placed a severe burden on the cost of doing business and therefore is a major impediment to long-term investment interests of businesses. This must be addressed by the GoA through enhanced coordination and streamlining of processes. As an immediate action, the formulation of an Industrial Policy can alleviate concerns over policy uncertainty while strategically supporting key sectors with inherent capabilities to increase exports and strengthen the economy.

Competitiveness, innovation and diversification must also be addressed by the government. Very few new foreign firms have registered over the last three years which is an imperative issue for job creation. Also, Afghan firms operate by and large informally and are not adequately exposed to international markets. The industrial sector is overwhelmingly linked to agriculture and agro-processing sectors and is not diversified. In the near term, any government policies under deliberation should encourage the private sector to practice productivity-enhancing behaviors including developing quality standards, export markets, better trained staff, current technology and new product lines.

In terms of regional and international trade, since 2004 Afghanistan has moved toward a more dispersed and less transparent tariff structure with higher rates and more tariff bands. However, ad hoc government actions are distorting the trading system and undermine the predictability and transparency of the tariff regime. In addition, Afghanistan failed to lower the costs of trade due to persisting difficulties of trading across borders and an unfinished agenda for dealing with behind-the-border issues.

On matters concerning trade facilitation, there is an overall lack of adequate support to the private sector while the full implementation of signed trade agreements are pending and a defined trade policy is yet to be formulated. The administrative burden to traders in Afghanistan remains overwhelming as administrative measures are often discretionary, both on valuation of tariffs and on inspection procedures, creating delays and vulnerabilities to corruption. According to the 2010 Doing Business report, trading across borders has become even more difficult in Afghanistan as compared to other countries.

In order to improve this situation, critical needs that should be addressed include: (i) the expansion of the computerized ASYCUDA system, (ii) greater transparency of laws, regulations and a simplification and harmonization of customs procedures, and (iii) overall customs modernization, including better data exchange, wider application of risk-management practice and post-entry audit.

Finally, the quality of officially reported trade data in Afghanistan remains very poor, preventing well-informed policy choices. There are major differences in trade values reported by the Central Statistics Office (CSO) and the Customs department of the MoF. Key export data such as goods sent under preferential trade agreements is not available. This prevents fully informed policy decisions, and indeed can lead to policy choices with negative effects to the economy. The MoCI, in collaboration with the World Bank, is planning to address this issue as part of the planned DTIS.

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Bank's Role

The Bank's current analytical and advisory assistance to private sector development of US \$24.5 million includes the completion of a recently conducted nationwide Enterprise Survey as evaluated in the Afghanistan Investment Climate in 2008 report, and several sectoral studies on Construction, Mining, and Economic Diversification. Our current technical assistance projects include support to the Jalalabad Industrial Park, institutional support to the MoCI and AISA and improving the overall regulatory environment around the Doing Business indicators.

Projects will include support for key sectors such as mining, construction, ICT and agro-industry as possible areas for growth and revenue generation. We will also extend considerable support to industrial parks as a means to promote private sector activity through addressing the lack of secure, serviced, well regulated and appropriately located industrial land.

In addition, upon the near completion of the Emergency Customs Modernization and Trade Facilitation Project (ECMTFP), the Bank aims to provide technical assistance to improve the overall governance environment of the Afghan Customs Department (ACD). A proposed grant for the project will assist with the further roll out of the Automated System of Customs Data (ASYCUDA) to key remaining customs stations and upgrading to a more automated environment. The project will also include technical assistance to improve the regulatory framework, set up coordination mechanisms for reforms

and
continue progress on the Customs Five Year Plan. Also, drafting of the DTIS report will be managed by
the Bank as part of assistance to MoCI to aid the WTO accession process.

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Financial Sector Development

Priorities for Action

- Develop a financial sector development strategy over the short, medium and long terms with an
action plan to expand the outreach and range of financial products and services and to ensure
stability and transparency in the sector.
- Increase access to credit and financial services to the underserved, particularly to MSMEs and
throughout the rural population.
- Reconcile and determine the role of two remaining state-owned Commercial Banks.
- Improve the capacity of Da Afghanistan Bank (DAB) to monitor and supervise both commercial
banks and non-bank financial institutions (NBFIs) including insurance and leasing services with
necessary rules and regulations in place.
- Develop necessary financial infrastructure including a modernized electronic payment system,
national accounting and auditing standards.

Context

Over the last few years, significant improvement of the formal financial sector has been achieved in terms
of entry of a large number of private commercial banks and an increase in the amount of loans and
deposits. However, this was achieved with disproportionately weak banking supervision capacity in DAB,
and underdeveloped financial infrastructure. Cognizant of the importance of an appropriate supervisory
function and well-developed financial infrastructure, the GoA has already initiated key reforms in this
area.

Given Afghanistan's weak linkages with international financial and capital markets, the impact of the
global financial crisis thus far has been limited. Afghanistan's financial sector today continues to be
dominated by a large informal system and still does not play an important role in financing economic
activity as it should be. Although there has been an increase in the establishment of private commercial

banks, the financial needs of businesses and individuals are not being met. Despite great efforts, access to finance remains to be one of the most major impediments to the growth of the private sector in Afghanistan today. In addition, Afghanistan faces a high risk of money laundering and terrorist financing given the factors of illicit drug trafficking, corruption, smuggling, and a largely cash-based economy.

The developing state of the financial sector and its fundamental importance to development has been the basis upon which the GoA has set out an objective to build the capacity of the sector so that it can serve the demand for credit from the private sector. In doing so however, there are two crucial challenges it must address: (i) ensuring that the financial regulator (DAB) has the proper institutional capacity to adequately carry out its core functions, especially in supervision of a rapidly growing banking sector and thereby properly manage systemic risk issues; and (ii) finding ways of establishing effective property rights and information that the financial sector can rely on for the purposes of extending credit.

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Issues and Challenges

Although Afghanistan has made some valuable progress in terms of financial deepening, there is still much work needed to raise the levels of activity in the formal financial sector of the country. In our recently conducted Enterprise Survey, only 51% of enterprises reported having a bank account and a very small percentage of firms reported using electronic banking mechanisms including using ATM cards, credit cards and payment services.

Given that only five percent of Afghan enterprises have a loan with a financial institution, innovative approaches can be taken to enhance access to credit. Although the 2010 Doing Business report did show a remarkable improvement in Afghanistan's "Getting Credit" ranking (127 in 2010 up from 178 out of 181 countries in 2009), this was primarily attributed to the passage of the new Secured Transactions Law and it is clear that significant challenges still exist in the lending practices of banks. Due to highly collateralized lending practices of banks along with a lack of intermediation capacity in the financial sector, access to formal credit remains to be a serious constraint for the greater majority of businesses and individuals.

In addition to existing planned measures to enhance information collection on collateral

and borrowers, develop an appraisal capability, strengthen contract enforcement, and train bankers to extend credit, there are other innovative measures that can be implemented to enhance financial access. Possible examples include mobile phone banking services, provision of insurance and collateral guarantee services and to meet the needs of larger customers, the feasibility of establishing an independent banking institution can be explored.

Providing guarantees to "strategic" investors in light of ongoing security issues is important to consider. For certain strategic investments (infrastructure, large services sector or manufacturing sector related activities), the Government could consider establishing an independent Investor Guarantee Fund that will provide insurance to investors for certain "security and rule of law" related events not covered typically by other political risk insurance offerings.

A fundamental challenge remains to provide access to credit to micro, small and medium enterprises (MSMEs) beyond micro-finance. New measures to support this niche market can include complementary matching start-up grants and credit financing as well as other supportive interventions. Well governed micro-finance providers could play an important role in extending this type of credit to businesses in need.

Bank's Role

The Bank currently has a number of programs to aid the development of a formal financial sector with enhanced capabilities to deliver services to the people. Work currently under implementation includes efforts to improve access to finance, especially for micro, small and medium enterprises (MSMEs), strengthen key financial sector foundations and strengthen key relevant agencies and ministries, as well as financial institutions. As part of our analytical assistance, we are in process of drafting a Financial Sector report. The results of the study will assist the Government in preparing a comprehensive Financial Sector development strategy which is currently lacking.

Our technical assistance projects include financial support to the Microfinance Investment Support Facility for Afghanistan (MISFA) with an objective to achieve operational sustainability for most

microfinance service providers and support their expanded outreach to meet the needs of poor Afghans, especially of women. While overall performance has been impressive, the security situation

has led to a deterioration of portfolio quality which is currently under review.

We have also supported the Afghanistan Investment Guarantee Facility (AIGF) for which a project was designed to attract investment through a program of political risk insurance in collaboration with MIGA, thus stimulating the local economy and generating employment. To date, six projects have been underwritten utilizing the AIGF and their total amount of FDI is estimated at about \$107 million with 830 jobs created.

The Financial Sector Strengthening project became effective June 2009 and aims to help Da Afghanistan Bank (DAB) to improve its core function of banking supervision and regulation and to help improve access to formal banking services by establishing key initial building blocks for further financial sector reform. As part of the project implementation, the Secured Transaction Law and the Mortgage Law have already both become effective legislation which are both necessary in order to provide an appropriate framework within which to conduct secured lending. Furthermore, with the help of the DAB's Project Implementation Cell (PIC), we have been able to make significant implementation progress in the areas of (i) establishing a Banking Training Institute; (ii) reviewing the legal regime and preparing regulations pertaining to the establishment of the Credit Information Bureau (CIB); and (iii) enacting the secured transactions law which has met the legal requirement to establish the Collateral Registry (CR).

