

EXECUTIVE SUMMARY

I. BACKGROUND

1. This report is about how to progressively reduce over time Afghanistan's dependence on opium – currently the country's leading economic activity – by development initiatives and shifting economic incentives toward sustainable legal livelihoods. These aspects will form an essential component of the broader counter-narcotics strategy, which also includes law enforcement, political and administrative actions, improving security, better governance, awareness-building, and demand reduction and treatment for Afghan problem drug users. The report does not cover these other topics, although as emphasized in the Government of Afghanistan's National Drugs Control Strategy (NDCS), it is only through a holistic strategy which encompasses all key elements that the country will escape from its dependence on opium. In particular, without strong economic and development underpinnings, other counter-narcotics efforts cannot achieve sustained success.

2. Specifically, the report identifies additional investments and policy and institutional measures to support development responses that can counterbalance the economic advantages of opium. It analyses ways to change the relative incentives between licit and illicit cropping and to help enhance rural livelihoods for the poor, under better governance and security conditions. The report puts forward concrete recommendations, and the expected impacts on growth, poverty reduction and the opium economy are assessed.

3. The report first briefly discusses the policy context (Chapter 1) and provides an overview of the opium economy (Chapter 2), focusing on how different segments of the rural population interact with it. The report then analyses the scope for increasing value added, competitiveness and productivity in agriculture (Chapter 3) and for promoting enterprise development and off-farm employment (Chapter 4). The complementary role of further investments in rural infrastructure is examined in Chapter 5, and measures for strengthening governance are analysed in Chapter 6. In Chapter 7 issues that cut across all counter narcotics efforts are examined. A final chapter looks at implementation, and at issues of prioritization, synergies and phasing (Chapter 8). The recommendations of the report are encapsulated in a matrix at the end of this Executive Summary

The Counter-Narcotics Challenge

4. Afghanistan is a desperately poor, war-ravaged country. The usual challenges of post-war reconstruction are made even more difficult by the continuing insurgency, by the age-old centrifugal forces that have always made Afghanistan hard to govern, by the extreme weakness of modern institutions, and by widespread corruption and lack of rule of law.

5. In the last two decades, Afghanistan has become the world's predominant supplier of illicit opiates, accounting for over 90% of world production and trade. Total gross revenues from the illegal drug trade in Afghanistan are equivalent to over one-third of licit GDP. Millions of Afghans benefit directly or indirectly from the opium economy.

6. The government's strategy, with global backing, is to fight drug trafficking and to progressively reduce opium production over time. Where farmers are better off and clearly have viable alternatives, law enforcement measures can be taken. Where farmers are poor, or where landless labourers are involved, government policy is to develop viable alternatives for

the rural poor, and only then use sterner measures to enforce a ban on opium poppy cultivation.

What Can Be Achieved Over What Time Frame

7. Afghans engaged in opium production can be broadly categorized in four types:
 1. *Better-off farmers who are not dependent on opium.* The exit of these farmers from the opium economy is largely a function of security and governance, and of legal market opportunities.
 2. *Smaller farmers currently dependent on opium but with some potential for producing for legal markets.* Where there are good markets for legal crops and livestock, and provided that a modicum of security and good governance are present, these farmers may be expected to shift away from opium in the medium term
 3. *Poor farmers in remote areas currently highly dependent on opium, with little potential to produce for the market and scant local labour opportunities.* Over the longer term, these farmers can move away from opium if value can be added to local on-farm and off-farm production and to labour. Out-migration is likely to play a significant role for this group.
 4. *The landless, currently highly dependent on providing labour for opium production (through wage labour or sharecropping).* Adding value to labour, developing employment opportunities, and facilitating orderly migration are exit paths for this category over the longer term.
8. The challenge is thus to enhance the access of farmers (particularly poor farmers) and rural labourers to markets, land, water, credit, food security and employment – at least in adequate measure to provide a minimum legal livelihood.
9. Legal livelihoods can only be sustained under conditions of decent governance and security that allow the development of licit markets, the accumulation of assets and the growth of normal economic activities and relations. It is, therefore, also essential to ensure security and to support better governance and effective grassroots institutions. This will strengthen the reciprocal relationship of responsibility and trust between rural people and their local and central government.
10. Where these conditions can be put in place, experience shows that reductions in opium poppy cultivation can be achieved. For example, in those parts of Badakhshan province where households are in close proximity to urban centres, with access to both agricultural commodity and labour markets, and where the writ of the government can be maintained, reductions in opium poppy cultivation have been obtained in a relatively short period of several years.

II. ENTRY POINTS

11. Four areas of development have the most relevance as entry points for shifting economic incentives away from opium and toward the legal economy: (i) agriculture, irrigation and livestock; (ii) rural enterprise development; (iii) rural infrastructure; and (iv) local governance.

Agriculture, Irrigation and Livestock

12. Agriculture, irrigation and livestock are prime areas for intervention. They account for up to half of GDP, support some 80% of the population, and are the main activities of

those who are engaged in opium production or at risk of becoming part of the poppy economy.

13. The greatest counter-narcotics impact is likely to result from interventions which reach the largest number of rural households, particularly the poor, and bring the most income and employment. The predominant farming system of the poor is anchored in cereals production for household food security, with most households having food self-sufficiency for only a few months of the year. Investments in raising cereals productivity would improve household food security and progressively release agricultural land for higher-value, labour-absorbing licit crops with market opportunities.

14. Afghanistan is an arid land where most agricultural production requires irrigation. Irrigation is thus essential for restoring livelihoods and promoting the transition to higher-value cropping. There is enormous scope for improving water productivity on 1.3 million hectares, for rehabilitating existing traditional and modern systems on up to 800,000 ha, and for expanding the irrigated area by several hundred thousand hectares through both large and small-scale irrigation schemes. Current rehabilitation programmes cover less than half of rehabilitation needs and do not provide for extending the irrigated area or for improving productivity of water use. Accelerated and scaled-up investments in irrigation would have a high impact against the drivers of the opium economy, and would provide broadly spread benefits, with the typically important multiplier effects of irrigated agriculture throughout the rural economy. There would also be a positive impact on governance, as irrigation management builds social capital and gives farmers a fixed asset stake in governance, security and market development.

