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Minutes of Executive Board Meeting 08/49-3

12:20 p.m., June 2, 2008

3. Islamic Republic of Afghanistan—Poverty Reduction Strategy Paper; Joint Staff Advisory Note

Documents: EBD/08/45; EBD/08/52

Staff: Elhage, MDC; Fisher, PDR

Length: 31 minutes

Executive Board Attendance

M. Portugal, Acting Chair

Executive Directors Alternate Executive Directors

	R. Gesami (AE), Temporary
	M. Sidi Bouna (AF), Temporary
	D. Vogel (AG), Temporary
	S. Duggan (AU), Temporary
	M. Jakoby (BE), Temporary
	R. Perez (BR), Temporary
	J. He (CC)
	A. Guerra (CE), Temporary
	S. Ladd (CO), Temporary
A. Fayolle (FF)	
	A. Rieck (GR), Temporary
	R. Bannerji (IN), Temporary
	F. Spadafora (IT), Temporary
	D. Kihara (JA), Temporary
J. Mojarad (MD)	
A.S. Shaalan (MI)	
	T. Rookmaaker (NE), Temporary
	J. Bergo (NO)
	A. Lushin (RU)
A. Alazzaz (SA)	
	C. Sucharitakul (ST)
	N. Raman (ST), Temporary
	G. Jung (SZ), Temporary
	D. Heath (UA)
	H. Rab (UK), Temporary

S. Anjaria, Secretary

W. Rahman-Garrett, Assistant

Also Present

IBRD: W. Byrd, A. McKechnie, M. Scuriatti. MESSAGE: P. Musinguzi (AE), K. Nissen (NO). External Relations Department: N. Buenemann. Fiscal Affairs Department: J. Tyson. Legal Department: G. Rosenberg. Middle East and Central Asian Department: J. Carlos Di Tata, M. Elhage, N. Erbas, M. Farahbaksh, D. Owen, L. Perez, T. Schneider, J. Wiczorek. Policy Development and Review Department: M. Fisher, M. Saxegaard. Secretary's Department: P. Ramlogan, M. Yslas. Advisor to Executive Director: H. Yung (CC). Senior Advisors to Executive Directors: A. Monajemi (MD). Advisors to Executive Directors: K. Harada (JA), A. Jbili (MD), F. Jeske Schonhoven (FF), F. Parodi (UA).

3. **ISLAMIC REPUBLIC OF AFGHANISTAN—POVERTY REDUCTION STRATEGY PAPER; JOINT STAFF ADVISORY NOTE**

Mr. Mojarrad and Mr. Jbili submitted the following statement:

On behalf of the Afghan authorities, we thank management and the joint staff of the IMF and the World Bank for their support in the preparation of the Afghanistan National Development Strategy (ANDS), which is also the PRSP under the current PRGF arrangement. This document has been officially approved by the Afghan Government and transmitted to the Boards of the IMF and the World Bank, and to the donor community. The authorities are also grateful to the international community for its unwavering commitment to the rebuilding of Afghanistan and the establishment of the institutional foundations for a well-functioning economy. The Joint Staff Advisory Note before us today lays out the assessment by the joint staff on the ANDS. The authorities appreciate the candid views expressed by the staffs on this document and will continue to work with them and with other partners to achieve their national objectives.

Main messages

The ANDS is an Afghan-owned program that establishes a road map for the authorities and the international community to work together in partnership to help Afghanistan rebuild a well-functioning economy and establish the foundations of an open and democratic society.

It is a consultative document that can be enriched and adapted to changing circumstances as the authorities move forward in implementing it. The Afghan authorities are open to comments and suggestions by the international community on how to strengthen their growth and poverty reduction strategy.

The authorities' clearly stated priorities rightly identify the specific needs of Afghanistan and the obstacles to economic development and poverty reduction. These priorities, which include security, good governance, infrastructure, and economic and social development feed into each other and would need to be addressed simultaneously to generate a virtuous circle of growth and poverty reduction. The scale of devastation in Afghanistan and the daunting

challenges facing its people are unique and require innovative and well-thought out solutions.

The ANDS is anchored in macroeconomic stability, which the authorities recognize as key to poverty reduction. The authorities also recognize that increasing revenues will be essential in order to move towards fiscal sustainability, and away from dependence on donor assistance flows, as soon as possible.

Donor support will be essential for the effective implementation of the ANDS and the authorities look forward to a successful outcome of the forthcoming Paris Conference for the Support of Afghanistan. Among other objectives, the Conference should seek to establish an effective framework of donor coordination.

We elaborate below on selected key issues.

A consultative development program

Building on earlier government strategy documents and joint cooperation initiatives by the international community, including the Afghanistan Compact agreed at the London Conference in 2006 and the I-ANDS, the current five-year ANDS is the product of an extensive national and regional consultation process supported by intensive efforts of analysis and priority setting. A major challenge in carrying out this task has been to put forward an integrated vision that draws clear links and synergies between sectors and areas of reform, and sets priorities to enhance aid effectiveness and deepen the reform process. As shown in the ANDS document, security, weak governance and corruption, the growing narcotics industry, and lack of transportation infrastructure are all inter-related factors that have detrimental effects on private sector investment, growth, and poverty reduction. The ANDS establishes clearly stated priority reforms that should be addressed simultaneously to produce maximum results and enduring effects.

Macroeconomic framework

As was highlighted during the third review of the PRGF-supported program on February 13, 2008, significant progress has been achieved in macroeconomic stability. Real GDP grew by 15 percent on average during 2002/03-2006/07, translating into a near

doubling of real per capita growth. Despite the security concerns and the effects of the 2006/07 drought on agricultural production, all sectors of economic activity exhibited good performance, supported by high foreign-financed investment. Inflation has been brought down to single digit levels due to prudent fiscal and monetary policies, but has picked up in 2007/08 owing mainly to the sharp increase in imported fuel and commodity prices. The fiscal position has continued to strengthen with improved revenue collection and prudent expenditure policy, which contributed to a reduction in the core budget deficit, excluding grants. Finally, the exchange rate has been stable, reflecting increased confidence in the Afghani, and foreign reserves have remained at a comfortable level.

The authorities are mindful of the importance of anchoring their growth and poverty reduction strategy in macroeconomic stability, and have articulated their policy objectives in the ANDS in line with their Medium-Term Fiscal Framework. Building on demonstrated commitment to fiscal sustainability under the PRGF, the authorities have set for themselves the objective of covering recurrent expenditure with domestic revenue sources, and bringing the operating budget balance (excluding grants) from a deficit of 4 percent of GDP in 2007/08 to a balanced position in 2012/13. The authorities agree that this will require sustained efforts to foster revenue mobilization by broadening the tax base and strengthening tax administration. They have reaffirmed their political commitment to work with the National Assembly to enact the needed amendments to the income tax law, and strengthen enforcement and collection of revenue. Over the medium term, a broad-based consumption tax will be introduced to support the revenue mobilization efforts.

The revenue shortfall under the PRGF-supported program that has emerged in 2007/08 due to exceptional circumstances is being addressed and an agreement has been reached with the Fund mission that visited Kabul in April 2008, which will be reported to the Board in the context of the fourth review of the program. This agreement included three prior actions for the fourth review, addressing customs and revenue collection issues. The authorities intend to implement all of these measures in advance of the Afghanistan Support Conference in Paris on June 12.