Taking the noted challenges and constraints into consideration, plans for the next phase of Bank assistance is currently under deliberation and will soon be prepared together with the GoA under the Financial Sector Strengthening II project. Assistance will likely focus on restructuring and privatization of state-owned commercial banks and an SME Line of Credit

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HUMAN RESOURCES

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Education

General Education, Technical and Vocational Education and Teacher Education and Training

Priorities for Action

Pedagogical Priorities

□ Need Flexible Strategies to Continue to Increase Education Access and Improve Teaching and Learning Quality. The heterogeneous context of Afghanistan (road access, security, climate, etc.) has made it difficult to delivery education services, especially through standard strategies for education access (of both boys and girls), school construction, pre-service and in-service teacher training, etc. Non-traditional teaching and learning strategies such as accelerated learning, distance or semi-distance education, rural education programs, etc., can provide flexible mechanism for education delivery depending on the regional context and needs.

□ Integration of Services for Teachers Is Required. Teacher training is a complex education service which requires: (i) coordination among different MOE departments: teacher education, curriculum, planning, school supervision; (ii) implementation across different education levels (central MOE, Provincial and District Education Departments, schools); and (iii) integrated planning across ministries (MOE and Ministry of Higher Education). Guaranteeing an integrated system requires, first, that different departments of the MOE plan and manage integrated services, and that specific guidelines be provided to third party providers of teacher training, such as NGOs.

Management and Institutional Priorities

□ Yield Further Benefits from Community Participation and School Based Management. School based management and community participation has been a flexible and pertinent mechanism to increase education services across Afghanistan. The MOE should consider formalizing the model by creating a formal unit within the MOE to support the role of community participation across other functions of MOE, such as pre-school services, teacher training, security, etc. Also, the community and school grants experience can serve as basis for a decentralized budget at the school level, especially for operational and maintenance (O&M) expenditures.

□ Continue to Improve Education Management and Institutional Capacity, including at the sub-national level (Provincial and District Education Departments). The MOE has both a large cadre of public servants with unutilized capacity or minimum skills (and low salaries) and highly paid TAS and advisors. The MOE need to define the pertinent number of civil servants

staff, functions

and capacity building needs to sustain education reforms at both the central and sub-national levels, with a clear strategic and operational plan to phase out the management of education services by technical assistance hired by externally funded programs (such as EQUIP and others).

□ Data Collection, Analysis and Use (for planning, management, monitoring and evaluation).

The GoA and MOE priority on evidence and result-based management requires an integrated data

collection, analysis and utilization strategy. However, the education data collection and analysis

process in the MOE is still fragmented across various MOE units, such as EMIS, ITC, M&E and

NESP. Additionally, appropriate tools to monitor student learning can no longer be postponed.

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□ Need to Strengthen Budget Execution and Liquidation of Sub-national Expenditures. The

Ministry of Education does not execute fully the annual investment budget allocated. Improved

planning, delivery mechanism and especially reviewing and improving budget execution at the

sub-national level are needed. In 2009, the MOE had to return more than US\$2 million of an

IDA grant for EQUIP I, given that it could not execute the investment within the grant period and

within an additional grace period provided. In addition to improving the use of funds, liquidation

of funds (accounting for expenditures) and managing of contract delivery are needed.

□ Procurement and Contract Management. The MOE has been increasing its capacity for procurement and financial management; however, such capacity is still uneven.

Initial procurement planning and implementation capacity has resulted in delays in designs, bidding

documents, bid evaluations. In addition to procurement management, contracts management is

also needed, that is the MOE needs to monitor and support the implementation of contracted

service delivery. School construction delays have been caused by the absence of mechanisms to

facilitate land ownership, transfer, or settlement of disputes. Even when School Management

Committees (SMCs) secured land donations, land titles could not be transferred.

Security Priorities

Need to Improve Security of Students, Teachers and Schools. In 2008 alone, there were more than 670

attacks on schools, teachers and students. The MOE and its partners need to define a

programmatic

response to this unfortunate situation, both for prevention and protection of schools and to provide psycho-social to students and teachers after a violence incident.

Context

In 2002, less than a million students were enrolled in school (grades 1-12), most of them boys. Today, overall enrollment in primary and secondary schools stands at 6.3 million, 35% of whom are girls -- most access increments are at the primary level (82% of all those enrolled). In line with the rapid basic education access increments there has been a massive mobilization of teachers, which totaled 164,771 teachers in 1388 (29.4% female). Primary Education curricular reform and textbook revisions have been completed. Curricular reforms for Islamic education and technical and vocational training are also being developed. The Ministry of Education (MOE) supports technical and vocational education across the country, and seeks to develop some post-secondary education model programs in management and administration. The MOE developed a national unified teacher training curriculum comprised of 8 teaching standards (pedagogy, active learning, questioning skills, group work, child development, lesson planning, evaluation methods, and diversity), which are now part of the Framework for Teachers of Afghanistan. As part of the development of a quality and result based pay and grade strategy for teachers, the MOE has finalized a national registration of teachers and has initiated a teacher competency exam.

The Ministry of Education has also improved data collection on education sector indicators. The Education Management Information System (EMIS) Department has prepared over the past three years a comprehensive education information report. The Ministry of Education is unveiling its second 5 year up-date for its National Education Strategic Plan (NESP 1387-1391), which will guide the education strategies, programs, budgets and monitoring and evaluation of education outcomes.

Issues and Challenges

Quality and efficiency of learning. In general, the fast expansion of schools required hiring teachers, often with much less than 12th grade education with low quality teaching practices. In addition, although access has increased overall completion rates for the primary and secondary cycles of education are low, given the high repetition and dropout rates after the 4th grade, especially for girls.

Evidence on the quality of teaching and learning is not collected by the MOE, and a standardized formative test to monitor student learning is to be developed. The only indicator of learning is the Concorde exam provided to those students that finalize 12th grade (to enter university), which only applies to a minimum percentage of the general education cohort (2% in 1387-88), and even for this privileged group of students, the learning results are low. .

Equity of Education Progress. National education progress indicators mask differences in education attainment across regions in Afghanistan. While national enrollment rates overall (including girls' school access) show an increasing trend, provinces in the south, south-east and south-west show less progress. Targeting of girls' school access is not followed with the same impetus by all provinces, and even when girls are enrolled their permanence is less than boys. For example 30% of IDA and ARTF financing for school infrastructure with the objective to increase girls' access did not comply with the gender equity criteria.

Secondary education access and quality. On the secondary education front, grades 7-9 account for only 13% of total school enrollment, while grades 10-12 account for a mere 5%. Some 5 million children remain outside the system. The secondary education curriculum has not been updated and major reforms are needed. The secondary education system is still the only source of training for many teachers in Afghanistan that have not acquired the required Teacher College credentials.

Education management and institutional capacity. Even with the planning and organization advances such as the NESP, the EMIS and the MOE's reorganization, there is limited evidence of strategic and capacity building planning by most MOE departments. The MOE is still dependent on large numbers of consultants and other technical assistance (TA). Consultant salaries increased rapidly and became unsustainable. Evidence suggests that the acceleration of education investments has been "input-led" (grants, infrastructure, goods and consultants) without integrated annual planning tools linking procurement activities with expected annual results indicators and targets, systematic planning of activities and implementation time, and in line with approved Ministry of Finance (MOF) budgets.

Schools attacks. To compound the access, quality, equity and management challenges, violence against schools has increased with direct attacks from grenades, shootings, fires and acid on students, teachers and schools. Rural and conflict-afflicted provinces have experienced more complex

obstacles for delivery of education services and, thus, have benefited less from MOE investments.

Donors' Role

The World Bank has been an ally of the MOE since 2002. There are two IDA and ARTF supported programs in the education sector: the Second Education Quality Improvement Program (EQUIP II) and the Education Skills Development Program (ESDP). EQUIP II supports community participation and school-based management, teacher in-service training, scholarships for prospective female teachers (at the high school and teacher college levels), and seeks to strengthen capacity of the MOE to plan more strategically, develop appropriate education programs (based on diversified regional needs), and improve

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data collection, and M&E. The ESDP supports technical and vocational training for poorly qualified youth and for the development of a National Skills Framework to improve quality and help integrate fragmented technical and vocational training. This program also supports the National Institute for Management and Administration, which has launched to provide post-secondary training for youth and young adults. As part of second 5-year National Education Strategic Plan, the World Bank and other partners are committed to continue to support the higher education sector under a national development framework.

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Higher Education
University Programs, Community Colleges and Post-Secondary Teacher Training
Institutions

Priorities for Action

□ Operationalize and execute the National Higher Education Strategic Plan (NHESP). The Ministry of Higher Education (MOHE)'s NHESP 2010-2014 provides an important road map for the development, expansion and quality of the Higher Education Sector. The priority now is to operationalize the two NHESP programs to improve access to quality higher education: program #1 to be carried out by universities and program #2 to those to be carried out by the MOHE and other higher education normative institutions.

□ Set up and implement the quality assurance and accreditation system. A key

priority for action

is to finalize the quality assurance and accreditation system to be carried out by the MOHE, including models, tools, and organizational structure to initiate the review and accreditation of university programs and guarantee minimum standards for teaching and learning.

□ Integration of externally funded higher education programs. Higher education investment programs supported by external donors (such as SHEP funded by the World Bank and HEP financed by USAID) need to be incorporated into the framework of the NHESP. For SHEP, integrating the planning and management of SHEP within the Ministerial line departments is a priority.

□ MOHE Planning and Management Capacity Building. Review and develop specific strategies to increase the planning and management capacity of the line departments of the MOHE – and especially of its civil servants. MOHE staff needs to develop plans to carry activities and investments on governance, access and expansion, the national admission examinations, and the accreditation and quality assurance system.