15. All Afghan rural households tend to have at least some livestock, and adding value to livestock is a first-class entry point to reduce the dependency on opium of poor farmers and landless households (Types 3 and 4), even in more remote areas.

16. Many areas of the country have potential for producing high-value horticultural, industrial or export crops such as cotton, oilseeds, fruits and nuts, and vegetables. Although these opportunities in large part directly affect better-off farmers (Types 1 and 2), they also have good scope for creating employment for the poor at production and processing stages. The key is development of technical packages, processing and marketing. Business models – the value chain approach, export promotion, and contract growing – have been successfully tested and have potential for scaling up. New high-value crops also have potential: a good example is saffron, which has been piloted with UK support.

17. For maximum impact on the opium economy, further investments should be focused on integrated agricultural support programmes, on irrigation, and on livestock. The policy and institutional constraints adversely affecting these programmes should be addressed. The focus needs to be on reorganizing production systems around market-driven supply chain approaches, increasing the endowment of productive assets, and expanding the involvement of the private sector. Selective investments, either private or in partnership between private and public sectors, in developing horticultural, industrial and export crops, with possible regional focus, should be undertaken where there is a viable business model.

Enterprise Development

18. The job and wealth creation impacts of rural enterprise development are considerable, and support to private enterprise development represents a good opportunity to achieve poverty reduction and counter-narcotics objectives.

19. Afghanistan faces a long and challenging agenda before it can build a modern, private enterprise-driven economy. There are problems of competitiveness due to appreciation of the Afghani (in real terms) and high wage rates; an unfavourable business climate with difficult access to land, poor power supply, corruption and high transaction costs; productivity impaired by poor infrastructure and services and by inadequate human resources; and strong competition from imports. Nonetheless, the generally market-oriented and liberal policy environment and the entrepreneurial character of the Afghan people create scope particularly for expanding the informal (micro-enterprise) sector and for building up small and medium-scale enterprises in certain import-substituting activities (vegetable oil, poultry, dairy, wool, processed foods, soaps, footwear, etc). Export products with potential include dried fruits and nuts, medicinal herbs, silk, leather, skins, carpets, etc.

20. The most direct impacts on the opium economy would be obtained by focusing on rural enterprise, as that is where opium farmers and labourers are located. It is also in rural areas that lower costs per job or enterprise created typically are found. Support to private rural business development would need to be accompanied by formation of groups and associations of farmers as required for development of viable business activities on a competitive basis, by targeted investments on a public-private partnership basis where needed, and by policy reforms and institutional development to increase competitiveness and develop enterprise across sectors. On the government side, MAIL should share the driver's seat with MRRD, and USAID and MISFA should be brought in as key partners. Improving outreach of financial services in rural areas would be an essential complement. Longer-term impacts could be achieved through vocational training and support to migration.

Rural Infrastructure

21. Rural infrastructure programmes are effective in improving livelihoods and in helping build governance. Roads and rural water programmes have a broad reach nationwide and a strong positive impact on poor communities and on the economic activities of the poor. Thus they can contribute to economic growth and poverty reduction, and over the longer term to the replacement of the poppy economy with legal rural livelihoods. Rural roads, in particular, contribute to the growth of the legal market economy and to better governance, and thereby enhance incentives for licit production. In addition, rural access improves governance: 108 out of Afghanistan's 396 districts currently have no road access to their provincial capital.

22. The major National Rural Access Programme (NRAP) and its predecessors have already improved 9,000 km of rural roads and have connected 3,000 villages (10% of the nation's total) to market centres during 2002-6. Rehabilitation of the remaining 75% of the nation's estimated 30-50,000 km of rural roads would have a potentially large impact on livelihoods and governance, thereby encouraging and facilitating the shift away from poppy. In addition, improvements in the policy framework and programme implementation for rural water supply and electrification could, combined with increased financing, significantly improve living standards and contribute to growth.

Local Governance

23. Afghanistan has made remarkable progress in community-based rural development since 2002. Some 18,250 Community Development Councils (CDCs) have been established in over two-thirds of the nation's villages, and block grants have financed small-scale rural infrastructure and development projects. This is one of the few programmes in Afghanistan which has clearly delivered results in the eyes of rural people. There are also District Development Assemblies (DDAs) serving about one-third of the population. These organizations, especially the CDCs, have strong local ties, can implement local projects, potentially could play an advocacy role vis-à-vis the government, and may potentially serve as development platforms to negotiate and channel support from national programmes and agencies. Further strengthening of these institutions will help build conducive conditions for the growth of the licit rural economy.

III. SIX PRIORITY SETS OF INTERVENTIONS

24. Matched against criteria of high impact, feasibility and political economy, six priority intervention sets targeted at the entry points discussed above have been identified for large-scale additional support. These interventions could have a considerable impact in improving incentives to engage in the legal economy, and over the longer term would help reduce opium production.

Intervention 1: An “Integrated Programme” for rural development and governance

25. A large impact on livelihoods, and hence on the opium economy, would be obtained by linking comprehensive support to rural development (reorganizing production systems around market-driven supply chain approaches, private rural enterprise development, rural infrastructure, access to social services) with governance building. Many programmes already exist to deliver both rural development investments and a certain degree of governance building at the village level, but they are characterized by lack of coordination and continuity, a supply-driven character, and fragmentation of objectives and activities. The result at the community level is lack of a critical mass of impacts to improve livelihoods and influence farmers to move away from opium.

26. There are, however, three already successful approaches which have potential, if combined, to create a critical mass of impacts on rural livelihoods, and hence to generate stronger incentives to move away from the opium economy: (1) the emergence of CDCs and clusters of CDCs as local development partners that can serve as entry points for further development initiatives as well as building social cohesion and adopting participatory planning; (2) the success of a number of NGO facilitating partners in offering integrated development services to communities; and (3) the growing effectiveness of the National Priority Programmes in delivering sectoral investments – in rural infrastructure (NRAP, WatSan), in agriculture (EHLA) and in social services (EQUIP, Health).

