SUPPORTING GROWTH AND STABILITY IN AFGHANISTAN

The Country Partnership Framework Summary **2017 to 2020**

WORLD BANK GROUP

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FOREWORD

The Afghanistan Country Partnership Framework (CPF) represents a significant milestone for Afghanistan and the World Bank Group. As the first medium-term strategy for the country after a series of short Interim Strategy Notes, the CPF emphasizes the Bank Group's long-term commitment in Afghanistan. It is also a joint World Bank Group strategy, bringing the integrated International Development Association (IDA), International Finance Corporation (IFC), and Multilateral Investment Guarantee Agency (MIGA) support under one framework.

The CPF builds on the World Bank Group's 15 years of experience delivering results in Afghanistan. It aims to support the Government of Afghanistan's national priority programs as outlined in the Afghanistan National Peace and Development Framework. The CPF helps us work on the short-term immediate needs, such as internally displaced people, while also investing in opportunities that can contribute to sustained growth in the long term, such as public financial management reforms, hydropower, and extractives.

I would like to note that the CPF recognizes the risks in a complex environment like Afghanistan and proposes a realistic program with the flexibility we need to calibrate and adapt to changing circumstances, security, and unforeseen political developments.

Development needs are huge in Afghanistan and the World Bank Group will work in the areas where we can have impact and the comparative advantage. We know that 39 percent of Afghans live in poverty and the country needs to create jobs for the nearly 400,000 people entering the labor market each year. The situation is exacerbated by the increasing numbers of returnees (5.8 million refugees) and internally displaced people (1.2 million).

Investments in agriculture, mining and extractives, human capital investment, and managed migration have the greatest potential to drive growth and reduce poverty. The institutional weakness and violent conflict are not expected to resolve in the short term, but the challenge is to mobilize private sector investment to drive growth despite these realities.

The CPF sets out to support this core agenda through key interventions to strengthen government capacity, mobilize private sector investment, and support social inclusion. The Bank together with IFC and MIGA aim to provide risk-sharing instruments and guarantees to encourage international and domestic private investment.

I am grateful to all those who contributed to this strategy in the Government of Afghanistan, IFC, MIGA, and IDA. With our partners in the Government of Afghanistan and development partners, we hope to use this framework as the basis for a continued strong engagement with Afghanistan for the years to come.

Shubham Chaudhuri
Country Director
World Bank in Afghanistan

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Introduction

There have been substantial improvements in development outcomes in Afghanistan since 2001, particularly in terms of improved access to basic services such as water, sanitation, and electricity, and increased human development in education and health. However, some gains are now being eroded due to growing insecurity, stagnating growth, and rising levels of poverty.

Economic growth in Afghanistan has slowed after a period of rapid growth between 2003 and 2012. While the Government of Afghanistan is committed to an ambitious reform program, it is doing so in the midst of political and economic uncertainty.

Afghanistan remains a deeply fragile and conflict-affected country. The long years of war have hollowed out state institutions and led to widespread disenchantment with the ruling elite and have fueled the Taliban insurgency. Internal displacement as a result of conflict has led to over 1 million internally displaced persons.

At the same time, the country's difficult topography, vulnerability to climate change, and growing population at 3 percent a year have imposed additional constraints on development. For economic growth to have any impact on poverty, it has to be particularly high and broad based to compensate for the high population growth rate and youth bulge. At nearly 50 percent, Afghanistan's proportion of population aged 15 years or below is the second highest in the world. Poor nutrition, especially of children, threatens welfare and education gains.

Key elements of the World Bank Group strategy

The World Bank Group strategy in Afghanistan is set out in the Country Partnership Framework (CPF). The activities in each of the three broad areas seek to respond to the drivers and consequences of fragility set out in the Systematic Country Diagnostic (SCD) while laying the foundations for longer-term growth. Several proposed activities contribute to more than one pillar and interact with and reinforce one another.

Three broad areas, or pillars, of engagement:

- BUILDING STRONG ACCOUNTABLE INSTITUTIONS
- SUPPORTING INCLUSIVE GROWTH
- DEEPENING SOCIAL INCLUSION

“For economic growth to have any impact on poverty, it has to be particularly high and broad based to compensate for the high population growth rate and youth bulge.

The strategy is closely aligned with Afghanistan’s own vision for development outlined in the National Peace and Development Framework (2016-2021), which calls for greater government ownership of the development process, a more equal government-donor partnership, and a greater proportion of aid provided as non-discretionary budget assistance.

Lessons have been incorporated from the World Bank Group’s long-term engagement in the country and take into account learning from the previous Interim Strategy Notes as well as inputs from experts across a broad range of sectors.