Context

Higher education is a valuable complement to basic and secondary education, to prepare professionals, researchers, strategic thinkers and innovators and to support the important road ahead in the economic and social development of Afghanistan. To-date the MOHE has focused on revamping the operations of universities and carrying an important dialogue with all stakeholders to define the goals and direction of the system. This process has culminated with a National Higher Education Strategic Plan (NHESP), which provides the basis for more profound development, increased access, and improved quality of teaching and learning in afghan universities. Afghanistan proposes to double the intake of students in higher education institutions (from 62,000 to 115,000) and to improve the qualifications of university professors.

Issues and Challenges

Unmet Demand for Higher Education. The demand for higher education access continues to increase.

Annually, more than 100,000 graduates from 12th grade are opting for post-secondary education studies (and taking the university placement exam, Konkori). Afghanistan requires a highly qualified pool of professionals to sustain its on-going reconstruction and development efforts.

Need to Improve Quality of Higher Education Programs and Institutions. Although many public universities, as well as private universities, successfully initiated their operation during 2002–2008, most of them still require support in updating their professional fields, academic programs, the qualification and modern pedagogy of their professors, and the management and governance of their institutions.

Need to Integrate Autonomy and Accountability within a Quality Assurance System.

Increased academic and financial autonomy allows universities to define and implement their programs to improve the quality of their programs and staff. However, increased university autonomy needs to be complemented by their accountability to a Quality Assurance System. Both processes—autonomy and accountability—require strengthening within the Quality Assurance system to be managed by normative institutions led by the MOHE.

Need to Improve MOHE Management and Institutional Capacity. Capacity building of MOHE line departments and civil servants needs to be comprehensive, including capacity and tools for strategic planning and monitoring of results, for organization and management of human resource, and for fiduciary (financial management and procurement) administration. The NHESP provides the areas that the MOHE needs to managed, and for which civil servant capacity needs to be developed.

Bank's Role

The World Bank has been supporting the Ministry of Higher Education since 2007 through the Strengthening of Higher Education Program (SHEP). SHEP has provided significant funding to higher education to improve the operational performance of 6 National Universities (Kabul, Kabul Polytechnic, Balkh, Nangahar, Kandahar and Herat). University support includes (i) financing of partnerships between Afghan and foreign universities (to improve the curriculum, materials and qualifications of some faculties) and (ii) grants to Afghan universities to improve curriculum, materials, infrastructure, and teacher training. SHEP has also a second component aiming at improving the governance of the higher education system and support the development and implementation of the quality assurance and accreditation system (a sub-program of the NHESP). Overall, the World Bank and other partners are committed to continue to support the higher education sector under the present national development framework for tertiary and higher education

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Priorities for Action

□ Assess the pros and cons of direct service delivery by the Ministry of Public Health (MOPH) versus contracting it out to NGOs and carefully review the implications of taking on service delivery before moving back in this direction. The contracting model so far has brought great improvements to the sector and has allowed the MOPH to focus on its stewardship functions, such as policy formulation, regulation, financing and coordination of health sector partners.

□ Develop streamlined business procedures to improve fiduciary responsibilities of the ministry. Weak procurement and FM management capacity of the MOPH had been a significant hurdle for effective health services delivery in the past.

□ Address the high level of malnutrition, as a crucial development agenda, in a multisectoral manner, involving the Ministries of Public Health, Education, Agriculture and others. Nutrition is an area which has received relatively little attention in the past. The level of malnutrition amongst children is very high in Afghanistan and this severely impacts on the potential of these children to grow up to healthy, intelligent and productive adults.

□ Seek additional donor support from other bilateral donors but especially also from ARTF. The HNSS is largely dependent on foreign financing. Such a situation easily leads to lack of leadership by the Government. It is being supported by the three "traditional" donors (EC, USAID and the World Bank), that have been financing health activities during the period 2003-2009. However, after these generous contributions, there will still be a significant gap in the financing of HNSS. The indicative financing arrangements for the 2009-2013 health sector program, including possible funding support from ARTF, is shown in Table 1.

Table 1: Indicative Financing Arrangements for Health Sector Program (2009-2013)

Donor	Duration of support	Pledges
		(USD million)
ARTF	2009-2013	163
EC	2009-2011	70
IDA	2009-2013	30

JSDF	2009-2011	17.9
Norway Trust Fund	2009-2011	11
USAID	2009-2012	236
Total		527.9

Context

Up to 2003, provision of primary health care services in Afghanistan was low and erratic. NGOs have been responsible for almost 80% of health service delivery in the country, though the service delivery was generally uncoordinated and unfocused. Though NGOs often provided good quality services, the coverage was modest with approximately one functioning primary health care facility per 50,000 populations. As a result of the modest availability of services, lack of clear objectives, unclear

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geographic responsibility, results were modest: a multiple indicator cluster survey conducted in 2003 found low rates of skilled birth attendants (6.0%), contraceptive prevalence (5.1%) and child immunization coverage (only 19.5% had received three diphtheria-pertussis-tetanus [DPT] immunizations) in rural areas.

Confronted by an uncoordinated and poorly performing health care system, in 2003 MOPH undertook a series of critical and strategic steps: it defined a package of priority health services, known as BPHS; it established large scale contracting with international and national NGOs for the delivery of services; and it prioritized monitoring and evaluation of health sector performance. MOPH assigned clear geographical responsibility to NGOs (typically for whole provinces with populations ranging from about 150,000 to 1 million) and selected them competitively. A common set of indicators was used to assess performance; and a third party was hired to perform national facility surveys on a regular basis. The threat of sanctions in case of low performance was invoked and MOPH did actually terminate contracts of underperforming NGOs. The Afghan health system has made considerable progress over the period 2003-2009, thanks to strong MOPH leadership, sound public health policies, innovative service delivery models and careful monitoring of performance.

Administrative data indicate that the number of functioning primary health care facilities has increased from 496 in 2002 to 1,169 in 2007 while the proportion of facilities with skilled female health workers has increased from 25% to 83%. The number of outpatients' visits increased fourfold from 0.23 visits per capita per year in 2004 to 0.94 in 2007. Comparing the results of household surveys conducted between

2003 and 2006, there have been significant improvements in the coverage of reproductive and child health services. At the outcome level, a nation-wide survey conducted in late 2006 found an infant mortality rate of 129 per 1,000 live births and an under-five mortality rate of 191 per 1,000 live births, representing a 22% and 26% decline, respectively, from the 2003 estimates. At the same time, the proportion of women of reproductive age using at least one method of modern contraceptive was tripled in 2006 compared to 2003. The trend in use of antenatal care show several folds increase from 5% in 2003 to 32% in 2006 and use of skilled birth attendance (SBA) increased from 6% to 19%. With regards to the child immunization, significant improvements have been made, proportion of children aged 12-23 months received DPT3 increased from 19.5% in 2003 to 35 in 2006.

The positive experience during the period 2003-2009 laid the foundations for a programmatic approach to building a country-wide health service system. The three donors supporting the health sector in Afghanistan (EC, USAID, and the World Bank) finance the BPHS. Over the years MOPH has maintained a crucial role in leading and coordinating activities, from managing contracts and grants, to carrying out annual strategic planning retreats to review performance and tackle bottlenecks for implementation. The retreats see the involvement of all donors and implementing partners and have contributed to create "one health program in Afghanistan. MOPH performance has been so impressive that in 2008 USAID agreed to provide direct budget support for implementation of health activities in Afghanistan.

The 2008-2013 HNSS represents a further step towards the establishment of a comprehensive health policy, as it (a) defines the objectives for the sector; (b) identifies BPHS and EPHS as the priorities for service delivery; and (c) creates a framework for donor financing. The HNSS is an integral part of the Afghan National Development Strategy (ANDS) and fits under the economic and social development pillar which includes improving human development indicators and making significant progress towards the MDGs. The HNSS goals for 2013 are to reach: (a) BPHS coverage of at least 90% of the population; (b) a 15% reduction in maternal mortality from the 2000 baseline; and (c) a 20% reduction of infant and under five mortality from the 2000 baseline. The HNSS identifies BPHS as the overarching priority for the sector, while also aiming at strengthening the referral network that links patients into the hospitals that provide EPHS.

While the results of the above efforts have been very encouraging, the challenges remain enormous.

Despite the progress made so far, the under-five mortality rate in Afghanistan is still 67% higher than the average for low income countries. Maternal mortality is the second highest in the world: with a ratio of 1,600 maternal deaths per 100,000 live births, women's survival remains a top priority for the health sector. As the country is large, poorly linked and with a thinly spread population, physical access remains an issue with more than 60% of the population living more than one hour from a health facility. This is one of the factors that explain very low vaccination coverage (Diphtheria, Pertussis and Tetanus (DPT3) coverage of 35% vs. 65% for low income countries as a whole) and limited number of institutional deliveries (<15%).

The total cost for the implementation of the HNSS over the period 2009-2013 is approximately USD 550 million: almost 70% of the funds will be allocated to the BPHS, and the remaining 30% will finance EPHS, strengthening of the MOPH stewardship functions and various innovations. There are important financial gap, which remains central challenge for the health sector to overcome.

Bank's Role

The World Bank very recently extended its commitment to the Health Sector by approving a grant of USD 30 Million towards the Strengthening Health Activities for the Rural Poor project (SHARP) for the period 2009 - 2013. The project has 4 components: (i) Sustaining and strengthening the Basic Package of Health Services (BPHS); (ii) Strengthening the delivery of the Essential Package of Hospital Services (EPHS); (iii) Strengthening MOPH stewardship function; (iv) Piloting Innovations (Norwegian Trust Fund USD11 million)

The support from the World Bank is provided in close coordination with the support of other Development partners, especially EC and USAID which both also provide financing for the contracting of NGOs to deliver basic health services,. Together these partners cover the whole national territory.

