Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 11-Sep-2018 | Report No: PIDISDSC25343

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Parent Project ID (if any)	Project Name
Afghanistan	P168274		Afghanistan: Fiscal Stability Facility (P168274)
Region	**Estimated Appraisal Date**	**Estimated Board Date**	**Practice Area (Lead)**
SOUTH ASIA	Oct 17, 2018	Nov 05, 2018	Governance
Financing Instrument	**Borrower(s)**	**Implementing Agency**	
Investment Project Financing	Islamic Republic of Afghanistan	Ministry of Finance	

Proposed Development Objective(s)

Supporting fiscal stability in Afghanistan during the period of political transition through financing of eligible recurrent expenditure.

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	100.00
Total Financing	100.00
of which IBRD/IDA	0.00
Financing Gap	0.00

DETAILS

Non-World Bank Group Financing

Trust Funds	100.00
Afghanistan Reconstruction Trust Fund	100.00

Environmental Assessment Category	Concept Review Decision
C - Not Required	

Have the Safeguards oversight and clearance functions been transferred to the Practice Manager? (Will not be disclosed)
No

B. Introduction and Context

Country Context

1. **Afghanistan is a deeply fragile and conflict-affected country, where the security situation remains precarious.** It has been in almost constant conflict for 38 years with no durable political settlement. This has had a destabilizing effect on social cohesion, weakening government institutions and rule of law. Gross domestic product (GDP) per-capita is among the lowest in the world, poverty is deep and widespread, and social indicators are still at very low levels. Over half of the population lives in poverty and roughly one-third is susceptible to dropping below the poverty line. Widespread poverty and limited access to services have contributed to poor living standards for most of the population.

2. **Following a sustained period of development progress since 2001, Afghanistan is currently undergoing a difficult adjustment.** Afghanistan sustained rapid economic growth and improved social indicators for more than a decade following the 2001 political transition. School enrollment increased from 0.8 million to over 8 million and life expectancy from 41 years to 61 years over this period. Annual growth in GDP averaged 9.4 percent between 2003 and 2012. However, economic and social progress slowed following the drawdown of international security forces in 2011 and a contested political transition in 2014.[1] GDP growth fell to 2.2 percent in 2016, recovering marginally to 2.6 percent in 2017. Afghanistan also faces a growing humanitarian challenge arising from large numbers of returning refugees (more than 2 million since 2015) and a large and growing internally displaced persons (1.7 million). Drought conditions are contributing this challenge. Armed conflict in Afghanistan claimed the lives of 26,512 civilians and injured 48,931 others between January 1, 2009 and June 30, 2017.[2] In 2017, civilian casualties reached similar levels to the previous year, with 10,451 civilians killed or wounded (down slightly from the peak of 11,418 in 2016). United Nations Assistance Mission in Afghanistan (UNAMA) reports loss of 1692 civilian lives during the first 6 months of 2018 that is highest than any comparable period.

3. **International assistance is declining, leading to weakening demand and follow-on impacts across the economy.** Aid flows decreased from around 75 percent of GDP in 2012 to 45 percent of GDP in 2015. Annual firm registrations have declined by more than half since 2012 while unemployment has increased from 13.5 percent in 2008 to 22.6 percent in 2014, both reflecting falling confidence. The security situation has also led to reversals and increasing disparities in access to services. Recent evidence from household surveys suggests that access to services is declining among the poor.[3]

4. **With an undiversified productive base, the economy relies heavily on foreign aid and public expenditure.** The private sector is extremely underdeveloped, with employment concentrated in low-productivity agriculture. Since 2001, investment has been focused around the aid-driven contract economy. Private sector development is constrained by weak institutions, inadequate infrastructure, widespread corruption,[4] and a difficult business environment.[5] Public expenditure

[1] The number of North Atlantic Treaty Organization (NATO) troops declined from about 130,000 in 2011, to around 15,000 by end-2014.
[2] Afghanistan Protection of Civilians in Armed Conflict Midyear report 2017, United Nations Human Rights *https://unama.unmissions.org/protection-of-civilians-reports*
[3] National Risk and Vulnerability Assessment 2008, Afghanistan Living Conditions Survey (ALCS) 2012 and 2014
[4] Afghanistan was ranked 177th of 180 countries according to the 2017 Corruption Perception Index.
[5] Afghanistan was ranked 183rd of 190 countries in the 2017 Doing Business Survey

constitutes 25.6 percent of GDP; however, foreign grants currently finance more than two-thirds of budget expenditure and substantial off-budget security needs. A large trade deficit, of around 39 percent of GDP in 2017, is also financed almost entirely by aid inflows. With aid expected to decline from around 46 percent of GDP in 2017 to 20 percent of GDP by 2030, and in the context of a rapidly growing population, new sources of growth, employment, revenues, and exports are needed, as are savings from improved management of public expenditure.