The staffs point to potential macroeconomic risks emanating from the envisaged scaling-up of expenditure. The authorities will

work with the IMF staff to update the medium-term macroeconomic framework in light of the outcome of the Paris Conference, and will continue to monitor macroeconomic developments under the PRGF. They intend to address potential risks to macroeconomic stability through close coordination between fiscal and monetary policies, as well as through the development of monetary policy instruments at the disposal of the central bank and the creation of a capital market to foster long-term financing. DAB is also committed to further strengthening bank supervision and risk management. More generally, as infrastructure bottlenecks are eliminated and the business environment for private sector investment and growth is improved, productivity gains will most likely offset some, or all, of the adverse effects of real exchange rate appreciation.

Poverty reduction

The authorities' poverty reduction strategy under the ANDS seeks to deliver enduring results by focusing attention on sectors and activities that could have maximum impact on poverty. These include, among others, allowing the private sector to play a key role in economic activity as the main source of employment and income, while reforming the public sector and improving the investment climate. In addition, by giving priority to the development of agriculture and infrastructure in rural areas, as well as water and energy, the strategy will improve the livelihood of the rural population, thereby contributing to a significant reduction in poverty. Finally, budget allocations to education, health, and social protection will be increased over the medium term, consistent with the need to maintain a prudent fiscal policy.

Improving absorptive capacity

Achieving the ANDS growth and poverty reduction objectives is predicated on strong and generous support by the donor community and international institutions, as well as by renewed efforts to increase absorptive capacity and remove bottlenecks that have constrained project preparation and implementation. The authorities are aware of the constraints imposed by Afghanistan's limited absorptive capacity, but do not consider historical performance in terms of project implementation as the best indicator of future absorptive capacity. The latter can be raised significantly through public administration reforms, further strengthening of public financial management (PFM)

and procurement systems, a deepening of the linkages between the ANDS and the medium-term fiscal framework, as well as through improved security, good governance, streamlining of procedures, and significant reduction in corruption. The authorities intend to give high priority to the implementation of these reforms with adequate technical assistance from donors and international organizations.

Implementation and aid effectiveness

The staffs rightly point out that the emphasis on aid effectiveness in the ANDS is appropriate and will be important for its implementation. The authorities believe that aid effectiveness could be enhanced significantly if donor funding is aligned with the country's priorities, resources are increasingly channeled through the core budget, and more information on external budget spending is provided on a timely basis. They underscore the importance of establishing effective coordination mechanisms for technical assistance and project financing and implementation. Donors and international organizations should seize the opportunity of the Paris Conference to establish an effective framework for coordination in a spirit of partnership and with the important goal of developing Afghanistan's management capacity.

Mr. Shaalan and Ms. Choueiri submitted the following statement:

We thank the staffs of the Fund and the International Development Association for a clear and well-written Joint Staff Advisory Note (JSAN). The Afghanistan National Development Strategy (ANDS) is an appropriate general framework aimed at providing an enabling environment for growth promotion, improved social conditions, reduced opium-related activities, and enhanced security and governance. Nonetheless, major external, political and institutional risks, highlighted by staff, face the implementation of the ANDS, including unpredictable aid flows, political support for achieving fiscal sustainability, and acute capacity constraints.

Against this background, we can broadly support the areas identified by staff as priorities for strengthening the ANDS and its implementation, since implementation is key to the success of the ANDS as rightly noted by the Afghani authorities. The authorities' intent to continue to work with the joint staff and the international community to strengthen their growth and poverty reduction strategy, as conveyed by Messrs. Mojarrad and Jbili in their informative buff

statement, is very reassuring in this regard. We particularly concur with those issues raised in the 2006 JSAN for the Interim-ANDS, in which progress has been limited. These comprise sector and project prioritization, firmer commitment to fiscal sustainability and improved governance, enhanced monitoring and evaluation of the ANDS process, and enhanced aid effectiveness aimed at channeling increased donor funding through the core national budget.

In light of the envisaged substantial scaling-up in expenditures—which as noted in the ANDS is not incorporated in the macroeconomic framework—a tighter integration of the ANDS within the Medium-Term Expenditure Framework is essential. Such integration would progressively help absorb expenditures, which are directly financed by donors into the central government budget. The commitment to enhance revenue mobilization, together with the improvements in public financial management (PFM) systems made in recent years and the additional progress in PFM envisaged in the ANDS, should yield further benefits in this regard.

We believe that the PRGF-supported program should continue to provide the adequate framework to closely monitor the effective implementation of the ANDS in areas that are consistent with the Fund's mandate. To that effect, it would have been more useful to combine the discussion of the ANDS/JSAN with that of the Fourth Review Under the Three-Year Poverty Reduction and Growth Facility, which is now scheduled to be discussed on June 30, 2008. In addition to the authorities' resolute commitment to the objectives of the PRGF, continued, timely, and coordinated delivery of technical and financial support by the donor community will be essential to implement the authorities' strategy.

With these remarks, we wish the authorities continued success in implementing their ambitious reform agenda during a challenging period ahead.

Ms. Lundsager and Mr. Parodi submitted the following statement:

The World Bank Board will meet tomorrow on the JSAN and the ANDS, and we defer to our counterparts there for the delivery of technical comments more within the Bank's areas of responsibilities. We limit our comments to issues with the IMF's competence, related to the macroeconomic framework and fiscal transparency.

The authorities made progress in the face of a challenging environment characterized by security issues and limited human capacity. We agree with Messrs. Mojarad and Jbili that Afghanistan faces daunting challenges that require innovative and well-thought out solutions. It is now the time for Afghanistan to commit to take concerted action to set the country on a stronger macroeconomic footing, as envisioned in the PRGF.

We are concerned that projected expenditure levels in the ANDS may not be consistent with long-run fiscal sustainability and macroeconomic stability. While we recognize that increased spending is necessary to achieve ambitious development objectives, the authorities must strive to fund a larger fraction of its expenditures, as committed under the Afghanistan Compact. In this regard, the authorities should redouble their efforts to increase revenues in line with the medium-term fiscal targets outlined in the PRGF. This will require the support of the most senior levels of government and for the authorities to broaden the ownership of revenue collection targets across all ministries.

We strongly encourage the authorities to implement the prior actions for the completion of the 4th PRGF review in advance of the Paris donor conference. Going forward, the authorities should appoint an inter-ministerial revenue committee, provide Finance Ministry Revenue and Customs Departments sufficient staff and budget, and work with the National Assembly to prioritize passage of stalled tax reform legislation.

We urge the authorities to increase fiscal transparency and continue with improvements in public financial management to ensure that donor funds are used effectively. In addition, the government should quickly commit to implement a comprehensive anti-corruption strategy by a date certain.

We fully agree with the staffs' recommendation that the authorities must engage in significant efforts of prioritization of the programs listed in the ANDS.

Finally, we strongly support the authorities' overall development vision. Their ANDS can serve as a useful instrument for

donors to expand further upon their support given to the Afghanistan Compact. We wish the authorities success at their donors' conference.