The World Bank is also analyzing the poor nutritional situation of the people in Afghanistan and assessing the present response to it. In the process we are hoping to identify opportunities to support a broadening and scaling up of this response.

GOVERNANCE

Governance and Anti-Corruption

Priorities for Action

□ Restore public trust in leaders and government institutions via attainable service improvements at the sector level. This would mean initial implementation of meaningful yet feasible short-run measures such as improvements at sector and agency levels (focusing on making simple technology and process improvements in a few agencies where the public interacts most frequently with service providers) instead of spending too much effort and resources on preparing more strategy documents.

□ Deepen civil service reforms. Another priority for government is to continue to address both the incentives and capacity in the civil service, so as to improve performance over time. A coherent strategy is needed between Government and donors for transitioning away from the excessive use of ad hoc arrangements for staffing and salary supplementation to a more coherent staffing and remuneration strategy that is fiscally sustainable over the long term. The ongoing roll out of the new pay and grading policy is only the first step in this direction, and will remain ineffective if donor financed distortions in the labor market will continue in parallel. At the same time, a more substantive capacity building approach is needed to ensure that that staffs coming into the civil service, now and in the future, have sufficient basic skills and competencies to ensure effective development and performance through the civil service.

□ Intensify anti-corruption efforts. Efforts should be stepped up on both the preventative and punitive side. On the preventive side, reduction of red tape and simplification of processes as well as continued roll-out of PFM to the provinces can greatly reduce opportunities for corrupt behavior. On the enforcement side, the authorities of the HOO need to be strengthened so that it has real teeth to ensure public officials declare their assets and allows for seizure of assets obtained by corrupt practices. The rules and procedures for disciplinary action against misconduct should be reviewed, improved and then consistently enforced.\

□ Strengthen the Rule of Law with more unified justice system. Better service delivery in justice would be achieved by a longer term focus with more realistic objectives, emphasis on service delivery by more unified legal systems (state and informal systems), improved accountability of public institutions, and concentration on legal empowerment. The three Justice Institutions themselves- Supreme Court, Ministry of Justice and Attorney-General's Office – recognize the need for change and work together with donors to improve the systems.

Context

Improving governance remains critical to Afghanistan's social and economic development. However, corruption, general crime and lawlessness as well as the growing insurgency in the south and east of the country continue to undermine the establishment of central state authority.

At the same time, government with support from donors has made some progress in establishing the foundations for state institutions. Public financial management reforms are beginning to make a real difference at the centre, but still need to be rolled out to the Provinces. The government has also had some successes in laying the foundation for a more effective civil service. A legal framework has been enacted, setting out the rights and obligations of civil servants and establishing the Independent Administrative Reform and Civil Service Commission (IARCSC) to introduce a merit based system for

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the administration of public sector employment. A significant number of ministries had been restructured through the Priority Reform and Restructuring Program (PRR). Government has begun to implement a comprehensive grading and pay reform across the entire civil service, in an effort to rationalize pay structures and provide better incentives to civil servants. Senior positions in the civil service are passing through the Civil Service Appointments Board, although a system for greater independent scrutiny of appointments made by the Board needs to be put in place.

Issues and Challenges

The institutional challenges confronted by the new governments are substantial; four interrelated challenges stand out.

Weak capacity. Capacity in most line ministries remains weak and heavily reliant upon external support, both in management and in sector-specific professional skills. The Ministry of Education, for example,

with 10,000 non-ajir staff, also employs 1260 national consultants and 11 international consultants. Donor-funded consultants working in different agencies receive between \$100 and \$9600 per month, while the new pay scales under the pay and grading policy will range from only \$100 to \$650 per month. This 'second civil service' funded by donors is unsustainable in the long term and makes development of a motivated civil service extremely difficult.

Inefficient organizational structures. Responsibilities both across and within ministries are fragmented and lack clarity creating overlap, coordination failures and inefficiencies. The internal and external control environment remains weak undermining accountability. Many procedures have become outdated, overly bureaucratic and vulnerable to corrupt activities. The IDA-supported Civil Service Reform Project set out to support ministries to restructure according to their mandates and services delivery functions, with the Commission acting as coordinator and facilitator of the process. But this restructuring has only partially happened. Pay and grading reforms although necessary are unlikely of themselves to lead to better service delivery in line ministries. With the recent re-focusing of the Civil Service Project there may be better chance of success against a narrower range of objectives. Nevertheless, we should recognize that civil service reform will take time, and until the distortions created by donor funding of the second civil service are removed, progress will be slow.

Unclear sub-national administration structures. Interactions between central ministries and sub-national administration are weak. But government's de-concentration agenda will need careful thought. Because Afghanistan has a unitary structure of government, the functional and budget authority is held by line ministries and their provincial branches. Provincial Governors are intended to play a greater coordinating role at the provincial level, but only a fraction of provincial governors' offices have been reorganized. Provincial councils, elected during the 2005 elections, were intended to provide inputs to planning, and perform monitoring and conflict resolution roles. The challenge is to establish meaningful roles for these and a host of sub-national bodies within the existing legal framework.

Growing corruption. Government's anti corruption efforts, while achieving some progress on the institutional front with the establishment of Anti Corruption High Office, have yet to result in significant impacts on the ground. Lack of strong government leadership has resulted in the widely held view that corruption is being ignored or tacitly allowed. No coherent anti-corruption strategy exists, although a number of separate and to some extent competing government anti-corruption documents are

in circulation. The legal framework for fighting corruption is unclear, and different institutions are working in isolation and often at cross purposes. Efforts have recently been made to clarify the institutional and legal framework through promulgation of an anti-corruption law in 2008. The law mandated the establishment of a High Office for Oversight of the Implementation of the Anti-Corruption Strategy (HOO). The office has little capacity to implement its mandate, and while the government's intention to

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give additional responsibilities to the HOO to coordinate the fight against corruption across government are welcome, the capacity weaknesses of the organization need to be addressed.

Strengthening the Rule of Law. The GoA has taken steps, assisted by the international community, to rehabilitate the justice system and improve the delivery of legal services.

Progress in the justice reform has been slow. The justice institutions are seen as the most corrupt and traditional systems continue resolving majority of common people disputes. The sector suffers from weak human capacity, a lack of basic physical infrastructure in the provinces, and the absence of uniformed business operations. The previous reforms focused on the central formal justice institutions. Today many agree that the challenges in the sector are bigger than originally thought and that better reform results would be achieved by a longer term focus with more realistic objectives, emphasis on service delivery by more unified legal systems (state and informal systems), improved accountability of public institutions, and concentration on legal empowerment. The three Justice Institutions themselves- Supreme Court, Ministry of Justice and Attorney-General's Office -recognize the need for change and work together with donors to improve the systems.

Donors' Role

The Bank will continue to strengthen core government systems as the basis for credible state building. This action will be conducted through efforts to strengthen public financial management, fiscal sustainability and improved transparency and accountability, while integrating the results of vulnerability to corruption assessments into ongoing work streams. In addition to IDA support for the ongoing Public Financial Management Reform Project and the Civil Service Reform Project, the Bank is helping government develop a further project in support of public financial management. This project will

continue to support using certifiably professional staffing in critical areas such as treasury operations, procurement, audit and control although possibly not through international consulting firms as has been the case. The project will support the MOF itself, and successively in line ministries with large expenditures and procurement responsibilities, and provinces. Other donors have been contributing to the planning aspect of public finance management (budget making) and resource mobilization (customs and taxation).

Reflecting the need for these core reforms to extend beyond apex institutions in Kabul, the Bank will actively support the dialogue between government and donors in order to come to a consensus on sub-national governance, capacity building and local service delivery. Building on the analytical work to date on sub-national structures and financing, the Bank will support MoF and line ministries in using the budget process to make expenditures at sub-national level more effective and equitable, through improving provincial allocations on a sectoral basis and integrating community and sub-national government planning and accountability mechanisms into the overall public financial management framework. Maintaining the delivery of essential services in a fiscally sustainable manner is important to building the credibility of the state. The Bank will continue to support, and encourage coordinated donor support for, national programs in education and health, while examining opportunities to enhance affordability and accountability of results to citizens. Community participation to support and monitor social services provision will be strengthened, as well as the capacity of provincial and district level public sector staff and NGOs. While continuing to manage the ARTF-funded Management Capacity project the Bank will consult with government and donors on a strategy for transitioning away from that ad hoc remuneration and employment practices in government, and for building a coherent capacity building framework for the civil service over time.

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Sub-national Governance

Priorities for Action

- Consider short-term local governance programs in terms of local insecurity and conflict dynamics, and outline a clear transition to show people how these transition to sustainable governance and service-delivery reforms to increase legitimacy over time;

national development local level

- Unambiguously support established and further improved community-based programs across sectors as the appropriate avenue of support to local all areas of the country where they can be implemented, in order to build empowerment and ownership over longer-term development;
- Clearly and more concisely define the different roles and responsibilities of line ministries, governors, elected representatives, and municipalities in delivering improved services, and develop a clear political consensus around these; clarify the role of governors in the coordination of provincial planning and problem-solving, sub-national ministerial departments in budgeting and delivering services, and elected representatives in ensuring monitoring and accountability of those services;
- In order to improve the fairness and transparency of public spending across all parts of the country, improve sub-national resource allocation within ministries through the adoption of transparent budget allocation criteria; shift public financial management, planning and execution responsibilities downward within ministries to local departments; support the capacity of these departments by reorienting public administration reforms to sub-national needs;
- In order to better connect resources and programs to these processes, coordinate among government institutions and with donors through transparent mechanisms such as the Sub-national Governance Task Force, and through the continued improvement of a coherent and feasible sub-national governance policy with all stakeholders.