5. **Afghanistan faces substantial risks in the short-term arising from the possibility of political instability and violence in the context of upcoming elections.** Elections of 2014 saw a major and unexplained declines in revenues (from 9.6 percent of GDP in 2013 to 8.5 percent of GDP in 2014), likely driven by increased revenue leakage in the context of election-related political economy pressures. The formation of the National Unity Government saw a disruption in reform progress as political competition came to delay the appointment and confirmation of senior officials. Political instability undermined investment confidence, with negative impacts on growth (which declined from 5.6 percent in 2013 to 1.5 percent in 2015). A similarly disruptive election period could have major negative impacts on revenues, investment, and growth over 2018, 2019, and beyond.

Sectoral and Institutional Context

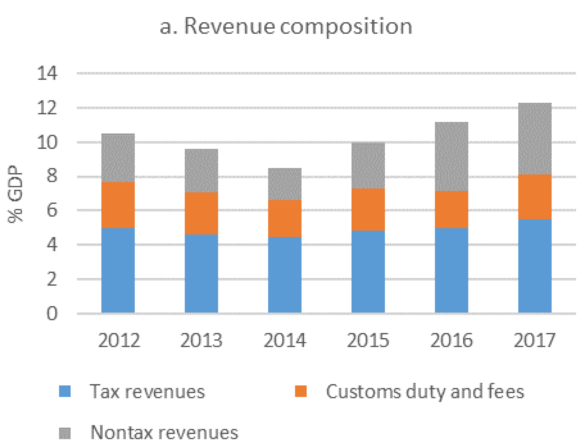
6. **Afghanistan has maintained broadly balanced budgets over recent years, but fiscal accounts are vulnerable due to emerging political and economic risks.** The budget is funded by a combination of aid and own-source revenues and the overall budget balance showed a small deficit in the two preceding years. The government is seeking to reduce the 2018 projected budget deficit from 2.0% of GDP to 0.5% of GDP. However, this objective is dependent on achieving the budget targets for the domestic revenue and foreign aid. The possibility of political and economic instability, in the context of upcoming parliamentary and presidential elections, poses a risk to achieving revenue targets for 2018 that would negatively impact the fiscal balance.

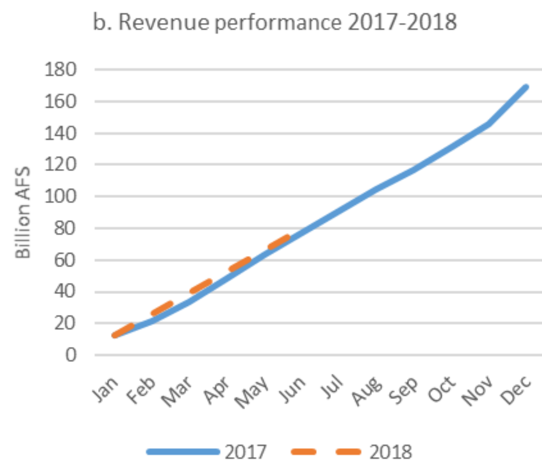
7. **In the previous period of transition, domestic revenues significantly declined, and expenditure arrears accumulated despite donor support.** During the security transition and 2014 elections, domestic revenues declined from 11.7 percent of GDP in 2011-12 to 8.5 percent of GDP in 2014), led by a decline in tax and customs revenues collected at border crossings. This decline in revenue may have had multiple causes – limited control of borders, diversion of revenues, and a reduction of taxable imports relative to GDP. In this context, investment confidence also waned, with negative impacts on growth. In September 2014, the government requested donors for an emergency assistance of US$537 million to cover the budget shortfall but the international community was unable to fill the entire gap. As a result, the government accrued arrears of US$ 200 million related to salaries, operating expenses and discretionary development expenditure at the end of the fiscal year. The government’s cash balance also remained below AFN 5 billion (about US$ 75 million) during most part of the second semester of the fiscal year 1393 (2014).

