AFGHANISTAN GROWTH AGENDA

FOR TRANSFORMATIVE CHANGE AND SELF-RELIANCE

THROUGH THE AFGHANISTAN NATIONAL PEACE AND DEVELOPMENT FRAMEWORK

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OUTLINE AND SUMMARY

1. AFGHANISTAN HAS ADVANCED TOWARDS SELF RELIANCE, BUT MORE NEEDS TO BE DONE.

- Government revenues account for less than one quarter of public expenditure.
- Grants are relied upon to finance a trade deficit exceeding 40 percent of GDP.
- More than half of Afghans live in poverty and poverty is increasing.

2. AFGHANISTAN HAS THE POTENTIAL TO ACHIEVE SELF-RELIANCE IN THE MEDIUM-TERM THROUGH:

- Intensive development of agriculture and horticulture
- Rapid mobilization of extractive resources
- Implementation of major regional connectivity projects
- Developing sectors to supply domestic markets and the ICT sector

ASPIRATIONAL TARGETS:

- Revenues of US$8 billion by 2025
- Exports of US$2 billion by 2024
- GDP growth at 8 percent by 2024

3. THE MAIN CHALLENGES TO REALIZING POTENTIAL CAN BE ADDRESSED BY:

- **Securing development** through sustainable peace.
- **Sustaining reform progress** to build confidence and improve the business environment.
- **Building human capital** so that all Afghans can participate in and support the realization of economic potential.
- **Mobilizing finance and optimizing expenditure** to meet the daunting upfront costs of transformation.

4. RISKS ASSOCIATED WITH RAPID GROWTH NEED TO BE CAREFULLY AND COLLECTIVELY MANAGED.

- Maintaining macro stability and ensuring sustainable investment of resource windfalls.
- Ensuring that the benefits of rapid growth are broadly shared.
- Managing environmental risks to ensure sustainability of a resource-based economy.

1. THE SELF-RELIANCE CHALLENGE

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THOUGH ON A PATH OF RECOVERY, ECONOMIC GROWTH REMAINS SLUGGISH

Afghanistan's economy continues to face serious headwinds.

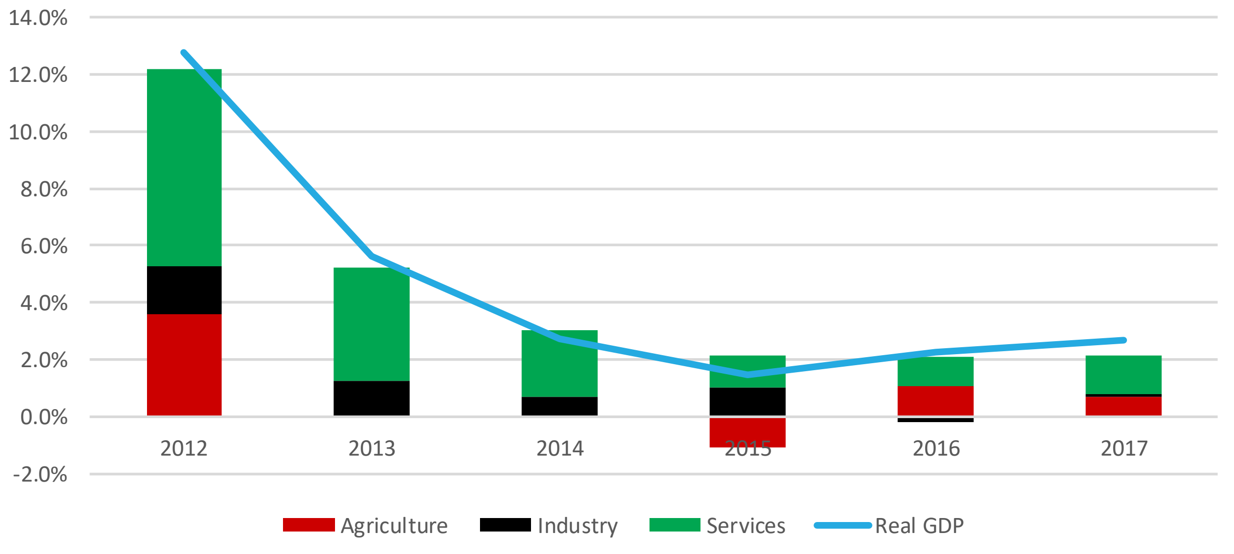
Afghanistan's economy experienced a long period of rapid growth between 2002 and 2012, driven by post-conflict recovery and aid inflows. Since 2012, however, the economy has faced major headwinds. These include:

- The sharp decline in international military expenditures during the 2011-2014 international troop drawdown
- Continued violent conflict and insecurity;
- Political uncertainty (initially after the 2014 presidential election, recently as the next election cycle approaches)
- Forced returns of Afghan refugees and migrants from Pakistan and Iran
- A serious ongoing drought.

Recent reforms have supported recovery of growth.

During the past two years there have been signs of improvement in Afghanistan's economy. GDP growth has increased from a low of 1.5 percent in 2015 to 2.7 percent in 2017 and an estimated 2.4 percent in 2018. Government revenue has recovered from its low point in 2014 and has increased at double-digit rates through 2017. Recorded exports of goods increased by 28 percent in 2017. These modestly positive trends are expected to continue.

Real GDP Growth and Sector Contributions



IN FOCUS: RECENT REFORM PROGRESS

Over recent years, the National Unity Government has implemented a range of vital reforms to open new private sector opportunities. These reforms have seen Afghanistan emerge as one of the top reformers in the World Bank's Doing Business rankings. Key reforms include:

- Afghanistan gained accession to the World Trade Organization (WTO) in 2015. Since then the government has endorsed 17 legislative reforms to meet the WTO requirements and has incorporated the required modification in the Standards Law
- A National Strategy for Combatting Corruption has been introduced. Progress has been made in identifying and sanctioning corruption, including through new asset declaration requirements for civil servants
- Implementation of Public-Private Partnership (PPP) model has been passed and several PPP projects are underway
- The government has ratified the law on investment support and protection of local industries
- Previous highly punitive tax penalties were abolished
- The government reduced regulatory burdens to cut the cost of obtaining a new business license from $440 to $1
- Procedures to obtain both electricity connections and building construction permits have been simplified
- The fee for publication of businesses' names and marks in the gazette has been reduced
- A one-stop-shop for business licensing operated by the Ministry of Commerce and Industry is operational in Kabul and 16 other provinces. A presidential decree placed a requirement on license-issuing government entities to establish their presence at the one-stop-shop
- Visas-on-arrival offers and easier foreign authentications for investors have been implemented
- The new Companies Law dramatically improves the protection of investors' rights
- Upcoming amendments to the Limited Liability Companies Law will improve the protection afforded to minority investors in Afghanistan
- A new Insolvency Law will increase the availability of credit from international financial institutions and investors. This law replaces one that had not been updated since 1942
- A new mining law provides a strong legal foundation and a transparent bidding process for the sector was approved by the Cabinet on September 4, 2018. It creates a two-tiered licensing system for small- and large-scale projects and ensures transparent tendering processes
- The Afghanistan Centre for Dispute Resolution (ACDR) was launched, which provides mediation and expert witness services in a limited number of cases referred by the commercial courts. The center is working to expand its services
- The new State-Owned Corporations Law creates a framework to improve the corporate governance of all state-owned companies, including appointing independent directors, and making the hiring process more transparent
- The new Land Development Corporation will allow the government to form joint ventures with private companies to develop state land;
- All National Priority Programs and implementation mechanisms of the Afghanistan National Peace and Development Framework have been developed to prioritize reforms that improve the welfare of Afghans.

GROWTH HAS BEEN INSUFFICIENT TO SUPPORT JOBS AND LIVELIHOODS

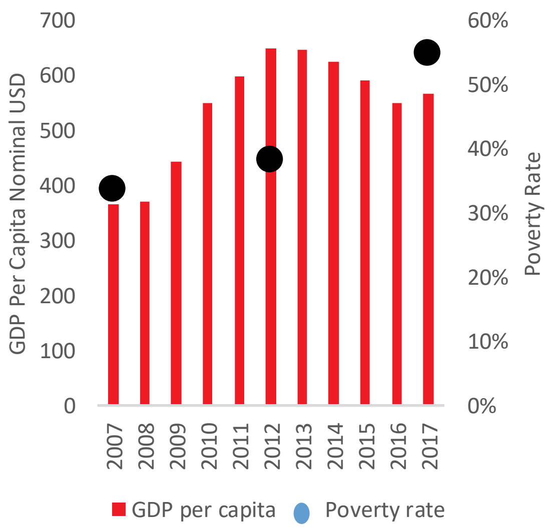
A step-change in growth is required.

While growth rates have picked up over recent years, the population continues to grow faster than incomes, placing negative pressure on living standards.

