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**POST-SETTLEMENT
ECONOMIC
INITIATIVES**

TO SUPPORT PEACE AND INCLUSIVE
GROWTH IN AFGHANISTAN

PREFACE

This paper presents a range of economic initiatives that could be implemented to help consolidate and sustain any political settlement in Afghanistan while also supporting inclusive long-term economic growth. The paper has been prepared in response to paragraph 15 of the Geneva Ministerial Conference on Afghanistan which called on the international community to develop:

...a specific action plan, consistent with fundamental values and existing frameworks, in support of broad-based program of economic initiatives which would advance: a post-settlement return of Afghan capital; increased Afghan and foreign investment; job creation; and, enhanced regional economic integration.

The purpose of this paper is purely to inform ongoing dialogue and discussions. Nothing included in this paper represents a commitment to additional aid support or in any way impacts existing pledges and/or commitments.

In presenting this paper, the international community recognizes that economic benefits alone are insufficient to sustain peace. This is also reflected in the recent communique from the Geneva Ministerial Conference on Afghanistan, which states that:

Peace must be underpinned by serious efforts and reform, as well as inclusive economic and social programs. Peace must also be based on a broad political consensus involving all of society; women's full participation in the peace process needs to be ensured. Respect for human rights and the rule of law will strengthen opportunities for sustainable peace. Peace will end the suffering of civilians and bring about opportunities for growth and prosperity.

Continued reforms, human rights including the rights of women, and an inclusive peace process involving all of society are the basis of the International Community's engagement with Afghanistan on its economic development priorities. A peace settlement is therefore required that underpins, and protects, the significant gains that have been achieved over the last 18 years in areas such as: i) human rights including women's rights and fundamental freedoms; ii) girls' education; iii) access to quality healthcare; iv) democratic governance including subnational governance; v) institutional reform; vi) justice; vii) anti-corruption; and viii) security sector reform. Preserving achievements in these areas would contribute to sustainable peace and social cohesion and would offer opportunities to deliver significant improvements to the lives of all Afghans – recognizing that existing achievements are fragile, and long-term commitment to these areas will be needed under any scenario. The International Community stands ready to engage as development partners of Afghanistan in a peace process that aims to build on these gains.

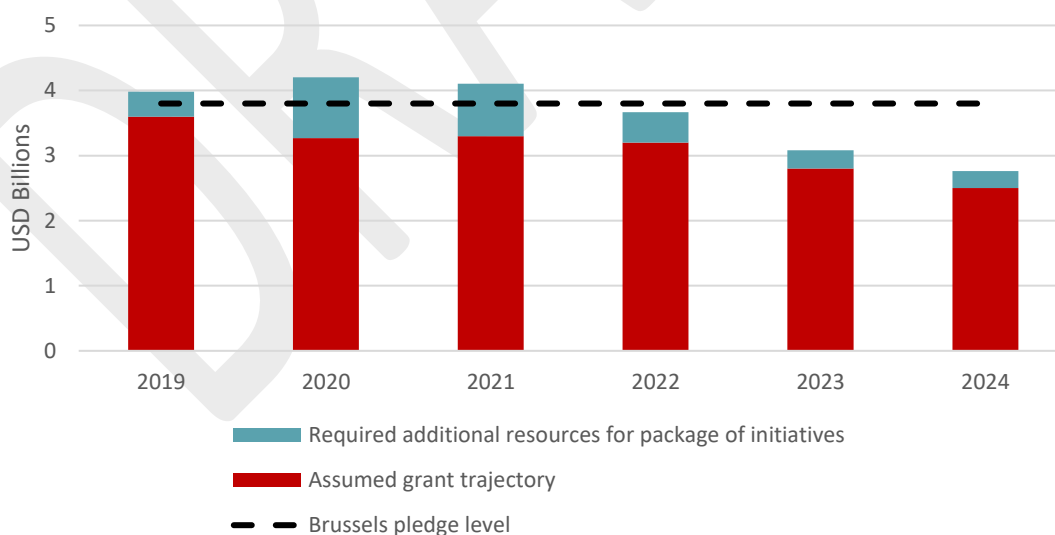
KEY MESSAGES AND OUTLINE

- **This paper presents a set of economic initiatives that could support any political settlement in Afghanistan.** Initiatives are actionable economic projects or programs that could be pursued by the donor community following any political settlement. Initiatives presented in this document are intended to deliver immediate benefits to Afghans to help consolidate and sustain peace, while also supporting long-term inclusive growth.
- **Selection of post-settlement economic initiatives reflects important key principles.** Firstly, initiatives will deliver immediate benefits to Afghans to signal change and help to consolidate peace. Secondly, initiatives will support equity and inclusion, offering benefits to disadvantaged people and areas rather than targeting individuals based on political affiliation or membership in armed groups. Thirdly, initiatives will strike a balance between immediate gains and sustainability through: i) building on existing platforms and institutions to ensure coordination and alignment; ii) mobilizing private investment as the only viable driver of long-term growth; and iii) beginning to address long-term macroeconomic imbalances and aid dependency.
- **Benefits of post-settlement economic initiatives will only be fully realized if progress continues with vital reforms.** Economic benefits arising from initiatives will depend on the broader environment for private sector activity and investment. Maximizing benefits will require progress with improving security, strengthening government institutions, and reforming the legal and regulatory environment in line with international good practices and current plans. Optimal outcomes will also depend on enhanced regional integration and increased international trade and investment.
- **Under the right conditions, post-settlement economic initiatives could support substantial improvements in living standards following a political settlement.**
 - Included economic initiatives could deliver substantial direct benefits, including 11.5 million workdays, access to healthcare for another five million Afghans, and up to US\$6 billion of additional private sector investment;
 - The benefits of sustained peace and therefore faster broad-based economic growth are much larger than those delivered directly by initiatives. Peace would bring a step-change in Afghanistan's economic performance and socio-economic outcomes, leading to substantially higher incomes and faster employment-creation over time;
 - Without faster and broader economic growth, outcomes will remain grim and chances or recurring conflict are high.
- **The total cost of economic initiatives included in this paper is estimated at around US\$5.2 billion over five years.** This costing reflects the full additional costs of new initiatives over any

allocated or programmed funding. Costs would increase over time from around US\$500 million in the year of a peace agreement to around US\$1 billion in the third year of implementation.

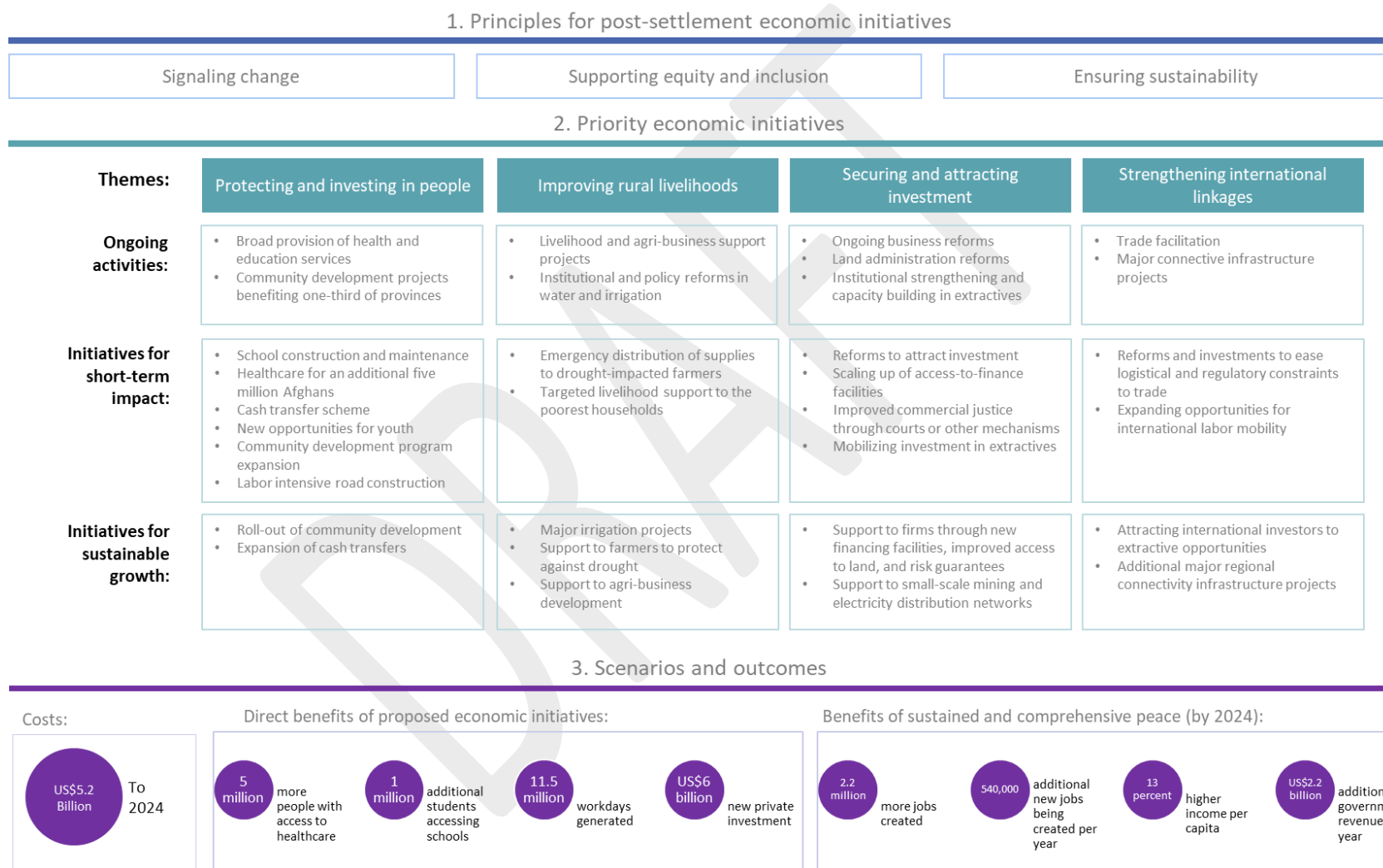
- **Costs could be met even with grants declining far below current levels.** The outlook for grant support to Afghanistan remains highly uncertain. A decline in grant support is expected following the expiry of Brussels and Warsaw commitments in 2020.
 - Under a mid-point scenario, grants decline from around US\$8.5 billion in 2018 to around US\$5 billion by 2024 and economic and revenue growth remain moderate. Economic initiatives could not be financed without disrupting general service delivery and infrastructure provision, derailing economic and social development progress;
 - If the pace of the decline in grant support was slowed and the extent of the decline reduced, sufficient financing would be available for economic initiatives. Only a slight increase in grants over current levels would be required and only for a short period (around US\$600 million over 2018 levels in 2020 and US\$500 million in 2021);
 - Under a best-case scenario of comprehensive peace and rapid economic and revenue growth, government would have sufficient resources to finance up to US\$2 billion of the costs of included economic initiatives, further reducing the need for grant support.

