

Diagnostic Facility for Shared Growth (DFSG) Fifth Call for Proposals Application Form

Title of the Proposed Study:	Opportunities for Sustained Inclusive Growth in Afghanistan
Country:	Afghanistan
Proposed Start Date:	August, 2010
Proposed End Date:	October 31, 2011
Total Amount Requested:	US\$ 75,000
Request for Cross Support:	-
Task Team Leader Name:	Claudia Nassif
Managing Unit (OUI):	SASEP
Telephone:	5221+3359
Trust Fund Certified (Yes/No):	Yes

1. Consistency with DFSG objectives:

The coming years will critically shape Afghanistan's future. The expected development of the mineral sector will transform the country's economy and help to reduce its dependency on external aid. However, after a destructive civil war, the country is left not only with a deteriorated economic structure but also a weak political, institutional and civil structure. By mid-90s Afghanistan was the poorest country in the world and is still the poorest country in Asia with more than half of the population living below the country's poverty line.

There are a number of economic indicators suggesting that Afghanistan is on an unsustainable growth path. Afghanistan official exports more or less collapsed in 2009 and the country is highly aid dependent with foreign aid disbursements of 47 percent of GDP in 2008/09. In the same year, private investments only constituted 8 percent of GDP compared with the total of 32 percent of GDP. The service sector is the main contributor to growth, but is currently highly dependent on aid inflows which will be phased out in the years to come. Another major concern is the fact that gross revenues from opium trade are equivalent to one third of GDP (= 90% of the World's opium supply).

Much hope is being placed on the development of the mineral sector which promises to bring over \$200 – 350 million per year from the exploitation of two miles alone. However, the development of the mineral sector will not only bring wealth but also bears the large risk of further destabilizing the fragile governance situation. Moreover, mining is pre-dominantly a capital-intensive activity which will only generate a limited number of jobs within the sector. Unless linkages to other economic sectors are strengthened, mining development is unlikely to bring relief to the poor and vulnerable population in Afghanistan which in majority is either un- or underemployed.

This background begs for a medium term strategy based on alternative sources for domestic, sustained and inclusive growth in Afghanistan. And understanding the economic growth process and the underlying political economy structures is, in this context, of utmost importance.

SASEP is currently preparing an economic growth study which will address the challenges the Government will be faced with in the medium and long term. It will deal with the following overarching question: How can policy makers in Afghanistan ensure that Afghanistan's emerging mineral wealth is not turning into a resource curse but translates into a source of sustainable and inclusive growth? In particular it will address the implication of mining development on the overall growth process, employment, greater inclusion and more efficient public expenditure. To this end the study will (i) analyze growth mechanisms, binding constraints and prospects in Afghanistan, (ii) illustrate the development paths for inclusive sustainable growth, in particular the economic linkages between the mining sector and the rest of the economy (iii) discuss the political economy underlying the prospective growth process (iv) and identify the key measures for sustainable and inclusive growth that need to be addressed by the Government and its development partners.

Throughout the analysis special attention will be given to specific challenges facing a post-conflict country and how those effect the framework, methodology and conclusions. To this end the team is also closely cooperating with the PREM team in DRC, which just finalized a Growth CEM

2. Technical soundness and originality:

There is a substantial volume of studies on Afghanistan and its many varied and complex development challenges. The key gaps lie in the quantitative analysis of the economic growth process in a manner that provides strategic guidance for the development efforts of the Government and its partners. Many of the existing studies focused on more short-term policy actions relevant for a country that is just coming out of a major conflict and to a large extent is still dealing with security issues. Hence, the proposed study is a first attempt to take a broader look at the medium term opportunities for Afghanistan. Sustained inclusive growth is not only an important objective in itself but the employment opportunities created are crucial to keep the country from falling back into conflict. The study is therefore timely and will cover new aspects compared to existing studies.

The study will analyze both macro (overall growth dynamics, sector dynamics, fiscal sustainability etc) and micro data (household/poverty data, employment dynamics, enterprise/investment climate data) as well as linking the two to further understand how the different economic actors are or could potentially contribute to and benefit from growth. Sector analyses will be important inputs as well – in this context the services sectors are of paramount importance as they are not only contributing directly to the growth process but also enable and foster the development of supply chains for the mining and agriculture sector.

Afghanistan, as other post-conflict countries, does suffer from limited data availability and the reliability of the data should always be questioned. However, there is certainly enough data, both at the macro and micro level, to better inform any inclusive growth strategy at this point and emphasize will be placed on sensitivity analysis, required conditions and presentation of

different growth and fiscal sustainability scenarios given alternative developments (using the MAMS framework) and their implications on fiscal sustainability.