Key drivers of fragility

A Systematic Country Diagnostic carried out by the World Bank Group highlights three key drivers of fragility in Afghanistan:

- Weak state and political institutions, which lack clear mandates and depend heavily on decisions driven more by intra-elite bargaining than by effective use of resources or accountability to citizens. This is exacerbated by privileged access by the elite to economic resources—public procurement contracts, revenue sources, land, mining contracts, and proceeds from illicit economic activities.
- The persistent Taliban insurgency, bolstered both by external forces as well as internally by poor governance.
- Internal ethnic divisions, which have been made worse during the past several decades of conflict. The tendency to distribute government positions and access to resources through patronage-based networks remains well entrenched.

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A Country in Need of Stability and Growth

Social and political situation

Continuing conflict in Afghanistan has had a destabilizing effect on the social cohesion of the country, exacerbating ethnic divisions, and weakening government institutions and rule of law.

A National Unity Government was formed in September 2014 after protracted negotiations between the two leading candidates, following the disputed second round of elections. The future, however, remains uncertain and the large losses of life due to the expanding insurgency continue. Some areas of the country are difficult to access because of insecurity and the political situation remains fragile.

Corruption is pervasive, fueled in large part by the illicit narcotics trade and the enormous 'off-budget' aid inflows over the past decade, which have strengthened patronage networks, funded armed groups, and exacerbated grievances. The magnitude and pervasiveness of corruption in Afghanistan in recent years have been striking.

Constraints to poverty reduction

Three critical constraints to poverty reduction in Afghanistan:

FRAGILITY & CONFLICT

DEMOGRAPHY & GEOGRAPHY

DECLINING AID

Recent economic developments

Economic growth averaged an impressive 9.4 percent per year between 2003 and 2012, but fell sharply between 2013 and 2015. Growth was driven by investments in reconstruction, expansion of services supported by aid, and periodic surges in agricultural production. Per capita gross domestic product (GDP) was estimated at $680 in 2014, three times the level in 2003. Figure 1 illustrates trends in GDP growth and sector contributions.

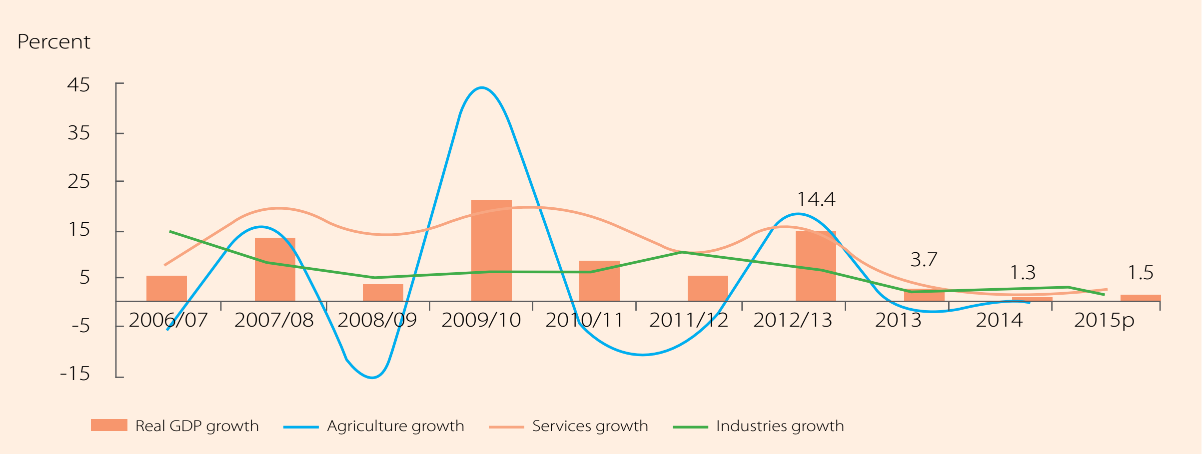
These levels of growth were not sustainable; total security and development assistance declined to 59 percent of GDP in 2013 and will likely decline further to about 39 percent by 2020. GDP growth fell to 3.7 percent in 2013, 1.3 percent in 2014, and 0.8 percent in 2015.

Growth rates are expected to increase gradually to about 3.8 percent by 2020.

With population growth rates of near 3 percent, the most recent economic growth rates and near-term projections are well below the levels needed to create jobs for the large numbers of people entering the labor force and to reduce poverty.

Afghanistan's formal private sector is extremely narrow. Labor force participation is slightly under 50 percent and domestic credit to the private sector is very low at 3.9 percent of GDP, well below the 28 percent of GDP average for low income countries. The continuing conflict has led private sector credit, firm registration, and private investment to contract sharply.

FIGURE 1: GROWTH AND SECTOR CONTRIBUTIONS TO GROWTH, 2006-2015



Source: Central Statistics Organization and World Bank staff estimates

> Agriculture accounts for 56 percent of employment and sector growth plays a key role in poverty reduction.