Mr. Kotegawa and Mr. Harada submitted the following statement:

We congratulate the Afghan authorities for successfully finalizing the Afghanistan National Development Strategy (ANDS) after a broad participation process. This document will be an anchor for the country's development process over the next five years. We are glad to see that the past continuous efforts by the authorities, embodied in the Interim-ANDS and the Afghanistan Compact, now lead to the formulation of a full-PRSP.

We also thank the staff for their candid Joint Staff Advisory Note (JSAN) and Mr. Mojarad and Mr. Jbili for their insightful statement.

The ANDS is a comprehensive and very informative document, which lays out wide-ranging challenges for the country. As the staff points out in the JSAN, we believe that prioritization will be a key component toward the effective implementation of the ANDS. In this context, the budget needs to be a strong instrument to achieve such a prioritization, and it will be necessary to establish close links between the medium-term expenditure framework and the ANDS. On this front, we ask the staff to carry out a meaningful dialogue with the objective of securing a sound macroeconomic framework for the country. We also encourage the authorities to implement their strategies in a step-by-step manner, especially those related to strengthening governance, fighting corruption, and replacing the opium economy. Progress in these issues is indispensable for Afghanistan to promote its development.

We believe that the most daunting challenge for the authorities, in terms of macroeconomic frameworks, is to make steady progress toward fiscal sustainability. Noting that the high level of expenditure envisaged in the ANDS would substantially slow down progress toward fiscal sustainability, we encourage the authorities to make their best efforts to establish a self-sustained fiscal structure by increasing domestic revenue. In this regard, we welcome the authorities' intention, to cover recurrent expenditures with domestic revenue within the medium-term. Nonetheless, in order to reach this objective, the reforms of tax policies and tax administration should continue to

be one of the top priorities for the authorities. Future Fund engagement with the authorities is expected to address this challenge in a meaningful manner.

Additionally, the quality of expenditures will become even more important during the course of implementation of the ANDS. While we welcome the authorities' emphasis on aid effectiveness, we are concerned about the fact that there has been little progress in reducing corruption. While we understand Afghanistan's difficult situation, the authorities should be aware of donors' responsibility towards their own taxpayers. In this context, in the medium term, a possible option might be to introduce the provision of grants based on incentives directed to increasing revenue.

Finally, we note the staff's explanation that the macroeconomic framework in the ANDS is consistent with the underlying framework in the third review of the PRGF. Nonetheless, with the finalization of the ANDS, we would like to know whether the staff intends to modify the current PRGF program. The staff's elaboration is welcome.

With these remarks, we wish the authorities every success in their future endeavors.

Mr. Charleton and Mr. Ladd submitted the following statement:

We congratulate the Afghan authorities for undertaking a thorough and comprehensive process to set the direction for Afghanistan's development in the medium and long term. We thank the staffs of the Fund and World Bank for their support to this process, and for their balanced analysis of the resultant plan. We also thank Mr. Mojarrad and Mr. Jbili for their reassuring buff. We agree with the findings and recommendations that the staffs offer on the Afghanistan National Development Strategy (ANDS) and note that many of the statements echo concerns expressed by the donors, including Canada.

Our key message is that implementation is critical. In particular, we agree that program prioritization within and across sectors should be strengthened in order to identify which programs will be implemented, given limited donor assistance and domestic revenue, and considering the absorptive capacity constraints to disbursing existing resources. Some additional points:

-We commend the Afghan authorities for acknowledging their current weaknesses and challenges, and for integrating their security plan into the national development strategy as “Pillar 1.” This is a sober recognition that security conditions are a constraint on efficient delivery of public services and on private sector investment intentions for the foreseeable future.

-It is critical to the success of the ANDS that the authorities maintain a strong macro framework and keep their PRGF-supported program on track. In this respect, we appreciate the authorities’ efforts to solve the revenue shortfall problem, which we discussed at the last PRGF review, prior to the Afghanistan Support Conference in Paris on June 12.

-We share the staff’s concern that the costing of the plan and the funding requested far exceeds Afghanistan’s absorptive capacity and that macro stability should be safeguarded (Para 16(i)). We strongly support the staffs’ advice on the need for discipline, for further improvement to PFM and procurement systems, for sensible ways to establish priorities, and to think ahead to the macro implications of scaling up (Paras. 15 to 17). Further development of public expenditure management and financial intermediation are key to reducing the role of cash transfers and reducing the scope for corruption. We look forward to an update to the 2005 Public Expenditure and Financial Accountability (PEFA) exercise.

-We would encourage the Government of Afghanistan to disseminate the ANDS to the Afghan public in the appropriate media and languages and to take steps to institutionalize participation in its implementation and monitoring (Para. 9). It is important for the over 17,000 people who participated in its elaboration to see the output and for everyone to know the direction that is set in each sector and overall. We would also welcome increased engagement with civil society in the implementation of the ANDS, not only as service providers, but also as advocates for greater accountability.

-We strongly support the staffs’ proposed course of action for monitoring targets and indicators (Paras. 10 to 12). It is a practical approach that acknowledges and tackles the data

limitations in Afghanistan. This has been a concern of the Canadian authorities in past Joint Coordination and Monitoring Board meetings.

-We cannot overemphasize the importance of structural reform to the potential for private-sector-led development (Para. 19). An up-to-date legal framework, stronger public administration, reduced corruption, access to land, stability in the banking sector, infrastructure and further financial sector development are all necessary precursors. Regarding the contemplated broad-based consumption tax, we would urge the Afghan authorities, with appropriate technical assistance, to implement this measure with due regard to both economic efficiency and the impact on the poorest.

With this, we extend our best wishes to the authorities, the broader administration and the people of Afghanistan, in the execution of the ANDS.

Mr. Murray and Mr. Duggan submitted the following statement:

We thank the Afghan authorities for the opportunity to discuss their National Development Strategy (ANDS), staff for the Joint Staff Advisory Note (JSAN) and Mr. Mojarrad and Mr. Jbili for their informative buff statement. We commend the Afghan authorities on the substantial progress made in the seven years since the fall of the Taliban regime against the backdrop of a very difficult security environment. The challenge now is to consolidate and build on these gains and in this context we support the ANDS as an ambitious framework for achieving a secure, stable and prosperous Afghan state, where the pre-conditions for success are strong Afghan leadership and long-term international support.

We will contain our specific comments on the ANDS to cross-cutting issues and Afghanistan's macroeconomic and financial sector challenges, noting that the World Bank Board will meet on Tuesday to discuss issues within its competency.

Cross-cutting issues

The ANDS identifies security, good governance and economic and social development as the key pillars of the Government's

development strategy. Sitting under this, however, is an enormous number of objectives and targets across a broad range of inter-connected development areas. The breadth of the strategy and proliferation of objectives may be a by-product of a broadly consultative and highly participatory process. Having captured these insights, however, an important next step will be to extract from the ANDS a set of core priorities as the basis for allocating scarce resources and to ensure coherence of domestic and international efforts. Therefore, we agree with the staffs that the ANDS would benefit from greater clarification of objectives and a more streamlined monitoring and evaluation framework, further refining the goals and objectives specified in the Executive Summary.