27. The innovation proposed is to scale up and complete existing initiatives so that rural communities would have access to a critical mass of support that would allow them to reorganize production systems along market-driven lines and to develop the physical and institutional infrastructure needed to support this shift toward commercial activity. The elements of such an integrated programme would include the following:

- Design and implementation would be Afghan-led, within national policy and the government budget, and financing could – in principle – be channelled through the Afghanistan Reconstruction Trust Fund (ARTF).
- Delivery by full service field-based implementing partners, typically NGOs; the greatest synergies would be achieved if the same partner can implement the entire package in an area.
- Scaling up from existing operations in order to capitalize on field presence and experience, and targeting poorer and more vulnerable areas.
- Support to farmer organizations set up around commodities or activities and to structuring of supply chains for higher value production, linked to private sector downstream processing and marketing.
- Strengthening of the productive asset base, especially through linkages to the rural finance system and to enterprise development programmes (see Intervention 4 below).
- Links to – or integration with – the programmes for strengthening CDCs.
- Linkages to other national priority programmes in order to achieve synergies.

28. The feasibility of this integrated approach has been demonstrated by the success of such programmes in several provinces. One programme supported by DFID in Badakhshan “contributed substantively towards the overall reduction in opium poppy cultivation in its target areas.” Impacts on the opium economy would be felt within several years in areas which are in close proximity to provincial centres, and would be high more generally in the medium to longer term once the programme achieves greater development impact in less accessible areas. In a province like Badakhshan, for example, in the more accessible parts of the districts of Kishim, Faizabad and Baharak, the integrated programme could bring down overall levels of opium poppy cultivation in the province by around 50% over a five to eight year period. In Helmand this kind of approach, combined with an improved security environment, could be expected to make a considerable dent in levels of opium poppy cultivation in the central districts, where as much as 50% (around 51,000 ha in 2007) of the province’s total opium poppy is currently grown.

29. Feasibility studies could be carried out in 2008 (cost \$500,000). Indicative incremental costs, assuming a start in 2009 and roll-out to cover about 10,000 villages (one-third of the total number in Afghanistan) by 2011, are estimated at \$30 million in 2009, rising to \$90 million in 2011. The estimated indicative total cost for an initial three year programme during 2009-2011 is \$180 million.

30. A number of implementation, policy and institutional measures are needed for this approach to be successful. These include: progressive strengthening of CDCs as focal points for development; strengthening of provincial and local planning processes; development of appropriate contract arrangements for service delivery with NGOs, farmer organizations, CDCs, etc.; development of structured linkages to existing and planned rural development and enterprise development programmes; and strengthened agricultural policy, planning and programme oversight, including stronger MAIL/MRRD collaboration.

Intervention 2: Expanding agricultural land under irrigation

31. As discussed above, irrigation is key to restoring livelihoods and promoting transition to higher-value cropping. Accelerated and scaled-up investments in irrigation would have a high impact against the drivers of the opium economy. Currently, the good performance of irrigation programmes under Afghan leadership and execution demonstrates their feasibility and strong community demand throughout the country. Irrigation investments have a typical life of 25-50 years, so sustainability is likely, although arrangements for operation and maintenance need to be put in place.

32. An irrigation and agricultural water management sector review should be carried out in 2008 (cost \$1 million), and a phased ten-year programme for increased investments should be prepared and financed. Estimated indicative investment costs are on the order of \$1.2 billion, of which \$125 million would be for completion in the short to medium term (2008-2012) of the rehabilitation of existing traditional irrigation on up to 500,000 ha; \$250 million for the physical and institutional modernization in the medium term (2010-2015) of existing large-scale irrigation schemes on up to 250,000 ha; and up to \$800 million in the medium to long term (2012-2018) for the development of new diversion structures, hydropower and large-scale irrigation on up to 150,000 ha.

33. A key supporting measure required is that concerned government agencies work out a framework for cooperation with each other and with NGOs and other outreach organizations to provide irrigation and cropping advice to farmers. For new irrigation schemes on trans-boundary waterways, constructive dialogue with neighboring riparian countries will need to be initiated.

Intervention 3: Improving returns to livestock

34. As discussed above, investment in livestock is a first-class entry point to reduce the dependency of the poor on opium. Scaled-up support is feasible: there are national programmes underway to strengthen veterinary services and to support small-scale initiatives in dairy and poultry, with considerable possibilities for scaling up. Other parts of the livestock economy should also be supported, but here further design work is required to delineate activities most relevant to the opium economy. There should be particular focus on the poorest, on women, and on extension to areas least served by development programmes and with susceptibility to opium. High-potential mechanisms to improve livestock value include sheep fattening, cashmere fibre development, and skin garments.

35. A preparation study should be carried out in 2008 (cost \$1 million). Indicative investment costs in dairy and poultry for the period 2009-2012 are \$120 million, including \$60 million for extension of the cooperative dairy model to a further ten areas and \$60 million for extension of the semi-commercial and household poultry models to ten more provinces. Investment costs for other value-added activities need to be determined. The key supporting measure required is to ensure that the transition to privatized but universally accessible veterinary services is carried through, and that services are available to the poorest.

Intervention 4: Rural enterprise development

36. Rural enterprise development would have a potentially high impact in providing legal livelihoods and shifting incentives away from opium. The government is developing a proposal for a massive and innovative Afghanistan Rural Enterprise Development Programme (AREDP). The programme is still at the early design stage, so the discussion in this report is preliminary and indicative. As presently conceived, AREDP is intended to provide full services to both micro and small and medium rural enterprises. Focusing on both import substitution and export development, the programme would work at two levels: rural micro-enterprises with less than 10 employees, and rural small and medium sized enterprises (SMEs) with 11-250 employees. The idea is to provide services adapted to the scale of the enterprise, facilitating access to finance, providing “end-to-end” business development services, putting in quality control, providing policy support as needed, and promoting partnerships between micro-enterprises and small and medium scale businesses. Management of these services would be contracted out. The institutional model would create links to other national programmes and work through the CDCs, linking local mobilization of communities with business development. A key element would be the formation of groups and associations at the grassroots level in rural areas, promoted and facilitated by CDCs. One proposal for example is to contract with communities to supply raw materials for agro-processing.