Agriculture was one of the largest contributors to economic growth during 2003-2012, but the sector is highly vulnerable to climate variability and this partly accounts for the volatility in growth. Other parts of the economy are also indirectly linked to agriculture, with food processing accounting for 96 percent of the manufacturing sector. Agriculture accounts for 56 percent of employment and sector growth plays a key role in poverty reduction.

Other main growth drivers are extractives and, linked to Afghanistan's strategic location between central and southern Asia, regional trade in energy as well as goods.

However, the country faces increasing fiscal constraints as donor financing declines and domestic revenue mobilization remains limited, while security expenditures continue to increase, squeezing funding for social and economic development. Domestic revenues fell to 8.4 percent of GDP in 2014 from a peak of 11.6 percent in 2011 as a result of the economic slowdown and weaknesses in enforcement and compliance. There was a turnaround in 2015, and revenues recovered to 10.3 percent of GDP. This was due largely to major efforts by the Ministry of Finance, including stronger revenue mobilization and tax collection, some new tax measures, political outreach, and strong measures to tackle corruption.

Poverty levels

In spite of the period of rapid growth, poverty levels remained stubbornly high at 36 percent of the population. In 2014, after two years of falling growth, poverty levels had increased to nearly 40 percent. In 2012, about 9 million Afghans, 600,000 more than in 2008, had consumption levels below the minimum necessary to satisfy basic food and non-food needs. Female-headed households are disproportionately affected.

Rural poverty rates are higher than urban, but the urban-rural poverty gap has remained stable. Rural areas accounted for 76 percent of the population and 81 percent of the poor in 2011-2012, but urbanization has led to an increase in the number of poor people living in urban areas. Inequality has also increased.

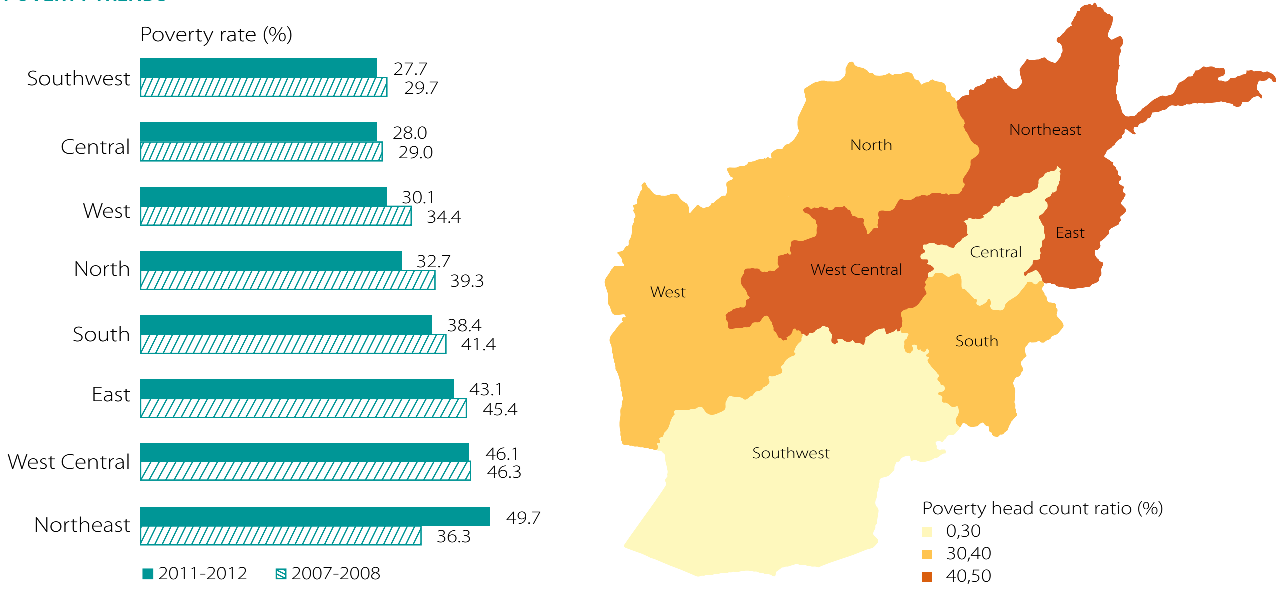
Population displacement caused by conflict and poverty is a growing challenge. Currently there are an estimated 3.5 million Afghans living in Pakistan and Iran. There has also been a recent upsurge in the numbers of Afghans fleeing to Europe.

Internally as well, conflict is causing increasing numbers of Afghans to flee the countryside and move to urban areas, where they make up a large proportion of those who are poor. The number of internally displaced persons is estimated in excess of 1 million. Increasingly, with potentially large numbers of returning refugees or internally displaced who have lost their livelihoods, government and host community resources are stretched to breaking point.