Security, corruption, narcotics, inadequate capacity and gender inequality are major cross-cutting impediments to Afghanistan's development that must remain at the forefront of policy discussions. We support the priority assigned to security issues in the ANDS, recognizing that greater internal stability would provide a more conducive environment for private sector growth and development. Similarly, the integrity of Afghanistan's development efforts will be strengthened by demonstrable progress in tackling corruption and narcotics, building capacity and addressing gender inequality. We are encouraged by the priority assigned to these issues in the ANDS and urge the authorities to heed the staff's advice in the JSAN on implementation in each of these areas.

Macroeconomic and financial sector challenges

The Afghanistan economy has performed well in recent years in difficult circumstances. Economic growth has been strong and is expected to remain solid over the medium-term. Inflation trended lower during 2006 and the first half of 2007 before picking up at the end of last year, largely due to exogenous factors. The budget position has improved, driven by measures to increase revenue collections, although we note that the tax-to-GDP ratio fell in 2007-08. Further, the external position appears to be strengthening, with the current account deficit expected to narrow and the level of international reserves increasing markedly. This improved macroeconomic performance can be attributed, at least in part, to the authorities' commitment to sound macroeconomic management and meeting the objectives of their PRGF-supported program.

Against this backdrop, we are encouraged by the authorities' stated commitment in the ANDS to maintaining macroeconomic stability over the medium-term through adherence to their Medium-Term Fiscal Framework (MTFF) and Da Afghanistan Bank's continued pursuit of low inflation. The ANDS identifies ongoing fiscal consolidation as a key priority and sets an objective of covering recurrent expenditure with domestic revenue over the medium-term. This is a laudable objective; however it will require further efforts to contain recurrent expenditure and to mobilize domestic revenue, combined with prudent debt management. It is encouraging that the central implementation tool for the ANDS will be the national budget.

As noted in the ANDS, Afghanistan faces a number of constraints that must be addressed to ensure long-term economic expansion and poverty reduction, some of which will require substantial additional expenditures. Nonetheless, like the staffs, we question whether the high level of expenditure envisaged under the ANDS – heavily dependent on a substantial increase in both donor support and domestic revenue raising – would risk undermining medium-term fiscal sustainability and pose a threat to macroeconomic stability, highlighting the importance of establishing a clear hierarchy of priorities under the ANDS so that scarce resources and implementation capacity are allocated to areas that promise the greatest development returns. We also encourage the authorities to move quickly on measures to improve tax enforcement, further broaden the revenue base (including by accelerating implementation of the proposed amendments to the income tax law and consideration of a broad-based consumption tax) and strengthen public financial management (including through the proposal to strengthen the role of the Control and Audit Office in the oversight of the expenditure functions of core spending ministries).

On financial sector issues, we welcome the authorities' proactive approach towards identifying financial sector risks and support their plans to address identified weaknesses, including strengthened banking supervision and enforcement, improving the regulatory framework, limiting the expansion of weak banks, restructuring state-owned banks and strengthening AML/CFT controls.

With these comments we wish the authorities every success in meeting the significant challenges that lie ahead.

Mr. von Stenglin and Ms. Rieck submitted the following statement:

We thank the staffs for the clear and candid JSAN and Messrs. Mojarrad and Jbili for their helpful buff statement. The ANDS clearly shows that the authorities are committed to a broad-based reform and development program. In the spirit of an effective division of labor between the IFIs, we leave specific comments on the ANDS to tomorrow's discussion in the World Bank and limit our remarks to the following macroeconomic points.

Tackling Afghanistan's significant development challenges will require considerable financial resources, including sizeable contributions from the international community. However, in view of the expenditure level envisaged in the ANDS, we share staffs' concerns about fiscal sustainability in the longer run. While the authorities' intention to cover recurrent expenditures with domestic revenues within the medium term is well taken, further efforts to strengthen revenue collection will be indispensable to successively reduce Afghanistan's dependency on donor financing. Tax base broadening, stronger law enforcement, and improvements in revenue administration will be key in this respect. Moreover, it would be helpful to incorporate the envisaged scaling-up of expenditures into the macroeconomic framework in order to ensure consistent policy action.

We urge the authorities to step up anti-corruption efforts. A reliable legal framework and the administrations' adherence to it are prerequisites for the effective use of both external and domestic financial resources as well as for private sector development, including the strengthening of the licit sector of the economy.

While we agree that there are daunting development challenges in many sectors of the economy, the ANDS would have benefited from a better prioritization. This is important from an overall development perspective but also, as staffs elaborate, to avoid the risk of falling back on substantial external borrowing in case donor contributions turn out to be less than expected.

Mr. Kiekens and Mr. Demirkol submitted the following statement:

We thank the Fund and Bank staff for the joint advisory note (JSAN) on the Islamic Republic of Afghanistan's Poverty Reduction Strategy Paper and Mr. Mojarrad and Mr. Jbili for their informative buff statement. The PRSP submitted to the Fund and the World Bank represents the Afghanistan National Development Strategy (ANDS) which was approved by the government last April. We commend the authorities for the comprehensive paper and the participatory approach in preparing the ANDS. We are particularly pleased with the multi pronged approach supported by policies on vital cross-cutting issues. While we consider the ANDS to be a very important step forward, we agree with the staff that it needs to be enhanced further by prioritizing policy targets and putting forward concrete policy steps to achieve these targets.

We agree with the proposal made by the Bank-Fund staff that a comprehensive monitoring and evaluation framework should be established within the existing structures of the government without duplication of activities. In this respect, the authorities should give serious consideration to the staff's advice with regard to the envisaged Central Monitoring and Reporting System.

Economic performance has been strong but needs to be reinvigorated, particularly on the fiscal side. Given the weak revenue performance, we reemphasize that the authorities, with the help of political leadership, maintain the implementation of fiscal reforms on the revenue side. The authorities should push ahead with the tax policy and administration reforms so that revenue performance lends confidence to international donors and boosts the credibility of the authorities.

The projected total resource requirement raises many questions about the absorptive capacity and macroeconomic stability. The ANDS takes an optimistic approach on the amount of expected donor assistance. The staff is rightly concerned that even if the projected donor assistance is secured, the authorities will have serious absorption issues and macroeconomic policy complications. We echo staff's view that it is not only the amount of resources, but how efficiently these are used that matters for the economic development and fight against poverty. Could the staff please elaborate on the projected donor assistance incorporated under the ANDS.

Political stability and security are the most important preconditions for resuming sustainable and healthy economic conditions in Afghanistan. The achievement of the ANDS targets and steps to be taken under the envisaged framework hinge upon the success of security forces in all Afghani territory. In the Report, the staff confirms that Afghanistan's security sector will not be fiscally sustainable in the foreseeable future. It is, therefore, necessary that continuous donor assistance is secured to support the Afghani security forces and avoid the crowding out of resources in the budget.

We fully share views of the staff on introducing prioritization of policy targets and putting forward concrete policy steps to achieve these targets. The ANDS is a very comprehensive document and sets out many challenging policy targets. However, there is no proper sequencing of policy actions or prioritization of policy choices, especially as the intermediate steps for policy targets have not been specified. The ANDS should be further enriched by incorporating these intermediate steps and policy prioritization. The Fund and the World Bank should lend technical support necessary for identifying the required intermediate steps and setting prioritization of policies for a successful implementation of the envisaged policy framework.