Context

Weak capacity and poor planning, budgeting and execution of services at sub-national levels combines with a lack of local accountability to drain legitimacy from the state and undermine outcomes across security, governance and development dimensions of Afghanistan's national strategy. Efforts over the past two years have not sufficiently integrated sub-national governance programming into a more coherent strategy. Stabilization initiatives aimed at the most insecure districts and provinces have unclear linkages to longer-term governance – for example, the adoption of selected local councils and local militia to secure areas have not been accompanied by clear plans to follow these efforts with more

sustainable reforms, and attention to rapid service delivery at the district level must be reconciled with sustainability and capacity to prevent mismatched expectations among the population and to bring efforts inside government systems such as the national budget.

The sub-national governance policy process has correctly identified the need for a more responsive system for development and service-delivery that meets the desires of the population for a fair, effective, and transparent system for delivering local services and development. However, by failing to adequately specify and prioritise the responsibilities and accountability relationships between the centre and sub-

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national administrative units, and between different entities at sub-national levels, the policy is not yet an adequate guide to concrete and consistent reforms. By including overly complex prescriptions for sub-national planning and budgeting that are inconsistent with other core ongoing budget reforms, the policy does not yet enable the administrative and fiscal reforms needed for improvements in sub-national service-delivery that can be understood, seen, and felt by the population across all parts of the country.

The combination of urgent concern and new resources, an ongoing policy process, and the coordination mechanism of the Sub-national Governance Task Force present a good opportunity to find a more coherent reform path for local governance in Afghanistan. This will not be the work of a single policy exercise or working group, but an ongoing process requiring the commitment of all government, non-government, and international stakeholders over a period of years.

Issues and Challenges

The most pressing issues and challenges include (a) implementing coherent governance responses to local insecurity, (b) broadening and deepening community and district development and thus links to the state, (c) and developing formal sub-national capacity, resources, and accountability to deliver improved services from provinces and municipalities. Steps can be taken in each of these areas now.

Insecurity of local populations has many aspects: insurgent attacks and intimidation, exclusion from local governance structures, victimization by state and non-state armed actors, lack of secure personal and property rights with inadequate recourse to impartial justice, and vulnerability to intensified conflict between armed forces. In meeting these challenges, difficult choices aimed at addressing one form of insecurity may have unintended effects on other forms. For example, armed militia may

decrease the problem of attacks on road traffic, but may expose local population groups to other insecurities. Similarly, addressing local needs through material assistance after conflict, while important, must be considered in the light of local conflict dynamics and the risk of some groups being excluded from benefits to promote justice and unity. The current emphasis on local governance presence and rapid assistance in insecure areas must be balanced with local conflict analysis and impartial (informal and non-governmental as well as formal) justice.

In moving beyond these immediate responses, it is crucial to continue to strengthen local governance capacities for development through activities that generate local empowerment, inclusion and participation. Here there is a record of success in community-driven development under the National Solidarity Program as well as similar methods under existing programs in areas such as Water, Transport, and District level planning. Several steps are needed to capitalize on these promising foundations. One is to broaden the involvement of communities and their Community Development Councils in the delivery and monitoring of services across other sectors, to better forge a chain of accountability from the local level upwards. A second is to strengthen the transition between immediate stabilization and longer-term community-driven development through improvements to the efficiency and predictability of community-based programs and their responsiveness in areas emerging from conflict. Finally, these methods must contribute to larger projects up to district level more widely across the country, a priority for both donors and government. These efforts must form a transparent path that promotes longer-term perspectives within and between local communities, in order to generate lasting commitment among people to the development process.

At the same time, there is a deep need to improve state capacity to plan, budget, and deliver services at sub-national levels. This capacity has institutional, fiscal, and administrative dimensions. Institutionally, further clarification of the roles and responsibilities of sub-national administrative entities is needed. This clarification should reinforce the central role of line ministries in delivering services to the people by shifting functions for planning and implementing downward to sub-national line ministry departments,

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while supporting the role of governors' offices in coordination and problem-solving, and deepening the role of elected representatives in planning, oversight and accountability. Fiscally, this process can be

supported within the framework of a unitary national budget by improving the sub-national allocation of resources by central ministries through the adoption of transparent resource allocation criteria, the devolution of budget authority to provincial departments, and a clarified framework for funding municipal responsibilities. This process, by making resources fair and transparent, will strengthen the government's ability to negotiate support for its budget with its international partners, its National Assembly, and its people. Equally important from an administrative point of view is the removal of bottlenecks in the spending of local budgets through expansion of public financial management reforms beyond Kabul, supported by a sub-national emphasis in civil service and staffing reforms.

A focus on these priorities will encourage a more coherent approach to reforming sub-national governance through realistic and achievable steps by building on the strengths, experiences and lessons of the system to date. These steps will increase the transparency and control needed to make resources effective at sub-national levels, which in turn contributes to donor confidence, and most importantly, improves the people's view of their government's efforts at local levels.

World Bank Role

The World Bank has strengths to offer. As a primary partner in both public financial management and public administration reform, the Bank can orient its assistance in these areas to strengthen financial management and civil service reforms for sub-national levels. Rollout of public financial management systems to provinces is already underway and will be a key enabler of reform, while civil service reforms and capacity-development can increasingly emphasize sub-national needs. As a key partner in developing community-based methods in Afghanistan's national programs, the Bank also can play a key role in supporting the deepening and broadening of this bottom-up dimension of local governance.

The Bank will continue to contribute to designing, funding, and coordinating national programs to deliver local services across a range of sectors including rural development, education, health, transport, justice and power. As these programs evolve, the Bank can contribute to reforms to bring resources and responsibilities down to local levels of the ministries. In support of this process the Bank is already engaging with Ministry of Finance and line ministries on how to make the budget process more effective, transparent and equitable for all Afghanistan's people. Finally, as a key donor and the manager of the ARTF, the Bank has an important convening role in the longer-term evolution of sub-national governance policy. The Bank can help in pushing for active coordination processes, for example

through the Sub-national Governance Task Force, or via analytical and advisory assistance – for example by helping to reconcile differing policy views within the government on sub-national financing.

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Public Financial Management

Priorities for Action

□ Strengthen technical Assistance on PFM. The Government has encouraged donors to put more and more money on budget. The record of transparency and fiscal discipline is good but rests on technical assistance that must continue since there is inadequate capacity in the civil service to develop policy and run the PFM systems. The piece meal approach on TA on PFM has worked in some areas but not others. A pooled approach should be pursued at least for all the budget implementation and accounting side of PFM; this could be best supported by an operation under the ARTF.

□ Improve capacity in PFM. The Government must address civil service capacity in PFM. The options open to the Government include the following.

□ Civilian Surge. The USA has already advanced the idea of funding a Civilian Surge whereby scores of international TA would be assigned to ministries in line with requests made by the same. UNAMA is already implementing the first stage of this program. The WB and the EC have expressed the view that the provision of TA alone outside of sector specific technical assistance projects won't touch the capacity building problem in a substantive way. The donor funding of specific specialist positions without the underlying reform program and project support leaves out the related needs assessment, training component and sequencing of reforms, all of which should define the inputs. In any case, this Civilian Surge on its own, outside of projects already developed to support sectors, competes for resources needed to support the sector strategies already calling for donor resources.

□ Different Regime of Service. Given that skills are developing in the market the Government could access these by establishing more competitive compensation

for key and scarce skills under a set of special regime of service for IT, accounting, auditing and procurement to attend the core functions under PFM. These special regimes could be paid for under investment projects

□ Performance Bonus to PFM Staff. In major reform related areas services are being performed by national consultants. These services could be taken over by civil services who take undertaking training but need additional monetary incentives if they are to be retained in the civil service and perform at a high level. An economical approach is to offer additional compensation for specific outputs. This scheme could be extended to all areas of PFM.

□ Anti-corruption. The MoF anti-corruption plan presents a good base for the supply side of anti-corruption, that is strengthening constraints on corruption. Exploration of creating more demand by civil society should be undertaken.

□ Provincial Capacity and Provincial Spending. Donors have expressed interest in improving service delivery in the provinces though the use of a standards-based allocation of the budget under the centralized ministries. Whether this approach is adopted or whether there is some fiscal decentralization there will still be a need for transparency and efficiency in the implementation of the budget. The current budgeting implementation arrangements

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payments in which are grounded in the AFMIS system, the centralization of accounting and employed by Treasury and central facilitation of procurement could and should be provinces provincial authorities to implement the budget. The roll-out of AFMIS to the would enhance the support that MoF could provide on provincial operations.

Context

Both the first and second Transitional Support Strategies for Afghanistan and now the Interim Strategy Note emphasized the need for Afghans to be in the driver's seat with regard to managing the reconstruction and development process. Under the government's steadfast direction, donors had increasingly supported government programs and accepted the budget as the instrument for managing donor resources. In parallel, the government has committed to manage resources in an effective and

transparent manner, with an increasing emphasis on rules-based economic governance and effective capacity building.

In support of these objectives, and within the governance and public administration reform agenda, the Bank's strategy has been to identify pragmatic opportunities for action in the short term, initiating a set of immediate reforms which would be supportive of longer term improvements in public financial management entailing: i) ensuring that emergency capacity is in place in key fiduciary areas – while launching medium term capacity building efforts; ii) undertaking extensive diagnostic work along with ongoing technical and policy advice to identify and address key constraints; iii) identifying short-term goals that are fully owned by government and agreed with all major donors; and iv) providing gap financing when needed.