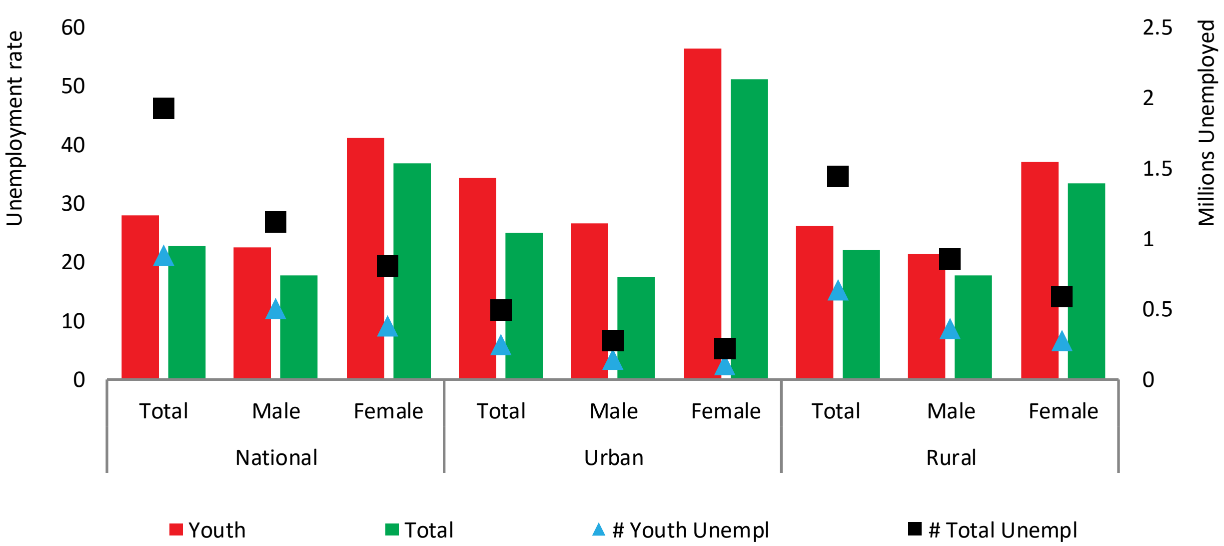
As a result of low and insufficiently inclusive economic growth, the poverty ratio rose to 55 percent in 2016/17, compared to 38 percent in 2011/12.

Much higher rates of growth will be required to substantially improve living standards and reduce poverty.

GDP Per Capita and Poverty Rate



Unemployment by Gender and Urban/Rural



DESPITE CONSISTENT IMPROVEMENTS IN REVENUE MOBILIZATION, WE REMAIN RELIANT ON GRANTS

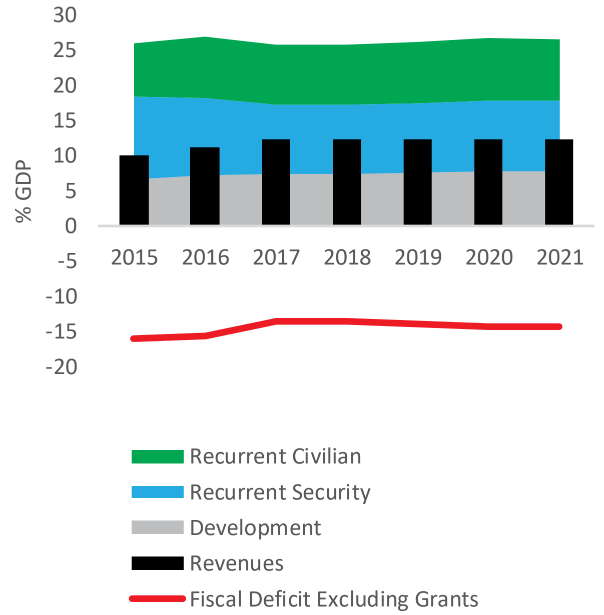
Despite continued efforts towards self-reliance, Afghanistan remains heavily dependent on grants.

Domestic revenues are currently only sufficient to cover around half of on-budget expenditures, and less than a quarter of total public expenditures. The trade deficit is currently equal to around 40 percent of GDP and financed almost entirely by grants.

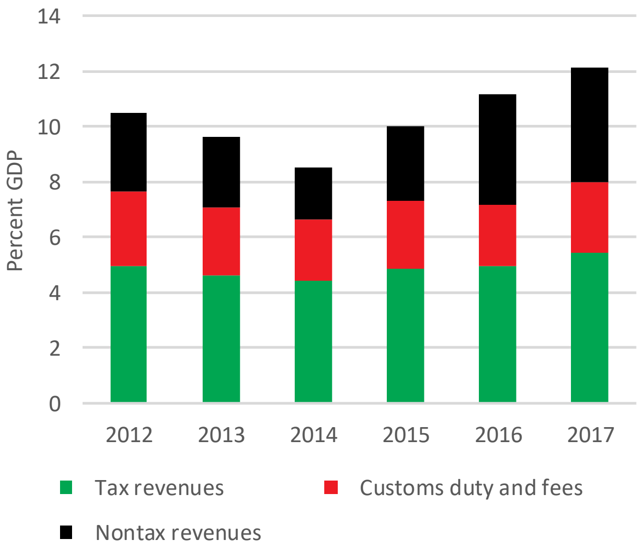
Current high reliance on aid is unsustainable and presents risks in an international environment where partners face multiple competing commitments for available development assistance and security resources.

New sources of financing for public expenditure and foreign exchange are needed.

Expenditures, revenues, and fiscal deficit (business as usual scenario)



Revenues as % GDP by source



ASPIRATIONAL TARGETS TO REALIZE SELF-SUFFICIENCY

Government has established a series of ambitious goals to achieve economic growth, poverty-reduction, and self-reliance by 2024.

- 8 percent growth rate by 2024
- Reduction in poverty, including in lagging areas (long term)
- Expansion of exports to US$2 billion by 2024
- Expansion of revenues to US$8 billion by 2025
- Increased mobilization of private capital for development.
- Substantially improving the trade balance

2. AFGHANISTAN'S UNTAPPED PRODUCTIVE POTENTIAL

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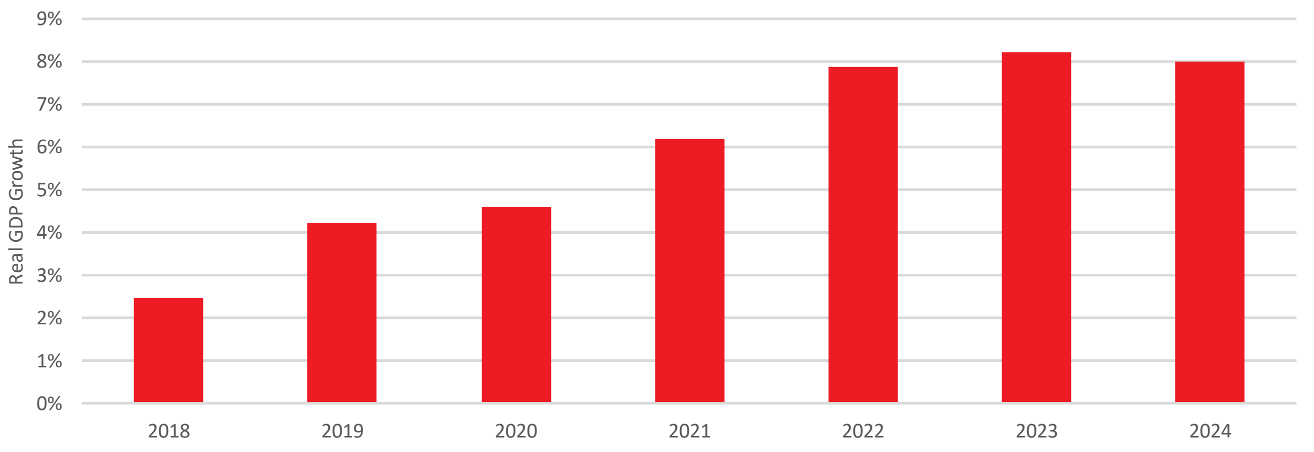
AFGHANISTAN HAS THE POTENTIAL TO ACHIEVE AND SUSTAIN HIGHER GROWTH RATES

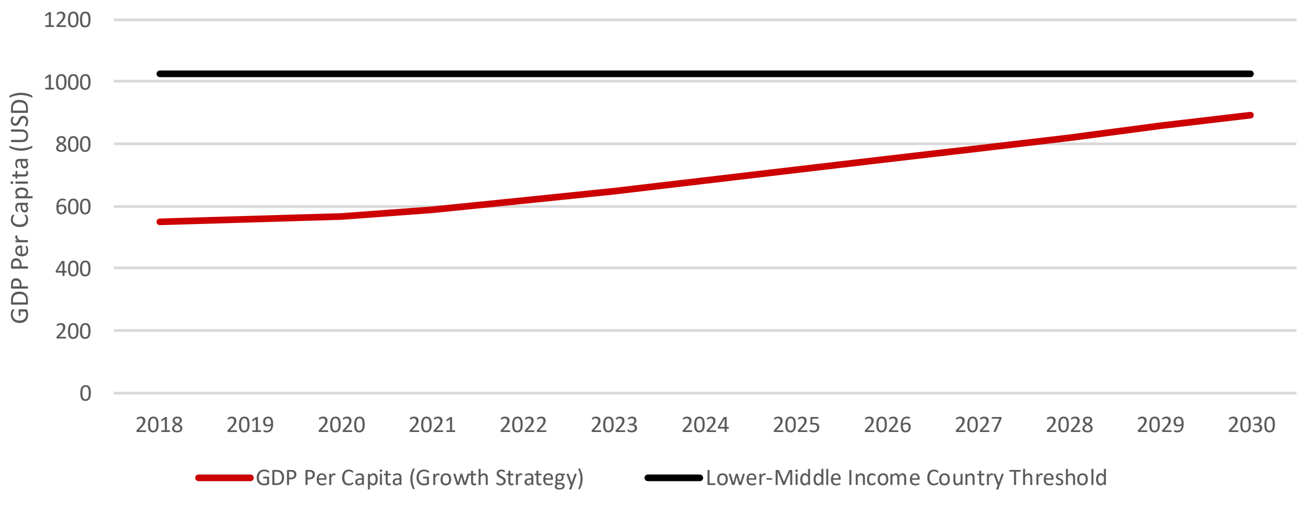
With abundant natural resources, a young and underutilized workforce, and a strategic location in a rapidly-growing region, Afghanistan has potential to achieve significant progress towards self-reliance by 2024.