The ANDS gives a fair account of the country's situation when describing the current conditions and challenges. The ANDS framework rightly attempts to deal with the problems in all policy areas that support private sector activity. However, we expect no short run private sector response to many of the policy initiatives. Many policy actions to encourage a private sector-led market economy seem either not feasible or not doable in the short run. Therefore, it is necessary that the public sector should take the lead in certain areas. The JAN recognizes this fact in areas like the energy sector. We would have preferred a more comprehensive strategy with respect to the role of the public and private sectors in other areas of the economy.

Lastly, we broadly share the overall staff analysis with respect to the priorities for strengthening the ANDS and its implementation. We agree with the list provided by the staff on the additional risks to the implementation of the ANDS and urge the authorities to continue to build on a good track record of policy implementation.

Mr. Bergo and Ms. Mogensen submitted the following statement:

We concur with staffs' assessment in the JSAN. We are prepared to support the Afghanistan National Development Strategy despite its shortcomings as it reflects the government's best efforts at this stage to reconstruct the state. While referring to the World Bank discussion to take place tomorrow on specific details, we would like to raise the following points of macroeconomic relevance namely on fiscal policies and related governance issues.

Fiscal sustainability is in our view a pivotal element to achieve the objectives of growth and poverty reduction and we welcome the objective to bring the operating budget, excluding grants, in balance within the timeframe of the Strategy. In order to achieve this objective, we emphasize the urgent need to increase domestic revenue collection. In particular, the authorities should have as a priority to enforce tax collection and administration within existing law provisions.

Considering the expenditure side, we share the concerns on the authorities' ability to absorb the envisaged rapid increase in development assistance. In order to address these concerns, several issues need to be handled. Firstly, the scaling-up of expenditures should quickly be incorporated in the macroeconomic framework with a view to formulating appropriate policy responses to ensure macroeconomic stability and avoid further erosion of external competitiveness as outlined by staffs. We support the authorities' intention to consult with IMF staff in this regard. Secondly, to make efficient use of resources, public administrative reforms and continued improvements in public financial management must be prioritized. Finally, the authorities must be prepared to further prioritize programs to inter alia address the risk of a dramatic increase in external borrowing highlighted by staffs.

On governance issues related to fiscal policies, we echo the calls for increased fiscal transparency and we would be interested to learn from staffs what the prospects are for Afghanistan joining the Extractive Industries Transparency Initiative as mentioned in the JSAN. As a more general point, efforts to fight corruption – from prevention to prosecution – need to be considerably enhanced. Among other things, this will support the authorities' efforts to increase domestic revenue and to effectively use resources.

We are generally committed to support progress in Afghanistan. The Strategy provides a reasonable basis for Afghanistan to move forward and we consider that the shortcomings in the Strategy can be addressed by the government as they progress. We commend the government for the broad participatory process and encourage them to disseminate the Strategy to the public to enhance ownership, understanding and accountability to the Strategy.

Mrs. Sucharitakul and Mr. Raman submitted the following statement:

We appreciated the comprehensive Afghanistan National Development Strategy (ANDS) document, the candid and concise assessment by staffs of both the Fund and the Bank, and Mr. Mojarrad and Mr. Jbili's thoughtful buff statement. We are particularly impressed by the depth and breadth of work put into the preparation of the ANDS, and the ambition of the authorities' development plans. We acknowledge that targets will need to be suitably ambitious if significant and visible progress is to be made in improving living standards in Afghanistan. We also agree that the general thrust of the document is appropriate, including its acknowledgement of the importance of improving security, expediting provision of social services such as health and education, enhancing infrastructure and providing the space for a vibrant private sector-led market economy to develop.

We commend the authorities for the progress already made thus far under the Interim ANDS (I-ANDS), which has been all the more remarkable given the unprecedented challenges Afghanistan faces. Growth has been rapid, infrastructure continues to be painstakingly rebuilt, the provision of social and economic services is expanding, the macroeconomic framework continues to evolve and structural reforms, including financial sector development, are ongoing. Having said that, the authorities rightly acknowledge the still-daunting task ahead. Provision of security and a significant and sustained reduction of poverty must be the priorities for the authorities, the basis on which all other strategies can built on.

Public Participation in Developing and Implementing the ANDS

We commend the authorities for their two-pronged approach in developing the plans contained in the ANDS. In particular, the

extensive and exhaustive consultation process paves the way for greater local ownership. We think the plan rightly builds up from the village and province levels, complemented by a top-down examination of cross-cutting issues such as security, macroeconomic management and infrastructure. We also appreciated the emphasis placed on environmental sustainability and women's participation. Having said that, our main concerns were much like those of the staffs': we missed a sense of how the plans would be rolled out. We see the announcement of the plan and, crucially, visible progress in its implementation as a way to build support and ownership for it, and could provide the necessary identification of economic progress with the government to achieve some of the security aims.

Prioritization

As we noted earlier, the plan appears to be very comprehensive and attempts to satisfy many competing needs. While none of the individual goals provoke disquiet, as a package, there seems a lack of focus in the document. We do not necessarily see that the plan as a whole as being unwieldy – simply that we missed a sense of priority and sequencing. For instance, while it is laudable that the Afghan authorities would like to increase the number of female school teachers by 50 percent by the end of the plan period, clearly this requires substantial improvements in enrollment of girls and women into school. Though we have seen remarkable progress on this front, it is also the case that girls only make up 35 percent of students enrolled in schools. We see potential tensions throughout the document, including the staffs' observation on the necessity to build the platform for an information technology rollout policy to work, including enhancing literacy. We agree with the staffs that some reordering of priorities is necessary to make this plan workable. We imagine that such priorities could already be discussed by the authorities, given the likely implementation constraints, and we encourage them to share their vision for the sequence of actions as well as their readiness to adapt the plans along the way, to help build support for the plan, and enable more effective monitoring.

Macroeconomic Framework and Resource Requirements

On the whole, we found the ANDS to be properly cognizant of the need to sustain macroeconomic stability. We acknowledge the substantial progress made in reducing inflation and building the

necessary public financial management infrastructure. However, we also take note of staff's view that both the substantial expenditure envelope proposed by the authorities as given in Table 1 of the ANDS and the limited absorptive capacity of the Afghan economy pose risks to stability and fiscal sustainability. By the authorities' own estimation, over the 5-year period, expenditures will outstrip revenues (including donor assistance) by US\$18.6 billion even as expenditures on security are projected to come down. It is not immediately obvious to us how the authorities propose to meet this funding gap, though we understand that the aid estimates may be too low as there is the possibility of a substantial scaling-up of assistance.

We understand the authorities' choice of priority areas for improvements in terms of Afghanistan's hard infrastructure – most notably transport and communication, sanitation and electricity. We agree further that improvements in these priority areas would have far-reaching positive consequences on the authorities' other goals, not least on health, security, employment prospects and living standards, which would build further consensus on the reform agenda. Having said that, we wonder if some sequencing of major projects is not called for. We understand that the absorptive capacity remains weak, and can see potential implications on inflation.