Figure 1: Projected grant decline and additional resources required for economic initiatives (USD Billion, civilian grants only)



Source: World Bank

Figure 2: Summary of this report



1. PRINCIPLES FOR POST-SETTLEMENT ECONOMIC INITIATIVES

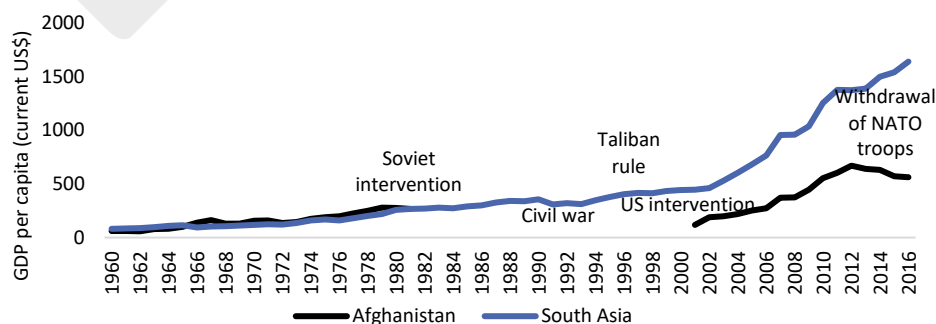
This section presents the current economic development context in Afghanistan. It discusses: i) the high economic costs that conflict has imposed on Afghanistan's economy; ii) the gains against socio-economic development indicators that have been achieved over the past 15 years; and iii) Afghanistan's current economic development challenges. Drawing from this discussion, the section outlines the purpose of potential post-settlement economic initiatives and principles applied through the selection process.

1.1. What has conflict cost Afghanistan?

Wars are extremely costly across all countries, and conflict has had a major impact on Afghanistan's economic development. The average cost of civil war is equivalent to more than 30 years of GDP growth for a medium-sized developing country. Ongoing conflict reduces annual GDP growth by an average of 1.4 percentage points (World Bank and United Nations, 2018). The impacts of war are long-lasting, with trade volumes returning to pre-conflict levels only after 20 years. Afghanistan's income levels have fallen below other South Asian countries largely since the outbreak of sustained violence and conflict from the late 1970s (World Bank, 2018). Geographical areas especially exposed to conflict and contested political control have experienced: i) reduced private sector activity; ii) limited access to services; iii) limited infrastructure provision; and iv) increased unemployment.

Conflict has been and remains a central constraint to Afghanistan's economic development. Resolving conflict therefore presents an enormous opportunity for economic development and improved standards of living.

Figure 3: Afghanistan has fallen behind other South Asian countries due to conflict
(GDP per capita, Afghanistan and South Asia average)



Source: World Bank/World Development Indicators

1.2. What gains have been achieved?

Despite ongoing conflict, substantial gains in socio-economic development have been achieved over recent years. This has reflected the development of government institutions to support service delivery as well as extensive international aid support. Specific gains include:

- **Higher incomes.** Per capita incomes have more than doubled from 2002 to today in real, purchasing-power adjusted terms, due to economic growth (World Bank, 2018);
- **Economic diversification.** The enabling environment for the private sector has allowed some diversification of the economy. Private sector investment has supported widespread availability of goods and services and a huge expansion in the economic opportunities available to many Afghans;
- **Access to health and education.** The number of children in school has increased from around 800,000 in 2001 to more than 9 million today (World Bank, 2018b). With improved access to healthcare, the expectancy of life has increased from 44 years in 2001 to 61 years today (World Bank, 2018c);
- **Improvements in the position of women.** Women's access to education and employment has substantially improved. Women are now active leaders in government, business, and civil society.

1.3. What are the main challenges?

While much has been achieved, important economic development challenges remain to be addressed. It will be important that progress in socio-economic development is not only sustained, but accelerates, following any potential political settlement. Main socio-economic challenges currently facing Afghanistan include:

- **Poverty.** Poverty rates remain stubbornly high and have increased over recent years, reaching 55 percent (ALCS 2016/17). The economy is not growing fast enough to support significant improvements in living standards, with the rate of GDP growth barely exceeding population growth over recent years (World Bank, 2018). This problem is compounded by the relatively rapid population growth rate, which is driven by several factors including insufficient access to basic health services, inadequate access to education, and continued exclusion of women from economic opportunities;
- **Exclusion.** The geographical distribution of poverty and opportunity is uneven. Some areas and groups experience high levels of poverty and exclusion from

services and infrastructure. Women and girls continue to face barriers to economic participation and access to services;

- **Displacement.** High levels of displacement, driven by returnees from neighboring countries and conflict-driven internal displacement, are placing additional pressure on livelihoods and services;
- **Shortage of opportunities, especially for youth.** Unemployment and underemployment are widespread. Afghanistan faces a youth bulge and there are insufficient jobs for the roughly 300,000 Afghans entering the labor force each year (World Bank, 2018d);
- **Aid dependence.** Afghanistan remains heavily reliant on grants, which finance around 70 percent of total public expenditure and a trade deficit of around 40 percent of GDP (World Bank, 2018);
- **Weak human capital.** Education and health outcomes continue to lag in many areas. Material mortality and stunting remain at unacceptable levels. Nearly 70 percent of Afghans are illiterate, with negative impacts on productivity and options for economic development (World Bank, 2018a);
- **Weak governance.** Crime, corruption, and weak rule-of-law are major impediments to investment. A large illicit economy (including opium production, smuggling, and illegal mining) deprives the public sector of resources, undermines productivity, and harms Afghanistan's international reputation.

1.4. What are post-settlement economic initiatives?

This paper presents a list of actionable economic programs and projects that could be delivered by the donor community following any political settlement to help address the challenges listed above. Initiatives would deliver short-term socio-economic benefits to leverage gains from and consolidate a peace agreement, while also supporting longer-term growth, investment, and improved living standards.

The initiatives are complementary and additional to ongoing reform, project, and program activities. Existing government and donor programs are already providing services and infrastructure across Afghanistan. Public spending in support of these programs will need to continue following a political settlement.

Realizing the full benefits of these initiatives will depend on broader improvements in the environment for private sector investment, including: i) improved security; ii) strengthened government institutions; and iii) reforms to the legal and regulatory environment for business, in line with international good practices. This paper does not include recommendations or propose financing for these required and ongoing policy, regulatory, legal, and institutional reforms. Needs in these areas are captured in a

broad range of existing planning documents and work is already progressing, often with the support of the international community.

The initiatives mostly remain at a concept stage of development and would be refined through project development processes. Through project design, initiatives should be subject to economic, social, gender, and conflict-sensitivity analysis.

1.5. What principles have informed the selection of economic initiatives?

Afghanistan will face several pressing economic development priorities following any potential political settlement. Initiatives recommended in this report have been selected based on the following broad principles:

- **Signaling change.** International evidence shows that countries experience recurring cycles of violence. The existence of a peace deal will not necessarily lead to sustained peace. The chances of sustaining peace are higher if peace delivers noticeable improvement in living standards, especially through improved employment opportunities and better functioning of core institutions. This means:
 - **Short-term impact.** Initiatives should achieve short-term impact, including by leveraging the opportunities arising from any improvement in the security environment. Short-term impact should be delivered, however, without creating incentives that undermine longer-term economic development or the functioning of existing agencies and institutions;
 - **Use of existing implementation platforms.** In practical terms, existing implementation platforms provide the best opportunity for achieving immediate impact given the lead-times and costs required to establish new delivery structures. Use of existing platforms can also support coordination and alignment in delivery.
- **Supporting equity and inclusion.** International evidence shows that ensuring inclusivity is vital for sustainable peace both in terms of: i) the distribution of services and opportunities; and ii) the institutional mechanisms through which they are provided. This means:
 - **Needs-based targeting.** Initiatives will deliver immediate and medium-term benefits to underserved and disadvantaged populations and areas. Initiatives, however, have not been targeted to provide benefits to specific groups based on their political

affiliation or previous participation in armed groups.¹ International experience and evidence from Afghanistan is clear that this type of targeting generates resentment and opportunities for corruption, potentially fueling further violence;

- **Addressing the position of women and youth (including for peace sustainment).** Women continue to lack opportunities for economic participation in Afghanistan, representing a substantial and unnecessary cost to the economy. International evidence shows that youth bulges can be an important driver of conflict. Initiatives need to create opportunities for peaceful economic participation of youth, including (but not limited to) those who have previously been involved in armed groups. Youth and gender issues are therefore mainstreamed in this report, with most initiatives expected to specifically benefit women and youth;
- **Conflict sensitivity.** Selected initiatives are intended to help address conflict to the extent that they contribute towards employment creation and signal change through improving living standards. International evidence, however, shows that the relationship between conflict, service delivery, infrastructure provision, and employment creation is complex and mediated by context-specific many factors. Specific programs and initiatives should therefore be subject to rigorous conflict sensitivity analysis. Program designs should be adjusted to take account of conflict risks.
- **Ensuring sustainability.** Afghanistan faces substantial constraints to fiscal sustainability, with aid now financing 70 percent of public expenditure. International evidence is clear that aid flows following a political settlement are volatile and often unsustainable. Interventions introduced immediately following peace therefore cannot impose long-term and unsustainable costs. Such initiatives must also balance short-term gains against longer-term goals of establishing a vibrant private-sector driven economy that can support broad improvements in living standards. This means:
 - **Sustaining and building on current programs and plans.** Much work is already underway through existing plans, projects, and programs. There is no need to reinvent the wheel, and proposed initiatives are intended to build upon rather than replace ongoing work;

¹ Proposed economic initiatives focus on reintegration of former combatants through expanding broad opportunities. Initiatives do not include measures for disarmament or demobilization. Additional financing, beyond what is included in the costing of this package, may be required for such programs.

- **Mobilizing private sector investment.** Public resources will never be sufficient to finance sustainable growth and employment creation. While government and donor resources may be needed to generate immediate short-term improvements in employment and livelihoods, focus must be retained on attracting and facilitating private sector investment. Private investment can be attracted through the provision of required public goods and through various public-private partnership (PPP) arrangements and risk-sharing mechanisms;
- **Helping to address macroeconomic challenges over the medium-term.** Afghanistan's macroeconomic situation is currently unsustainable. Action is required now if exports and revenues are to allow self-reliance over the medium-term;
- **Coordination and alignment.** With limited resources available, it is vital that all public funds are used as efficiently and effectively as possible. Coordinating around a single Afghan-owned plan presents the greatest possibility of maximizing impact and avoiding overlaps, gaps, and wastage.

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2. PRIORITY ECONOMIC INITIATIVES

This section presents potential economic initiatives to support increased incomes, socio-economic inclusion, and the consolidation and sustainment of any potential political settlement. Potential initiatives are organized under four key themes: i) protecting and investing in people; ii) improving rural livelihoods; iii) attracting and securing private investment; and iv) strengthening international linkages.