Assuming that a peace deal with the Taliban leads to a substantial improvement in security, sufficient financing for all projects is available, and if all potential growth sources can be fully and rapidly mobilized, Afghanistan could achieve rapid and sustained high rates of growth, reducing poverty. Government has set an aspirational target of an 8 percent growth rate by 2024, with per capita incomes increasing to close to the lower-middle income country threshold by 2030.

Real GDP Growth with all Potential Sources Realized



Potential Trajectory of GDP Per Capita



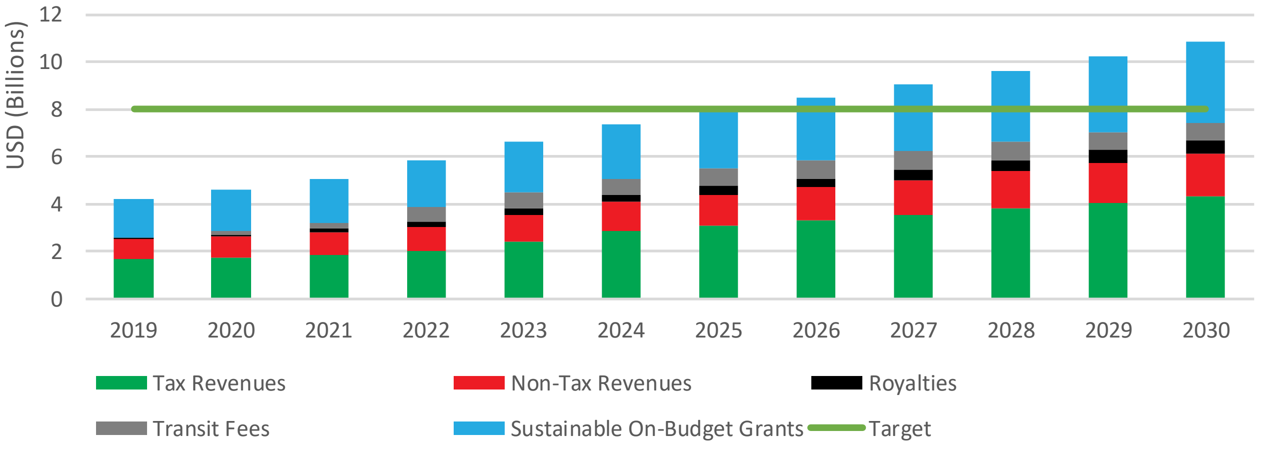
PEACE SCENARIO: PROGRESS TOWARDS SELF-RELIANCE WILL BE SWIFT

Realizing Afghanistan's productive potential would allow much progress towards self-reliance by 2024.

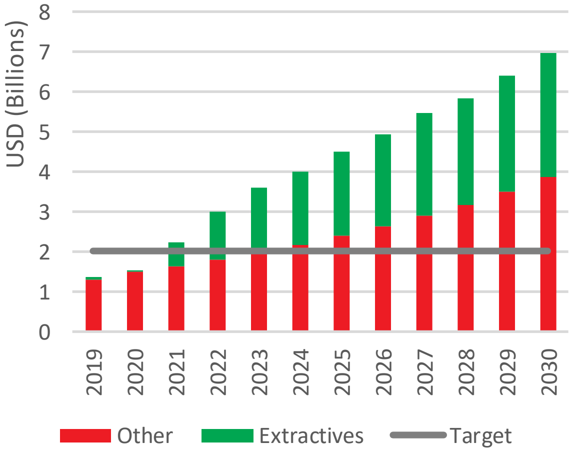
Government seeks rapid development of extractives, which could support export growth to significantly substitute aid inflows, with total potential exports reaching around US$4 billion by 2024.

Government will also seek to improve revenues rapidly, driven by general economic growth, and new revenue sources from extractives and transit projects. Government revenues could reach US$8 billion by 2025, equal to the current level of international grants. Government revenues would include an estimated 10 percent of GDP in international grants, which is the average level for a low-income country and could be considered a sustainable level of grant support.

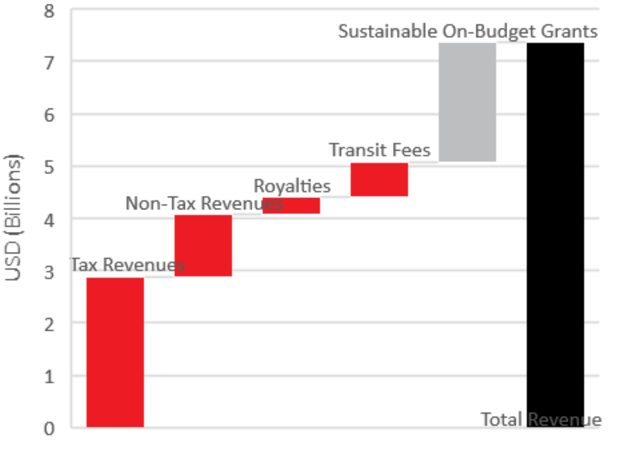
Potential Revenues



Potential Exports



Level and Composition of Revenues in 2024

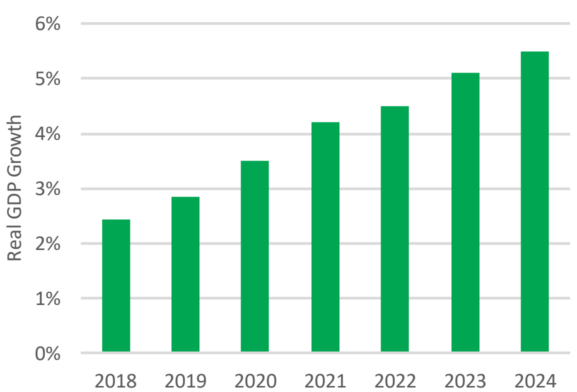


CONFLICT SCENARIO: GROWTH AND REVENUE WILL REMAIN BELOW POTENTIAL

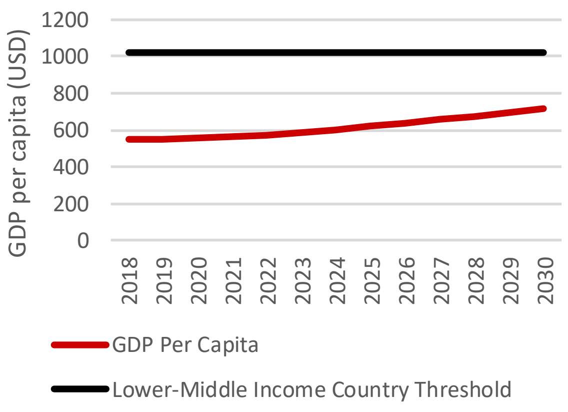
Afghanistan's full potential can only be realized through peace.

Achievement of Growth Agenda targets is predicated on substantial improvements in the security environment, which will – in turn – underpin adequate financing for required investments, and effective implementation of ambitious reforms. Under a scenario where reforms are fully implemented but conflict continues, growth, revenue, and export potential is substantially reduced. The difference between the outcomes of the peace and conflict scenarios represents the potential dividend from a sustainable peace agreement.

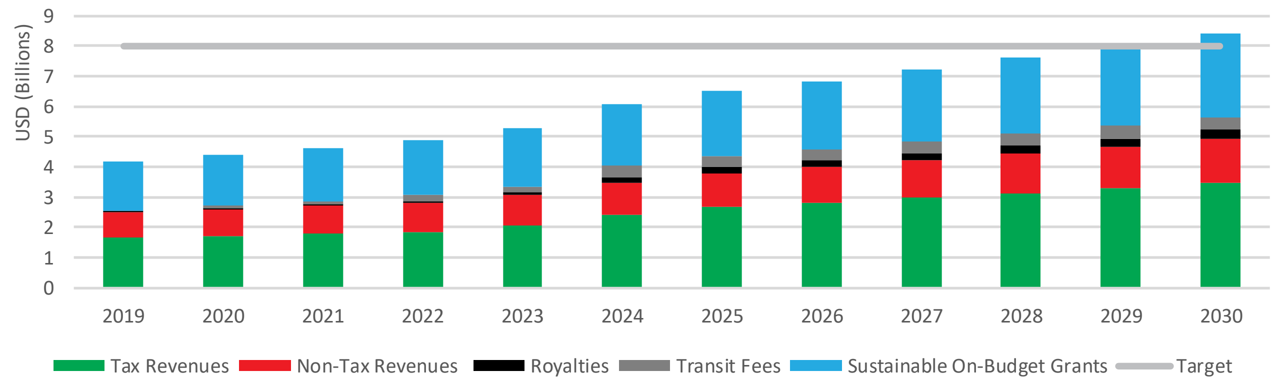
Continued conflict scenario - GDP Growth Rate



Continued conflict scenario - GDP Per Capita



Continued conflict scenario - Revenue and Composition



The Peace Dividend – Difference between conflict and peace scenarios by 2024

Additional annual revenues of US$1.1 billion.

Additional annual exports of US$1.5 billion.

US$3.3 billion higher GDP.

Additional fiscal space of US$1.3 billion.

AGRICULTURE SECTOR CAN SPUR GROWTH AND CREATE JOBS

Agriculture and agribusiness present substantial opportunities for growth, job creation, and niche exports.