37. The programme is intended to be longer-term, nationwide and large. It has a proposed time horizon of 10 years, highlighting the need for long-term commitments. A pilot project and feasibility studies will be carried out in 2008 (the latter estimated to cost \$1 million). A rough preliminary estimate of the net financing requirement for the programme during 2009-2018 is \$550 million. Currently indicated programme targets with this level of financing are very ambitious and would need to be reviewed: 900,000 micro enterprises created, 12,000 SMEs, 2.1 million long-term jobs, and \$2 billion in annual production value.

38. Feasibility remains to be demonstrated during the design stage, but clearly this is potentially a very large and important programme. AREDP would provide a massive alternative labour market to opium poppy. The multiplier effect of such an intervention would further increase wage labour opportunities and the opportunity cost of allocating labour to opium poppy cultivation.

39. Next steps will be critical. Donors should work in close and intensive partnership with the government to help it develop the programme on a sound basis. All relevant government and national agencies should be involved. In particular, MAIL should share the driving seat with MRRD. Government should make a particular effort to bring in the local private sector, USAID and MISFA as key partners. Programme design should emphasize building local capacity in business development.

40. Finally, attention needs to be devoted to improving the business environment and to aligning and harmonizing approaches of business support programmes (see Box A). Another related priority is a Diagnostic Trade and Investment Study (DTIS, estimated cost \$500,000), including an import substitution and counter-narcotics lens.

Box A: Agenda for Improving the Business Environment and Business Support Programmes

The report makes many recommendations that would help improve the business environment and enhance the impact of business support programmes:

- *Access by Afghan trucks to neighbouring countries* should be negotiated in transit and trade agreements.
- *Grants and other support in current business development services need to be streamlined and transparent*, and the services should be built up to be locally run.
- *Pooled financing should be considered to ensure consistency and coherence of matching grants for investment.*
- *Investments in Industrial Parks should be scaled up* in response to existing strong business demand.
- Attention should be paid to *setting and supporting export standards.*
- Government and partners should work together to *further strengthen the Customs Service.*
- Support should be provided to the *development of representative business and civil society organizations* that have a stake in anti-corruption measures and in improved security.

Intervention 5: Local procurement

41. A quick action that would have high impact would be a massive increase in local procurement by the foreign community. A worldwide study found that only 4-9% of the benefits of international peace-keeping budgets stay in the host country. The feasibility of sharply increasing local procurement has been demonstrated by the US lead (switching, for example, from \$58 million of annual spending on imported drinking water to locally procured water), and other sizeable opportunities are evident. The multiplier effects in the economy of hundreds of millions of dollars of extra local purchases would be extraordinary. The bulk of such procurement would be high-value agricultural produce, and much of it could be grown in opium-vulnerable areas: the US, for example, is proposing to procure fresh fruits and vegetables in Nangarhar, formerly a major opium producing area to which opium is returning in many localities. In addition to the economic benefits, the dividend in terms of trust and “hearts and minds” would also be considerable.

42. All governments supporting the Afghanistan Compact should make firm commitments to sharply increase local procurement in 2008, with a view to achieving a target of, say, 50% local procurement by 2009, and instruct relevant agencies to prepare feasibility studies and to make institutional preparations (e.g. for hiring local purchasing and inspection staff) to achieve this target. In addition, the operations of the Peace Dividend Trust, which has been supported by DFID amongst others to foster local procurement, should be scaled up and fully financed (cost \$2 million in 2008-9).

Intervention 6: An integrated production and market development programme for suitable crops such as cotton, targeted initially at Helmand province

43. Afghanistan has in the past demonstrated comparative advantage in cotton production. Revival of the cotton sector could have a high impact as cotton has a relatively high value, grows in areas such as Helmand where opium is also widely grown, and the standard business model is similar to that of opium. However, the feasibility of major investments in the cotton sector is not clear at present, and attempts to date to revive the cotton industry have encountered many problems. Major new investments in plant and equipment together with a high level of support to the business, at least initially, would be required to rebuild the cotton economy on a profitable and sustainable basis. There are viable commercial models for

small-holder cotton development practised in many countries, in particular the attractive nucleus factory and out-grower contract farming model, which reduces farmer risk by providing inputs, advice and a guaranteed market and price, and reduces business risk by binding out-growers to a contract relationship with a single industrial buyer. Other industrial crops such as oilseeds may also be economically viable, and their prospects would need to be assessed as well. There are evidently political economy issues, at both local and central levels; government policy in practice has taken a statist approach, although this may change with the reforms occurring in MAIL. In addition a number of economic and technical issues need to be addressed before considering major investments.

44. Despite these uncertain prospects, cash crops such as cotton present considerable possibilities, and the business model is prima facie highly attractive. It is therefore recommended that an immediate sector review and pre-feasibility study should be carried out. The indicative budget for the study is \$500,000.

IV. OTHER PRIORITY ACTIONS

Adding Value to Key Ongoing National Priority Programmes

45. Ongoing National Priority Programmes are having high impact, particularly: (1) the National Rural Access Programme (NRAP) for rural roads; (2) the National Solidarity Programme (NSP) for community development; (3) the Micro-Finance Support Facility of Afghanistan (MISFA) for rural finance; and (4) the Water and Sanitation Programme (WatSan) for rural drinking water supply. The impact, particularly the opium-relevant impact, of these programmes can be enhanced by increased financing and by improvements in the programmes.