2.1. Protecting and investing in people

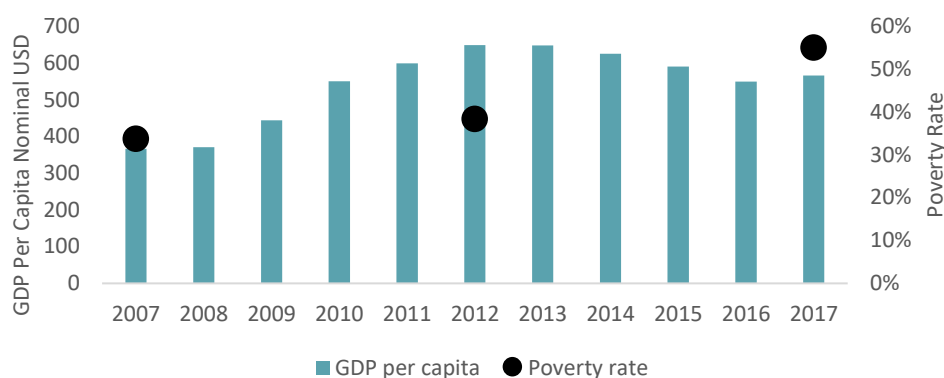
Gains achieved and current challenges

Afghanistan has achieved important gains in health and education access and outcomes since 2001. More than 9.2 million children are currently enrolled in school (World Bank, 2018b). The number of births attended by skilled health staff has increased from around 12 percent in 2000 to more than half today (World Bank, 2018c). Under five mortality rates have declined from 137 to 91 deaths per 1,000 live births, while newborn mortality rates have declined from 53 to 36 deaths per 1,000 live births (World Bank, 2018c).

Important social development challenges remain to be addressed. Many children, especially girls, remain out of school. Only 43 percent of children and youth under the age of 24 actively attend school. In some provinces, the proportion of children out of school exceeds 88 percent. More than half of teachers do not meet basic qualification requirements (completion of grade 14) (World Bank, 2018b). Life expectancy remains 11 years short of the global average and slightly below the low-income country average. Overall progress with expanding access to both health and education has slowed, and in some areas reversed, over recent years. Disparities in access at a regional level and between males and females have worsened since 2014.

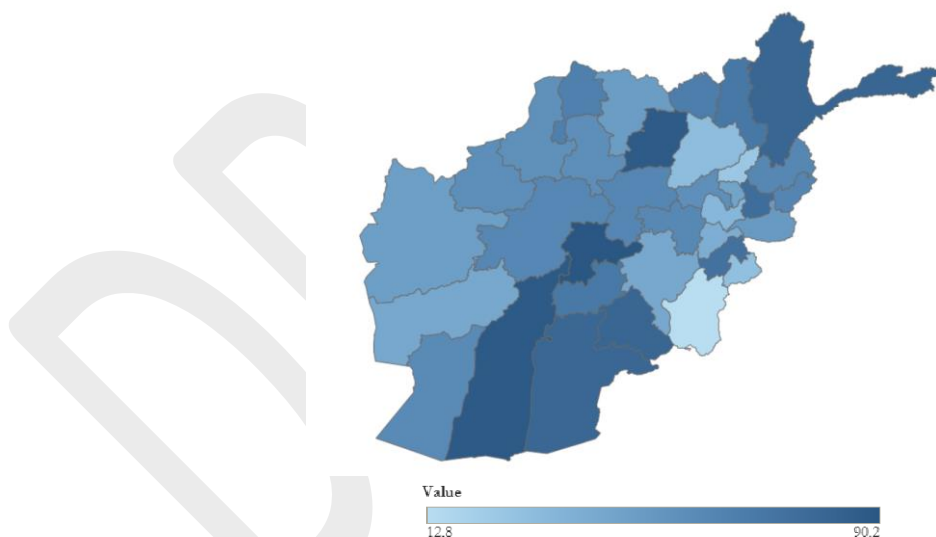
The poverty remains widespread, with 55 percent of Afghans living in poverty (World Bank, 2018d). Poverty is highly concentrated in some areas, with poverty rates by province ranging from as low as 12 percent to as high as 90 percent. Many households are frequently exposed to negative shocks, including weather and climate-related shocks (nearly 90 percent of households experience at least one shock every year). Households typically respond to shocks with harmful coping mechanisms such as selling assets, reducing food purchases, buying food on credit, and taking on loans (World Bank, 2018a). Health outcomes remain poor, with more than 40 percent of children stunted. Drought conditions have undermined food security and livelihoods for many Afghans, creating widespread hardship.

Figure 4: Poverty rates have increased as per capita income has declined
(GDP per capita and poverty rates)



Source: World Bank data/ALCS

Figure 5: Poverty is distributed unevenly across Afghanistan
(Poverty rates by province)



Source: World Bank data/ALCS

Ongoing activities

Donors are supporting basic social services throughout the country including through major on-budget programs in health and education. On-budget spending on education as a share of the budget (16 percent) and as a share of GDP (4.6 percent) is comparable to that of other low-income countries, partly due to large on-budget education projects financed by international donors.

Donors and government support health delivery through both direct provision and support to a contracting-out model based on contracting of NGOs for provision of key health services. The current model of health service delivery has proven highly effective, with Afghanistan achieving more-rapid improvements in access to health services and health systems performance than most other low-income countries.

Community Driven Development programs, including the previous National Solidarity Program and the current Citizens' Charter program, are crucial to service delivery and livelihoods in Afghanistan. Evaluations show that such programs have positive impacts on access to drinking water and electricity and perceptions of economic wellbeing (World Bank, 2018a). The Citizens' Charter has a budget of US\$800 million for phase 1 including a contribution equivalent to US\$128 million from Government. The program will support improvements in the delivery of core infrastructure and social services to all communities in Afghanistan, starting in phase 1 (2016-2020) with an estimated 12,600 rural and urban communities across the 34 provinces through Community Development Councils (CDCs).

Opportunities and challenges from peace

Within a peaceful Afghanistan, there will be substantial scope to improve access to services and reverse recent insecurity-driven declines. Provinces with a better security environment experienced significantly greater improvements in access to some health services between 2010 and 2015. Peace may also help to address inequities in access. Nationally, seven girls attend school for every ten boys, but in conflict-impacted areas, only five girls attend school for every ten boys (World Bank, 2018b).

Improvements in security may also allow the expansion of community development programs and other social protection mechanisms into new communities, where operations have so far been constrained by conflict. While poverty is widespread, households living in insecure areas are much more likely to adopt harmful coping strategies in the face of negative shocks than those in secure areas. 44 percent of households in the lowest decile resort to harmful coping strategies in secure areas, while 56 percent of households adopt such strategies in insecure areas (World Bank, 2018a). To the extent that improved security allows the expansion of community development mechanisms and other social protection mechanisms it may help shield the most vulnerable.

A political settlement may also bring risks. Peace may lead to substantial movement of people and potential influx of returnees, placing additional pressure on services and livelihoods. Expectations regarding improvements in incomes and access to services may be high, generating pressure for rapid expansion of services that cannot be accommodated with available capacity and resources.

Priority economic initiatives

Improved security following any political settlement is likely to lead to improved access to services. Significant improvements in access could be expected through programs already being provided by government and financed through own-revenues or donor grants. Increased resources will be required for core government programs along with continued efforts to strengthen the central government institutions that deliver these services in accordance with existing strategy and planning documents.

In addition, the following specific initiatives (scaling up existing programs or introducing new programs) could be pursued:

Table 1: Initiatives to meet immediate needs

No.	Initiative summary description	Additional financing requirement
A.1	Access to schools for an additional one million students. Potentially delivered under the donor-financed EQRA program, which is currently operating in 17 conflict-affected and lagging provinces. Financing for construction of structures and boundary walls for existing schools without structures, especially in formerly insecure areas. Roll-out of operations and maintenance grants to an additional 6,000 schools, supporting improved education quality and access, increased participation of girls, and employment opportunities in school maintenance.	US\$330 million over three years Priority level: High
A.2	Expansion of basic healthcare to five million people in unserved areas. Through existing donor-supported programs, healthcare services provided in areas where operations have been disrupted by conflict and contested political control. Clinics established or repaired, fully staffed, provided with medical and pharmaceutical supplies, and subject to proper supervision. The initiative would provide improved health services to up to five million people as well as creating new employment opportunities in health.	US\$190 million over six years Priority level: High
A.3	Cash-transfer mechanism providing targeted support to vulnerable households. New mechanism targeting households led by or supporting widows, those with large family size, or those with young children. Delivering to 400,000 households in the first year and scaling up to 1 million in year two. The transfer mechanisms could be delivered through the Community Development Committee mechanisms already established under the Citizens' Charter program.	US\$50 million per year Priority level: High
A.4	Economic opportunities for youth in insecure or disadvantaged areas. The program would include: i) enhanced employment generation through public works; ii) a competitive grants scheme for socio-economic projects prioritized by youth; and iii) improved	US\$35 million per year

	linkages between community youth and existing government, donor, and NGO-provided programs providing skills training and work opportunities. The program would benefit up to 3 million youth after full scale-up and be delivered through the Citizens' Charter program.	Priority level: High
A.5	Citizens' Charter for Peace. The current Citizens' Charter program would be expanded into 3,200 communities across 40 disadvantaged or insecure districts. The program would include: i) provision of potable water and additional basic services in all communities; and ii) short-term employment creation through public works. The program would be expected to create approximately 2.8 million workdays per year.	US\$85 million per year Priority level: High
A.6	Labor-intensive rural roads. Construction and maintenance of provincial and secondary roads in underserved provinces and especially those where road-construction has previously been impeded by insecurity. Utilization of labor-intensive construction methods to ensure maximum employment creation. The initiative could be delivered through existing government delivery mechanisms and utilize community development councils for targeting. The scheme would be expected to generate around 1 million work-days per years for unskilled or semi-skilled workers and deliver more than 1,000 of roads connecting underserved areas.	US\$50 million per year Priority level: Med

Table 2: Initiatives to support sustainable growth

No.	Initiative summary description	Additional financing requirement
A.7	Citizens' Charter Phase II rollout. Scale up of Citizens' Charter program to an additional 117 districts, including those districts that have so far been excluded from coverage due to security concerns. The program would include standard components for delivery of minimum service standards in water, energy, roads, irrigation, health and education through community public works. Based on experience with Phase I, provisions for emergency response (e.g. drought, displacement) and cluster level interventions for higher order economic impact would be included.	US\$500 million over four years Priority level: Med
A.8	Implementation of comprehensive cash-transfer scheme. Broad-coverage cash-transfer system providing targeted and shock-responsive support to poor households.	US\$100 million per year Priority level: High

Implications for a peace agreement

New initiatives are likely to have the greatest impact if any potential peace agreement includes:

- **Provisions committing all parties to the facilitation of service delivery.** Ensuring unimpeded expansion of government and donor service delivery programs will be important for delivering economic benefits. Provisions in any peace agreement could express joint commitment to enhanced service delivery based on principles of equal and undisturbed access;
- **Provisions recognizing community governance mechanisms.** Donor-supported development programs depend heavily on community governance mechanisms that adhere to principles of participation, equity, and inclusion. Provisions in any peace agreement could explicitly recognize the legitimacy and important role played by existing or proposed community-level governance mechanisms and commit parties to their continued, apolitical operation.