We have great sympathy with the authorities' inability to coordinate aid efforts, given that much of the flows have been outside the budget. We urge donors to work with the authorities to centralize their contributions through the budget. We recall in the discussion on the Fiscal Policy Response to Scaled-Up Aid¹ that extra-budgetary support has been pervasive, and that it complicates fiscal management. While we agree that, as a priority, the Afghan authorities will need to step up improvements to PFM – a point they readily acknowledge in the ANDS – donors must also stand ready to provide the necessary support with fewer strings.

Structural Reforms and Encouraging Private Sector-led Growth

We concur that a vibrant private sector has the potential to spur growth over the longer term, providing better employment opportunities for Afghans in the future. Having said that, we are less optimistic that fostering competition in areas such as infrastructure

¹ SM/07/199

development and provision of utilities is a key area for improvement. First, while welcoming the enactment of laws that support private sector growth, we think it is stability and enforcement of these rules that would be key to enhancing business confidence.

Second, we are not certain how privatization alone will spur better provision of infrastructure. For instance, we welcome the authorities' aim to corporatize the national electricity authority, Da Afghanistan Brishna Mowasesa (DABM), if by corporatization, the authorities mean to improve governance and allow the DABM to make decisions on a commercial basis. However, we see that expanding the power grid has implications that go beyond commercial logic alone. Therefore, corporatization may need to be supported by direct budgetary assistance to expand coverage to areas where commercial feasibility is in question. In such circumstances, we think there is merit to moving forward as proposed. Similarly, if corporatization is a precursor to full privatization in order to improve access to financing, and the larger social goals are not compromised, we certainly support the authorities. However, if corporatization and privatization are done for their own sake, we fail to see how concrete improvements can be delivered. Certainly, privatizing to introduce competition in the power sector makes little sense since the Afghan electricity market does not appear to be contestable at present. We would encourage the authorities to pursue their legislative plans in this area, as proposed, but to be more flexible in moving forward on areas such as privatization. We think that as an ultimate goal, the authorities' intentions are laudable but it is not clear that such aims are imminently achievable.

Concluding Thoughts

The recent discussions on dealing with the impact of higher food prices here at the Fund also have a bearing on the ANDS. We welcome the priority placed on agriculture, especially food security, and but missed a sense in both the authorities' view and staffs' assessments as to whether the goals are achievable and to what extent Afghanistan will remain vulnerable to food price shocks. In particular, we could see an adverse impact on external sustainability in the event access to food, especially from Afghanistan's neighbours, were to be curtailed. Finally, we see a further benefit in crop substitution from poppy farming, which will increase the supply of arable land for food

production in particular, and is likely to help significantly improve food security.

To reiterate, we found the authorities' proposals to be well-articulated and structured, comprehensive and ambitious. We think the ANDS outlines a broadly appropriate way forward in meeting the challenges of rebuilding Afghanistan and developing a flourishing and vibrant state. Our concerns are more practical – related to implementation capacity, potential risks and issues of sequencing. However, we also acknowledge that given the pressing need to show progress to garner political support, a significant level of ambition will need to be demonstrated. We think the ANDS could find that balance between ambition and pragmatism and we wish the authorities' well in the challenging period ahead.

Mr. Alazzaz submitted the following statement:

I thank the staffs of the Fund and the World Bank for a thoughtful and candid Joint Staff Advisory Note (JSAN). I also thank Mr. Mojarrad and Mr. Jbili for their informative buff statement. The Afghan authorities are to be complimented for the preparation of the Afghanistan National Development Strategy (ANDS), which is based on an extensive participatory process. Here, I am reassured that the government will also institutionalize participation in the implementation of the ANDS. Moreover, I agree that the ANDS provides a reasonable road map to move forward in rebuilding Afghanistan's economy, reducing poverty, and addressing the impediments to sustainable high growth rates.

That said, the staffs have rightly emphasized the need to move forward from strategy formulation to implementation. In this regard, I agree on the importance of streamlining the large number of policy measures and other actions in the ANDS. It is equally important to enhance capacity building, including through better management and coordination of technical assistance. Prioritizing sectoral strategies and increasing domestic revenues are also critical to an effective implementation of the ANDS in view of the envisaged large increase in spending as well as the need to move towards fiscal sustainability.

Finally, the risk factors outlined in the macroeconomic section of the ANDS along with those detailed by the staffs would require substantial efforts by all the parties concerned to help mitigate those

risks and move forward with an effective implementation of the ANDS.

With these remarks, I wish the authorities success.

Mr. He and Mr. Yung submitted the following statement:

We thank staff of the Fund and the International Development Association for their joint advisory note and Mr. Mojarad and Mr. Jbili for their buff statement.

The Afghanistan National Development Strategy (ANDS) provides a comprehensive road map to improve security, strengthen government capacity, and embark on sustained economic development and poverty reduction. We are impressed by the authorities' ambitious efforts to formulate strategy. Moving forward, implementation will be key to the success of the ANDS.

We see an urgent need to address poverty in Afghanistan and are encouraged by the attention given to the poverty reduction strategy under the ANDS, although its smooth implementation cannot be guaranteed. We agree with staff's recommendation that ANDS sectoral programs be subject to further prioritization to take account of their impact on poverty reduction. To help fine-tune policy priorities and monitor progress in poverty reduction, we also note the benefits of timely compilation and analysis of the ongoing national household survey. Furthermore, it is important for the authorities to conduct poverty analysis to establish clear priorities among programs and investments that can be aligned to the goal of poverty reduction.

Staff has rightly identified the key implementation risks—political support for efforts to expand the tax base and increase revenue, the government's weak institutional capacity, the breadth and depth of government-wide ownership of, and commitments to, some key elements of the ANDS, and the unpredictability of aid flows. As some of these risks are not easy to mitigate, we call for strong and sustained efforts by the authorities and their partners to minimize any adverse impact from these risks.

With these remarks, we wish the authorities success in implementing the reforms.

Mr. Gibbs and Mr. Rab submitted the following statement:

Islamic Republic of Afghanistan

We congratulate the authorities on a very comprehensive Afghanistan National Development Strategy (ANDS). We are grateful to Bank and Fund colleagues for a clear Joint Staff Advisory Note (JSAN) on the ANDS. We thank Messrs. Mojarrad and Jbili for their helpful statement. We agree with the recommendations in the JSAN and fully support its messages on prioritisation, aid effectiveness (including the need for donor action), and implementation. We focus our comments on macroeconomic issues highlighted in the JSAN.

We agree with staff advice on the need to tighten links between projected ANDS expenditure and medium term fiscal sustainability. There are significant recurrent cost implications for the Government in the proposed externally financed \$43.3 billion development programme. As noted in the JSAN, the envisaged expenditure scale-up is not incorporated in the macroeconomic framework and would substantially slow down progress towards fiscal sustainability (i.e. 100 percent of the recurrent budget covered by domestic revenues). We welcome the authorities' commitment to working with staff on reviewing the macroeconomic framework following the Paris Conference as noted in the statement of Messrs. Mojarrad and Jbili.