A key factor behind stagnant poverty nationwide is regional disparities, with the highest poverty in the lagging Northeast, West Central, and East regions of the country (see Figure 2). Poverty rates range from 27.7 percent in the Southwest to 49.7 percent in the Northeast. Poverty trends either remained flat or declined in most regions.

Paradoxically, the lagging regions were not those that experienced the most conflict. The conflict has had the perverse effect of increasing economic integration and employment in the better off but more conflict-affected regions, while the more remote Northeast, dependent on agriculture and vulnerable to natural disasters, received relatively less attention from government and donors.

FIGURE 2: REGIONAL DISPARITIES ACCOUNT FOR POVERTY TRENDS



Source: World Bank staff calculations using National Risk and Vulnerability Assessment 2007-2008 and 2011-2012

"There is a case for programs to target poorer regions if disparities are to be reduced, as well as for greater focus on reducing vulnerability to weather-related disasters.

Vulnerability to shocks, including weather-related shocks and natural disasters, is particularly acute in Afghanistan, especially among poorer households, and climate change is likely to increase these vulnerabilities in the future. Nearly half of all households experiencing shocks report using at least one harmful coping mechanism, such as selling assets or taking children out of school, trapping them further into poverty. There is a case for programs to target poorer regions if these disparities are to be reduced, as well as for greater focus on reducing vulnerability to weather-related disasters.

Undernutrition in children

In Afghanistan, 41 percent of children under the age of five are stunted. Poorly nourished children are more susceptible to disease, have poorer learning outcomes, and are more likely to remain in poverty than well-nourished children. More broadly, reductions in stunting could help increase GDP.

International aid

The government faces the risk of a tailing off of international aid and increasing security expenditures that could crowd out civilian expenditures, just at a time when Afghanistan needs increased and more effective development assistance. Total security and development aid is expected to gradually decline as a share of GDP over the medium term, from about 59 percent of GDP in 2013 to about 44 percent by 2018. Sustainability is a serious risk.

Internal revenue mobilization is weak, though 2015 saw some improvement. It will be critical that more aid be channeled through the budget so it can be coordinated and prioritized together, and more goods and services can be procured within Afghanistan to boost the economy. As aid is drawn down going forward, ensuring greater aid effectiveness will be critical.

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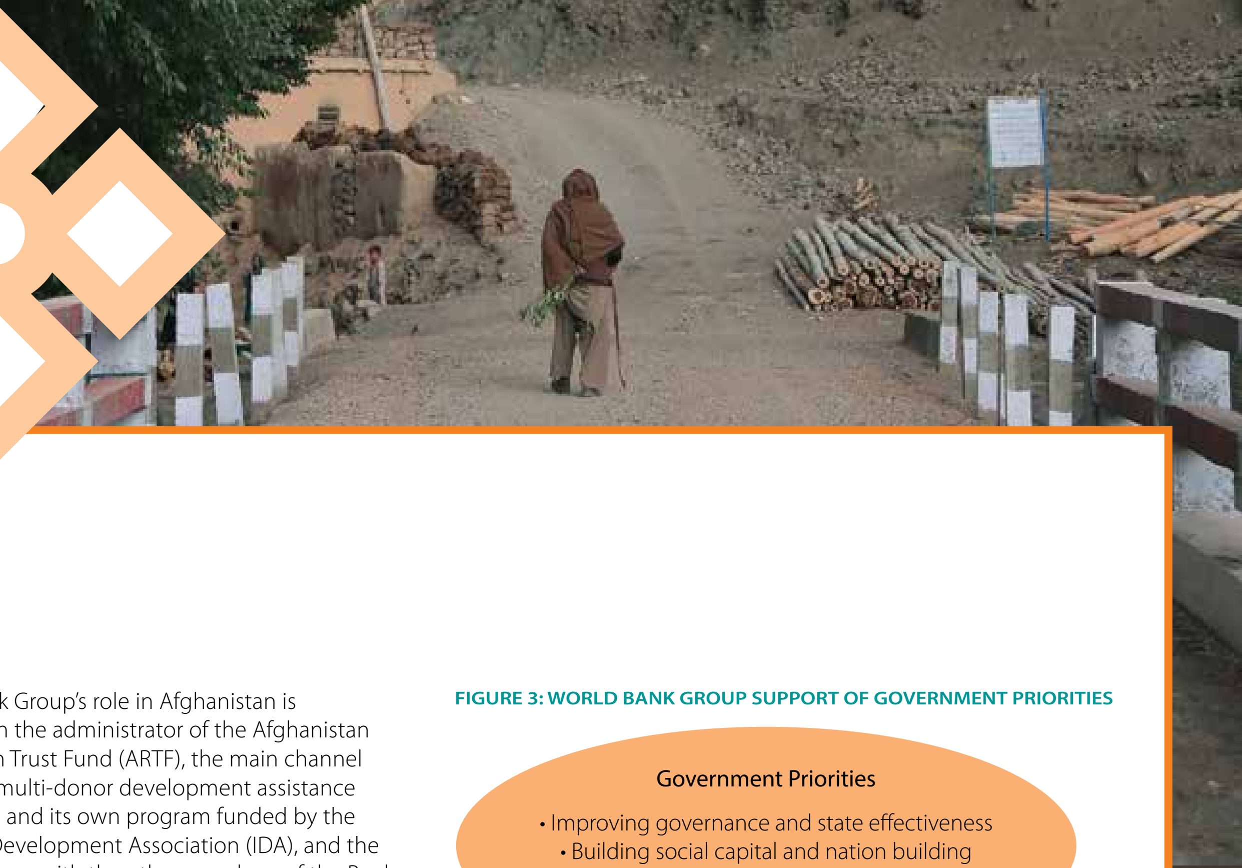
The World Bank Group in Afghanistan