To achieve potential, land under cultivation will be increased by an average 150,000 ha per year, and reach 3.5 million ha by 2030, allowing an additional 1 million tons of wheat production. Agro-processing value added will increase by around US$330 million through the establishment of agri-business parks. Agricultural exports will increase by 5 percent per annum through improvements to export procedures and certification. The number of farmer learning centers will increase to 400. Agricultural growth will be driven by grains and horticulture, including grapes, almonds, pomegranates, and pine nuts.

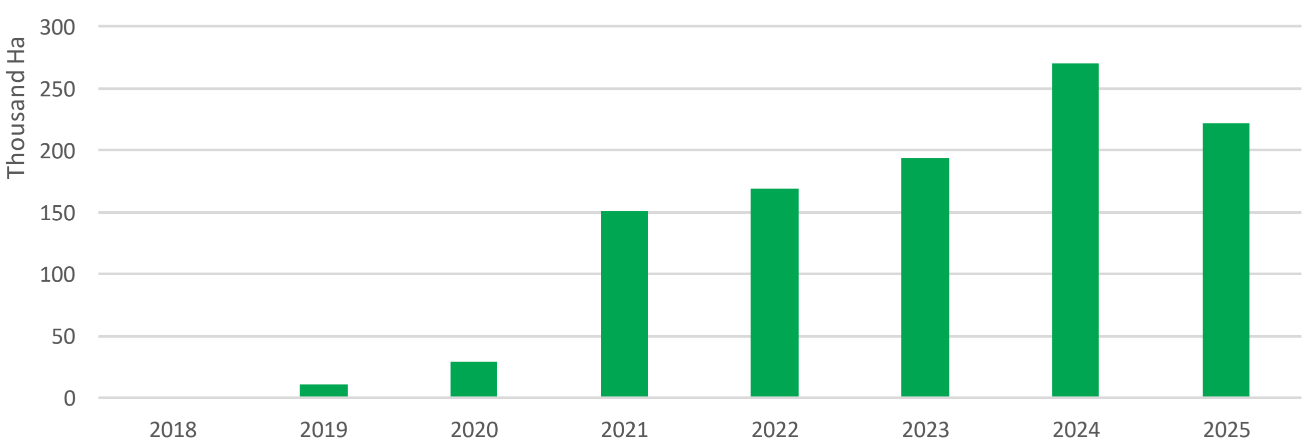
Revenues: Limited, given high levels of informality in the sector

Jobs: 2.5 percent faster employment growth by 2024. Development of agriculture will disproportionately benefit women, who account for the majority of the agricultural workforce.

Exports: 1.7 percent higher export growth by 2024 through agro-processing

Growth: Full implementation of agriculture potential could drive growth of 7.5 percent by 2024 – 2.6 percentage points over baseline.

Potential Expansion of Irrigated Land by Year



EXTRACTIVES CAN DRIVE REVENUE AND EXPORTS

Extractives are the only sector with potential to replace aid as a source of revenue and exports.

To realize extractives potential, government will pursue rapid mobilization of major oil and gas projects, including Amu Darya, Afghan Tajik, Tirpul, and Totimaidan, and major mines including Aynak, Hajigak, Shaida, Balkhab, Badakhshan, and Ghoryan as well as marble, talc, and chromite. Existing small-scale mining will be regulated and taxed to improve revenue collection. To ensure that potential revenues are captured and adequately managed, and that environment and social risks are managed, an appropriate regulatory and legal framework will be established, and capacity built within the Ministry of Mines and Petroleum.

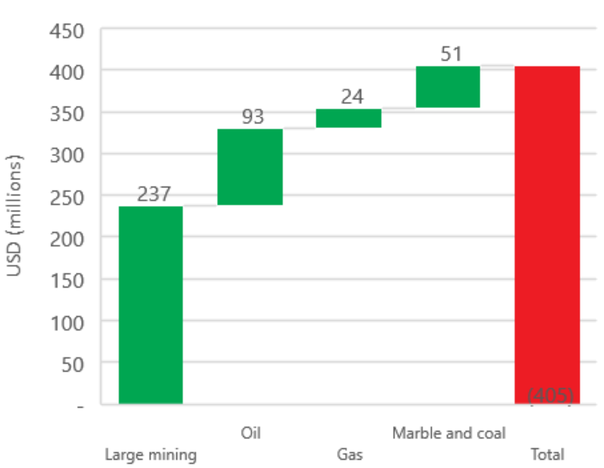
Revenue: Around US$400 million by 2024, depending on rapid implementation of planned and prospective major projects, development of the marble sector, and taxation of informal semi-precious stone mining

Jobs: Mining is not labor intensive, and for major employment generation, extractive development would need to be integrated with a broader growth strategy. Around 100,000 jobs will be generated directly from identified projects

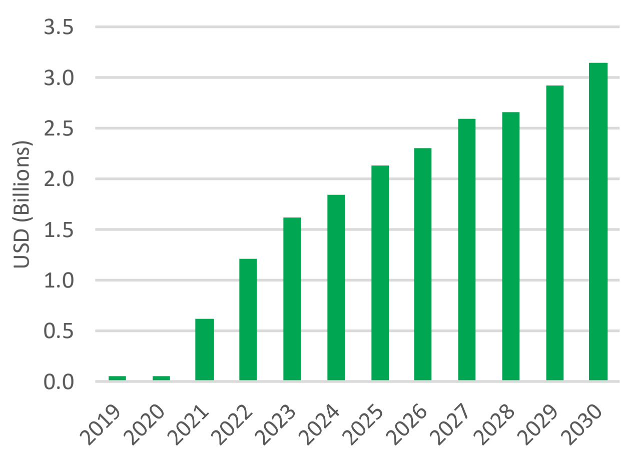
Exports: Around US$1.8 billion by 2024

Growth: Full implementation of extractives could drive growth to 5 percent by 2024 – limited impact when extractives pursued in isolation, given limited integration with economy and strong reliance on imported inputs.

Extractives Revenue Potential (2024)



Extractives Export Potential



REGIONAL INTEGRATION WILL BOOST TRANSIT AND TRADE

Rapid implementation of major regional integration projects could support substantial revenue improvements while boosting growth and exports.

To achieve potential, major planned projects will proceed to expedited timelines, including TAPI, TAP, CASA-1000, and additional major transport infrastructure projects. Impacts will be magnified through improvements in logistics and regulatory constraints at border points. New economy opportunities will be realized through expansion of internet connectivity, including regional fiber-optic cable connections.

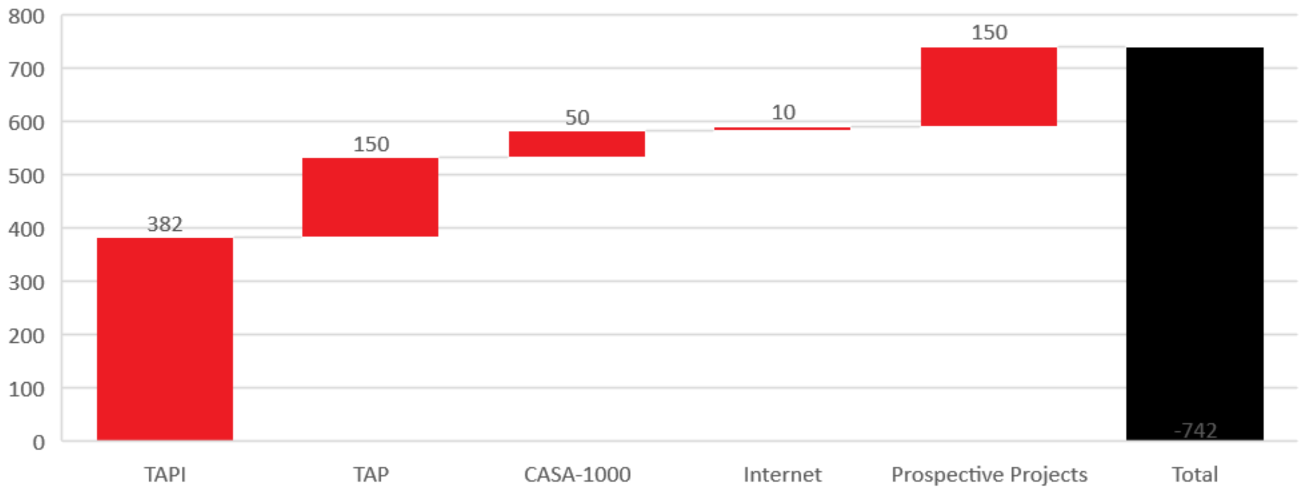
Revenue: Around US$740 million by 2024, based on best-case estimates from planned and prospective projects

Jobs: Substantial short-term employment associated with major construction works

Exports: Improvements in connective infrastructure, documentary and procedural requirements, and harmonization of transportation standards will boost exports by around 10 percent

Growth: Full implementation of regional integration projects could lead to growth rates of around 7 percent by 2024 due to increased exports and broader economy-wide productivity improvements associated with improved access to transport and energy.

Revenue Potential from Transit (2024)



CAPTURING DOMESTIC MARKETS, DIVERSIFICATION, AND NEW OPPORTUNITIES

Afghanistan's prospects for rapid diversification are limited in the short-term by human capital and physical infrastructure constraints. But government will pursue several important opportunities to recapture domestic markets and improve value chains in high-potential areas.

Transport protected commodities.

- High transport costs should support competitive domestic production for some heavily-imported commodities
- The potential for domestic production of oil and gas is well-established
- Afghanistan has the potential to substitute large current cement imports through domestic production, including through mobilizing private investment in existing cement plants
- Domestic cement production could displace imports of around US$700 million.