46. **NRAP and rural roads.** There are strong linkages between rural access and the counter-narcotics agenda. Investment in rural roads should be scaled up, with substantial additional financing provided for NRAP, subject to policy and institutional changes and to improvements in programme design and implementation. Financing of rural roads currently outside NRAP should be brought within the programme. To enhance counter-narcotics impacts, priority should be given to poor areas and to areas where market linkages can be strengthened, and to linking isolated districts to administrative centres. Implementation should prioritize community buy-in, emphasize labour-intensive construction, and provide for locally managed and executed maintenance. An indicative additional budget of \$300 million could be allocated for NRAP during 2011-2014.

47. **NSP and community development.** Community-based rural development can play a role in moving the counter-narcotics agenda forward. NSP should be strengthened and further scaled up. Additional financing should be provided to continue the roll-out of CDCs and to finance further block grants, albeit it at lower levels of funding, in order to consolidate and sustain the CDCs. CDCs should be empowered step by step to take on local service delivery and governance functions in limited functional areas, and progressive engagement with CDCs as focal points for local development should be encouraged and followed up. Counter-narcotics considerations should be mainstreamed in the district and provincial planning process. An indicative supplementary budget of \$100 million for NSP during the period 2008-9 is proposed.

48. **MISFA and rural finance.** Opium credit plays a major role in locking rural people into the business, and increasing outreach of rural financial services is an important way to change the incentive structure. In addition, provision of financial services is vital for private sector-led rural economic growth, and would support the priority intervention sets proposed above. Ongoing initiatives to improve the outreach and coverage of rural financial services should be strengthened, by: (i) completing the process of maturation of micro-finance institutions; (ii) developing new areas of finance for rural areas, in particular innovative solutions for financing agriculture and rural enterprise; and (iii) increasing rural outreach significantly.

49. **WatSan and safe water in rural areas.** The provision of safe water forms an essential component for improving rural livelihoods, and ongoing safe water programmes should be improved and scaled up. A sustainable low-cost strategy for operation and maintenance should be developed, a water resources assessment carried out to determine the effect of drought, and a study conducted to revise and strengthen WatSan programme planning and management and to resolve current implementation problems.

Preparing Further High-Impact Activities For Later Implementation

50. A number of activities are high-potential areas for engagement, but there is a need to carry out studies or preparation before the scope for further interventions is clear.

51. **Promoting high-value agriculture and labour-intensive processing.** There is considerable growth potential for high-value agriculture and labour-intensive processing, which will be key elements in improving incentives for the legal economy. Current initiatives have stimulated some increased investment and activity in the private sector, and more private sector involvement will be essential for moving production systems toward higher-value commodities (as proposed under Interventions 1 and 4). However, the many current initiatives are ill-coordinated. A first step should be stocktaking and evaluation, to provide the basis for preparing strategies for scaling up interventions, many of which can then be promoted through the proposed integrated programme and through AREDP. Areas that need to be addressed include the following: (i) supporting high-value horticulture production, with a focus on opium-vulnerable provinces that are currently under-served; (ii) effectively supporting the fruits and nuts processing and export sectors along the entire value chain; (iii) market development and agricultural export promotion; (iv) development of sub-sector policies and investment plans for industrial crops and agro-processing; and (v) contract growing, particularly for industrial crops.

52. **Rural employment and adding value to labour.** These are key mechanisms for providing alternatives to opium. However, opportunities for improving the employment prospects of the largely unskilled labour force and for adding value to migrant labour have not been exploited. A demand-driven vocational training programme needs to be designed and financed, and a study should be carried out to identify entry points for higher-value and more humane migration, and to develop a roadmap for this purpose.

53. **Rural electrification.** Rural electrification can make an important contribution to rural well-being and to rural economic productivity, but little has been done systematically so far in this area. What is needed is a *national policy framework for rural electricity development*. Such a framework should (i) set out ways to facilitate private investment, including rules under which the private sector should operate; (ii) spell out subsidy policy to

help reduce high initial capital costs of rural electric power; (iii) specify ways to promote renewable energy technologies; and (iv) propose institutional options for larger rural energy projects (1-10 Mw). Also required is the establishment of a **central agency for facilitating rural electricity access**. Based on institutional and policy improvements along these lines, increased **financial support** to rural electrification should be provided.

V. INSECURE AREAS

54. Development programmes are encountering difficulties in as much as one-third of the country due to insecurity. Ominously, the coincidence between opium poppy and insecurity is becoming increasingly, apparent. Growing insecurity needs to be factored into development planning, and some tough choices present themselves, often requiring judgment calls based on the local conflict and security situation on the ground. One option is to reduce the presence of all foreigners in the field – and at the policy table. Afghans should lead and implement programs both in Kabul and in the field. Another option is to scale back some of the more aggressive military interventions and give priority to more integrated development approaches and community partnerships – with a low-key role for the military. One diplomat with field experience said: “There is a need to create an environment of trust, to support the Afghan army and police as a people’s defence force, and to leave development to civilian agencies. If you chase terrorists, you create an unstable environment.” Box B outlines some suggestions for operating in insecure environments in Afghanistan.

55. In the extreme case of Helmand, the window for development initiatives to counter poppy is very narrow. It may be possible to invest heavily in the enclave in and around Lashkar Gah where security is adequate, generating a “development pole” impact. For example, rural enterprise and industrial parks could be promoted, together with some specific agro-industrial investments to develop contract growing (e.g. for cotton). Labour-intensive public works may also remain an option. In rural development, continuation of the current DFID-funded NGO programme is a high priority, and there may be opportunities for expanding certain short cycle horticultural crops through contract growing, including new crops such as mint. NRAP’s rural road coverage could be expanded in areas where the security situation is still manageable but where opium poppy cultivation is extensive or where its return is considered likely. This could apply in Nad e Ali, Nawa Barakzai and Lashkar Gah. Linked to this, responsible local governance is a critically important pathway, and the apparent success of NABDP in Kandahar in working with District Development Assemblies and promoting thousands of labour-intensive micro-projects could be replicated. Finally, it may be possible to promote investment in human capital through a pro-active education programme, if necessary in educational institutions outside the province. These measures taken together could help provide economic alternatives to rural people that can be taken up as the security situation improves. There should be no illusion however about prospects for quick success, particularly if conflict and insecurity continue at current levels.