Box 1: Costing and prioritization of initiatives

All listed initiatives are either: i) entirely new activities; or ii) proposals for scaling up existing activities beyond current plans. Costings for most initiatives are indicative and would need to be refined throughout project design and preparation processes.

The costing approach is based on identifying additional resources directly needed for implementation of these initiatives. For entirely new activities, this means the full cost of implementing that activity. For initiatives that involve scaling up existing activities, this means the additional marginal cost of the scale-up over any existing allocations.

The costing is not associated with any assumptions regarding the source of funds. Financing for activities could come from development partner on- or off-budget resources or from government own-financed resources. Resources could be mobilized through increases in development grants or through reprioritizing existing allocations.

The costing exercise has involved some analysis to distinguish between: i) programs that would likely need to be financed on-budget because they use existing on-budget delivery platforms; and ii) initiatives that do not depend on on-budget delivery platforms and could therefore be delivered either on- or off-budget. This categorization is used to inform the assessment of on- and off-budget financing needs presented in section three of this paper.

All initiatives are assigned a priority level of low, medium, or high. This prioritization reflects an aggregate score against three main dimensions: i) impact and expected value for money; ii) timescales for impact; and iii) project preparation and readiness. As most initiatives have not yet gone through detailed project development and design, scores against the first dimension are based largely on the judgement of project teams.

Source: World Bank

2.2. Improving rural livelihoods

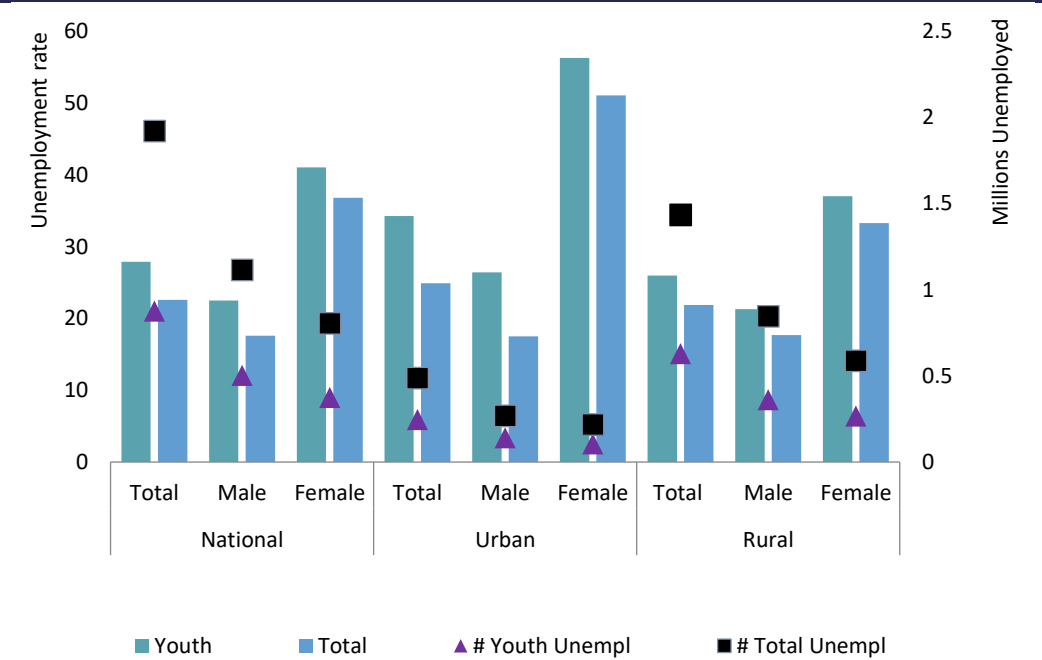
Gains achieved and current challenges

Growth of the economy and the private sector has driven a rapid expansion of livelihood opportunities since 2001. The agricultural sector has grown steadily up to 2012. There has been some recent diversification of agricultural exports, supporting rapid export growth during 2017 and 2018.

However, unemployment levels remain high and have increased over recent years. The overall unemployment rate is around 23 percent. The overall proportion of Afghans in employment (over 14 years old) is around 41 percent. Unemployment and under-employment is extremely high among youth (27 percent) and women are excluded from many opportunities. More than 20 percent of the employed population is underemployed. The unemployment rate for urban female youth is around 56 percent. Opportunities are unevenly distributed, with unemployment rates as high as 48 percent in some provinces (World Bank, 2018d).

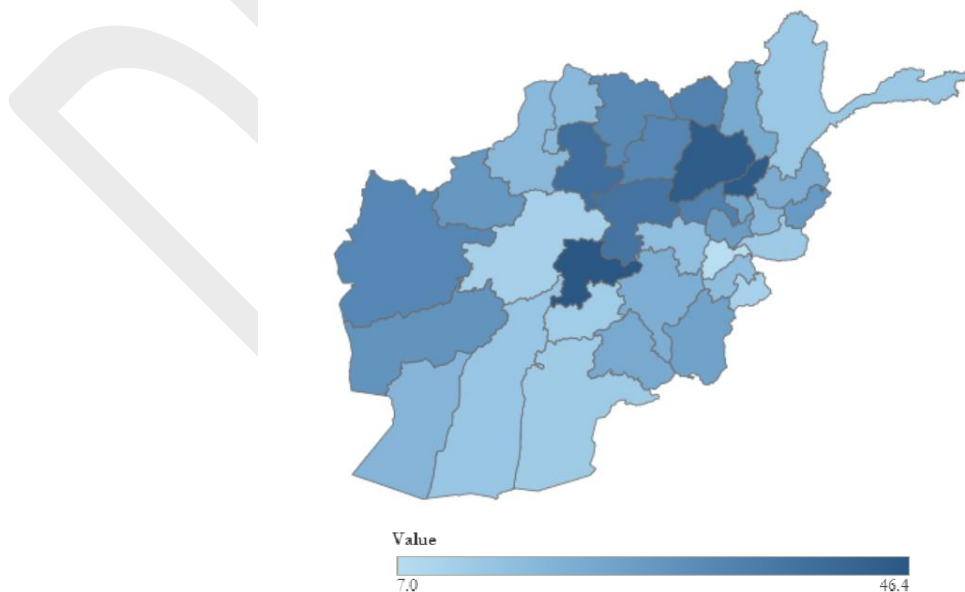
Agricultural development is key to rural livelihoods. Agriculture employs around 40 percent of the total workforce. 61 percent of households derive income from agriculture and agriculture is the main source of income for 28 percent of household (World Bank, 2018a). The agriculture sector has grown by only 0.1 percent per year on average since 2012. Agricultural production is currently constrained by several factors including water shortages, uncertain land property rights, and absence of supporting transport and other connective infrastructure. Only 2 million ha of Afghanistan's 8 million ha of arable land is irrigated. Lack of irrigation leaves rural populations heavily exposed to weather-related shocks, with recent droughts leading to drastic reductions in cereal production and declines in agricultural wages. The severity of shocks is expected to increase due to the impacts of climate change.

Figure 6: Unemployment remains high for all demographic groups
(Unemployment rate and total number unemployed)



Source: World Bank data/ALCS

Figure 7: Unemployment rates vary by province
(Unemployment rate, percent)



Source: World Bank data/ALCS

Ongoing activities

Existing development projects focus on improving farmer capacity, building capacity of agricultural workers and firms, improving water management, reducing input costs, and establishing the infrastructure for a growing agri-business industry. The capacity of government institutions to manage land and water rights is being steadily strengthened, including through recent reforms to move to an administrative system of land rights. Recent reforms will clarify institutional responsibilities for irrigation construction and management, facilitating faster progress. Expansion of irrigation networks is planned through a series of major projects.

Work is underway to realize Afghanistan's agri-business potential. Projects are underway to strengthen key value chains (horticulture and livestock), linking small and medium size agricultural producers to markets. Over time, this is expected to provide employment and entrepreneurial opportunities in both rural and urban areas.

Opportunities and challenges from peace

Peace creates many opportunities for a growing rural economy and associated livelihoods. Current high risks to transport arising from insecurity are a major constraint to development of Afghanistan's horticultural export industry. Insecurity also constrains the availability of vital infrastructure, including electricity (for cold storage) and roads. Reduced local-level conflict may strengthen formal and informal institutions for the management of water and land rights, increasing confidence and investment.

There will be immediate and pressing needs for rapid job-creation following any political settlement. Rural livelihoods will be required to support reintegration of those previously involved in armed groups. Job creation pressure may be increased in particular areas through large-scale internal population movement and an increased number of returnees from neighboring countries.

Priority economic initiatives

Significant benefits from improved security following any political settlement are likely to arise from accelerated and expanded implementation of existing government and donor-financed programs. These include efforts to develop agri-business parks, expand access to irrigated land, improve farmer capacity, and strengthen institutional systems for the management of water and land rights.

In addition, the following specific initiatives (scaling up existing programs or introducing new programs) could be pursued:

Table 3: Initiatives to meet immediate needs

No.	Initiative summary description	Additional financing requirement
B.1	Emergency distribution of drought-resistant wheat seeds to small and medium-scale farmers in drought affected areas. Utilization of community development councils and NGOs to support targeting and distribution. The initiative would be expected to benefit 150,000 farmers directly, with significant indirect benefits in terms of food security to drought-impacted areas.	US\$7.5 million per year Priority level: Med
B.2	Targeted livelihood support to vulnerable households. Expansion of existing program providing targeted support to the poorest households in a community. This would involve a sequenced, multisectoral intervention comprising social assistance to ensure basic consumption, skills training, asset transfer (e.g. livestock) to jump-start an economic activity, financial education and access to savings, and mentoring to build confidence and reinforce skills. The program would be targeted at vulnerable households in disadvantaged areas and would generate more than 30,000 jobs over five years with more than 85,000 beneficiaries.	US\$40 million over five years Priority level: High

Table 4: Initiatives to support sustainable growth

No.	Initiative summary description	Additional financing requirement
B.3	Package of major irrigation projects. Financing of three implementation-ready projects would lead to a 125,000 ha expansion of irrigated land. Expansion of irrigated wheat area by 10 percent over ten years could increase production by 2.25 million mt, generating more than 220,000 jobs in wheat production and agro-industry.	US\$700 million over five years. Priority level: Med
B.4	Drought resilience support to farmers. To enhance drought resilience of rural communities, this initiative would support: i) establishment of small-scale grain storage facilities for community-level wheat reserves to ensure food supply during disruptions to production; ii) installation of small-scale fodder drying and storage facilities to ensure that adequate fodder is available to maintain livestock during drought periods; and iii) improving farmer skills through roll-out of Farmer Resource Learning Centers providing training on dry land farming and modern water management practices. The initiative would provide 1000 communities with small-scale grain storage and fodder-drying facilities and establish an additional 100 Farmer Resource Learning Centers.	US\$10 million per year Priority level: Med

B.5	Coordinated development of agri-business. This initiative would support profitable and competitive agribusinesses. The project would provide inputs and services to farmers, in partnership with the private sector, and support public-sector policies and institutions to facilitate increased private sector investment in agribusiness. Integrated agri-foods parks would be established in high potential regions (major and growing population centers, major trade routes). Agri-food parks would be equipped with suitable infrastructure and services to reduce costs and improve competitiveness for agri-processors as well as to create ready markets for farming communities in the surrounding production catchment areas (through strengthening of supply chain linkages).	US\$48 million over 4 years.
		Priority level: High

Implications for a peace agreement

New initiatives are likely to have the greatest impact if any potential peace agreement includes:

- **Provisions committing all parties to a sustainable and collaborative approach to reducing opium production.** International support to rural livelihoods will be undermined if inputs and infrastructure are utilized for poppy production. International cooperation is necessary to stem opium production and export, including support to alternative livelihoods.

