Afghanistan: Transition to Transformation Update

January 29, 2014
JCMB Meeting

The World Bank
Outline

• Progress and Challenges

• Key Messages from Tokyo and Transition Report

• Recent Economic and Fiscal Developments

• Looking Beyond 2014 – The Reform Agenda:
  – Ensuring Fiscal Sustainability
  – Growth Prospects and Drivers: Agriculture, Resource Corridors, Services
  – Human Capital and Skills
  – Strengthening Institutions and Governance
The last decade:
Significant economic and social progress from a very low base

• Economic Progress:
  – GDP growth averaged 9.4 percent during 2003-12
  – GDP per-capita from $186 in 2002 to $688 in 2012
  – Domestic revenues increased from 3% of GDP in 2002 to 11% of GDP in 2011
  – Public financial management improvements enabled increases in on-budget expenditures from $346 million in 2002 to $4.9 billion in 2012

• Social Progress:
  – School enrollment increased from 1 million (few girls) in 2001 to 9.2 million (3.6 million girls) in 2013
  – Access to improved water source increased from 22 percent to 50 percent of population
  – Life expectancy increased significantly to 64 years over the same period
  – Maternal mortality more than halved
Afghanistan faces formidable development challenges in poverty reduction, job creation, and service delivery

- GDP per-capita lowest in Asia and among lowest 20 in the world
- Afghanistan remains highly aid dependent, with total estimated aid 47% of GDP in 2012
- Job creation challenge formidable, with 400,000 new entrants into the labor force each year
- Poverty remains high at about 36 percent and more than 50% considered vulnerable
- Infant mortality among highest in the world and Literacy still very low at 25 percent
- Uncertainty related to security and stability remains high and impacts development prospects

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<tr>
<th>Indicator (2011)</th>
<th>Afghanistan</th>
<th>South Asia</th>
<th>Low Mid Inc</th>
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<tbody>
<tr>
<td>GDP per capita ($)</td>
<td>620</td>
<td>1410</td>
<td>1891</td>
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<tr>
<td>Revenue (% of GDP)</td>
<td>11.3</td>
<td>11.9</td>
<td>15.5</td>
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<tr>
<td>Life Expectancy</td>
<td>64</td>
<td>66.4</td>
<td>66.0</td>
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<td>Inf Mortality (per 1000 births)</td>
<td>72.7</td>
<td>48.3</td>
<td>46.8</td>
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<td>Improved Water (% of pop)</td>
<td>60.6</td>
<td>90.2</td>
<td>87.4</td>
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<tr>
<td>Pri Sch Enrollment (% gross)</td>
<td>98.2</td>
<td>110.0</td>
<td>105.5</td>
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<td>Sec Sch Enrollment (% gross)</td>
<td>48.6</td>
<td>58.7</td>
<td>61.4</td>
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Key messages from Tokyo conference and World Bank’s *Afghanistan in Transition* (2012) Report

- Economic growth was projected at 5 percent per year during 2012-18 given improvements in security and stability.
- Progress on policy reforms in key sectors could raise growth to a high case scenario of 7 percent per year over the same period.
- Financing Afghanistan’s very significant security and development expenditure needs would require a combination of continued donor grant aid and improved revenue mobilization.
- Any reduction in donor grants from planned levels would result in a loss of progress in poverty reduction, job creation, and service delivery.
After strong growth in 2012, increased uncertainty and flat agricultural production have led to a slowdown in 2013

- Economic growth 14.4% in 2012 due to a bumper agricultural harvest and rapid growth in services
- Growth slowed considerably in 2013 to an estimated 3.1%
- The number of newly registered firms declined 43% in the first 7 months of 2013
- Opium production increased 49% in 2013 to 5,500 tons or about 4.6% of GDP at farm-gate prices

- Growth is projected to remain weak at 3.5% in 2014, with any further increase in uncertainty likely to further dampen growth prospects and prolong the slowdown.
Agriculture and Services continue to dominate the composition of economic activity.
After a decade of strong fiscal performance, revenue collection has weakened in 2012 and 2013

- Revenues Afs 109 billion or 9.6% of GDP in 2013, down from 10.3% of GDP (Afs 109 billion) in 2012 and 11% of GDP (Afs 94 billion) in 2011
- The decline as share of GDP is due to the economic slowdown plus continued weaknesses in enforcement
- MoF has introduced a number of measures to stabilize revenues, which have had a modest effect to date: an accelerated decline in revenues has been avoided, but the decline has not been reversed
- Revenues expected to remain weak at about 10% of GDP in 2014 as uncertainty and the slowdown undermine improved revenue mobilization
Foreign grant aid finances more than 50 percent of total budget expenditures... 
...as more operating expenditures have moved on-budget

• In 2013, total budget expenditures amounted to $5.4 billion (or 26% of GDP), with domestic revenues financing $2 billion and grants financing the rest
• Grants finance all off-budget expenditures, estimated to be another 25-30% of GDP
• Operating expenditures have increased from 12% of GDP in 2006 to 19% of GDP in 2013, while development expenditures have declined slightly as a share of GDP, from 9% in 2006 to 7% in 2013
Looking Beyond 2014: Policies for Poverty Reduction and Development