Box B: Suggestions for Dealing with Insecurity

- Work through decentralized planning and programming mechanisms, to ensure that the local administration and local people are aware and on board
- Select only villages that are willing to sign a cooperation agreement and to give a community security guarantee
- Maximize local ownership and community engagement through working with community institutions (CDCs and others), local contracting, labour-intensive works, etc.

- Remove all “foreign badging” – or perhaps even government badging where this is essential for working in the most insecure areas, and be thoroughly Afghan in the field.
- Use local implementing partners and locally recruited staff, preferably from the communities themselves, including local facilitators, “barefoot engineers”, and technical monitors.
- Give priority to relevance: the project has to be at the top of the local community’s priorities, and preferably one that gives rural people a stake in stability, security and good governance.
- Use decentralized and participatory monitoring and evaluation approaches.

VI. HIGH LEVEL POLICY AGENDA

Key Cross-Cutting Policy and Institutional Issues

56. Above the programme level there are a number of issues that constrain development across the board in Afghanistan and where a political-level consensus may need to be developed or – where it already exists – to be translated into action. These issues require constructive and persistent dialogue amongst all partners, leading to consensus and, most importantly, to change. Decision-makers will face some unpalatable trade-offs, requiring good understanding and sustained political commitment to move forward with the chosen options.

57. **Increasing Afghan ownership and leadership.** All programmes should be within the Afghan government-determined strategy, and need to be accountable to the Afghan government. The existing National Drugs Control Strategy (NDCS) provides a good basis for the Afghan government to exert leadership, although prioritization and sequencing will be essential. Afghan leadership and management of key ministries and programmes should be improved as necessary in the interest of ensuring sound policies, programmes and implementation. Institution-strengthening efforts need to continue and should be further improved based on sound Afghan leadership, and technical assistance from donors must be fully supportive of government leadership and sustainable capacity building. The government should engage in open dialogue about counter-narcotics strategy, priorities, and instruments with all concerned donors.

58. **Enhancing aid effectiveness.** The effectiveness of the measures recommended in this report could be greatly increased by better harmonization and alignment of aid. Government and international partners should implement their commitment to funding National Priority Programmes, and should channel aid flows through the ARTF and the national budget. Capacity strengthening should be provided to help the government steer the National Priority Programmes and to manage the related budget flows efficiently. Joint programming – rather than just “coordination” – should be the rule. This will require bilateral programmes to surrender national badging and “give up control to gain Afghan ownership”.

59. **Applying counter-narcotics mainstreaming to development activities.** “Mainstreaming” is the process of appropriately enhancing the counter-narcotics outcomes associated with development programmes, ranging from agriculture and rural development to health and education. Mainstreaming is agreed government policy, but implementation has been very slow. Yet it can usually be implemented with modest extra effort. Counter-

narcotics mainstreaming guidelines should be fine-tuned and generalized. Government should help agencies to apply the guidelines systematically.

60. **Long-term commitment should be the watchword, not short-term expediency.** Clearly, further development interventions on a broad front, beginning in the immediate future, are essential if improvements in governance and the prospects for Afghanistan's longer term development are not to be undermined by narcotics. However, there is an asymmetry between the political expectations of government and donors for rapid changes in the opium economy – and the reality of the one to two decades realistically needed before the opium economy dwindles. So-called “quick impact projects” have been implemented, but these have had at most very limited sustainable results. Effective counter-narcotics efforts are a combination of economic development, provision of social services, and better governance and the rule of law. Although significantly scaled up development action is essential straightaway (as well as better deployment of existing resources), achieving counter-narcotics goals will take considerable time, massive and sustained financial commitment, and political vision and stamina. The message of “start now but plan long-term” should be consistently transmitted in all policy dialogue.

61. **Piloting, innovation and the private sector.** In addition to these broader issues, and while recognizing that no short cuts to phasing out opium in Afghanistan exist, there will be a premium on innovative thinking and economic policies, experimentation, pilot development initiatives, scaling up based on positive experience, dropping failures, etc. Particular attention will need to be focused on effective support to private initiative, i.e. how to put public resources combined with private sector expertise and entrepreneurship effectively to use in a transparent manner to help jump-start, scale up, and sustain promising economic activities that will over time shift incentives away from opium.

Consistency, Perseverance and Partnership Are Essential – Under Afghan Leadership

62. Overall, the progressive elimination of the opium economy in Afghanistan will come about through the creation of a web of good governance and incentives in favor of legal economic activities. This requires a broad-based governance building and development effort over many years. There are no short cuts. If opium poppy is to be eliminated, even in a small geographical area, a long-term and multi-sectoral effort is required to foster the needed governance and security conditions, and to put in place the critical mass of infrastructure, markets and services that can create a sustainable licit economic growth dynamic. Much is already happening and very large investments are being made, but the dividend will be in the medium to long term, and will be reaped through consistent approaches, persistence in the face of short-term setbacks, and massive, coordinated and sustained investments. This provides a daunting challenge for the Government as well as its donor partners.

63. Financing should be directed not only to new initiatives but also to scaling up and improving many excellent existing programs. Chasing quick fixes in the hope of rapid reduction of opium production creates illusions and undermines long-term impacts. A strong institutional framework needs to be built, based on the promising community institutions already set up. Planning and investments should be guided by empirical evidence: successful National Priority Programmes like NSP, NRAP and MISFA need to be backed, and innovations piloted and tested exhaustively. The government's thoughtful and sound counter-narcotics strategy needs to be mainstreamed in development policies and

programmes. And above all, partnership and integration need to become universal practice, under strengthened Afghan leadership.