2.3. Attracting and securing private investment

Gains achieved and current challenges

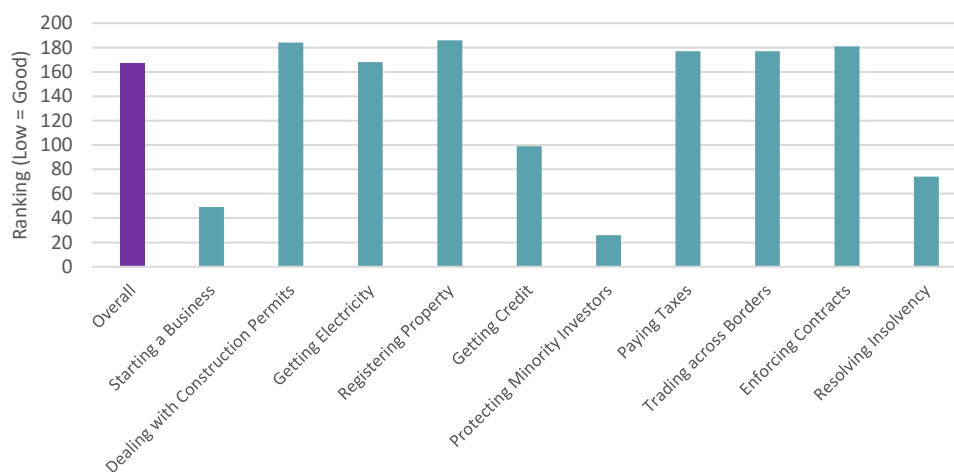
Major gains have been achieved in establishing an enabling environment for business since 2001. A legal and regulatory framework has been established that recognizes the rights of investors, enables contracting, and protects property rights. Afghanistan performs well against several international indicators related to the quality of the business environment, including the adequacy of legal protection of minority investors, procedures for starting a business, and processes for resolving insolvency (World Bank Group, 2018). There have been major improvements in access to electricity, telecommunications, and transport infrastructure. Afghanistan now has around 27 million active telephone subscriptions. The number of connections registered to the national grid has increased by more than one million over the past 6 years.

Investment confidence has been supported by sound macro-economic management and an adequately regulated financial sector. Public debt has been drastically reduced through programs of debt forgiveness (public debt is equal to around 7 percent of GDP). Government finances are sound, with revenue collection at record levels and deficits

limited (around 0.5 percent of GDP in 2018). Inflation is under control and – since the Kabul Bank Crisis of 2010 – the financial and banking sector has been adequately regulated to prevent the reemergence of systemic risks.

Substantial challenges remain, however. Afghanistan is still ranked 167th out of 190 countries in the World Bank’s international assessment of the business environment (World Bank Group, 2018). Business growth remains constrained by limited access to credit, with less than one in 20 Afghan firms having access to a line of credit from a financial institution (World Bank, 2018a). Afghanistan has been unable to attract large-scale international investment in the extractives sector, despite vast proven natural resource deposits. Infrastructure coverage remains inadequate, quality is uneven, and costs are often high. Insecurity and crime deter investment, while the large illicit economy deprives the public sector of resources, undermines certainty in the business environment, and harms Afghanistan’s international reputation. Land property rights are often unclear and disputed. Reflecting the impacts of political uncertainty and conflict, private investment has declined over recent years, and growth rates have fallen.

Figure 8: Afghanistan remains a difficult place to do business
(Doing Business ranking)



Source: World Bank Group 2019 Doing Business Report

Ongoing activities

Substantial efforts are underway to attract private investment and improve the business environment. A range of development partner programs are providing technical assistance and capacity building to improve the business environment at the national and sub-national level. Tax reforms are planned and being supported by international donors, including removal of the distortionary Business Revenue Tax and its replacement with a business-friendly Value-Added Tax. Work is ongoing to improve the security of land property rights through the introduction of an administrative land

system. Significant work is also ongoing to strengthen institutions and capacity in the extractives sector to attract private investment towards key projects. A range of facilities have been established to ease access to credit for SMEs and other firms. Development partners are working with government to facilitate private investment in infrastructure, including through PPP models. Donors are providing ongoing support to the Ministry of Finance and accountability institutions to reduce opportunities for corruption.

The 'Growth Agenda for Transformative Change and Self-Reliance', presented at the recent Geneva Ministerial Conference on Afghanistan, presents a clear vision and action plan for private-sector led economic growth based on: i) development of extractives; ii) strengthened agriculture; and iii) regional integration.

Opportunities and challenges from peace

Sustained peace could provide enormous opportunities for increased domestic and international investment. Political instability is the number one constraint to investment cited by firms. Firms in Afghanistan also spend much more on security costs (3.2 percent of annual sales) than firms in other countries impeding competitiveness and profitability. Recent analysis has shown that investment and business activity are deterred by violence, with business activity reducing in areas that experience frequent security incidents. Firms are often subject to informal taxation in areas where territorial control is contested. Insecurity has been an important constraint to international investment in major extractives projects. Experience from other countries shows that improvements in security can spark additional domestic investment, facilitate foreign investment, and support the repatriation of capital from overseas.

While potential medium-term gains from peace are enormous, the process of reaching a political settlement may create further concerns for investors in the short-term. The process of negotiating a peace agreement is likely to involve intensified uncertainty, which is already a constraint on investment. These concerns may be particularly severe if the process of reaching a political settlement involves the possibility of changes to legal and constitutional provisions that protect private sector property rights and underpin contracts. A political settlement may also lead to contestation over various property rights, including land, due to population movements and changes to configurations of local-level governance and political power. Widespread insecurity of property rights may further undermine confidence and investment.

Priority economic initiatives

Peace may bring important increases in private investment and economic activity if improvements to the business environment since 2001 are preserved. Additional gains will be achieved if continued progress is made with current initiatives aimed at: i) further strengthening the business regulatory environment; ii) strengthening regulatory

frameworks and institutional capacity in the extractives sector; iii) improving access to finance; iv) reforming land administration; and v) improving tax policy and administration.

In addition, the following specific initiatives (scaling up existing programs or introducing new programs) could be pursued to both maximize potential gains and manage possible risks:

Table 5: Initiatives to meet immediate needs

No.	Initiative summary description	Additional financing requirement
C.1	Support to flagship business reforms. Existing technical assistance support to business regulatory reform scaled up (potentially under an existing project) to drive a small number of reforms to signal continued commitment to business environment improvements to local and foreign investors. Such reforms could be targeted towards improving Afghanistan's scores against Doing Business Indicators to ensure visibility and recognition.	Negligible Priority level: Med
C.2	Scale-up of existing facilities to improve access to financial services for micro, small and medium enterprises and agriculture. The focus would be on further developing and rolling out sharia compliant financial products. This would involve scale up access to microfinance through MISFA (Microfinance Investment Support Facility for Afghanistan); scale up access to finance for SMEs with partial credit guarantees, building on ACGF (Afghanistan Credit Guarantee Foundation) and scale up access to finance to agriculture through ADF (Agriculture Development Fund).	US\$100 million Priority level: High
C.3	Establishment of a commercial justice project. The project could provide short-term technical assistance support to strengthen both the functioning of and confidence in courts dealing with commercial disputes. The program could also establish new (or provide additional support to existing) alternative dispute resolution mechanisms for addressing business- and property-related disputes.	US\$20 million over three years Priority level: Low
C.4	Development of the extractives pipeline. Existing technical assistance to the extractives sector could be scaled-up. Additional resources could be used to expand the transaction pipeline and accelerate required legal, regulatory, and policy reforms to maintain momentum and investor perceptions during any post-agreement period.	US\$20 million over three years Priority level: High
C.5	Business plan competition for Afghan youth. Competition for existing or aspiring young Afghan entrepreneurs. Prizes of cash grants to implement business development plans. Draws on design of similar competitions in other developing countries where rigorous impact	US\$60 million Priority level: Med

	evaluations have shown positive results in terms of employment, firm survival, and firm growth.	
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Table 6: Initiatives to support sustainable growth

No.	Initiative summary description	Additional financing requirement
C.6	Land bank, providing the private sector with easy access to available state land via MUDL. Access to land remains a major problem for private investors. Reforms to land administration will take time to deliver results. In the interim, a package of technical assistance could be provided to MUDL (potentially under existing land reform projects) to establish a land bank of surplus state land and manage sales or long-term leasing to the private sector using auction-based mechanisms.	US\$10 million over three years Priority level: Med
C.7	Establishment of small-scale electricity distribution concessions model. Informal distribution networks, often utilizing illegal connections to the transmission grid, are already operating in Afghanistan. Support could be provided to DABS to: i) design and implement a small-scale concessions model to formalize small-scale distribution networks and encourage additional distribution operators; ii) provide output-based subsidies for connection in uneconomic areas; and iii) provide technical assistance to firms seeking to operate concessions. This could be complemented with the provision of financing for concession operators through an existing or new facility. Through this initiative, access to network electricity could be expanded to 3.5 million Afghans.	US\$350 million Priority level: High
C.8	Political risk guarantee facility for domestic investors. Resources could be provided to a new or existing facility to provide political risk guarantees for major investments to local investors. MIGA currently provides political risk guarantees to international investors. MIGA could be provided with grant financing to extend its products to local investors or an alternative dedicated mechanism could be established.	US\$100 million Priority level: Med
C.9	Outsourced extractives development facility. Financing could be provided for an independent extractives development facility, established through the negotiation of a peace agreement and operating under international governance mechanisms. A private sector contractor could manage the facility, focusing on a small number of key transactions and monitoring regulatory and fiscal	US\$50 million over four years

	compliance of extractives investors. The facility could operate under: i) a strict time limit on its operations, after which all responsibilities would revert to government agencies; and ii) requirements to twin its staff with and build capacity of counterpart staff in government agencies.	Priority level: High
C.10	Facility to catalyze private sector investment in infrastructure. Technical assistance and funding to establish a facility designed to mobilize commercial institutional private capital to support infrastructure investment in Afghanistan. The facility would have a robust governance structure that facilitates transparent, efficient decision making and clear controls. This facility would offer a single platform for pooled financing of a program of investments and reduce the risk profile of investing in Afghanistan, with a first loss component. The estimated initial size of the facility would be around US\$350 (with ability to raise more capital subject to market demand), with a first loss component around 30-40% of the initial size of the Facility.	US\$100 million Priority level: High
C.11	Affordable housing finance facility. This facility would aim to address demand and supply sides constraints to the development of affordable housing in the context of post-conflict population movement and likely construction sector boom. On the demand side (demand for affordable housing), the Facility would support the issuance of mortgages through a mortgage refinance window (which provides long term financial resources to financial institutions), accompanied by a mortgage guarantee product (and possibly a targeted subsidy program) to support low-income households qualify for mortgages for affordable housing. On the supply side (supply of affordable housing), the Facility would support the development of the affordable housing value chain, which has high job creation potential.	US\$200 million Priority level: Med
C.12	Formalization and development of current informal mining. Under existing programs, technical assistance could be extended to support the development and growth of mines currently operating outside of the current legal and regulatory framework, including: i) establishing a process for formalization, including recognition of de facto property rights and amnesties on outstanding tax obligations; ii) support to regulatory and standards compliance to improve profitability and support employment generation.	US\$30 million Priority level: High

Implications for a peace agreement

New initiatives are likely to have the greatest impact if any potential peace agreement includes:

- **Provisions to maintain investor confidence.** Such provisions might include agreement between all parties to protection of investor property rights and agreed investor dispute resolution mechanisms;

- **Provisions to ensure central bank independence.** Such provision might include agreement between all parties that the Central Bank will retain full autonomy and independence in monetary policy and financial sector regulation;
- **Provisions to ensure merit-based appointment of senior staff in key government agencies.** Such provisions might include agreement between all parties that specified public sector roles that are vital to private sector confidence will remain subject to merit-based appointment processes, including senior staff positions in the Ministry of Finance.