We fully support the strong emphasis on the need to increase domestic revenue. This is central to reducing Afghanistan's dependence on (and vulnerability to) external assistance, and will provide resources to sustainably finance reconstruction and development. We urge the authorities to accelerate necessary reforms on tax policy and administration. We welcome the authorities' commitment to implementing ahead of the Paris Conference the prior actions on revenue agreed with staff under the PRGF-supported programme.

We note that unless concrete and decisive steps are taken to improve absorptive capacity, it is unlikely that the ANDS' development objectives will be achieved. A recent Public Expenditure and Financial Accountability (PEFA) exercise highlighted important progress. But more public financial management and public administration reforms (particularly in the provinces) are required to improve the credibility of the budget. There are still significant

margins between planned and actual expenditure particularly in the core development budget. Prioritisation of expenditure by focussing on key productive investment in infrastructure, education and health, will be important to maximise the impact of public policy.

We welcome the messages on the need to maintain strong macroeconomic management and vigilance against external shocks. The JSAN is right to point out the risks of high levels of external financing on Afghanistan's competitiveness (e.g. through Dutch Disease). External shocks (e.g. due to increased food and fuel prices) will pose an ongoing risk to macro stability and we encourage staff to continue their support to strengthening capacity particularly in the Ministry of Finance and the Central Bank to effectively deal with these crises.

With these comments, we wish the authorities success with implementation of the ANDS.

Mr. Sadun and Mr. Spadafora submitted the following statement:

We congratulate the Afghan authorities for developing and approving the Afghanistan National Development Strategy (ANDS), which represents a crucial tool to continue addressing the country's daunting development challenges. We also thank the staffs of the Fund and World Bank for their candid and constructive JSAN and Mr. Mojarad and Mr. Jbili for their informative buff statement.

The authorities' commitment to developing a private sector-based market economy provides the base for sustained economic growth and employment opportunities. The ensuing positive impact on poverty reduction can contribute to improving security and reinforcing the development process.

As correctly pointed out by the staffs, a major contribution to the success of the ANDS can derive from increasing its national ownership by disseminating the strategy to the Afghan public and favoring its participation in the implementation and monitoring phases.

We concur with the staffs and other chairs in underscoring the urgent need for establishing clear priorities among programs and investments in the ANDS, in order to more closely align them toward the goal of poverty reduction. Such a prioritization is also needed in light of the country's limited absorptive capacity and would be

instrumental in effectively channeling available resources should donor funding prove lower-than-expected. As mentioned in paragraph 16, this latter possibility cannot be ruled out and carries the risk that, absent a prioritization of sectoral programs, actual funding might end up being allocated on the basis of sub-optimal criteria.

The authorities' commitment to fiscal sustainability will contribute to safeguard macroeconomic stability. We encourage the authorities to follow the disciplined approach suggested by the staffs to meet the fiscal objectives targeted by the ANDS, particularly by broadening the tax base and improving the revenue policy and administration. The budget should also play a key role in the crucial phase of implementing the national strategy.

With these remarks, we wish the authorities well in their future endeavors.

Mr. Rutayisire submitted the following statement:

We welcome today's review of the Afghanistan National Development Strategy (ANDS), and we thank staff for the comprehensive joint advisory note, and Mr. Mojarad and Mr. Jbili for their helpful buff statement. The Afghani authorities continue to face considerable challenges in their efforts to improve security, build an effective and accountable state, and embark on sustained economic development and poverty reduction. We welcome the progress they have achieved so far in those areas.

We share staff's view that the ANDS provides a reasonable basis for the Afghani authorities to address the difficult development challenges they faces. However, given the uncertainty surrounding the resource envelope and absorptive capacity, we also agree that the implementation of the ANDS should be further enhanced by better prioritizing sectoral programs, and taking into account their impact on poverty reduction. In this regard, we note that while the analytical base for the ANDS, in particular the poverty diagnostics, has improved, significant weaknesses in the statistical data remain. The number of policy measures and actions in the ANDS should also be streamlined, for decision-making, implementation, and monitoring purposes.

To increase domestic revenues needed to finance the poverty reduction strategy, we agree that additional efforts by the government

will be required. In view of the envisaged large increase in expenditure and the faltering revenue performance in 2007/08, we urge the authorities to make every effort to ensure fiscal sustainability. We also encourage them and international partners to work to ensure that the availability of external resources does not undermine incentives for revenue collection. With the improvement of ANDS prioritization, donors would be able to increasingly align their aid with the priorities of the ANDS. The authorities need, however, to develop their institutional and absorptive capacity to manage a rising share of donor resources. This would enhance aid effectiveness.

Capacity development is also an urgent priority, requiring a range of actions, including a better management and coordination of TA.

A number of significant risks may affect the implementation of the ANDS. In addition to the security situation, we agree that the authorities need to foster political support in order to expand the tax base and increase domestic revenue, which represents a substantial source of financing in the ANDS. They will have to enhance their weak institutional capacity and the associated limited absorption capacity for sharp increases in resources. Government-wide ownership of the strategy needs to be broadened and deepened, and commitment to key elements of the ANDS, such as fiscal sustainability, a merit-based civil service, and a private sector-based market economy need to be sustained.

While some of these risks are indeed hard to mitigate and will require effective risk management, others call for strong and sustained efforts by the government and its partners to mitigate and reduce any adverse impacts especially the unpredictability of aid flows and problems with aid effectiveness.

With the remarks, we wish the authorities success in their challenging endeavors.

Mr. Rojas and Mr. Guerra submitted the following statement:

We congratulate the Government of Afghanistan for the comprehensive work that delivered the National Development Strategy (ANDS). The five-year plan reflects the Government's vision and the strategy to reach poverty reduction and sustainable economic growth.

The strategy has been developed after broad-based consultations throughout the country, both with government and civil society institutions. This ensures full ownership not only for the government but also for the other relevant actors, including provinces whose development priorities have been incorporated.

We want to thank Mr. Mojarad and Mr. Jbili for their comprehensive buff statement that reviews the main elements of the ANDS and clearly presents the most important objectives. We are certain that the international community, and in particular the IMF, will continue to support the rebuilding of Afghanistan and the development of the institutions and markets that can set the basis for long-term economic growth and poverty reduction.

We also thank the staffs of the IMF and the World Bank for a clear assessment of the ANDS. We support the staff view that the Strategy is a good basis to cope with the development challenges that Afghanistan faces. We broadly concur with the staff assessment related to the key implementation risks and issues that could be addressed in order to strengthen the implementation of the ANDS.

Looking forward, we regard the development of organizational and human capacity in the government as a key factor to achieve implementation of the strategy. In this regard, coordination of technical assistance will have to be strengthened. We also ask for increased efforts by the staffs of the IMF and the World Bank in order to better coordinate their TA services to Afghanistan. This coordination should render not only lower costs but also greater efficiency of this important public good.

We support the staff view that given the uncertainty surrounding available resources and the absorption capacity, there is a need for prioritization of sectoral expenditure in order to have a greater impact on poverty reduction. Specially, we would add, in the present context of increased risks due to higher food prices that affect the poorest sector of the population.

Finally, as Mr. Charleton and Mr. Ladd, we encourage the Government of Afghanistan to disseminate the ANDS as broadly as possible to ensure full support of the different sectors for an efficient implementation of the development strategy.