SUMMARY OF RECOMMENDATIONS

I. Six priority intervention sets

Cost	Government Actions	Partner Actions	Impacts and Security
<i>1. An “Integrated Programme” for rural development and governance (8.2.1)</i>			
Study (2008): \$500,000 Investment (2009-2011): \$180m	<ul style="list-style-type: none"> ▪ Consolidate evaluations of ongoing programmes and prepare an Integrated Programme for scaling up and replication nationwide, with an initial three year investment phase 2009-2011 (3.3.1) ▪ Strengthen CDCs as focal points for development (6.3.4, 6.4.2) ▪ Strengthen provincial and local planning processes (6.4.2) ▪ Implement contract arrangements for service delivery with facilitating partners: NGOs, farmer organizations, CDCs etc. (3.4.1) ▪ Strengthen agricultural policy, planning and programme oversight, and strengthen MAIL/MRRD collaboration (3.4.3) 	<ul style="list-style-type: none"> ▪ Harmonization and alignment within MRRD/MAIL strategies, ARTF and government budget (3.4.2) ▪ Support and capacity building for MAIL. (3.4.3) ▪ Finance investment of the Integrated Programme through ARTF and government budget (7.2) 	High potential impact, especially on those most dependent on opium (Types 2-4) /a Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<i>2. Expanding agricultural land under irrigation (8.2.2)</i>			
Sector review (2008): \$1m Ten year investment programme (2008-2017) \$1.2b	<ul style="list-style-type: none"> ▪ Carry out irrigation and agricultural water management sector review and prepare phased ten year investment programme (3.3.3) ▪ Develop framework of cooperation MEW/MAIL (3.3.3) ▪ Assess issues of riparian rights and transboundary water sharing agreements, and initiate dialogue where needed (3.3.3) 	<ul style="list-style-type: none"> ▪ Participate in sector review and preparation of investment programme (3.3.3) ▪ Help finance investment programme through ARTF & gov't budget (7.2) 	High potential impact on all dependent farmers (especially Types 2 and 3) Moderately sensitive to insecurity.
<i>3. Improving returns to livestock (8.2.3)</i>			
Review (2008): \$1m Four year investment programme (2009-2012): \$120m	<ul style="list-style-type: none"> ▪ Review of dairy, poultry and opportunities for livestock value-added, and preparation of a four year investment programme (3.3.4) ▪ Complete transition to privatized but universally accessible veterinary services (3.3.4) ▪ Pursue reform and institutional development for MAIL (3.4.3) 	<ul style="list-style-type: none"> ▪ Participate in sector review and preparation of investment programme (3.3.4) ▪ Help finance investment programme through ARTF and government budget (7.2, 8.2.3) 	Very high impacts, especially on most dependent (Types 3 & 4) Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<i>4. Rural enterprise development (8.2.4)</i>			
Preparation study (2008): \$1m DTIS study (2008): \$500,000 Ten year programme (2009-2018) \$550m Initial three year phase (2009-2011): \$200m	<ul style="list-style-type: none"> ▪ MRRD and MAIL to develop the proposal jointly, with support from concerned national agencies and donors (4.3.1) ▪ Include USAID and MISFA as principal partners (4.3.1) ▪ Introduce measures to improve the business environment, including: (i) access by Afghan trucks to neighbouring countries (3.4.1); (ii) pool financing and streamline and align incentives, subsidies and current business development services (4.4.1); (iii) scale up Industrial Parks in response to business demand (4.4.2); (iv) improve setting and supporting of export standards (4.4.2); (v) strengthen the Customs Service (4.4.2); (vi) DTIS study of trade policy with an import substitution and counter-narcotics lens (4.4.2) and (vii) support development of representative business and civil society organizations (4.4.3) 	<ul style="list-style-type: none"> ▪ Close and constructive support to preparation (4.3.1) ▪ Help finance investment programme through ARTF (7.2, 8.2.4) 	Very high potential impacts, and good employment potential benefiting the highly dependent (Types 3 and 4) Moderately sensitive to insecurity

/a See Section 2.3. Type 1 (better off) farmers are not dependent on opium; Type 2 (marginal) farmers are dependent on opium; Type 3 (poor remote) farmers are more dependent and Type 4 (landless labourers) are highly dependent on opium.

Cost	Government actions	Partner actions	Impacts and security
5. Local procurement (8.2.5)			
Support to PDT (2008-9): \$2m	<ul style="list-style-type: none"> ▪ Require compliance and accountability of signatories of Afghanistan Compact to increase proportion of local procurement and of local labour content of construction (4.3.1) 	<ul style="list-style-type: none"> ▪ Set local procurement targets, to reach (say) 50% by 2009, prepare feasibility studies, make institutional preparations (4.3.1) ▪ Scale up and finance PDT (4.3.1) 	High potential impacts for all Types of farmers. Sensitive to security risks Adapt procurement measures to security & food safety requirements
6. An integrated production and market development crop for suitable crops such as cotton, initially targeted at Helmand (8.2.6)			
Sector review and pre-feasibility study (2008): \$500,000 Investments: tbd	<ul style="list-style-type: none"> ▪ Carry out sector review and pre-feasibility study, including of public/private partnership and contract farming options (3.3.2) and of applicability to Helmand (7.7) 	<ul style="list-style-type: none"> ▪ Support sector review and pre-feasibility study, and help finance resulting proposals (8.2.6) 	High potential impact on Types 1 and 2, potential employment for 3 and 4 Sensitive to insecurity, develop security guidelines