2.4. Strengthening international linkages

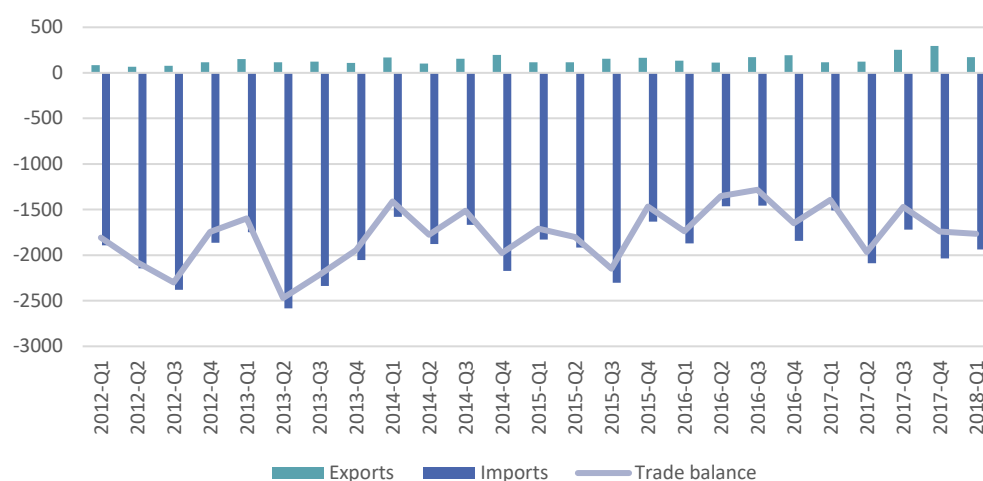
Gains achieved and current challenges

Over the past 15 years, Afghanistan has returned to full and active membership of the international economy. Afghanistan is now a member of the World Trade Organization, a signatory to a range of regional trade facilitation agreements, and a recipient of very substantial international aid flows. It is represented at a broad range of international economic organizations, including the International Financial Institutions (World Bank and IMF).

Exports have grown rapidly over recent years, reaching nearly US\$1 billion, with Afghanistan leveraging its comparative advantage in agri-business and location at the heart of a rapidly growing region (World Bank, 2018). Afghans are working and contributing to economies around the world, with remittances currently equal to an estimated three to seven percent of GDP and providing a vital source of income to around 6 percent of Afghan households. A range of regional infrastructure projects are at various stages of planning and implementation including gas pipelines, digital connectivity cables, and transport links.

Important challenges remain. Exports remain far below the level of current imports (US\$8 billion), driving a trade deficit that is entirely financed by aid and unsustainable in the medium- to longer-term. Foreign investment remains extremely low, with Afghanistan not viewed as an attractive investment destination. Options for Afghans to participate in international labor markets are constrained by the shortage of formal labor mobility channels.

Figure 9: Afghanistan has a large and persistent trade deficit
(Trade balance in million USD)



Source: NSIA/World Bank

Ongoing activities

Development partners are supporting a range of regional connectivity projects including oil and gas pipelines, transport linkages, and internet connectivity infrastructure. Work is also underway to assess the feasibility of several major regional transport projects, including in rail. Ongoing projects are seeking to strengthen value chains, address regulatory and logistical border constraints, and otherwise support the development of Afghanistan's export sectors. A new program is being developed to support improved labor mobility for Afghan workers, utilizing private sector outcome-based contracting methods. Formal labor migration arrangements are being negotiated with a range of regional and international partners.

Opportunities and challenges from peace

Insecurity has been a major constraint to the development of regional infrastructure projects. An improvement in the security environment would lead to reduced cost and increased viability of major connectivity investments. Improved security and political stability would also support increased foreign direct investment and the repatriation of capital that has moved overseas during the period of conflict. Finally, a political settlement may provide a window of opportunity for Afghanistan within the international community to deepen its engagements and take full advantage of any preferential trade or investment relationships that might be negotiated with regional or international partners.

Achieving a political settlement may also lead to an increased volume of returnee inflows. While this represents an important opportunity to access returning skills, capital, and labor, it also brings risks. Returning populations may contribute to the existing displacement crisis, placing additional pressure on services and potentially

generating new conflict pressures through contestation over land, water, and other resources.

Priority economic initiatives

Peace can bring important benefits in terms of Afghanistan’s international relationships through: i) reducing risks and costs associated with planned or ongoing major regional infrastructure projects; ii) supporting increased foreign investment, including into the extractives sector, by addressing perceptions of political risk; and iii) generating increased international goodwill and support.

In addition, the following specific initiatives (scaling up existing programs or introducing new programs) could be pursued to both maximize potential gains and manage possible risks:

Table 7: Priority initiatives for strengthening international linkages

No.	Initiative summary description	Additional financing requirement
D.1	Regional trade facilitation program to leverage international goodwill. Support to Afghanistan and regional partners through a new or existing trade facilitation program to: i) support review and renegotiation of tariff and duty rates for Afghanistan’s exports, seeking preferential access arrangements where possible; ii) address physical infrastructure constraints at border points; iii) address policy and procedural reforms at borders (customs, phyto-sanitary); iv) support capacity building of border control agencies; v) address regulatory constraints to inwards investment, including reviewing visa arrangements; and vi) regulatory and system harmonization to facilitate financial flows.	US\$100 million over four years Priority level: High
D.2	Scaling up of labor migration opportunities. Existing programs could be scaled up to provide new labor mobility options to Afghans living in disadvantaged areas, including those previously beyond government control. The program could seek to leverage international goodwill to identify additional potential markets and introduce outcome-based contracts for overseas job placements. This initiative could generate an additional 23,500 overseas jobs for Afghans by 2024, increasing remittances by up to US\$40 million.	US\$75 million over three years Priority level: High
D.3	Extractives investment packaging and marketing. Through a new or existing program, technical assistance could be provided to help attract foreign investment into the Afghanistan extractives sector. This would include financing of geological and seismic work to de-risk	US\$30 million over five years

	potential investment, packaging of projects to attract large-scale investors, and marketing investment opportunities internationally, including through an international Afghanistan extractives conference/summit.	Priority level: Med
C.4	Mazar-Herat railway. Transformational regional integration project, enabled by improved security. The railway would enable a continuous alternative route for Central Asia to the seaports of Iran. The construction cost is estimated at US\$3 billion with, in addition, US\$4 billion for rolling stock. This would need to be developed as a regional public project, with an Afghanistan financial contribution estimated at US\$500 million (resources of US\$300 million have already been notionally tagged for this initiative). Construction would take around 6 years. The initial step would be for the Government of Afghanistan to establish a consortium with key regional Government counterparts interested in the project.	US\$200 million Priority level: Low

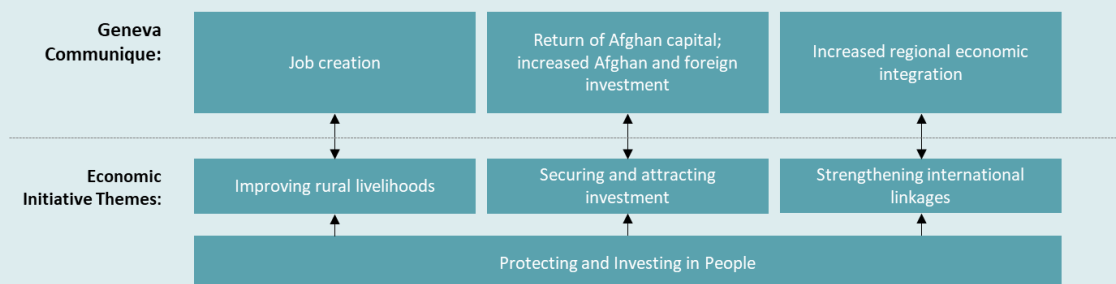
Implications for a peace agreement

New initiatives are likely to have the greatest impact if any potential peace agreement includes:

- **Provisions regarding regional integration.** These provisions could include agreement from all parties and regional partners to prioritize regional integration as a development strategy and commit to associated trade openness (or preferential access) and support to connective infrastructure investment;
- **Provisions regarding labor mobility.** These provisions could include agreement between all parties and regional and international partners to maximize opportunities for Afghan migrant workers and commit to avoiding further involuntary mass return migration.

Box 2: Alignment between Proposed Economic Initiatives and the Geneva Communique

Key themes in this paper align with the priorities identified in the Geneva Communique. Specifically, Article 15 of the communique called for a plan to support “a post-settlement return of Afghan capital; increased Afghan and foreign investment; job creation; and, enhanced regional economic integration”. The ‘securing and attracting private investment’ theme is aligned with attracting the return of Afghan capital and increased local and foreign investment. The ‘securing and attracting private investment’ theme also supports job creation. Job creation is also supported by the ‘improving rural livelihoods’ theme, given the high proportion of Afghans employed in agriculture. The ‘strengthening regional linkages’ theme is directly aligned with calls for regional economic integration. The ‘protecting and investing in people’ theme reflects the overall requirement to provide a short-term improvement in living standards to signal change while also building the human capital base for long-term sustainable growth.



Source: World Bank

3. SCENARIOS AND OUTCOMES

This section summarizes the costs and potential benefits of proposed economic initiatives. The first section presents an assessment of direct costs and potential outcomes. Section two assesses the affordability of proposed initiatives and the broader potential economic benefits of peace by analyzing fiscal and economic developments under three basic scenarios. The final section presents main conclusions and implications for implementation of proposed economic initiatives.