8. **The upcoming electoral cycle poses a risk to the recovery in domestic revenues since 2014, and revenues have already fallen short of targets.** Domestic revenues grew strongly in the last three years and reached 12.3 percent of GDP in 2017, exceeding the previous peak of 11.7 percent achieved in 2011/12. However, continued violence in early 2018 and large number of election-related incidents appears to have created negative sentiment. During the first 6 months of 2018, UNAMA reports 1692 civilian causalities higher than any comparable time over the last ten years. Business sentiment across nearly all indicators and business types deteriorated since the last quarter of 2017. This had an impact on domestic revenue collection. As of mid-August 2018, revenues have already fallen 3.3% short of IMF targets (approximately US$77

million on an annualized basis). MoF notes that slow business activity, a reduction in retail activity and shortfalls in revenues collected by customs offices as reasons for lower revenue collection.[6]

Figure 1: Revenue growth has been strong for several years, but is now slowing





Source*: Ministry of Finance data*

9. **A decline in foreign aid against committed levels would expose Afghanistan to fiscal imbalance.** The recent PEFA assessment notes volatility in foreign aid impacting revenue and overall budget outturns. Total grants in 2017 fell short of budgeted levels by around US$600 million, reflecting both a shortfall of discretionary grants and weak execution of development projects. For 2018, the government has budgeted foreign aid receipts of US$ 2.6 billion and any significant decline in aid from the committed levels would have negative consequences for fiscal balance.

10. **While public debt remains at negligible levels, Afghanistan is classified at 'high' risk of debt distress under the World Bank-IMF Debt Sustainability Framework.** The most recent World Bank-IMF debt sustainability analysis (DSA) (December 2017) finds Afghanistan at high risk of debt distress despite very low levels of public debt (8 percent of GDP in 2016). The 'high' risk rating is driven by the sensitivity of Afghanistan's debt sustainability to the continued availability of external grants.

11. **The strategic vision of the Government to achieve self-reliance is outlined in the 2016 Afghanistan National Peace and Development Framework (ANPDF).** The ANPDF recognizes that a credible national budget and improved government performance is key to translate policy into tangible outcomes. The main instruments for implementation of the strategy are the National Priority Programs (NPPs) and Fiscal Performance Improvement Plan (FPIP). The FPIP was developed as a five-year rolling roadmap for PFM reform. The first five-year rolling plan was approved in February 2016 with an objective to deliver: (i) more efficient and effective public services; (ii) significantly improved fiscal discipline; and (iii) more strategic use of fiscal policy as a tool for development. To this end, the FPIP targets three key PFM reform areas, including: (i) improving investment performance through strengthened macro-fiscal planning and policy coordination; (ii) ensuring a more accurate, transparent and accountable budget through improving budget preparation and reporting,

[6] Ministry of Finance. 2018. Monthly Fiscal Bulletin, Month 7, Fiscal Year 1397 (2018)

treasury and procurement functions, and revenue and customs management; (iii) building capacity to manage reforms in the areas of HR, administration, finance, IT and communications.

12. **In line with MOF's directive and to support the government's FPIP reform initiative, the Bank has designed a new engagement model ("programmatic approach") that consolidates existing activities into three interrelated and complementary instruments**. The FSP, a US$100 million IPF, constitutes the implementation arm of the new engagement model and is intended to provide critical inputs in the form of upfront investments drawn directly from FPIP work plans. The second instrument, the FPIP Advisory Facility, is a programmatic package of Advisory Services and Analytics (ASA). The third instrument is the Incentive Program (IP) DPG, which is the major channel for multi-donor policy-based budget support to the GoIRA, providing approximately US$300 million per year.

13. **The FSF is designed to support fiscal stability enabling the government to absorb fiscal shocks arising from lower revenue collection due to uncertain political and security situation as well as decline in foreign aid against budgeted levels.** The FSF stretches the government to keep up the efforts to maintain fiscal stability by including withdrawal conditions related to revenue collections, cash management and expenditure management.

14. **The International Monetary Fund (IMF) has also approved a US$45 million three-year Extended Credit Facility (ECF) for Afghanistan in July 2016.** The program supports a policy mix that aims to preserve macro-financial stability by strengthening fiscal and external balances, keeping inflation low, maintaining exchange rate flexibility, adequate cash buffer and foreign exchange reserves.