As one example of the sort of analysis that can be credibly produced with existing household survey data, one component of this proposal will be to analyze change over time based on two rounds (2005 and 2007-08) of the National Reconstruction and Vulnerability Assessment (NRVA) household surveys. With this analysis, we will examine sectoral change in labor activities over time (in particular, percent of population engaged primarily in agriculture relative to non-farm activities) at the national, regional, and provincial level. The sub-national analysis will be able to inform what regions appear to be transforming more rapidly. In addition to looking at a set of labor-related indicators, this analysis will also examine general indicators of wellbeing (such as access to services, school enrollment, and caloric deficiency) and describe how these are changing over time. This two components will help fill large knowledge gaps by revealing not only which provinces are changing the most in terms of labor activities, but also those where the change is most inclusive (in terms of improved wellbeing as measured by the social indicators).

Another innovative feature will be that the political economy analysis will be supported by already existing surveys done in the context of the National Solidarity Program and economic experiments planned within the framework of this study. The guiding question in the political economy paper will be centered on the avoidance of a resource curse in an already fragile state. Particular questions which the political economy study seeks to answer are: What are the incentive structures of politicians and economic agents to invest in growth-enhancing public projects and how can they be altered? Which incentives do decision makers have to support fiscal rules for a sovereign wealth fund? Which benefit sharing mechanisms could contribute to better protection of public goods? Are direct cash transfers preferable to community level grants? Or what would be the optimal complement rule? In this context the study will make an attempt to step out of sharing a set of global practice ideals and shape policy recommendations through original, country-specific analysis.

3. Relevance to country priorities:

Demand for this study originated in different stakeholder groups: (i.) policy makers in order to highlight policies they need to focus on, (ii.) a Bank audience in order to guide our thinking and work on the growth agenda as we go forward, iii.) donors to inform their agendas.

This demand steams from the increasingly urgent need for analysis on the how to best manage Afghanistan's transition process, in light of decreasing aid, foreign military deployment, increasing security expenditures and risk of resource curse. Many aspects in the economic context in Afghanistan are critical but the purpose of the proposed study is to help the different stakeholders to take informed policy decisions and to prepare Afghanistan for the complex challenges which the coming decade will bring.

The study is considered a major AAA flagship, coordinated with all sectors in the country team. The growth projections and recommendations will serve as critical input for the upcoming CAS. The fiscal sustainability scenarios, developed in the study, will directly feed into another report on the "Sustainability of the State" which is currently in preparation

(concept note stage). Moreover, the study will have strong operational implications by serving as an underlying piece of analysis for a planned Development Policy Operation in 2011/12 which will support reforms to unleash the “Sources of Economic Growth”.

4. Knowledge sharing, dissemination and capacity building plan:

The report is organized along five papers (Sources of Growth, Mining and the Development of Resource Corridors, Agriculture and Rural Development, The Role of the Private Sector, Political Economy of Growth) which, in combination, will present a strong and focused story line that highlights the issues discussed above and their strategic interdependence. As mentioned above, there are several audiences for this study and each entails (i) a different process (in terms of stakeholder participation), and (ii) different kind of recommendations. The team therefore intends to develop different outputs to engage the different audiences in the dissemination process, including a concise and reader-friendly summary report, topic papers, comprehensive PowerPoint presentations, and short videos.

TA activities are planned in the coming years to support the Government in meeting the many complex challenges which the coming years will bring to fiscal sustainability and management.

5. Client and donor engagement and any participation of external agencies:

Different avenues of stakeholder engagement will be explored: First, a series of workshops will be conducted on different aspects of the growth study. The first workshop will be conducted in March 2011, jointly with the mining team, in order to discuss first results from the growth projections, as well as fiscal sustainability scenarios. Second, a webpage for the economic growth study will be developed to reach out to a broader public during the preparation and dissemination. Close cooperation with the IMF will be ensured.

6. Budget – Total Amount to be requested: US\$ 75,000

	FY 2010	FY 2011	FY10&11	FY10&11
Activity / Category	DFSG	DFSG	DFSG Sub-Totals	Other (BB, TF, donors)
Activity				
- Consultants	45,000	20,000	65,000	85,000
- Travel				40,000
- Media & Workshops	5,000		5,000	10,000
- Other (survey related)	5,000		5,000	
Sub-Totals	55,000	20,000	75,000	135,000

Staff costs and travels will be fully funded by BB.