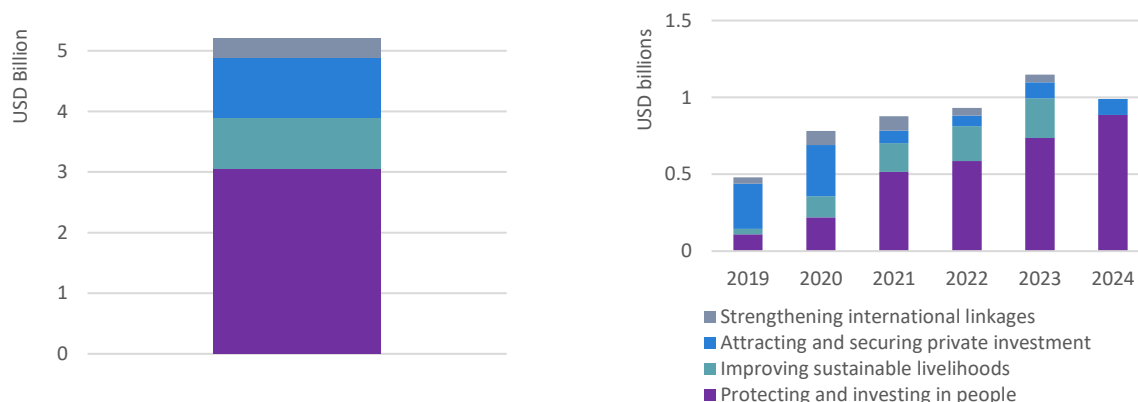
3.1. Initiative costings and outcomes

Costings

The full set of proposed economic initiatives would require financing of around US\$5.2 billion to 2024. This requirement is for total new and additional public financing against these specific initiatives, none of which has so far been programmed. Costs could be met through: i) new grant resources from any source (bilateral, multilateral, regional); or ii) redirecting current government or development partner expenditures.

Costs of proposed initiatives would increase over time from around US\$500 million in the year of a peace agreement to around US\$1 billion in the third year of implementation. Nearly 60 percent of total costs are associated with initiatives under the ‘protecting and investing in people’ theme, reflecting large public investment requirements of: i) expanding the Citizens’ Charter program; and ii) expanding access to health and education in new geographical areas.

Figure 10: Total costing by theme – total and annual
(Billion USD)

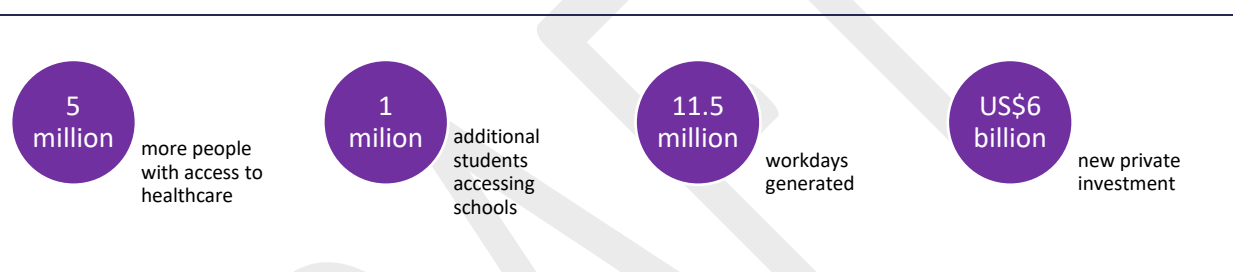


Source: World Bank

Direct outcomes

Implementation of proposed initiatives is expected to lead to the following quantifiable direct outcomes: i) access to healthcare and/or education provided to five million people through expansion of services into new geographical areas; ii) direct and immediate creation of more than 11 million work-days of employment through public works schemes; and iv) attraction of around US\$6 billion in new private investment through new guarantee and risk-sharing facilities. In addition, initiatives would provide a social safety net to around one million Afghans through a cash-transfer scheme and immediate drought relief and resilience to 150,000 farmers.

Figure 11: Direct outcomes of proposed initiatives



Source: World Bank

3.2. Scenario analysis

Purpose of analysis

Affordability of proposed economic initiatives will depend on the broader economic and fiscal context. Potential economic benefits from a peace agreement will not arise solely from publicly financed programs, but through improved economic growth and private sector investment. The following scenarios have been developed to illustrate: i) how the proposed economic initiatives could be financed; and ii) the broader economic benefits of improved security.

Grant assumptions

The future of grant support to Afghanistan is highly uncertain, with Brussels and Warsaw pledges extending only to 2020. Across all scenarios we assume a substantial and steady reduction in grant support from current levels of around US\$8.5 billion in 2018 to around US\$5 billion in 2024. We assume security grants decline from around US\$5.1 billion to around US\$2.5 billion, with the proportion of on-budget grants

increasing from around 35 percent to 60 percent. We assume civilian grants decline from around US\$3.6 billion in 2018 to US\$2.5 billion in 2024, with the proportion of on-budget grants increasing from around 40 percent to around 50 percent.

Figure 12: Grant decline projections
(Billion USD)



Source: World Bank

Baseline scenario

Under a baseline scenario the security situation remains unchanged. Real GDP growth continues at around 3 percent per year, reflecting weak investor confidence and security-related impediments to investment and public services and infrastructure programs. No major private sector extractive projects are advanced.

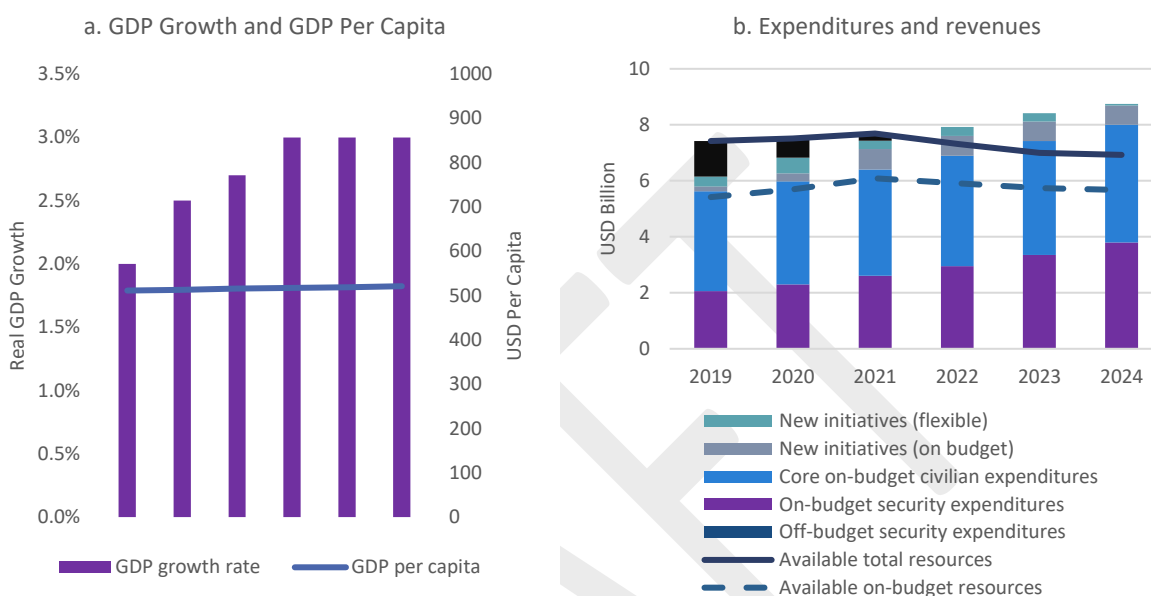
Government revenues remain flat as a share of GDP. Consistent with current policy, government takes on a greater share of security sector financing, with own-revenues financing US\$2.6 billion of a total security sector cost of US\$4.6 billion per year by 2024.

Declining grants and increased on-budget security spending lead to immediate fiscal pressures. There are insufficient on-budget resources to finance proposed economic initiatives. There are insufficient on-budget resources available to finance basic service delivery at current levels by 2021 and insufficient total resources to meet on-budget needs by 2023.

The main outcomes under this scenario are: i) declining living standards for most Afghans, with incomes barely increasing; ii) declining availability of public services such as health and education, with insufficient resources to finance service delivery needs, even if all grants were brought on-budget; and iii) an increased proportion of public

resources devoted to the security sector, at the cost of improved human development outcomes and livelihoods.

Figure 13: Outcomes under baseline scenario



Source: World Bank

Partial peace scenario

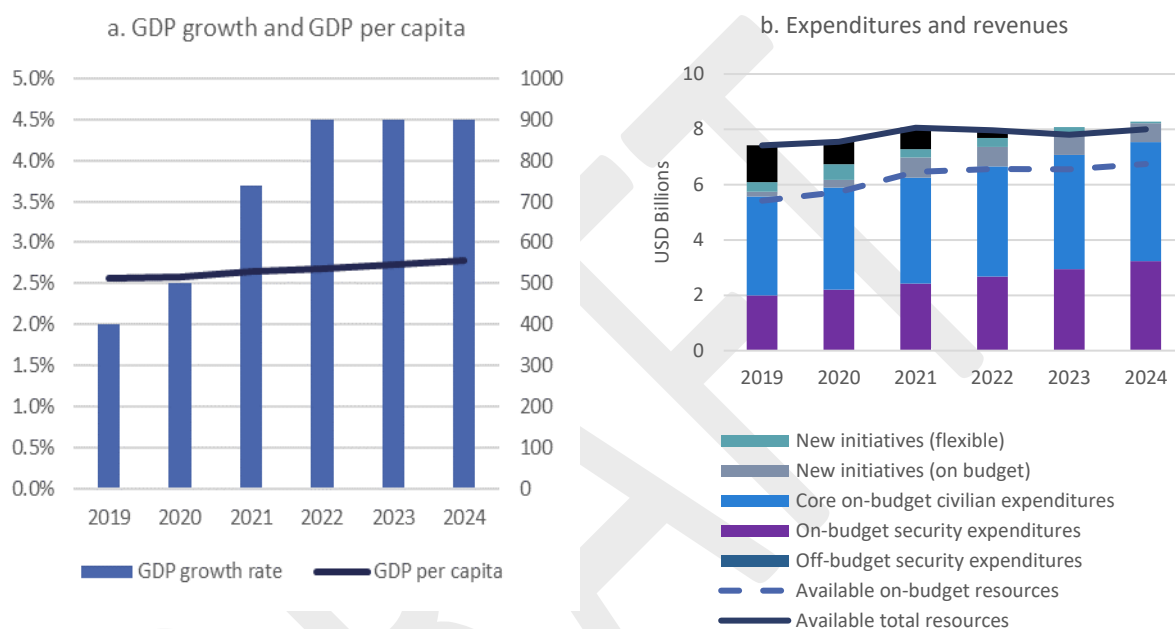
Under a partial peace scenario, a peace agreement is reached but does not lead to a full cessation of conflict. The security situation improves overall, but conflict continues to impede service delivery and infrastructure provision in some areas. Real GDP growth accelerates to around 4.5 percent per year, reflecting improved investor confidence and reduced constraints to transport and private sector activity. Some major extractives projects are implemented towards the end of the projection period.