Relationship to CPF

15. **The proposed project will contribute to the achievement of higher level objectives of the Government of Afghanistan and the World Bank.** It is fully aligned with World Bank's Afghanistan Country Partnership Framework (CPF) 2017-20[7] pillar 1 – "Building strong and accountable institutions". The project is closely aligned with two CPF objectives within this pillar, namely: CPF Objective 1.1: Improved public financial management and fiscal self-reliance, and CPF Objective 1.2: Improved performance of key government institutions and municipalities. Recognizing that tackling fragility and conflict are long-term endeavors, the CPF sets out this core agenda through key interventions to strengthen government capacity, promote economic growth, and support social inclusion. Equally, the proposed project is fully aligned with the ANPDF which recognizes the centrality of a credible and implementable national budget as a key basis for supporting the improvement of government performance in the country's complex circumstances.

C. Proposed Development Objective(s)

Supporting fiscal stability in Afghanistan during the period of political transition (2018 and 2019 elections)through financing of eligible recurrent expenditure.

[7] The CPF is also aligned with country priorities as outlined in the government's "Realizing Self-Reliance: Commitments to Reforms and Renewed Partnership" paper presented to the London Afghanistan Conference in December 2014 and the National Peace and Development Framework (ANPDF). It is based on the findings and recommendations of the Systematic Country Diagnostic (SCD), which was completed in February 2016.

Key Results (From PCN)

16. During the period of political transition and economic instability, FSF would help the government in:

- maintaining revenue collection performance to a reasonable level;
- making timely salary payments to ensure public service delivery;
- maintaining sufficient cash balance to absorb any fiscal shock.

17. Key indicators to measure progress towards achievement of the PDO are:

- % reduction in deviation of revenue outturn compared to the budget;
- %age of salary payments made within 10 days of the close of the month;
- % (Reduced) negative deviation from the minimum liquidity threshold as agreed with IMF.

D. Concept Description

18. **Under the emerging political, security and economic risks, the FSF will support the government to maintain fiscal stability.** The project design stretches the government to keep focus on revenue collection, prioritizing expenditure and maintaining adequate cash balance during the period of transition. The project will reimburse civilian recurrent expenditure when withdrawal conditions are fulfilled, and sufficient recurrent expenditure is verified by the Monitoring Agent, up to the allocated amount.

19. **The FSF will replace the baseline financing of the ARTF Recurrent Cost Window (RCW).** Since 2002, the ATRF RCW remained the primary vehicle for the ARTF donors to finance recurrent civilian expenditures of the government. The Bank, ARTF donors and the government agreed to regularize the ARTF RCW implementation modalities into two standard World Bank operations: (i) a Development Policy Grant (DPG) that was approved on June 14, 2018, and (ii) the proposed FSF that is planned to be effective by November 2018. The DPG incentivizes policy reforms and disburses funds on the achievement of policy actions whereas the FSF is designed to safeguard the government from fiscal risks to a certain extent. While the design of the disbursement arrangements under the ARTF RCW baseline financing did not provide for any conditions beyond the eligibility of expenditures, the proposed FSF will disburse funds against the eligible recurrent expenditures only when the following conditions are met:

- xx percent[8] of the revenue target for the fiscal year 1397 (2018) achieved.
- monthly civil servant salaries within ten days of the submission of claims by the line ministries.
- Not more than 20% negative deviation from the minimum liquidity threshold agreed with IMF.

Box 1: ARTF Recurrent Cost Window (RCW)

The ARTF RCW became effective on May 13, 2002 and provides a coordinated financing mechanism that has enabled the Government of Islamic Republic of Afghanistan (GoIRA) to make predictable and timely, payments for eligible recurrent non-security costs. Since 2002, the ARTF RCW has reimbursed recurrent civilian and capital expenditures of more than US$5 billion to the GoIRA. The ARTF RCW consists of the following three modalities:

i. **Baseline Recurrent Cost Financing:** In 2002, when the ARTF and the RCW were first established, the only financing modality under the RCW was the provision of baseline support intended to help the government start

[8] Specific target will be finalized in consultation with the government and the IMF.

functioning. The baseline support was provided annually, usually in quarterly tranches, with few conditions attached. Initially this was the only financing modality under ARTF RCW and over the period, the amount allocated to the baseline financing was gradually reduced. In 2017, US$ 75 million were disbursed under baseline financing.

ii. **Incentive Program (IP):** the IP was introduced in 2008 as an additional mechanism for budget support under the RCW, to support government reforms through a series of annual incentive payments in exchange for completion of agreed reforms, coupled with a reduction in baseline support over time. Reforms have included the improvement of fiscal sustainability by increasing domestic revenue mobilization and strengthening expenditure management and efficiency.

iii. **Ad Hoc Payments (AHP):** The AHP facility introduced in 2013, allows for ad hoc donor contributions to be channeled through the ARTF. These contributions arise from bilateral agreements between ARTF donors and the GoIRA, to which the Bank as Administrator of the ARTF is not privy.