The IDA funded technical assistance on PFM projects primarily supported the first and second prongs of the above strategy. Other Bank instruments, including analytical work (PEFAs in 2005 and 2007 and the Vulnerability to Corruption Assessments of 2008) and policy dialogue in administrative reform, as well as the Programmatic Support for Institution Building (PSIB) adjustment operation, have supported the third and fourth components.

This strategy initially focused on achieving progress in the governance and public financial management reform area through quick-wins, and in ways that did not undermine medium-term goals. As the Bank engaged in an increasingly substantive policy dialogue with the government in the area of public financial management reform, a progressive shift had been made towards supporting medium-term solutions to build capacity within government, including: i) support for the broader public expenditure legislative reform agenda covering budget, procurement, and audit laws; ii) strengthening sub-national governance through the Afghanistan Stabilization Program; iii) ministry rationalization; iv) reforming pay and payroll systems; and v) strengthening financial control, reporting, audit and procurement systems.

As evidenced both in the increasing level of on-budget development spending and the PFM performance indicators documented in the PEFA studies, the public financial management functions are performing satisfactorily in attaining acceptable standards in developing the necessary regulatory frameworks. Specifically a new modern, robust public financial management and procurement legal framework has been promulgated and is under implementation. Outcomes include more and more contracts being processed in line with the new procurement laws, and Government maintaining adequate

control and reliable reporting of budget operations. All of these has allowed donor funding through the Government budget to increase year on year from 2002 to 2009 and development expenditure to rise from \$ 165 million in FY 2003/04 to \$ 891 in FY 2008/09. A similar rise in revenue can be attributed to reforms on the reforms in policy and administration of income tax and customs. While external audits of donors funds by the CAO with the assistance a firm of public accountants is done to a high standard, only limited

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progress has been made in strengthening internal and external audit capacity although work practices tools have been developed and the timeliness and quality of the Qatia review has improved.

The approach followed to attain these results rested first on the commitment of MoF to fiscal discipline and transparency whose implementation was supported by the centralization of accounting and payments in Treasury for the entire Core Budget and the establishment and operation of a automated integrated financial information system to support Treasury. Similarly, a government-wide centralized procurement facilitation operation was established under ARDS to assist and review all major procurement in the non-security sectors of the Core Budget. To assist with this work the Government accepted technical assistance for direct operations support in the areas of Treasury, procurement and external audit. Firms have been in place in these areas since 2003 and there is agreement that this will continue for the mid-term.

Issues and challenges

Sustainability of Current Capacity. The current good performance in PFM depends on international advisors for policy input in PFM and on local consultants who are not available at civil service compensation rates because adequate capacity has not been developed in the civil service. This is the situation in Treasury, external audit and procurement across government. Training of civil servants is being delivered but needs to be intensified and matched by improvements in compensation to both motivate staff and retrain newly qualified staff. In the line ministries, some progress has been made in training procurement staff but generally PFM functions are staffed with inadequately trained or qualified staff and high performing ministries with large development budget depend on consultants to carry-out these duties. In discussion between the Bank and MRRD for example the Ministry expressed a lack of interest in investing in training or incentives for civil servants given the abundance of

funds with which to
hire individual consultants to carry-out routine Ministry-wide functions.

Procurement Decentralization. The Public Procurement Law allows for interim arrangements for the centralized of facilitation of procurement. While these expire in 2011 the phase out should be gauged to the capacity for procurement processing in the line ministries.

Provincial Level Operations. While the level of development expenditures rose for 5 years and leveled off in SY 1387, there is limited capacity in the Provincial offices of the line ministries to propose and execute development expenditure. Both budget preparation and program delivery in terms of capacity for procurement planning and execution need more attention. Related to provincial operations is the growing difficulty for central oversight bodies both Government and donors to supervise conflict affected areas. The extension on-line access to the AFMIS system is providing more control and access by centralized authorities

Corruption. The control environment, on which Afghanistan's PFM formal controls, rest is undermined by corruption in its various forms and manifestations. This is increasingly seen as one of the most important threats to Afghanistan's entire state-building and to delivering public services. The GOA recognizes the critical importance of addressing corruption and the MOF is seeking advice on how to fight it. The MoF has recently circulated an Anti-Corruption Plan for comments which covers the key recommendations of the WB Vulnerability to Corruption Assessments. Actions under the plan should consider the WB comments and should be initiated without delay. Key among the action is the restoration of Article 61 of the Public Finance and Expenditure Management Law regarding the government-wide mandate for the Internal Audit Dept of the MoF and the enactment of a new law for the external audit in the public sector.

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Donors' Role

On World Bank's technical assistance on PFM, its current support for PFM reforms and operations support is provided through the PFMR project and through the budget support policy actions of the ASI PDG; and with the Customs Reform project on the revenue side. Revenue operations and budget reforms are supported by DFID principally.

The IDA funded PFMR project closes in 2010 and while the Afghanistan ISN indicates that

the Bank
will continue to strengthen core government systems as a basis for credible state building, through efforts to strengthen public financial management and improved transparency and accountability, the IDA program does not include the renewal of PFMR.

The current comprehensive budget, the centralization of accounting and payments for the entire budget and the centralized oversight of procurement through ARDS (over specified thresholds) and high standard audits of donor funds have all contributed to both fiscal discipline and transparency and are behind the decision of the USAID to move more funds on budget and for other donors including the WB to keep funds in the Government mainstreamed systems. The performance of this framework however rests on the direct operations support by international consultant firms in Treasury, ARDS and the CAO. It is also time to accelerate PFM capacity building and to extend both the support and the capacity building to line ministries and provincial offices of the MoF.

USAID would like to step up its impact of PFM and ensure that the fiduciary framework used for WB operations on-budget be maintained for their funds which are now coming on budget. It has noted the opportunity to move from direct implementation on PFM and make a significant invest in this area by providing funds with a preference for PFM to the ARTF Trust Fund. In discussions between the Bank and USAID, a very rough outline of the components and costs gave a figure of \$ 60 million over 4 years. USAID has a large project on TA on PFM underway, the Capacity Development Project, but no key processes are dependent on this program nor were any key reforms brought about with their support.

DFID on the other hand has, since the beginning of the Reconstruction, provided support for international and local advisors in the Budget and Revenue Depts. There are 70 local paid under this program who do the key budget preparation work, as well as support to the Revenue Dept. This support must continue if Budget and Revenue reforms and performance are to continue.

Priorities for Action

- 1) Contain unanticipated increase in non-security wages and salaries
 - ☐ Prepare semi-annual Pay and Grading (P&G) reform report/ action plan and implement
 - ☐ Reflect results of the reports in budget & Medium-Term Fiscal Framework (MTFF)
- 2) Improve predictability of security sector operating budget
 - ☐ Involve MoF in decision making process of Afghan National Army (ANA) and Afghan National Police (ANP) with establishing ministry level committee with donors (2010/11)
 - ☐ Agree upon and assess future financing plan based on the sizes of ANA and ANP, on a semi-annual basis (2010/11)
 - ☐ Reflect the results in the budget and MTFF (2011/12)
- 3) Improve Medium-Term Fiscal Framework and initiate Medium-Term Expenditure Framework
 - ☐ Analyze and estimate future recurrent costs associated with core and external development budget (start mid-2010), and incorporate results in MTFF (2011/12)
 - ☐ Prepare realistic costing under revised sector strategies (start 2010/11) under ANDS mid-term review
- 4) Ensure predictability of grant financing for the core operating budget
 - ☐ Formulate realistic multi-year financing strategy for the core operating budget (2010/11 and after)
 - ☐ Align financing decision and sharing financing information with Afghan budget calendar (2010/11 and after)

Context

Afghanistan is one of the poorest and most aid dependent countries in the world, with overall aid in 2008/09 amounting to \$6.3 billion or 45% of GDP [6]. The critical issue is not so much the amount of aid to Afghanistan but its mode of delivery and impact. Aid has made a significant difference to Afghan lives since 2002, but its impact has been limited by major weaknesses. Three-quarters of the national budget bypasses the Afghan government, which undermines efforts to build effective state institutions. Much more aid needs to be on-budget and aligned with Afghan priorities. The budget is unable to serve as the key tool of national development policy. But there are good signs. In nominal terms core budget expenditures doubled in the last three years to reach \$2.2 billion in 2008/09, demonstrating rising absorption capacity for funding channeled through the budget. Greater potential exists for the budget to absorb donor funds if channeled through mechanisms such as ARTF with sound fiduciary controls. Currently, only 60% of the operating budget is covered by domestic revenue, and the rest is financed by donors through the Afghanistan Reconstruction Trust Fund (ARTF), the Law and Order Trust Fund for Afghanistan (LOTFA) and other smaller sources of assistance. Though Afghanistan is forecast to depend on aid support for the foreseeable future, demonstration of bare minimum fiscal

sustainability is essential
for the continuation of donor support and reinforcing of state legitimacy.

Issues and Challenges

The prospect of fiscal sustainability is receding as the size of the security sector grows, P&G reforms are implemented, and O&M requirements increase as public investments come on line. Using the simple definition of fiscal sustainability as achievement of a 100% ratio between domestic revenues and

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Including aid to both the core and external budgets.

operating expenditures, progress towards fiscal sustainability has fallen well short of expectations.

Between 2002/3 and 2006/7 fiscal sustainability
Indicators 1/

improved from 38% to 67%, but has subsequently
deteriorated. In the 2005 MTFF, the government

planned to achieve fiscal sustainability by

2009/10. However, in 2008/9 it actually dropped

to 60% (Figure 1) mainly due to higher than
expected operating budget expenditures which
grew by 60% between 2006/7 and 2008/9 mainly
as a result of growth in the security and education
sectors.