Value chains in areas of comparative advantage.

- Afghanistan has significant potential in specific niche products. Extensive work has been undertaken to identify priorities for strengthening value chains in areas of comparative advantage
- Agribusiness in niche areas has major potential, including pine nuts, pistachios, and licorice
- Development of niche agribusiness sectors could support increased exports of US$200 million by 2024 and an additional US$20 million in government revenues.

New economy opportunities.

- Government is seeking to maximize the potential of the digital economy for Afghanistan's economic development. Key initiatives will include:
  - Regional fiber-connectivity projects to reduce cost and improve access speeds
  - Various e-government and e-services initiatives to improve public sector efficiency and reduce regulatory compliance costs
  - Development of infrastructure for e-money, to expand access to financial services and reduce business transaction costs.

IN FOCUS: ICT OPPORTUNITIES FOR AFGHANISTAN

New and emerging technologies may support the achievement of Afghanistan's economic development goals.

Afghanistan's economy is likely to be based around extractive and agricultural resources over the medium-term. However, new technologies can potentially provide new productive opportunities and facilitate government transparency, effectiveness, and efficiency.

Connectivity projects	Through development of physical infrastructure, Afghanistan will increase internet connectivity with surrounding economies, reducing prices, improving services, and increasing resilience of the network. Through recent policy changes, Afghanistan has opened access to the domestic internet backbone among telecommunication companies, generating competition which is expected to have further positive impacts on services and prices.
Open data	The spread of internet access via mobile devices will enable increases in transparency. Government will vigorously pursue open data initiatives and encourage public participation, improving governance and accountability.
E-government	Government has potential to substantially improve services through the use of modern ICT. Government is working to establish a cost-efficient Government Cloud and data center for hosting Government data and e-services. It will establish a set of common e-service enablers such as online authentication, e-payment gateway, SMS gateway, and cybersecurity safeguards, to accelerate e-services implementation by line ministries.
Digital payments and e-money.	We are aggressively pursuing the roll-out of systems and infrastructure to support digital payments and e-money, including digital payments for government salaries. Roll-out of e-money has significant potential to reduce business transactions costs, facilitate financial inclusion, and reduce opportunities for corruption.

IN FOCUS: THE PRODUCTIVE AFGHANISTAN STRATEGY

The Growth Agenda is aligned with and complementary to the new Productive Afghanistan strategy.

The Productive Afghanistan strategy examines opportunities to displace imports through domestic production, contributing to accelerated growth, increased employment, and an improved trade balance. The Productive Afghanistan Strategy includes the following elements:

Afghanistan First

- Contracting Afghan firms wherever possible and desirable
- Developing local content directives and regulations
- Ramping up efforts to de-dollarize the economy
- Developing the domestic debt market including sukuks
- Overcoming weaknesses in domestic output expansion
- Lowering the costs of production and lowering risk
- Generating growth and employment at home.

Industrialization

- Identify and support value chains that represent the most competitive prospects for value addition in selected industrial clusters
- Improve access banking products to support industry and SMEs
- Strengthen the industrial incentives package available to domestic producers to promote internal trade and investment
- Target investments that overcome market failures such as lower priced energy, improved product aggregation, cold storage, packaging, certification, transportation and market information
- Accelerate development of special economic and ago-industrial zones
- Further deploy public private partnerships including concessions.

Commercialization

Large-scale commercial expansion, including for agriculture and pharmaceuticals. Large-scale commercial agriculture will not only boost production and offset import dependency, it will also go a long way to promoting technological transfers and in generating employment, and forward and backward linkages.

Industrial Clusters

The Productive Afghanistan Strategy identifies 10 potential industrial clusters. Selected industrial clusters are those likely to have the largest impact on the trade deficit, but also those with a revealed comparative advantage for scaling up, and for generating value addition and employment. The candidate industrial clusters cover agriculture, cement, pharmaceuticals and gold. The goal is to substitute 50% of imports in these clusters with home production by 2025.

3. A PATHWAY TO SELF-RELIANCE

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WE MUST CONTINUE TO ADDRESS CONSTRAINTS TO SELF-RELIANCE

Afghanistan's potential sources of growth will only be realized in the short-term if major existing constraints are rapidly overcome.

To realize Afghanistan's potential, government will ensure that existing constraints are thoroughly, and systematically addressed, and sufficient investment is available to mobilize new growth sources. If this does not happen, there is little hope that growth targets will be realized.

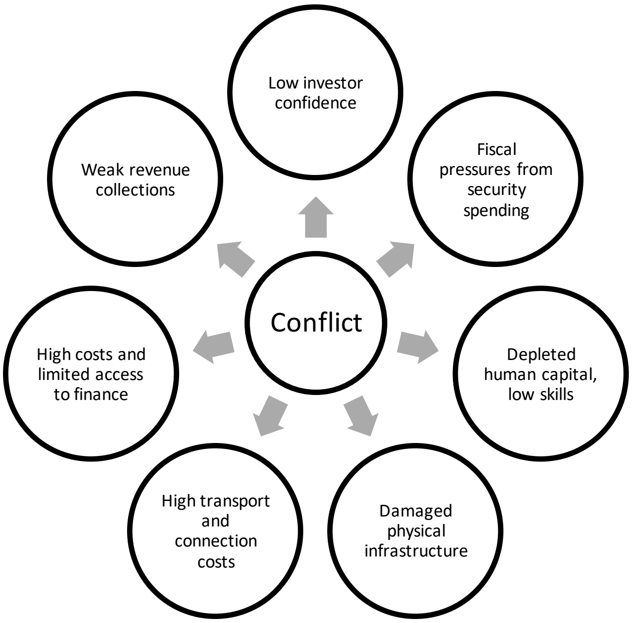
The following main challenges are discussed in this section.

1. **Securing development** through sustainable peace.
2. **Sustaining reform progress** to build confidence and improve the business environment.
3. **Building human capital** to ensure that all Afghans can participate in and support the realization of Afghanistan's economic potential.
4. **Mobilizing finance and optimizing expenditure** to meet the daunting upfront costs of transformation.

1. WE MUST REALIZE PEACE TO SECURE DEVELOPMENT

Continuing conflict is the most serious current constraint to realizing Afghanistan's productive potential.

Ongoing conflict is exerting a major negative impact on Afghanistan's growth and economic development. Years of conflict and aid-dependence have fundamentally shaped the structure of the economy and limited the range of economic activities. A sustainable resolution to conflict and insecurity is a prerequisite for realizing Afghanistan's productive potential.



A peace agreement with the Taliban may provide a major positive impact for economic development.

Such an agreement would help the economy by improving confidence, mobilizing investment, and increasing fiscal space (through reducing security expenditure pressures and a potential additional influx of civilian aid).

To ensure the benefits of a peace agreement are maximized and sustained, government will ensure that: i) any post-conflict aid influx is invested to sustainably expand Afghanistan's productive potential; and ii) the benefits of growth are broadly shared to change incentives towards continued peace.

Progress in securing peace will have important impacts on the viability of addressing other constraints. A major reduction in conflict could increase fiscal resources for required investment, through higher levels of aid, and reduce the risks facing potential investors.

Continued conflict, on the other hand, would present a continued deterrent to investment, a major drain on fiscal resources, and a distraction from key business reforms.

IN FOCUS: ECONOMIC DEVELOPMENT PRIORITIES UNDER A PEACE AGREEMENT

Under a potential peace agreement with the Taliban, government will pursue economic reforms that maximize the potential positive benefits of peace and that help consolidate and sustain any peace agreement. Key priorities include:

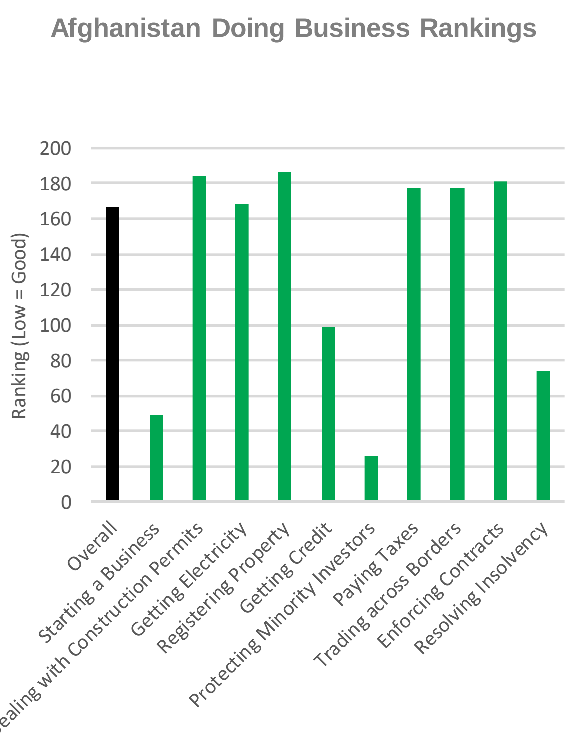
Post-conflict job creation.	Job growth is important after a peace agreement, to provide an early peace dividend, spread incomes more widely among the population, and indirectly absorb combatants. The Afghanistan Growth Agenda therefore prioritizes measures that will support rapid creation of jobs in both rural and urban areas. Ensuring broad-based improvements in opportunities will avoid the perverse incentives and administrative challenges associated with job creation schemes targeted at ex-combatants.
Enabling sectors with post-conflict potential.	International experience shows that pot-conflict growth is often concentrated in the agriculture and construction sectors. To enable growth in these sectors Government will invest in irrigation and infrastructure, develop the domestic cement industry through mobilizing private participation, and identify and address specific business constraints facing firms operating in the construction sector.
Facilitating capital repatriation.	A peace agreement that ends widespread violence may reverse recent capital outflows, with return of Afghan expatriate capital and savings from nearby countries for investment in Afghanistan. To facilitate capital inflows, Government will maintain prudent macroeconomic policies, improve the business climate, and work toward a more robust financial sector, including through improving governance of the banking sector and strengthening payment systems. These measures will make bringing funds into Afghanistan feasible and more attractive.
Ensuring continued and coordinated international support.	A peace deal should not be viewed as an immediate exit opportunity by international partners. International experience shows that fiscal pressures do not typically decrease in the immediate aftermath of conflict, given the need for demobilization, expansion of services, and generation of economic opportunities. Effective implementation of the Growth Agenda depends on continued development partner support over the medium-term. Commitment to such support can help maintain confidence and investment.