20. **The FSF will require the following three withdrawal conditions for disbursements.** The proposed withdrawal conditions are critical elements in maintaining fiscal stability and the core government functions under possible shocks to fiscal space.

a. **Minimum Revenue Target: xx percent of the revenue target for the fiscal year 1397 (2018) achieved.** A deteriorating security situation and an upcoming election period may have an impact on revenue collections, with tax and customs revenues collected at border crossings particularly at risk during periods of transition. Revenue performance for the first eight months indicates that tax revenue will fall short of the budgeted target. This withdrawal condition aims to maintain the minimum level of revenues under the current trend, considering the expected economic slowdown and adverse impacts on revenue from deteriorating security conditions. Specific target level will be determined in consultation with the IMF and the government.

b. **Cash Balance Management: Not more than 20% negative deviation from the minimum liquidity threshold agreed with IMF.** Timely fiscal adjustment is key to absorb fiscal shocks through expenditure adjustment in times of revenue shock. Given the underdeveloped domestic debt market and no access to international commercial debt markets, it is critical for GoIRA to maintain a minimum level of cash balance to meet its day to day cash needs. By requiring the government to maintain prudent cash buffer anchored in the IMF's indicative treasury cash balance target (10 billion afs), this withdrawal condition aims to support the government in close monitoring of cash balance situation and implement prompt and timely expenditure adjustment.

c. **On-time Salary Payments: Monthly civil servant salaries within ten days of the submission of claims by the line ministries.** Prioritizing salary payments in a fiscal distress is important to ensure delivery of essential government services and preserve the core functions of the government. Disruption to civil servant salary could also undermine social stability during political transition. This withdrawal condition, requiring timely payment of salary, aims to ensure that the government focus on preserving the core government functions through timely payment of salary against potential shocks to budget expenditure plan.

21. **The project only has one component "Support to Core Government Functions (US$100 million)".** The support will be provided as reimbursement of civilian recurrent expenditure to ensure continuity of core government operations

during the period of political transition. The disbursements, up to the allocated amount, will be made once the withdrawal conditions are fulfilled and sufficient recurrent expenditure is verified by the Monitoring Agent.

22. **Eligible Expenditure:** As in the ARTF RCW, the eligible expenditure for FSF will be civilian government recurrent expenditure. The Monitoring Agent will continue to verify the expenditure and submit reports to the World Bank. The proposed FSF will reimburse eligible expenditures to the government, based on verification by the Monitoring Agent, up to the allocated amount. The eligible expenditure will consist of specific line items within the government's budget – principally, compensation of employees. The budget line items for a few departments relevant to the FSF interventions will be selected in consultation with the MoF during preparation.

SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

Not applicable

B. Borrower's Institutional Capacity for Safeguard Policies

Not applicable.

C. Environmental and Social Safeguards Specialists on the Team

Shankar Narayanan, Social Safeguards Specialist
Obaidullah Hidayat, Environmental Safeguards Specialist

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	
Performance Standards for Private Sector Activities OP/BP 4.03	No	
Natural Habitats OP/BP 4.04	No	
Forests OP/BP 4.36	No	
Pest Management OP 4.09	No	
Physical Cultural Resources OP/BP 4.11	No	
Indigenous Peoples OP/BP 4.10	No	
Involuntary Resettlement OP/BP 4.12	No	
Safety of Dams OP/BP 4.37	No	

Projects on International Waterways OP/BP 7.50	No
Projects in Disputed Areas OP/BP 7.60	No

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Oct 29, 2018

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

Not applicable.

CONTACT POINT

World Bank

Syed Waseem Abbas Kazmi, Muhammad Wali Ahmadzai
Sr Financial Management Specialist

Borrower/Client/Recipient

Islamic Republic of Afghanistan

Implementing Agencies

Ministry of Finance
Khalid Payenda
Deputy Minister of Finance
Khalid.payenda@mof.gov.af

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Syed Waseem Abbas Kazmi, Muhammad Wali Ahmadzai

Approved By

Safeguards Advisor:		
Practice Manager/Manager:		
Country Director:		