Wages and salaries are the biggest items in the

operating budget at roughly 70%. The education

2006/7 2007/8 2008/9

and security sectors account for more than 80% of
total government employees. Security is by far the 1/ Domestic revenues / operating
expenditures

largest source of operating expenditures. In 2008/9

the sector accounted for 46% of total operating expenditures and this is set to grow as
the sector expands

over the next few years. But even aside from security sector costs, P&G reforms in the
mainstream civil

service will continue to put upwards pressure on the wages bill further delaying fiscal
sustainability. The

government needs to improve management of its wage bill and domestic revenue collection.
Neither of

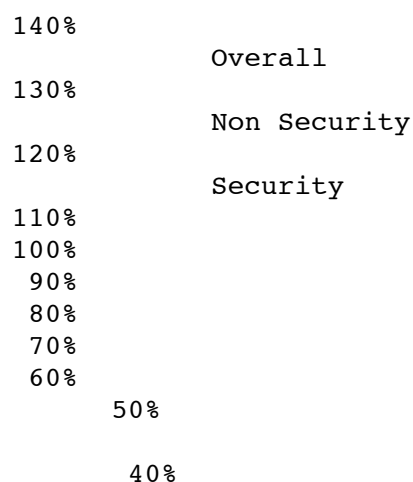
these is easy. The biggest risk to wages is the spiraling cost of the security sector.

The latest MTFF projections (July 2009) by the Ministry of Finance indicate that the
overall fiscal

sustainability indicator is expected to reach 98% by 2014/15. But this is based not only
on heroic

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Figure 1 Fiscal Sustainability



2003/4 2004/5 2005/6

Source: MoF, World Bank

assumptions about revenue mobilization (10.8% share of GDP as opposed to the current 7%) and GDP growth prospects at over 9% per year, but it also excludes all O&M and other costs currently paid by the external budget, and assume a combined Afghan National Army and Afghan National Police force of only 216,000 against a likely combined force of more than double this.

The recurrent cost implications of increases in the development budget are a major concern, especially the 'contingent liabilities' for the operating budget that exist in both in the external budget and in the core development budget. These future liabilities relate, in particular, to the operations and maintenance costs of capital investments in equipment and infrastructure as well as pension liabilities and the various enhanced packages paid to civil servants and consultants by donors to implement ongoing programs and keep the wheels of government turning.

Illustrative scenarios suggest that increasing development spending by an additional one billion dollars per year over the next five years will worsen fiscal sustainability by 3 percentage points by the fifth year. To illustrate the connection between higher operations and maintenance costs and the investment budget we can envisage three scenarios—a base scenario based on current MTFF projections (with no additional funds), a medium scenario based on a \$0.5 billion increase and a high case with an additional \$1 billion of assistance —based on current core development expenditure projections.

Bank's Role

- ☐ Provide analytical supports, for example, through the Public Expenditure Review;
- ☐ Participate in a technical working group on the security sector fiscal sustainability;
- ☐ Advice on the MTFF and MTEF;

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Gender

Priorities for Action

- ☐ Increase girls' and women's access to education, health, and other services. Enhance the safety and appropriateness of school environments for girls and young women by having separate buildings for girls in secondary school, boundary walls around these buildings, proper water and sanitation facilities for females, and female-only dormitories to house women teachers and girls who live far from schools. In the longer term, MoE and MoHE need to invest resources in not only increasing numbers of female teachers, but also ensuring sufficient quality and retention—e.g, by using community-level

approaches to train local women as teachers. Training local women in basic health care provision will improve female access in those communities to more fundamental health services, such as child immunization, nutrition training, and reproductive health services that can be provided inside the home (especially during delivery).

□ Enhance women's productive employment. Train more women as extension trainers in agriculture and livestock production to help local women working build productive capacity in culturally appropriate ways. Set aside budget to provide stipends for Maharam—male family members to accompany women extension trainers who train women in other communities. Similar approaches that work around women's mobility constraints could be employed in vocational training programs, such as the National Skills Development Program (NSDP).

□ Improve women's access to financial markets, control over assets, and awareness of rights. Train women in how to manage loans and build sustainable businesses so they can more productively utilize credit, create small businesses, and repay loans. MFIs could refer clients to other sources of training e.g., in GoA projects such as the Rural Enterprise Development Project (REDP) and NSDP. Use community institutions such as NSP's CDCs to increase community awareness of women's rights to inheritance, protections under Family Law (which in the longer term needs to be reformed where gender inequities persist), and the benefits to family and community of enhancing women's control over land and other assets.

□ Allocate a greater share of budget—at first from external donors and GoA, and solely from GoA in the long term—to line Ministries to better support gender mainstreaming in their projects. Include women at all levels of program staffing and decision-making to ensure greater gender balance in project outcomes.⁷ Collect sex-disaggregated data to document women's and men's involvement in all sectors and enable monitoring of effects of investments.

□ Given the current security situation, nurture initiatives where communities agree to women's engagement in economic activities and other forms of broader public

involvement. A sense of local ownership motivates communities to protect activities that

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A recently completed independent review has found that inclusion of women in NSP's Community Development Councils and assurance that they meaningfully participate in and influence community decision-making requires a dedicated and well-planned approach that is inclusive of female staff at all stages. National Solidarity Program. Particip GmbH. Contract Performance Evaluation of the National Solidarity Programme's Phase II's Facilitating Partners (FPs). 2009.

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can benefit the maximum number of women, strengthening their income earning abilities and opportunities. In the longer term, improved abilities and opportunities help secure women's increased mobility and greater decision-making roles in their households and over their own lives.

Context

Since the fall of the Taliban, GoA policies in support of gender equity and women's empowerment are increasingly common, promulgated in Afghanistan's Constitution (2004), ANDS (2008),⁸ and the National Action Plan for Women in Afghanistan (NAPWA, 2006). GoA commitment to reducing gender-based inequities is evident from its adoption of the Millennium Development Goals (2004) and signing of the Convention on the Elimination of all forms of Discrimination Against Women (CEDAW, 2003).

Although Afghanistan remains among the world's lowest-ranked countries in many dimensions of gender equality,⁹ it is important to note the progress that has been achieved in just eight years. Girls' primary school enrollments have risen from essentially 0 percent in 2001 to more than one-third of all primary enrollments. NSDP has consistently managed to exceed targets of 35 percent women among TVET recipients. Women comprise more than 60 percent of microfinance clients nationwide, accessing credit markets at greater rates than ever before. Afghan women's enhanced access to financial markets to be positively correlated with improved immunization rates and health service-seeking for young children, increased involvement of the women clients in decision-making of their households, and modest improvements in socio-economic status. There have been great gains for women in some areas of community decision-making as well: thanks to NSP, for the first time in history Afghan women's participation is institutionalized in CDCs, the decision-making apparatus of rural

communities. In many urban areas, women are increasingly employed in government sectors associated with women's issues, such as health, education, and MoWA and its provincial directorates.

Issues and Challenges

There remain vast gender inequities across all social and economic sectors, with Afghanistan lagging other South Asian countries in health, education, and employment outcomes for girls and women. This is in large part due to (a) the lack of female teachers and trainers in most schools and job training programs—in particular in rural areas—and women health care providers, and (b) cultural mores that discourage the teaching of girls and women by male teachers and delivery of health services to females by male providers. UNICEF estimates Afghanistan's maternal mortality rate (MMR) to be 1,600—the second highest MMR in the world after Niger. According to the Afghanistan National Risk and Vulnerability Assessment (NRVA) 2005, nationwide literacy rates are 36 percent for males and 18 percent for females over age 15, but as low as 10 percent for females in rural areas. Even in urban areas, school attendance drops dramatically as girls reach puberty, so that only about one-fourth of high school and 18 percent of higher education students are female. Women who receive vocational training have lower rates of job placement than male trainees. Although women comprise up to 65 percent of the agricultural workforce, their economic participation is primarily family-based and without remuneration, as it is not accorded a monetary value. The average wage for urban women who work outside of

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The Afghanistan National Development Strategy (ANDS) has identified gender mainstreaming as a primary strategy for attaining gender equality, "To eliminate discrimination against women, develop their human capital, and promote their leadership in order to guarantee their full and equal participation in all aspects of life in Afghanistan (Islamic Republic of Afghanistan, 2008, Afghanistan National Development Strategy).

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At .310, Afghanistan's Gender Development Index is the second-worst in the world (Source: Afghanistan Human Development Report, 2007). UNDP estimates Afghanistan's maternal mortality rate (MMR) to be somewhere between 1,600 and 2,200 per 100,000 live births—the highest MMR in the world.

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agriculture (less than 18 percent of the urban labor force) is less than 60 percent of urban men's average wage.¹⁰ Violence against women—in the household as well as in the workplace, in the form of sexual

harassment—is prevalent. In rural areas, where more than 75 percent of the population resides, early marriage, bride price, and denial of women's inheritance rights are common practice. When such a large portion of the female population is underutilized, neglected and even exploited, it is at great cost to social welfare, economic growth and poverty reduction for all Afghan people.

Bank's Role

Officially endorsed and launched by the MOWA in 2006, the Bank's Country Gender Assessment (CGA) of Afghanistan has documented the situation of women within key sectors of society such as health, education, agriculture, employment, microfinance, and the legal sector.¹¹ Under the prevailing social, economic and political conditions, the CGA recommends interventions in support of gender equity that inform the priorities for action listed above. A broad-based, Bank-funded gender mainstreaming program has helped operationalize many of the CGA recommendations in the past two years across the Bank's lending portfolio. Gender mainstreaming will continue across development sectors as gender-sensitive interventions are increasingly prevalent in Bank-supported projects in the line Ministries. Projects that have made progress in gender mainstreaming and/or have great potential to do so include the Afghanistan Skills Development Program (ASDP), which supports both the NSDP of MoLSAMD and MoE's the TVET program; MAIL's Horticulture and Livestock Project (HLP); MRRD-led NSP and REDP; EQUIP and SHEP in MoE and MoHE, respectively; and Bank-supported projects in partnership with the Microfinance Investment Support Facility for Afghanistan (MISFA). MoWA has been working with the Civil Service Commission on gathering gender-disaggregated data from GoA Ministries for a gender analysis as part of the Bank-supported Civil Service Reform Project (CSRP).