The World Bank Group's role in Afghanistan is unique, as both the administrator of the Afghanistan Reconstruction Trust Fund (ARTF), the main channel of 'on budget' multi-donor development assistance to the country, and its own program funded by the International Development Association (IDA), and the synergies it brings with the other members of the Bank group, the International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA), with their focus on the private sector.

IDA has committed over $3.34 billion for development and emergency reconstruction projects, and five budget support operations in Afghanistan since 2002. This support comprises over $2.9 billion in grants and $436.4 million in no-interest loans. The World Bank has 16 active IDA projects in Afghanistan with net commitment value of over $1.3 billion.

The Bank Group's strategy to support Afghanistan for the period 2017-2020, set out in the CPF, supports the government's strategic vision and goal to reduce poverty, outlined in the National Peace and Development Framework (see Figure 3).

FIGURE 3: WORLD BANK GROUP SUPPORT OF GOVERNMENT PRIORITIES

Government Priorities

- Improving governance and state effectiveness
- Building social capital and nation building
- Economic growth and job creation
- Poverty reduction and social inclusion

SCD Priorities

- Strong and inclusive growth and job creation
- Expansion of prioritized service delivery
- Fiscal stability

1. Building strong and accountable institutions
2. Inclusive growth
3. Social inclusion

Gender | Governance | Climate Change | Institutional Development

The CPF comes at a critical juncture as the current government seeks to build on important achievements in the first two years of its term, but is faced with a range of challenges from growing insecurity to stagnating growth and rising levels of poverty.

Support for Afghanistan over the four-year period will be guided by this strategic framework that is intended to be flexible and responsive to the rapidly evolving situation in Afghanistan.

Strategic aims

The World Bank Group strategy includes a balanced use of financing, knowledge advisory services, and technical assistance to meet immediate needs while investing in select 'foundational' investments that can contribute to sustained growth in the longer term. The strategy will support Afghanistan in three areas of engagement:

Build **strong and accountable** institutions to support the government's state-building objectives and enable the state to fulfil its core mandate to deliver basic services to its citizens, and create an enabling environment for the private sector.

Support **inclusive growth,** with a focus on lagging areas and urban informal settlements.

Deepen **social inclusion** through improved human development outcomes and reduced vulnerability amongst the poorest sections of society, including the large numbers of internally displaced persons and returnees.

The CPF seeks to improve governance through building a more responsive, capable, and accountable state, including tackling corruption. In recognition of climate-related shocks that affect in particular Afghanistan's poorest citizens, the Bank Group strategy, for the first time, identify explicit measures to increase resilience to climate variability and change, such as planned energy engagements with a focus on sustainable renewables to tackle climate change, and to develop capacity for early warning and response to natural disasters.

The partnership framework also directly addresses the need for greater social and economic inclusion to ensure an equal and just society. It will support development of a platform on gender and social inclusion to help the government promote gender equality.

Program activities under the CPF

Program activities seek to respond to the drivers and consequences of fragility, while laying the foundations for longer-term growth.

Building strong and accountable institutions

Program activities respond directly to the government's state-building objectives. State building and promoting trust in the government are long-term agendas, but also address some of the key fragility drivers and sources of the conflict.

The program links support for the recurrent budget with measures that strengthen state institutions and improved public expenditure management and fiscal stability. It supports building a professionalized civil service and more capable municipalities and community-based institutions that can hold the state to account. These proposed activities focus on improving the effectiveness and responsiveness of government, addressing poor governance and pervasive corruption, and strengthening the institutional framework for service delivery and enhanced private sector performance.