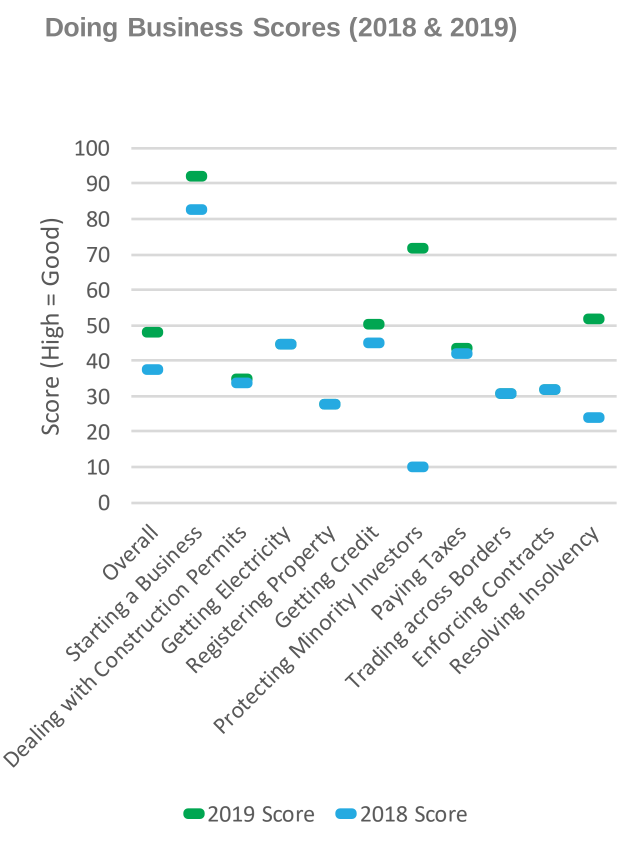
2. WE MUST SUSTAIN REFORM PROGRESS

Recent gains are encouraging. However, our business and regulatory environment needs to become attractive for private investors.

We recognize that our productive potential is unlikely to be achieved without addressing pressing regulatory constraints. A broad range of measures are required to target and address the regulatory constraints that are having the greatest negative impact on investment, including:

- Successful implementation of land management reforms, including transfer to an administrative system of land management
- Improving Doing Business scores for construction permits and accessing electricity
- Resolve financial sustainability of DABS through restructuring of existing debt and reducing technical and commercial losses
- Reforming the governance of state-owned banks and the development of electronic money and interoperable payment systems
- Continued efforts to curb corruption through implementation of the National Strategy for Combatting Corruption, including increased simplification of regulatory procedures and use of electronic systems for tax filing and payments.





3. WE WILL INVEST IN BUILDING HUMAN CAPITAL

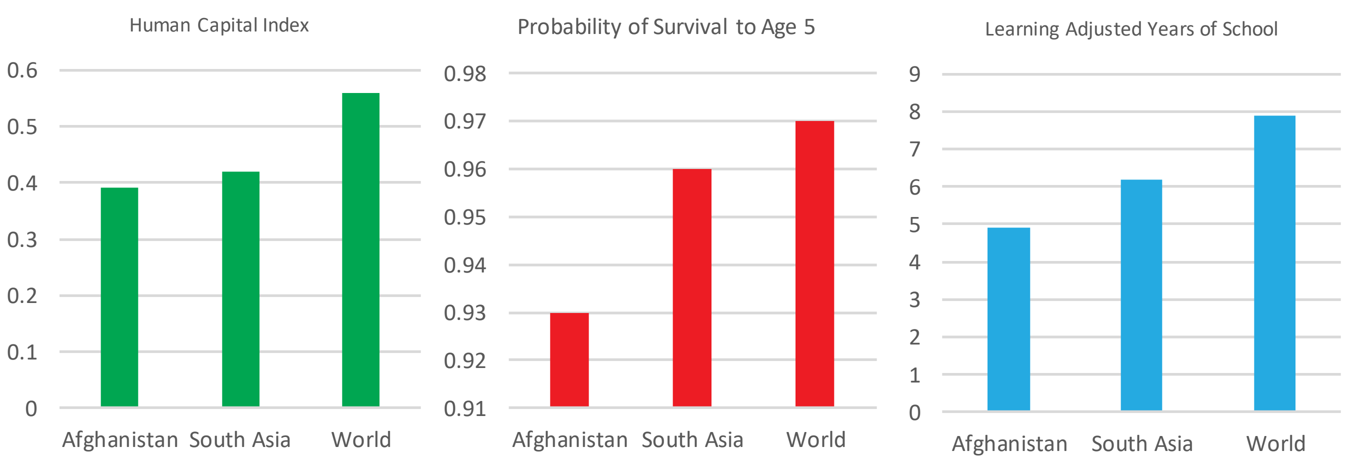
A healthy, educated, and productive workforce will be vital for achieving Afghanistan's economic potential and self-reliance.

Government will do more to ensure that Afghans are able to participate in and support growth and self-reliance. This is a major challenge. Only around half of children attend secondary school, and literacy rates are among the lowest in the world. There are important concerns regarding education quality and perceived mismatches between investment in skills and labor market demands. Per capita on-budget government spending on health and education has declined over recent years. Health remains overwhelmingly privately financed (75 percent), and government spends only around US$7 per capita on healthcare.

To support development of Afghanistan's human capital to support transformative change for self-reliance, Government will:

- Increase the proportion of on-budget public expenditure on health and education to 50 percent of total, reversing recent declines. Increased human capital investment will reduce fertility rates and increase labor productivity
- Address constraints to education facing girls, including by improving security at schools and recruiting more female teachers
- Strengthen link of TVET sector with labor market by creating quality and market relevant TVET institutes across the country (1 per district) by 2020
- Support the development of managed labor mobility schemes to increase incentives for investment in human capital and improve outcomes for migrant workers and their communities. This will drive increases in remittances to 18 percent of GDP by 2030.

Afghanistan's Scores Against Human Capital Index Dimensions



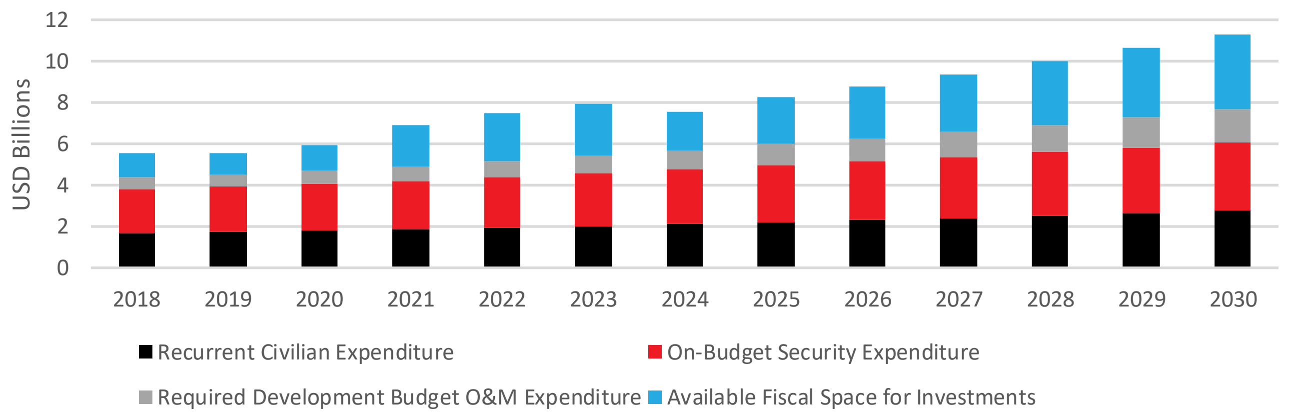
4. WE MUST COLLECTIVELY MOBILIZE DEVELOPMENT FINANCE

While new growth sources will mobilize substantial additional revenues, Afghanistan faces major pressures on available public resources over coming years.