II. Adding value to key ongoing National Priority Programmes

Cost	Government actions	Partner actions	Impacts and security
1. NRAP and rural access (8.3.1)			
Seven year investment programme (2008-14): \$400m Financing gap: \$288m	<ul style="list-style-type: none"> ▪ Develop rural roads policy and investment planning mechanism ▪ Strengthen coordination amongst providers, with beneficiaries ▪ Define institutional responsibilities at all levels ▪ Develop a capacity building programme ▪ Prepare new, low cost standards for rural road construction ▪ Design and implement strategy for road maintenance ▪ Adopt low cost and labour-intensive technologies ▪ Set up a simple M&E system to collect economic data (5.4.1) 	<ul style="list-style-type: none"> ▪ Finance investment through ARTF and government budget (7.2, 8.3.1) 	Very high impact on rural economy, including Types 3 and 4 in remote areas Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
2. NSP and community development (8.3.2)			
Phase II of NSP (2007-9): \$120m Supplementary financing required (2008-9): \$100m	<ul style="list-style-type: none"> ▪ Complete roll out of CDCs countrywide, finance block grants for consolidation of CDCs (6.3.1) ▪ Strengthen linkages to stable facilitating partners (6.3.2) ▪ Assess possible continuation and scaling up of NABDP, DDAs (6.3.3) ▪ Mainstream counter narcotics in district, provincial planning (6.3.3) ▪ Strengthen CDCs as focal points for development (6.3.4, 6.4.2) 	<ul style="list-style-type: none"> ▪ Provide further financing through ARTF and government budget to continue the NSP programme (7.2, 8.3.2) 	Strong governance and rural development impacts on all Types Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
3. MISFA and rural finance (8.3.3)			
Tbd	<ul style="list-style-type: none"> ▪ Complete process of maturation of MFIs (4.3.3) ▪ Develop new areas of finance for rural areas, especially innovative solutions for financing agriculture and rural enterprise (4.3.3) ▪ Increase rural outreach significantly (4.3.3) 	<ul style="list-style-type: none"> ▪ Continue to provide financial and technical support as needed ▪ Encourage and support new areas of finance and expanding rural outreach 	Access to finance key driver for rural development and shifting incentives away from opium; sensitive to insecurity; adopt security guidelines
4. WatSan and safe water in rural areas (8.3.4)			
Tbd	<ul style="list-style-type: none"> ▪ Develop sustainable low cost strategy for O&M (5.3.2) ▪ Conduct water resources assessment for sustainability and expansion (5.3.2) ▪ Conduct study on programme planning and management, resolve current implementation problems (5.4.2) 	<ul style="list-style-type: none"> ▪ Participate in sector review ▪ Continue to provide financial support 	Strong livelihood benefits, especially for poorest Sensitive to insecurity. Security guidelines(7.6)

III. Recommendations on preparing further high impact activities for later implementation

1. Promoting high value agriculture and labour-intensive processing (8.4.1)

- **Support high-value horticulture** with a focus on opium-vulnerable provinces that are currently under-served. MAIL and MRRD to work together through AREDP (3.3.2).
- **Support fruits and nuts processing and export sector** all along value chain, with actions on the policy and institutional constraints before further major investments (3.3.2).
- **Evaluate value chain approach** linking producers, processors and export markets in preparation for the AREDP programme (3.3.2).
- **Support market development & agricultural export promotion:** AREDP to develop plan, identify investment opportunities, help build commodity export associations (3.3.2).
- **Expand industrial crops and agro-processing:** Sector studies of prospects for oil seed development should be carried out and investment pursued under AREDP (3.3.2).
- **Promote contract growing:** A detailed study of experience and opportunities, and conclusions implemented with investment support under AREDP (3.3.2).

2. Rural employment and adding value to labour (8.4.2)

- **Promote skills development:** A demand-driven vocational training programme to be developed and financed (4.3.2).
- **Support flexible migration:** A study to identify entry points to higher value and more humane migration, and to develop a road-map for this (4.3.2).

3. Rural electrification (8.4.3)

- Prepare a **national policy framework**, covering ways to facilitate private investment, subsidy policy, and institutional options for larger projects (5.4.3).
- Set up a **centralized agency for facilitating rural electricity access**, and **increase financial support** (5.4.3).

IV. Key cross cutting policy and institutional issues for dialogue (8.5)

Increase Afghan ownership and leadership: All programmes should be within an Afghan government strategy, accountable to government. Improvements in the quality of Afghan leadership should be treated as a priority. Unremitting capacity building efforts (7.1).

Enhance aid effectiveness: Government and partners to finance National Priority Programmes and channel aid flows through the national budget. Capacity strengthening for government to steer NPPs and manage budget flows efficiently. Joint programming – rather than just “coordination – should be the rule (7.2).

Move from vision to action on mainstreaming: Counter-narcotics mainstreaming guidelines should be adopted and applied systematically (7.3).

Pursue long-term commitment rather than short-term expediency: Political expectations for rapid change do not match the 1-2 decades needed before the opium economy dwindles. Counter-narcotics requires combination of economic development, provision of social services, better governance and the rule of law. This requires strong near-term actions but will take considerable time, vision and sustained commitment and resources (7.4).

V. Taking account of insecurity, including in Helmand (7.6, 7.7, Box 19)

Suggestions to deal with the insecurity situation in general

- Work through decentralized planning and programming mechanisms, ensuring local administration and local people are aware and on board.
- Select only villages that are willing to sign a cooperation agreement and to give a community security guarantee.
- Maximize local ownership and community engagement, working with community institutions (CDCs etc.), local contracting, labour intensive works etc.
- Remove all “foreign badging” – or perhaps even government badging when necessary on security grounds, and be thoroughly Afghan in the field.
- Use local implementing partners and locally recruited staff, preferably from the communities themselves.
- Give priority to relevance: the project has to be at the top of the local community’s priorities, and provide a stake in stability, security and good governance.
- Use decentralized and participatory monitoring and evaluation approaches.

Additionally for Helmand, building on the current valiant, thoughtful and well managed development effort

- Invest heavily in the enclave in and around Lashkagar to create a “development pole” impact, including promoting the business park model.
- Finance agro-industrial investments such as cotton, working with farmer groups through negotiated contracts that pay guaranteed market prices.
- Push hard on the local participatory agenda, including cooperation agreements and community security guarantees and working both at NSP/CDC and (as in Kandahar) NABDP/DDA levels. Support District Development Fund to finance labour intensive public works at adequate wage rates. Strengthen linkages between CDCs/DDAs and strong facilitating partners.
- Expand NRAP’s rural road coverage in areas vulnerable to poppy but where security is still manageable: Nad e Ali, Nawa Barakzai and Lashkargah.
- Implement programmes as far as possible through NGOs without government badging, and with locally recruited staff.
- Promote massive investment in human capital through a positive action educational programme, including in institutions outside of the province.