> "State building and promoting trust in the government are long-term agendas, but also address some of the key fragility drivers and sources of the conflict.

Supporting inclusive growth

Inclusive growth—which includes women, youth, poor people, and the marginalized and displaced, with a focus on lagging areas and urban informal settlements—is key to sustained poverty reduction. In the short term, the public sector will need to drive growth through public investments in labor-intensive infrastructure and job creation.

Program activities lay the foundation for private sector development over the medium to longer term, including strengthening the financial sector and more inclusive access to finance for micro, small, and medium enterprises, and improvements in the business investment climate, land markets, and market development. They also support enhanced connectivity and regional integration within and outside the country, especially in roads, information and communication technologies, energy markets, and trade.

The program supports the two identified growth drivers, i.e., agricultural productivity (the livelihood of over half the population) and extractive industries, but the latter will have little impact on jobs and will take time to develop. Agricultural programs will support improved land and water management, productivity, value chains, and small enterprise development, including in poorer, lagging areas.

Support for extractive industries aims to improve governance and increase revenues, and to provide a base for more diversified growth in the longer term along key resource corridors.

Deepening social inclusion

Program activities respond to the government's objective to create a more socially inclusive society. Access to quality education and health is largely dependent on geography and household income. Past gains are slipping and it will be increasingly important to ensure greater equity in access to quality services going forward.

Much more effort needs to be made to address undernutrition particularly in lagging areas, build resilience to shocks, and improve disaster management and response. At the same time, the establishment of basic social safety nets for poor people protects the weakest members of society and builds trust in government and, thus, may help address a key conflict driver.

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Gender focus in World Bank Group programs

Building strong and accountable institutions

The Capacity Building for Results project has a 30 percent quota for female recruitment of civil service positions, while the National Solidarity Programme mandates women's representation on Community Development Councils.

Supporting inclusive growth

Almost half of the more than 67,000 beneficiaries of the ongoing Afghanistan Rural Enterprise Development Project are women; an impact evaluation focusing on rural women has informed design of the follow-on project and the Women's Economic Empowerment pilot project, which seeks to expand women's financial inclusion.

The National Horticulture and Livestock Project has supported more than 34,000 women in establishing kitchen garden production units, and additional financing will expand this program geographically. Additional financing to the New Market Development Project will include training and business support targeting women.

The Irrigation Program has appointed women as social inclusion assistants to reach out to other women, both as farmers and non-irrigation water users, and encourage their involvement throughout sub-project development.

IFC's support to the First Microfinance Bank of Afghanistan has reached out to some 60,000 borrowers, 16 percent of whom are women. IFC's Business Edge program has successfully trained almost 10,000 individuals, 43 percent of whom are women, with follow-up support expanding this.

Deepening social inclusion

The focus on expanding access to health and education services adapted to women's priorities will continue, together with programs to increase the numbers of women education and health workers. The increased focus on nutrition will target women and young children.

Social safety nets will also target female-headed households. Early warning systems for disaster risk mitigation also include gender-focused actions. Almost three-quarters (70%) of Bank Group projects have gender focal points in related line ministries and are encouraging gender-balanced staffing.

Financial commitments

IDA and ARTF resources underpin the Bank Group's long-term engagement and commitment to Afghanistan. Annual IDA and ARTF commitments to Afghanistan have been around $200 million and $900 million, respectively. IDA allocations are expected to be increased in Afghanistan and other fragile and conflict-affected countries. The additional funds available will provide the necessary flexibility for the Bank to respond to new priorities fully aligned with the strategy, such as additional support in education and health service delivery, expansion of social safety nets, and urban development.

IFC, the Bank Group's private sector arm, aims to expand its commitments in Afghanistan from its current portfolio of $54 million to a cumulative investment of about $80 million over the 2017-2020 period. MIGA, the Bank Group's political risk insurance arm, stands ready to provide additional support with a focus in the finance, manufacturing, agribusiness and services, and infrastructure sectors.

Promoting inclusive growth

The World Bank Group's current strategy recognizes that, with growing insecurity and poverty and inequality on the increase, promoting more inclusive growth that includes women, youth, the displaced, residents of lagging regions, and the bottom 40 percent is a more urgent agenda than ever, and that a "business as usual" approach to service delivery will be inadequate.