Addressing priority policy reform goals for the medium term will be important in four key areas:

i. Ensuring fiscal sustainability by mobilizing revenue, securing grant assistance, and safeguarding non-security expenditures

ii. Supporting inclusive and job-creating private-sector led growth by unlocking the potential of the agriculture, services, and natural resource sectors and by tapping regional integration

iii. Improving upon the still low levels of human capital and skills

iv. Continuing to strengthen institutions and governance
Fiscal sustainability will require improving revenue mobilization and securing grant assistance

• Raising revenues to the target of 14% of GDP by 2018 will require a concerted effort in strengthening enforcement, expediting introduction of the planned VAT, and progress on legislative and regulatory framework for the mining sector.

• Total off and on budget expenditures projected at 41% of GDP by 2018 (of which 38% of GDP will be on-budget), thus leaving a large financing gap estimated at 25% of GDP (or $7 billion) in 2018.

• Afghanistan will continue to need considerable foreign grant aid for the foreseeable future, with the estimated financing gap still 20 percent of GDP in 2025.
With on-budget security expenditures rising rapidly, safeguarding civilian operating and development expenditures will be critical

• On-budget security expenditures have increased rapidly from $0.5 billion in 2007 to $2.4 billion in 2013
• On-budget civilian expenditures (particularly infrastructure, agriculture, rural development) actually declined as a share of GDP, while education, health, and social protection spending held steady
• Given large projected security expenditure needs and constrained resources, safeguarding financing for civilian expenditures will be critical for growth prospects and service delivery
Supporting job-creating post-transition growth: Agriculture, extractive industries, and services the key drivers

- Post-transition growth projected at about 5% per year during 2015-18 under the baseline scenario, less than the 9.4% average growth in 2003-12 fueled by aid and security spending
- Agriculture, mining, and services expected to serve as the key growth drivers, with manufacturing essentially linked to agriculture
- Reforms to stimulate higher agricultural productivity and expansion of mining could raise average growth to 6.7% during 2015-2025.

Job creation is expected to come primarily from agriculture and services

The employment impact of mining is expected to be modest

Tapping the potential of regional integration and urbanization could also become important contributors to jobs and growth
Reforms to stimulate job-creating growth: Infrastructure, human capital, access to land and finance, investment climate

- Improved infrastructure, human capital, access to land and finance, and investment climate will benefit job-creation and growth across the board
- Higher agricultural productivity will require investments in irrigation, extension services, and tapping opportunities to move to higher value-added products
- Unlocking the potential of extractive industries will require progress on the legislative framework as well as securing financing for the necessary infrastructure
Improving literacy and skills will be critical to growth and job creation in the medium term

- Improving human capital and skills will require:
  - continuing to expand equitable access to quality basic, TVET and higher education
  - strengthening systems to deliver quality basic and secondary education services
  - better linking TVET and vocational training initiatives to market needs
- Promoting female access to basic, TVET and higher education and increasing female labor market participation will require specific attention
- Improving health outcomes will require increasing uptake of immunization and nutrition programs, strengthening systems at Ministry of Public Health, improving tertiary care hospitals in poor maintenance

**Literacy Rates by Age Group, Area of Residence, and Gender (in percent)**

![Graph showing literacy rates by age group, area of residence, and gender](image-url)
Improving governance is critical to all aspects of nation building in Afghanistan

• Progress in critical governance areas, such as corruption and rule of law, has lagged, with Afghanistan tied in the last position for two years in a row in TI’s corruption perceptions index.

• Improving governance and accountability will be critical for improving service delivery, attracting investment, and supporting job creation and growth in Afghanistan.

• Improving the governance environment calls for attention in a number of areas:
  – Improving service delivery at the local level through better provincial budgeting, improving O&M management, and improving capacity.
  – In the area of civil service reform, strengthening the capacity and effectiveness of the core civil service is an important component of improving the governance environment.
  – In strengthening public financial management, while much progress has been made in budget transparency and treasury financial management, further progress will be needed in procurement decentralization, development budget execution, and external scrutiny.
Concluding Thoughts

• Uncertainty surrounding the security and political outlook will determine the depth and duration of the transition related slowdown

• The strength and durability of the post-transition growth pick-up will depend on reform progress to stimulate key sectors (agriculture, mining, services) and will require improved security and stability

• If key sector-specific reforms (e.g. the mining law) are not implemented in the next few months, the new government will face the challenge of advancing a large backlog of critical reforms

• Recent weaknesses in revenue generation mean that the new government will need to take concerted action to face the challenge of raising revenues annually by 1 percent of GDP during 2015-18 to meet fiscal targets

• Progress in reforms and enforcement, improved security and stability, and continued donor commitment to adequate grant assistance will all prove critical in supporting Afghanistan in meeting its formidable poverty reduction, job creation, and service delivery challenges