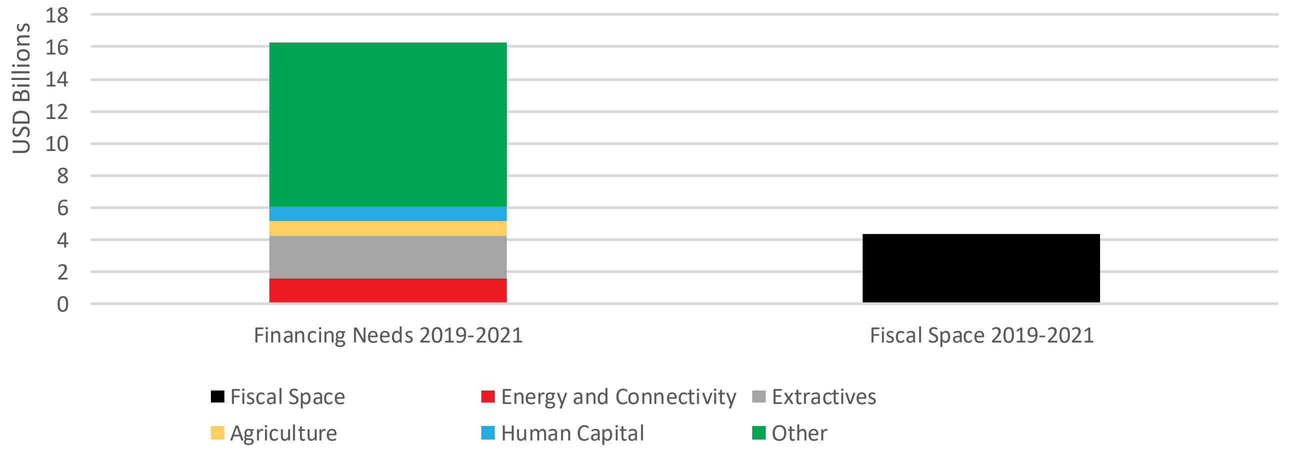
Investment needs to trigger transformative change substantially exceed available fiscal resources and imply a rapid increase in private investment. A combination of public and private investment will need to be mobilized. We will therefore pursue the following priorities to finance its growth agenda:

- Mobilize private finance, including through innovative financing instruments
- Strengthen public finance systems to maximize efficiency in public resource use
- Work closely with development partners to maximize the impact of international assistance.

Expenditure needs and space for development investment



Short-term investment needs for transformative change and available fiscal space



4. FINANCING DEVELOPMENT –
MOBILIZING NEW SOURCES OF FINANCE

Mobilize Private Finance

- Mobilizing private investment is the most important potential source of development financing
- Domestic and foreign investment in private sector activity is vital for both large projects in extractives and for broader job creation and growth
- General business environment reforms and expanding access to finance is core to the growth agenda.

Priorities:

- Develop and roll out new risk-sharing mechanisms, including with development partner support
- Progress general business-enabling reforms
- Finalize and implement the financial inclusion strategy
- Implement state-owned bank reforms.

Prepare for sustainable borrowing

- Over time and as grant aid declines, Afghanistan may face opportunities for sustainable borrowing from the domestic private sector and official creditors
- Sovereign borrowing is associated with high risks if not approached carefully and with appropriate systems in place
- Emergence of a domestic debt market will depend on an adequate legal and regulatory framework.

Priorities:

- Finalize legal and regulatory framework for he development of a domestic sukuk market
- Build debt management capacity in the Ministry of Finance
- Over the medium-term, plan to issue a domestic sukuk debt instrument in accordance with a clear debt management strategy.

Pursue PPP opportunities

- While unlikely to represent a substantial share of overall investment requirements, PPP opportunities have been proven in some sectors
- Ensuring a robust approach to project selection and that associated fiscal risks are carefully managed is vital.

Priorities:

- Progress the PPP framework to identify projects with potential for private investment
- Finalize ongoing PPP transactions
- Over the medium-term, develop a pipeline of large-scale PPP transactions.

4. FINANCING DEVELOPMENT – STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

Ensure policy-budget links

- Reforms to the budget process are required to ensure that scarce public resources can be reliably allocated to the projects and programs that have the greatest potential to spur growth
- Without ensuring close alignment between expenditures and a clear growth strategy, available resources will fall short or requirements
- Development partners should also align available resources behind growth strategy.

Priorities:

- Complete National Priority Programs
- Develop standard costing methodology and monitoring frameworks
- Establish sectoral allocations through the budget process, aligned with strategic growth sectors.

Strengthen Public Investment Management

- Processes for selecting, developing, and implementing projects are currently lacking. As government comes to play a greater role in managing development projects as aid declines, strengthening systems is vital
- An adequate public investment management system can support alignment between projects and priorities, ensure that full costs are considered, and support effective execution.

Priorities:

- Subject all projects to strategic fit screening using approved criteria aligned with growth strategy
- Apply life-cycle costing methodologies to projects and broaden the use of economic analysis in project selection.

Ensure quality of existing expenditure

- Only a small proportion of expenditure is considered through the budget process each year – a large proportion of expenditure is locked into existing programs
- Effort is required to identify opportunities for reallocating existing programmed resources in ways that better align with government priorities.

Priorities:

- Implement a rolling program of public expenditure reviews
- Use the budget process to reallocate funds from existing programs informed by expenditure analysis to reduce inefficiency and increase resources available for priority investments.

IN FOCUS: OPPORTUNITIES FOR RISK-SHARING AND GUARANTEE MECHANISMS

The Afghanistan investment in environment is characterized by high perceived and real risks.

Ultimately, government will seek to reduce risks by improving the predictability of the institutional environment and addressing conflict, insecurity, and lawlessness. In order to attract required investment for transformative change in the short-term, government and donors can play an important role in helping the private sector manage risks. Several financial mechanisms for managing risk could be mobilized.

Financial sector development

Over the medium-term, deeper and better functioning financial markets are required to help firms manage risks. This will require development of a well-regulated insurance industry and an increase in savings rates through expanding financial inclusion, including trust-building through strengthened deposit insurance. Financial sector development and expansion of the banking sector would also help with the development of social protection mechanisms.

Credit guarantees/ risk sharing facilities

Risks of crime and insecurity are to some extent idiosyncratic and can therefore be shared. Internationally, risk sharing facilities supported by governments and development agencies have helped promote investment by sharing risks across investors.

Political risk guarantees

Development agencies offer products by which firms can ensure themselves against political risks. Greater use could be made of such facilities, providing protection to a larger number of smaller firms. Constraints will need to be considered and carefully addressed, given current high pricing of Afghanistan's sovereign risk.

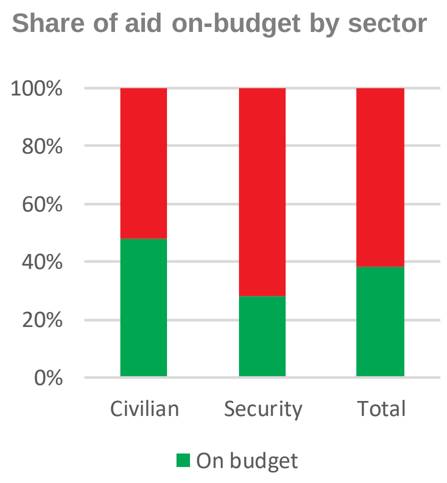
4. FINANCING DEVELOPMENT – PRODUCTIVE PARTNERSHIPS

The Growth Agenda for Transformative Change and Self-Reliance presents a clear path for Afghanistan to escape aid dependence over the medium-term. The viability of this path is heavily dependent on the extent and nature of international support over the short-term.

The goals laid out in this strategy will not be achieved without the financial resources, technical assistance, and confidence of the international community. Given the tightly constrained resources available to implement this agenda, full coordination and alignment of development partner support around government policy priorities is needed. International support has a vital role to play in maintaining the domestic and international private sector confidence that will underpin necessary investments. Government will work closely with regional partners to further deepen trade relationships, develop infrastructural links, and share knowledge and experience. Financing flows from regional partners, both official and private, may play an important role in implementation of the Growth Agenda.

Government proposes the following priorities for development partners for continued productive partnerships towards self-reliance.

- Support public and private confidence by committing to continued grant support over the medium-term
- Use grant resources (especially off-budget flows) to catalyze private investment, including through insurance, risk sharing, and guarantee mechanisms
- Commit to delivering 60 percent of aid on-budget, including by specifying the Public Financial Management improvements that would be required to underpin further increased use of government systems
- Improve reporting on off-budget aid flows to provide the Ministry of Finance with a comprehensive overall picture of public resource flows
- Work with Ministry of Finance on regular aid portfolio reviews to ensure the alignment of off-budget aid flows with government policy priorities
- Revise the actions supported by policy-based programs to ensure consistency with priorities for transformative change and self-reliance.



IN FOCUS: ADDRESSING POVERTY AND UNEMPLOYMENT THROUGH GROWTH

The Growth Agenda for Transformative Change and Self-Reliance presents a strategy for inclusive growth with direct links to employment creation and poverty reduction.

Economic growth in Afghanistan does not necessarily lead to poverty reduction. Services-led economic growth between 2007 and 2011 was not pro-poor. In fact, for every 1 percent increase in GDP per capita, poverty increased by 0.2 percent during this period. However, subsequent slow economic growth and declining per capital incomes was even worse for poverty outcomes. Between 2012 and 2016, each 1 percentage point decline in GDP per capita was accompanied by a 6.5 percent increase in poverty. During the last decade as a whole, on average, each percent increase in growth has been matched by an equal percent increase in poverty.

Government is therefore committed to not only achieving growth and self-reliance but ensuring that the benefits of growth are more-widely shared. The Growth Agenda for Transformative Change and Self-Reliance includes several measures to achieve this outcome:

Agriculture focus

The focus on agriculture is explicitly pro-poor. Agriculture employs around 44 percent of the total workforce and the poor disproportionately depend on agriculture. Improvements in agricultural production and productivity will therefore have widespread employment and income benefits that benefit the poor.

Human capital focus

Investment in human capital is an integral part of our growth agenda. Investments in human capital through improving access to and quality of services such as health and education will open new opportunities for participation and ensure all Afghans can contribute to and benefit from growth.