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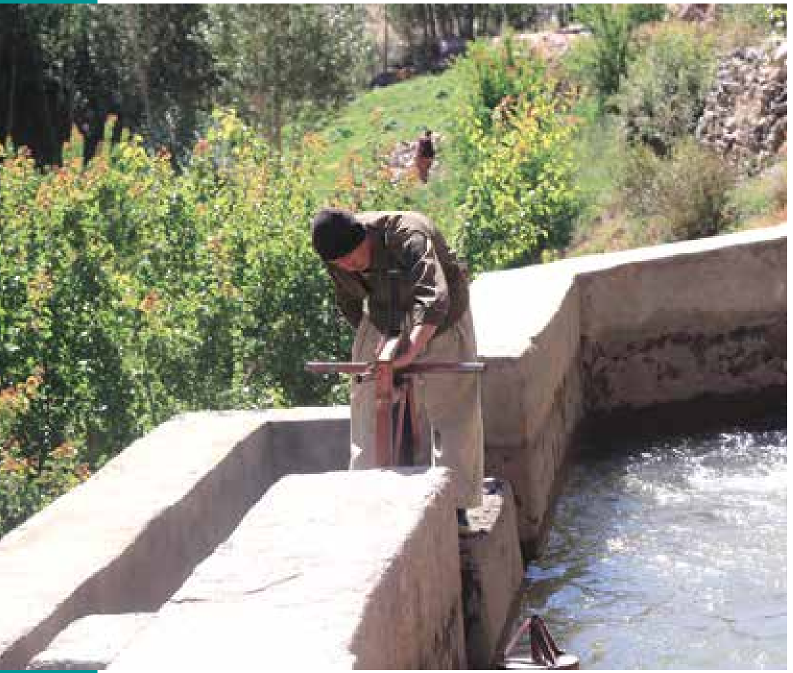
A Challenging Environment

Afghanistan is a high-risk environment and in such an environment it is critical to stay engaged and committed for the long term in spite of the risks. Afghanistan's transition moment has proved difficult and destabilizing. The two principal risks to the Bank Group's program are the intensifying conflict and the political instability of the NUG coalition. Managing these risks, which are interrelated, will not be easy as they are both outside the direct control of Bank Group management. In these circumstances, it will need to strive to mitigate their impact on the program through ensuring, both at a strategic and programmatic level, it can respond flexibly to the deteriorating security and uncertain political environment. The strategy and program are intended to mitigate the impact of these risks.



There are three new factors since 2014 that need to be taken into account:

1. The withdrawal of most international troops at the end of 2014, which has led to a deteriorating security environment.
2. A drop in aid assistance levels, which has led to wider repercussions on the economy, and exacerbated underlying fault lines and tension between different groups.
3. The inconclusive and protracted 2014 election, which has led to a weakened central government that is dependent for its mandate on a political agreement between the two main candidates, which is increasingly subject to internal disagreement.

In this environment, the overall risk to the Bank Group's program achieving its objectives over the next four years is judged to be high, with five high-level risks.

Political risks and governance

The unstable political situation and poor governance is one of the most important risk factors in Afghanistan. The risks of political instability are high both within the NUG coalition and from outside. The government is committed to reforms, improving governance, and tackling corruption, but the political context is uncertain.

Conflict and violence

The insurgency has expanded to encompass much of the country, which raises issues for effective implementation and monitoring of projects. At a program level, new or restructured programs need to be designed to ensure they can respond flexibly to rapidly evolving circumstances; build in the increased costs of supervision through third party monitoring as well as citizen feedback and community monitoring; and reflect on how to reach end users in conflict-affected areas, where government civil servants are unable to access.

Macroeconomic and fiscal sustainability

The prospects for more rapid economic growth and greater domestic revenue generation are not good over the next four years, despite the government's commitments to reform. A ramping up of security expenditures at the same time as a decline in international aid is occurring puts increasing strain on the government budget.

Institutional capacity for implementation and sustainability

Capacity is weak and the government is suffering from talent flight. Reduction in the size of the parallel civil service and integration of fiduciary management in country systems is the right long-term strategy, but it may bring transition costs as government staff lack the confidence or experience to make appropriate decisions quickly.

Environmental and social risks

The Bank Group's program is designed to mitigate core environmental risks to development through its support for climate resilience and disaster management. However, extreme weather events may impact implementation across sectors. This risk would be addressed by rapid response and reallocation of resources to facilitate disaster recovery.