So far funded largely by the Bank's Gender Board and external donors, gender mainstreaming in the Bank's lending portfolio has also included the following activities: (a) the CGA follow-up initiative mentioned above, Operationalizing CGA Recommendations; (b) sector-specific studies of (i) Household Decision-Making and School Enrolment, (ii) Micro-finance and Gender Roles, (iii) Gender-sensitive study of Rural Access and Mobility, (iv) Knowledge on Fire: Attacks on Education in Afghanistan, (v) Facilitating Women's Participation in AREDP, and the ongoing (vi) Gender Dimensions of Trade Markets, (vii) Gender Equity in NSP, ; and (c) the stand-alone Female Youth Employment Initiative (FYEI), a job-training pilot (still in preparation phase) designed to ease the transition of young Afghan women from school to the workplace. As committed in the Bank's new Interim Strategy Note (ISN

FY09-11), in the coming ISN period, it is expected that more internal resources will be made available, while at the same time leveraging external sources from donor partners, to ensure sustainable gender mainstreaming across the Bank portfolio, not only at the preparatory stages but also for provision of continued support and assistance to overcome obstacles or to address challenges which may arise in later stages of implementation.

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Ministry of Labor, Social Affairs, Martyrs, and Disabled (MoLSAMD). 2008. An Urban Area Primary Source Study of Supply and Demand in the Labor Market. Kabul, Afghanistan: Labor Market Information and Analysis Unit, under National Skills Development Program.

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World Bank. 2005. Afghanistan: National Reconstruction and Poverty Reduction – The Role of Women in Afghanistan's Future. World Bank: Washington, DC.

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Environment

Priorities for Action

- Establish or appoint a high level multi-sectoral body tasked with creating a comprehensive long term vision for sustainable development of natural resources in Afghanistan that would consider the economic, environmental, and social expectations/outcomes from major priority development projects (eg. Aynak mining project) and developing an integrated plan to address these concerns.
- Develop a regulatory system for the Aynak mining project which would establish clear policies and procedures to meet the contractual obligations and requirements under the Environment Law, particularly as it relates to environmental and social impact assessment, and establish clear roles and responsibilities for National Environmental Protection Agency and Ministry of Mines.
- Strengthen the institutional capacity among environment and sector agencies, especially those with responsibilities for implementing/regulating development projects, in understanding sustainable development principles, managing environmental and social impact assessments, and monitoring compliance and enforcement.
- Prioritize activities recommended in the Kabul Urban Air Quality Strategy

based on their relative expected impacts/benefits and level of difficulty in implementation, including developing a program to phase out older vehicles coming into Kabul; expanding air quality monitoring data and establishing ambient air quality standards; and developing a program to promote public awareness of urban air quality issues.

Context

It is estimated that approximately 80% of the population of Afghanistan relies on the natural resource base to meet its daily needs. According to UNEP post-conflict environmental assessment, the livelihoods of many Afghans are under threat from environmental degradation caused by a combination of conflict, poverty, population growth, and survival tactics. The decline in the natural resource base has also increased vulnerability to natural disasters, food shortages, and human health risks. Environmental degradation can be found in the country's surface and groundwater, forests and rangelands, wildlife and biodiversity, and urban environment.

The Afghanistan National Development Strategy (ANDS) recognizes that as economic development occurs, proper attention to environmental protection is required. The ANDS explicitly states, "Environment is a cross-cutting issue, must be mainstreamed across all sectors and in each program area through the development of policy benchmarks to ensure that the Government, donors and implementing agencies follow established norms with respect to the incorporation of environmental considerations into the design and implementation of projects, and provide adequate oversight and monitoring of the environmental impacts of economic and social development projects."

Afghanistan has taken some important steps towards better protection of its natural resources and environment. In 2005, the Government of Afghanistan established the National Environmental Protection Agency (NEPA) and in the same year, Afghanistan's first Environmental law was drafted and signed into

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law. The Environment Act establishes an important legal framework for promoting sustainable development and managing Afghanistan's natural resources, and other environmental legislation (eg. Forest Law and Rangeland Law) are waiting approval or under development. The challenges lie in the institutional capacity and effective implementation of these laws.

Issues and Challenges

Mineral Development : The Aynak copper mine project is the first major private investment in Afghanistan with the potential of creating tremendous opportunities for economic development, but can also bring significant adverse economic, environmental and social consequences if not developed in a sustainable manner. The Aynak project falls within the water catchment area for Kabul and the potential for contamination of ground and surface water is great, as well as posing serious water supply issues for entire catchment area from the mining operation as well as the ancillary facilities. In addition to water impacts, mining and related infrastructure development will generate serious air emissions (including greenhouse gases) which will have an impact on the environment and community health. There are also significant social implications for the surrounding communities that may be created by the Aynak project and have been voiced by some community representatives. These concerns include the potential physical displacement of communities to enable mining operations, conflicts from population in-migration to the project site, and community health and safety issues from routine operations.

Under the Aynak contract, the MCC-Jiangxi Copper Consortium (MCC) has committed to comply with the environmental laws and regulations of Afghanistan, World Bank Environmental and Social Safeguard Policies, and the Equator Principles. There is an urgent need to establish an effective environmental and social management system to ensure that the Aynak project is designed and implemented to meet these commitments and sets the performance standard for future major investments in the pipeline such as the Hajigak iron ore project. This would include institutional strengthening as noted below and establishing Environmental Impact Assessment (EIA) Advisory Board of experts as required under the Environment Law. In addition, it will be important for the GoA to establish a comprehensive and long term vision/plan for the expected economic, environmental, and social outcomes from the Aynak project, including the entire area of influence - the mine, processing facility, power generator facility, railroad line, and related development. This will require a multi-sectoral approach which would integrate the economic, environmental and social expectations/outcomes with participation from affected communities.

Institutional Strengthening: The National Environmental Protection Agency (NEPA) was established with the legal responsibility for making and enforcing national environmental policies and regulations, including the EIA system. However they lack sufficient technical capacity, training, equipment and budgetary resources to effectively meet their mandates. Another major institutional challenge is that

while NEPA has the legally mandated responsibility for overall protection of the environment in Afghanistan, implementation of environmental policies, such as EIA, rests with the line agencies. Consequently, the ability of NEPA to ensure EIA compliance and enforcement in key development projects relies heavily on the institutional capacity of the line agencies as well.

The line agencies have the same institutional constraints regarding lack of technical capacity, training and resources that confronts NEPA. The Ministry of Mines has established an environmental unit, but there is very limited, if any, technical experience in environmental issues and environmental impact assessments. Moreover there is no knowledge at all of the social issues and social impact assessments associated with mining projects. There is an immediate need for training in environmental and social management issues as it relates to mining and long term this institutional capacity should be expanded to cover all major sectors. A formal mechanism for inter-agency coordination on the environmental review and enforcement of development projects to ensure the proper integration of cross-sectoral concerns is also needed.

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Urban Air Quality: According to the Ministry of Public Health, worsening air pollution in Kabul is seriously threatening public health and it is predicted that more than 3000 people will die in Kabul every year from diseases aggravated by air pollution. It is projected that 75% of the air quality problems in Kabul come from the transportation sector. There are an estimated 678,000 vehicles and additional 9,000 vehicles are registered a month. More than 80% of these vehicles are at least 15 years old or older with limited, if any, fuel efficient technologies and poor standards of vehicle maintenance. Another major air pollution problem is the poor quality of imported fuel and the adulterated fuel mix. The inadequate road network in Kabul is also a major contributor to air pollution, due to low carrying capacity and low surface quality resulting in high concentration of airborne dust. There are approximately 800 kilometers of roads in Kabul, but only a small portion of the road network includes asphalt roads. The Ministry of Transport and Civil Aviation believes that without a master plan for Kabul, roads cannot be widened to accommodate less polluting alternative public transportation and traffic management measures will be very difficult to implement.

From an industry perspective, the primary sources of industrial air pollution are brick kilns, bakeries, bathhouses, and other food processing units that burn wood, rubber, plastic as fuel. While many

industries are either not functioning or partly functioning after several decades of war, the government is planning to rehabilitate several damaged industries and create a new industrial park beside the existing industrial park close to the center of the town. In addition, construction has been a main driving force in development and to meet the increasing demands for road construction, the number of asphalt mixing units in the country is increasing along with the toxic emissions they generate. As development increases, the industry sector will also grow along with the increased demand for power which will contribute to urban air pollution.

Bank's Role

The Bank's Interim Strategy Note for FY09 – FY11 recognizes that environmental and social considerations and institutional capacity building are cross-cutting themes that must be incorporated into all of the Bank's assistance efforts. This is particularly important for Pillar III – Supporting Growth of a Formal, Modern and Competitive Private Sector – where support for the national infrastructure and private sector development will require rigorous environmental and social review. The Bank's assistance to the GoA includes a two year non-lending technical assistance program to the National Environmental Protection Agency and Ministry of Mines which includes: (i) institutional assessment of NEPA's environmental policies and implementation capacity; (ii) training programs on environmental and social management; and (iii) technical assistance in developing regulatory framework for managing Aynak.