Geographical balance

The Growth Agenda will mobilize growth sources across Afghanistan's regions and provinces. Agriculture and horticulture opportunities are widespread. Connectivity projects will benefit the North, where poverty is concentrated. The benefits of extractives will be broadly shared through complementary infrastructure investments that ensure integration into local supply chains and broader economy-wide benefits.

4. SAFEGUARDING PROGRESS

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WE MUST SAFEGUARD AGAINST THE RISKS ASSOCIATED WITH RAPID DEVELOPMENT

Afghanistan's Growth Agenda for Transformative Change and Self-Reliance presents a vision for resource-based development. While resource-based growth has supported sustainable post-conflict development in many countries, there are substantial risks. Government is aware of these risks and will ensure that they are carefully managed.

Macroeconomic management risks.	Rapid resource driven development presents several important macroeconomic risks, including: • Short-term worsening of the current account deficit as firms import capital goods for major projects • Strengthening of the exchange rate over the longer-term, negatively impacting the development of other export industries • Wasteful public expenditures as resource windfalls are utilized for consumption rather than investment. To manage these risks, Government will ensure responsible fiscal and monetary policies. This will involve sustainable investment of resource windfalls, including through the establishment of a sovereign wealth fund to sustain benefits and smooth resource-financed expenditures.
Social and poverty risks	The benefits of resource driven development must be fairly shared, including between investors, citizens, and government. Negative distributional outcomes from extractives investment can drive instability and conflict. Agricultural development can lead to intensified competition over water resources, especially in the context of climate change. To ensure that social and poverty risks are managed, Government will sustainably invest the proceeds of resource development, including for policies that directly benefit the poor. Such measures will include increased investment in basic public services and increased spending on social protection and community development. Measures are already underway to improve governance of water resources, including new Irrigation and Drylands Agriculture policies which will be effectively implemented over coming years.
Environmental risks.	The environmental risks of resource-based development – especially large-scale mining – are well known. To manage these risks, Government will work to strengthen the existing legal and regulatory framework for environmental protection, including and especially in the mining sector. Capacity for effective implementation of environmental safeguards will be strengthened, drawing on the support of development partners.

Ultimately, Government will seek to calibrate the pace and scale of resource development to match its institutional capacity to manage associated risks. If risks described above are realized, Government will seek to slow the pace of resource development to allow time for required risk-management capacities and frameworks to be developed and strengthened.

ANNEX: MACROECONOMIC SCENARIOS

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ANNEX: MACROECONOMIC SCENARIO ASSUMPTIONS

Variable	Reforms and continuing conflict	Peace and reforms
Security	• No significant improvement in the security situation.	• Comprehensive and sustained peace • Peace drives an exogenous increase in private investment (equal to 2 percent of GDP per annum), reflecting repatriation of off-shore capital and improved confidence.
Fiscal and grants	• Grants continue at pledged levels to 2024, when they decline to a regularized level of 10 percent of GDP • On-budget security expenditure increases at 9 percent per annum in nominal terms per year as greater responsibilities are transferred to national security forces and by an additional US$1 billion in 2024 (to compensate for rapid decline in off-budget expenditures) • Civilian expenditures remain constant in real per capita terms • O&M expenditures increase to estimated minimum requirement of 7.2 percent of GDP.	• Civilian grants increase by 5 percent of GDP over baseline levels for 5 years following a 2019 peace agreement • Total grants decline to 10 percent of GDP by 2024 • Security and demobilization costs are roughly equivalent to current real security sector costs over the period • Civilian expenditures remain constant in real per capita terms • O&M expenditures increase to estimated minimum requirement of 7.2 percent of baseline GDP.
Extractives and regional integration	• Production begins at Badakhshan, Shaida, Aynak, Amu Darya, and Afghan Tajik projects towards the end of the period • Production increases in cement, marble, and coal • TAPI, TAP, and CASA proceed as planned.	• Production begins at Goryan, Badakhshan, Balkhab, Shaida, Aynak, Hajigak, Amu Darya, Tirpul, Totimaidan, and Afghan Tajik projects to fastest physically possible timeframes • Production increases in cement, marble, and coal • TAPI, TAP, and CASA proceed as planned • Significant rail transport projects are implemented.
Agriculture	• Irrigation is expanded over 500,000 hectares by the end of the period.	• Irrigation is expanded over 1 million hectares by the end of the period.
Human capital and labor mobility	• Human capital investment increases as a share of budget to reach 50 percent of recurrent expenditures by 2024, driving reduced fertility rates and improved labor productivity • Through mobilization of managed migration schemes, remittances increase to 18 percent of GPD.	• Human capital investment increases as a share of budget to reach 50 percent of recurrent expenditures by 2022, driving reduced fertility rates and improved labor productivity • Through mobilization of managed migration schemes, remittances increase to 18 percent of GPD

ANNEX: MACROECONOMIC SCENARIO OUTCOMES

Selected economic indicators: Reforms and continuing conflict scenario

REFORMS AMID CONTINUING CONFLICT												
YEAR	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
GDP (USD)	20.5	21.2	22.0	23.0	24.1	25.3	26.7	28.0	29.5	31.1	32.7	34.4
GDP Growth	2.8	3.5	4.2	4.5	5.1	5.5	5.5	5.5	5.5	5.5	5.5	5.5
GDP Per Capita	550	556	566	575	588	604	621	639	657	677	697	718
GOVERNMENT FINANCES (% of GDP unless otherwise indicated)												
Government Revenues incl. Grants	27.0	27.5	27.2	26.2	25.5	24.9	25.4	25.3	25.5	25.5	25.4	25.4
Government Revenues	12.3	12.8	13.0	13.4	13.9	15.9	16.4	16.3	16.5	16.5	16.4	16.4
in USD (millions)	2,526	2,714	2,856	3,067	3,349	4,035	4,377	4,584	4,859	5,120	5,373	5,650
of which extractives and transit	9	113	151	246	275	547	573	580	646	686	707	739
Grants	39.6	37.9	34.4	31.2	28.2	10.0	10.0	10.0	10.0	10.0	10.0	10.0
On-budget	14.6	14.6	14.2	12.9	11.6	9.0	9.0	9.0	9.0	9.0	9.0	9.0
in USD (millions)	3,000	3,100	3,134	2,954	2,791	2,279	2,399	2,524	2,657	2,796	2,942	3,096
Off-budget	24.9	23.2	20.1	18.3	16.6	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Total Expenditures	27.0	27.5	27.2	26.2	25.5	24.9	25.4	25.3	25.5	25.5	25.4	25.4
Security Expenditures	10.7	10.7	10.7	10.7	10.6	13.4	13.2	13.0	12.8	12.7	12.5	12.3
Civilian Recurrent Expenditures	8.4	8.4	8.4	8.3	8.3	8.2	8.1	8.0	7.9	7.9	7.8	7.7
Civilian Development Expenditures	7.9	8.3	8.1	7.2	6.7	3.4	4.1	4.3	4.7	5.0	5.2	5.4
EXPORTS												
USD (millions)	1,362	1,535	1,752	1,922	2,109	2,489	2,719	2,982	3,259	3,594	4,164	4,746
% GDP	6.7%	7.3%	8.0%	8.4%	8.8%	9.8%	10.2%	10.6%	11.0%	11.6%	12.7%	13.8%

Selected economic indicators: Peace and reforms with all sources of growth fully realized

REFORMS AND PEACE												
YEAR	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**
GDP (USD)	20.7	21.6	22.9	24.6	26.6	28.6	30.7	32.9	35.2	37.6	40.2	42.7
GDP Growth	4.2	4.6	6.2	7.9	8.2	8.0	7.8	7.6	7.2	7.2	7.2	6.6
GDP Per Capita	557	569	589	617	649	682	716	750	784	819	857	892
GOVERNMENT FINANCES (% of GDP unless otherwise indicated)												
Government Revenues incl. Grants	26.8	27.6	30.5	30.6	30.4	26.8	26.9	26.7	26.7	26.6	26.5	26.4
Government Revenues	12.4	13.3	14.0	15.7	16.9	17.8	17.9	17.7	17.7	17.6	17.5	17.4
in USD (millions)	2,565	2,871	3,218	3,868	4,481	5,078	5,508	5,838	6,219	6,626	7,036	7,442
of which extractives and transit	16	210	401	839	954	997	1,124	1,138	1,195	1,258	1,297	1,344
Grants	39.0	42.4	38.6	35.0	31.6	10.0	10.0	10.0	10.0	10.0	10.0	10.0
On-budget	14.5	14.3	16.5	14.9	13.5	9.0	9.0	9.0	9.0	9.0	9.0	9.0
in USD (millions)	3,000	3,100	3,775	3,680	3,598	2,573	2,764	2,964	3,168	3,385	3,618	3,846
Off-budget	24.6	28.1	22.1	20.0	18.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Total Expenditures	26.8	27.6	30.5	30.6	30.4	26.8	26.9	26.7	26.7	26.6	26.5	26.4
Security Expenditures	10.5	10.5	10.3	9.9	9.6	9.2	8.9	8.6	8.4	8.1	7.9	7.7
Civilian Recurrent Expenditures	8.3	8.2	8.0	7.8	7.6	7.3	7.1	7.0	6.8	6.7	6.5	6.4
Civilian Development Expenditures	8.0	8.9	12.2	12.9	13.3	10.2	10.9	11.1	11.5	11.8	12.1	12.3
EXPORTS												
USD (millions)	1,362	1,535	2,248	3,008	3,586	4,017	4,518	4,923	5,480	5,831	6,420	6,988
% GDP	6.6%	7.1%	9.8%	12.2%	13.5%	14.1%	14.7%	14.9%	15.6%	15.5%	16.0%	16.4%

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