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5

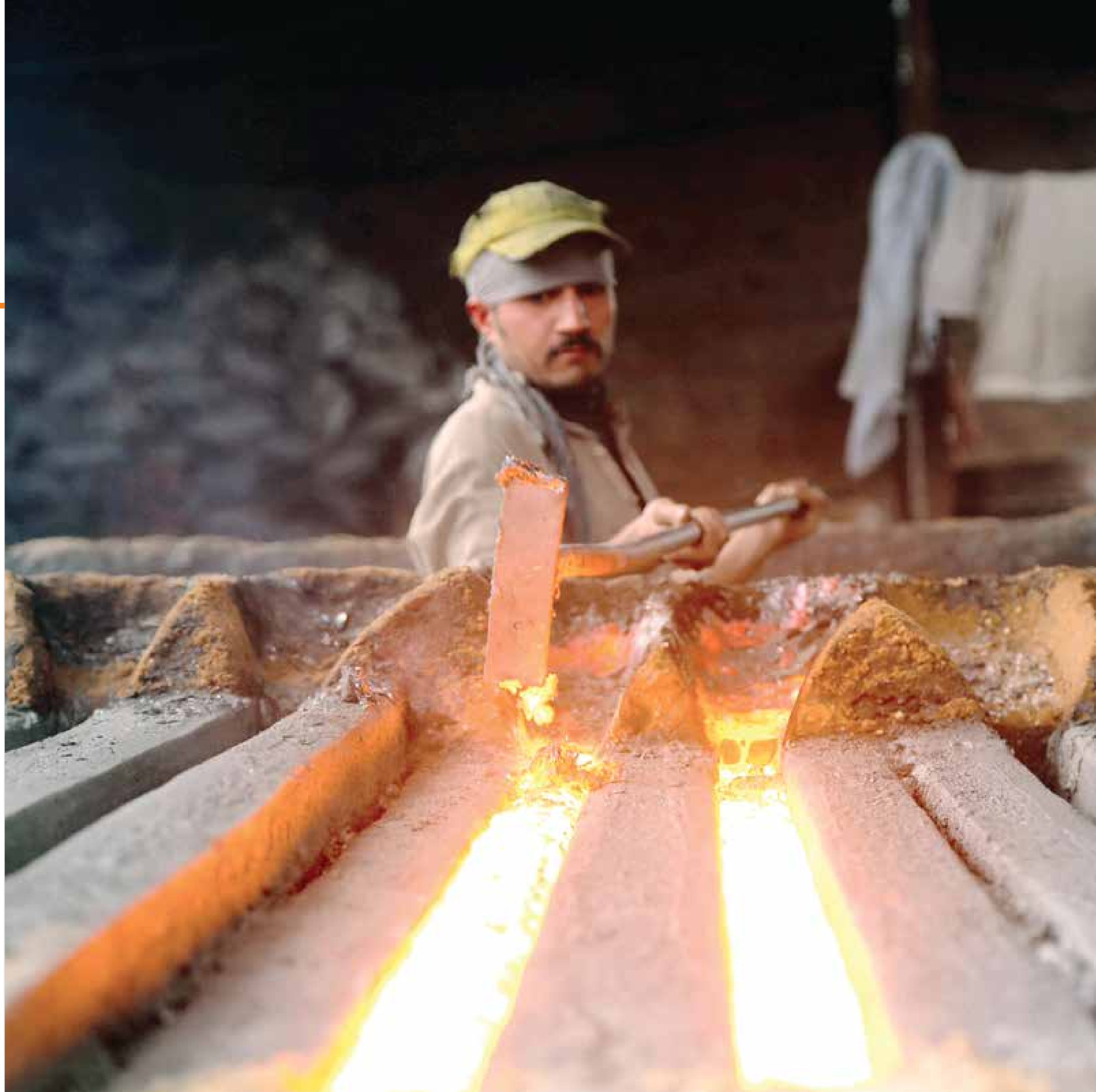
Toward a Strong Partnership

The Government of Afghanistan has an ambitious reform and development agenda but the high-risk environment threatens many of its objectives. The World Bank Group's Country Partnership Framework is framed with this in mind, and has in-built flexibility to respond to the pressures and opportunities as they occur.

Given the uncertainty over the next four years, the challenge for the Bank Group will be getting the balance right between protecting the poor and yet also laying the foundations for longer-term growth and productivity gains. Under a scenario of deteriorating security and conflict, the best that may be achieved is to preserve the gains and mitigate increases in poverty.

On the other hand, reduced uncertainty and conflict can usher in a scenario of improving prospects. Under such a stabilizing scenario, improved confidence and increased resources to expand infrastructure and social services can accelerate job creation and poverty reduction. This would provide space for broader institution building and further enhancing the inclusiveness of growth.

The path to long-term resilience and stability will contain many protracted periods of instability and it will be important that the Bank Group can stay the course. Internally, this will require a willingness to effectively manage the risks, while ensuring its own project and human resource procedures are sufficiently flexible and streamlined and incentive structures aligned to the level of difficulty and risk entailed.



This publication is a summary of the Country Partnership Framework, the World Bank Group's strategy in Afghanistan for 2017-2020. The strategy focuses on three broad areas, or pillars, of engagement: building strong and accountable institutions, supporting inclusive growth, and deepening social inclusion. It is closely aligned with Afghanistan's own vision for development outlined in the National Peace and Development Framework (2016-2021), which calls for greater government ownership of the development process, a more equal government-donor partnership, and a greater proportion of aid provided as non-discretionary budget assistance.

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