Government revenues increase by around one percent of GDP reflecting tax reforms and an improved security environment to enforce compliance. Major new extractives projects deliver around US\$600 million of revenues by 2024. Improvements in security allow for a reduction in security expenditures to US\$4.2 billion by 2024, with US\$1.7 billion of costs met by government and the remaining US\$2.5 billion met by the international community.

On-budget resources are sufficient to finance core service delivery needs through to 2023. However, there are insufficient resources to meet the on-budget costs of proposed new initiatives. Over time, fiscal space is eroded with declining overall grants and needs marginally exceed available resources by 2023.

This scenario sees a slight improvement in living standards, with incomes increasing by around nine percent by 2024. Access to services and infrastructure improves through spending on economic initiatives and broader expansion in public services. Employment growth is limited, however, and areas where conflict continues would be excluded from benefits.

Figure 14: Outcomes under partial peace scenario



Source: World Bank

Comprehensive peace scenario

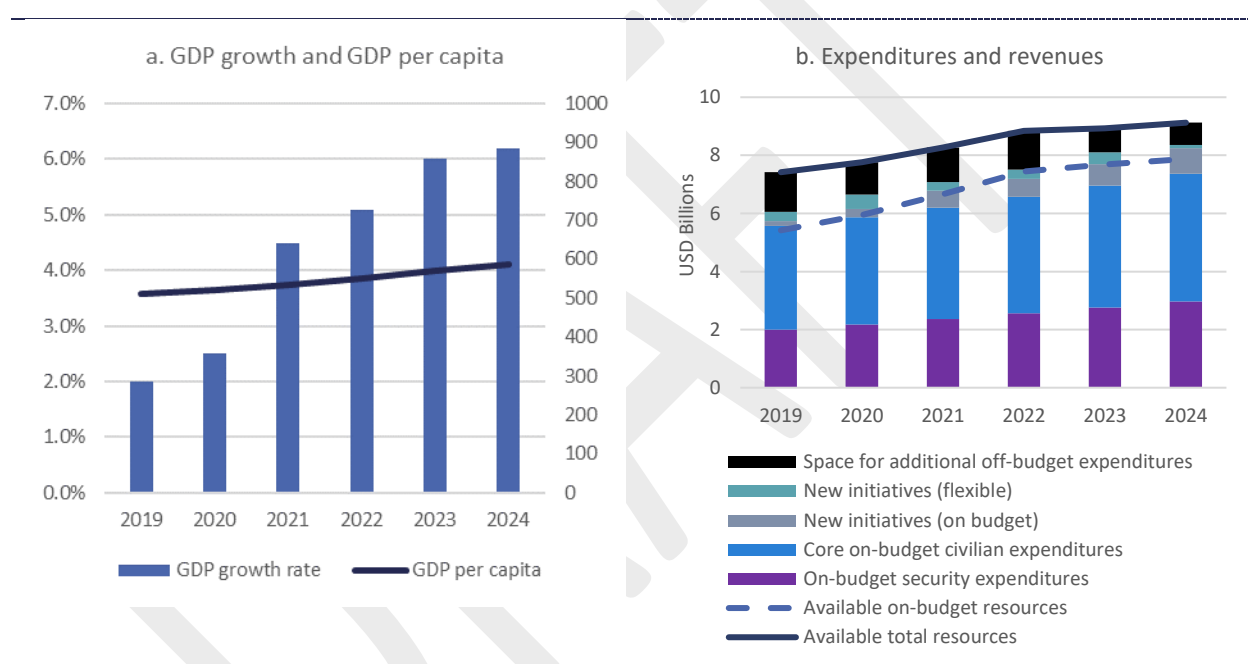
Under a comprehensive peace scenario, a peace agreement brings substantial improvements in security across all geographical areas. Real GDP growth accelerates to around 6.5 percent per annum, driven by improved investor confidence, repatriation of overseas capital, and improved infrastructure and services. Growth is supported by mobilization of major projects in extractives and development of regional connectivity infrastructure.

Government tax revenues increase by two percent of GDP by 2024 due to reforms and improved compliance. Major extractives and connectivity projects generate revenues of US\$1.3 billion by 2024. Civilian grants remain at current levels to 2020 and then decline to around US\$2.5 billion by 2024. Improvements in the security environment allow security expenditures to decline to US\$4 billion by 2024, with government financing US\$1.5 billion and the remaining US\$2.5 billion financed by the international community.

On-budget resources are almost sufficient to finance both core service delivery and infrastructure and the on-budget component of the costs of proposed economic initiatives through to 2024. Sufficient resources are available to also allow substantial (although declining) additional off-budget programming.

This scenario sees a significant improvement in living standards. Real incomes increase by around 16 percent by 2024. Access to services and infrastructure improves through spending on economic initiatives and broader expansion in public services. With the combination of improved security and rapid growth, an additional 540,000 jobs are created each year by 2024.

Figure 15: Outcomes under comprehensive peace scenario



Source: World Bank

3.3. Implications

Outcomes for living standards

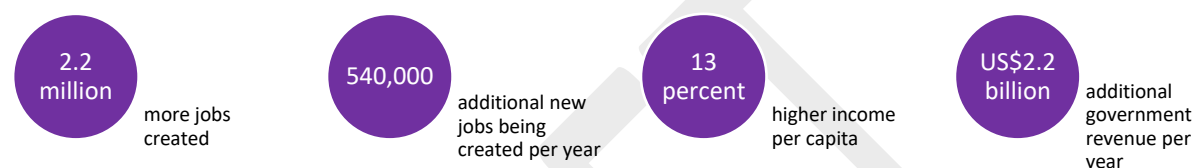
The proposed economic initiatives could have a meaningful and rapid direct impact on outcomes for many Afghans. However, the potential indirect impact of the proposed initiatives is much more significant. Resolving conflict would allow faster and broader economic growth, sparking rapid job creation and with benefits able to flow to all areas

of Afghanistan. The impacts of sustained growth driven by private investment will, over time, vastly outweigh direct impacts from public programs.

Without substantial improvements in security and faster and broader economic growth, outcomes remain grim. The proposed economic initiatives would have limited impact in meaningfully or sustainably improving outcomes if the security situation does not improve or broader improvements in economic growth are not achieved.

Figure 16: Economic outcomes of peace

(Difference between baseline and comprehensive peace scenarios by 2024)



Source: World Bank

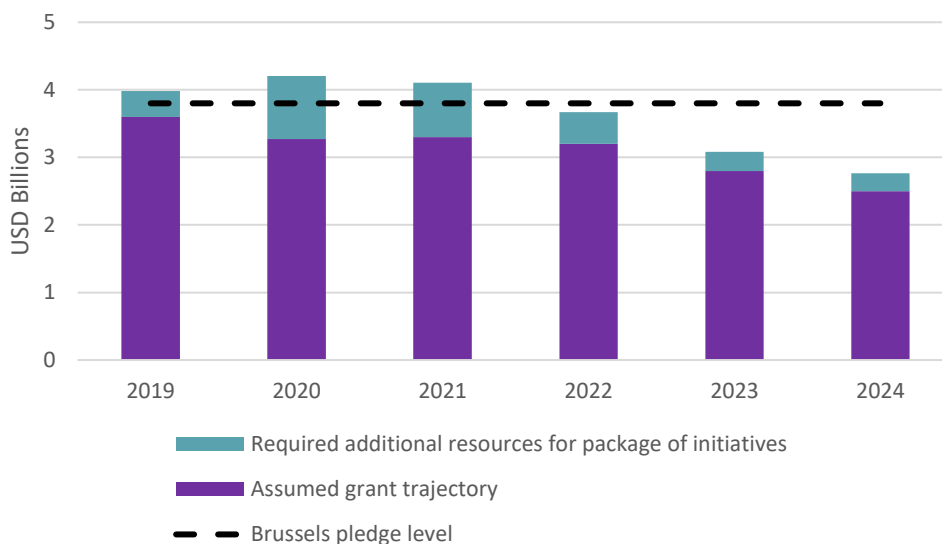
Fiscal outcomes and implications

Under a scenario of comprehensive and immediate peace, existing grant and government resources are sufficient to finance the proposed economic initiatives while also sustaining current levels of service delivery and infrastructure provision.

Under partial peace scenarios where growth rates take time to accelerate and security sector expenditure pressures remain high, there will be greater pressure on available resources. While the total resource envelope is likely to be adequate to finance both the proposed economic initiatives and ongoing levels of service delivery and infrastructure provision, increased on-budget resources will be required.

Financing the full list of proposed economic initiatives under a partial peace scenario would therefore require a ***slower pace of grant decline and a slight increase in civilian grant support in the years immediately following a political settlement*** (around US\$600 million over 2018 levels in 2020 and US\$500 million in 2021).

Figure 17: Projected grant decline and additional requirements for new initiatives
 (USD Billion, civilian grants only)



Source: World Bank

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Box 3: Modeling assumptions and approach

Total costs

Estimated costs are based on project-by-project inputs. The total estimated cost of US\$5.2 billion reflects the marginal additional costs of the package of new initiatives beyond current government and donor project and program allocations.

Fiscal assumptions

Under all scenarios, government recurrent expenditures are projected to remain steady in real per capita terms. O&M expenditures are projected to increase to reach the estimated need of seven percent of GDP by 2030. Development project expenditures similarly remain steady in real per capita terms, at levels sufficient to finance core projects included in the National Infrastructure Plan.

Grant flows over 2019-2020 are projected based on Brussels pledges. From 2020, grant flows are projected to decline steadily to US\$5 billion by 2024, split evenly between security and civilian grants. The proportion of total aid on budget is projected to increase to 50 percent for civilian grants and 60 percent for security grants.

With security grants held constant between scenarios, government-financed security expenditures are modeled as the residual based on overall security sector expenditure needs. These range from US\$2.3 billion under the 'baseline' scenario to US\$1.5 billion under the 'comprehensive peace' scenario.

Under the 'comprehensive peace' scenario, additional revenues are modeled from: i) mining (around US\$400 million per year); ii) oil and gas projects (around US\$100 million per year); iii) small-scale extractives (around US\$100 million per year); and major connectivity projects (around US\$700 million per year). These revenue sources are reduced and delayed under the 'partial peace' scenario and excluded entirely from the 'baseline' scenario.

Calculation of benefits

Direct benefits are based on a bottom-up aggregation of estimated project-level outcomes. These estimates are highly conservative, given that data limitations have precluded a comprehensive analysis. Only benefits directly arising from project activities are included.

Indirect benefits are based on a top-down comparison of outcomes under the 'baseline' and 'comprehensive peace' scenarios and are therefore intended to capture the differences between continuing conflict and peace at the level of economy-wide benefits. Incomes are calculated based on growth and population assumptions. Revenues are calculated using the assumptions described above. Employment outcomes are calculated based on estimated employment elasticities with regards to economic growth rates using data from the 2008 and 2012 Afghanistan Living Condition Surveys. These calculations assume no change in sector composition of GDP over the period.

Source: World Bank

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