Mr. Bakker and Mr. Rookmaaker submitted the following statement:

We welcome the huge effort by the Afghan authorities in preparing the ANDS paper. The document identifies the severe challenges facing Afghanistan, not in the least in terms of security and high poverty rates. Afghanistan's geographical location makes it an archetypical frontier state with both specific challenges and opportunities. In their rich history, Afghans have often made successful use of this position, for instance by making it an important regional center for trade. Such potential may become easier to tap in the longer run, along with a steadily improving level of security.

In the ANDS, the authorities have identified a large number of individual measures with the potential to spur development. We commend the authorities for their ambitious approach. Given its comprehensiveness and high level of ambition it may turn out that the authorities could build upon the document for a much longer period than the 5 years for which it is intended. Like Mr. Charleton and Mr. Ladd, we believe it would be useful to spread the ideas of the strategy to the general Afghan public through the appropriate media and languages.

From a practical point of view, we agree with the staffs on the need to prioritize measures at the sectoral level and to streamline monitoring and evaluation. One could argue that the country currently faces many challenges that need to be dealt with simultaneously, but simply to make swift implementation possible it seems that a number of immediate priorities should now be identified, along with the appropriate sequencing of individual measures. Prioritization seems also needed in light of the limited absorptive capacity of both the administration and the economy, and could also be guided by principles of effectiveness and feasibility. It seems to boil down to striking the right balance between the different objectives of the authorities.

The authorities emphasize that the ANDS is an Afghan-owned blueprint for progress and the product of extensive national, provincial and local level consultations. At the same time, we note the risk factor mentioned by staff concerning the breadth and depth of government-wide ownership of and commitment to certain key elements of the ANDS, including fiscal sustainability and a private sector-based economy. These are key elements of the PRGF program. In this light,

we look forward to a renewed discussion on fiscal and structural reforms during the Board meeting on the next PRGF Review.

The JSAN rightly points to the need for fiscal discipline to meet the fiscal objectives of the ANDS and PRGF program. Revenue has increased over the years, but levels are still very low. Reforms to increase revenue are critical. We welcome the fact, mentioned in the informative buff statement by Mr. Mojarrad and Mr. Jbili, that agreement has recently been reached between the Fund mission and the authorities on remedial measures to address the revenue shortfall under the PRGF. We encourage the authorities to implement these measures swiftly, as the next PRGF Review and the Afghanistan Support Conference are coming up soon.

We agree with staffs' recommendations to streamline the JCMB process. The current number of working groups and discussion forums seems very large. The national household survey proves very useful and we encourage the authorities to continue to use this survey.

To conclude, time has now come for the actual implementation of the strategy. We wish the authorities all the best in doing so as soon as possible and in line with their most immediate priorities.

Mr. Fayolle submitted the following statement:

The Afghan National Development Strategy Paper (ANDS) is indeed an important step, which provides the Afghans, as well as the international community, with a roadmap for the development of the country. It provides for a comprehensive and ambitious strategy, which builds on the considerable progress made since the fall of the Taliban regime in 2001.

In order for the international community to build its long-term support around the ANDS, progress is however required on the issues emphasized by both the IMF and the World Bank Group.

We welcome the quality of the poverty diagnosis and the extensive participatory process that have fed into the ANDS. We share nevertheless staff's view that the links of the poverty diagnosis with the overall strategy should be enhanced.

With respect to the macroeconomic framework, we commend the authorities for the progress made in terms of economic growth and macroeconomic stabilization. The achievements reached under the PRGF have been supported by the country's qualification under the Enhanced HIPC Initiative, which will provide Afghanistan with a much welcome alleviation of the debt burden, and will help it accomplish its goal of enhanced growth and reduced poverty. We commend the authorities for the progress achieved in terms of public financial management, as indicated in the PFM performance assessment. At the same time, for the sake of achieving gradually fiscal sustainability and getting away from long-term aid dependence, we would encourage the authorities to focus on the quality of public spending, rather than on its level, and to increase domestic revenue. Implementing the economic reforms laid out in the PRGF, as well as in the ANDS, will be crucial for building up Afghanistan's limited absorptive capacity and for facilitating private sector-led growth.

Like staff, we welcome the commitment of the ANDS to private sector development, while urging the authorities to press ahead with the structural reforms set out in the ANDS. Besides, we agree with staff that sectoral policies and programs need to have more realistic targets, be prioritized and fully costed. We are concerned that in most of the sectors, no information on investment plans is available. Besides, the proposed sector expenditure levels do not correlate with the weak implementation capacity of the government and the lack of domestic professional skills. We are also concerned that increased informal activities impact the rule of law, weakening the effectiveness of state institutions.

We believe that the situation with the export sector would require further reforms. We are disappointed with the ANDS conclusion that exports are unlikely to increase substantially from the current very low base as it continues to be dominated by low value-added agricultural products and carpets. Most FDI is concentrated in not export-oriented industries. We would have expected more attention and a stronger commitment for change in this sector.

The ANDS rightly points out key political challenges, which will be of critical importance to sustain progress in development and security, such as strengthening of good governance and the rule of law and scaling-up counter-narcotic activities. In particular, the commendable improvements in public financial management

demonstrates that progress can be made in the fight against corruption, which remains a major impediment to development and an important concern for donors.

Aid must become more efficient, predictable and international support needs to be prioritized. The ANDS appropriately emphasizes the role of the budget as the key instrument for implementing the strategy. At the same time, staff rightly points out that only a more effective and coherent policymaking with the conducive institutional arrangements and processes, notably an enhanced medium term fiscal framework, will lay the ground for aid effectiveness and provide donors with the comfort sought to increase their direct budget support.

Successful implementation of the ANDS will first require clear commitments by all stakeholders and then willingness to actually implement these commitments: to this respect, a clear signal that the authorities could deliver to the international community prior to the International conference in support of Afghanistan would be to take the prior actions requested by the IMF.

We believe that the monitoring and evaluation of the progress achieved under the ANDS will be of crucial importance for the international community. In this perspective, we welcome the development of a comprehensive framework for monitoring and evaluation. We agree with staff that the institutionalization of the CMRS within the existing structure of the government would clearly improve the M&E. In the same vein, we believe that the strengthening of the CSO would be warranted.

Ms. Agudelo and Mr. Perez submitted the following statement:

We thank the staffs of the Fund and of the International Development Association for the Joint Staff Advisory Note and Messrs. Mojarrad and Jbili for their candid and informative buff statement. We commend the authorities for their commitment to the Afghanistan National Development Strategy (ANDS) which addresses much needed reforms to improve social conditions, to develop infrastructure, to reduce the illegal drug's activities and to improve governance and security.

Macroeconomic stability of the ANDS should be the center of the Afghan authorities' concerns for the long-term sustainability of the

country. We are encouraged that the authorities recognized it as key for poverty reduction as Mr. Mojarrad and Mr. Jbili state in their buff. In that sense, we strongly encourage the authorities to work in the integration of the ANDS with the medium-term budget to avoid that the high level of expenditure envisaged risks fiscal sustainability. We recognize that an important increase in the expenditure is indispensable given Afghanistan's needs, but we urge the authorities to prioritize the components of the ANDS, bearing in mind the countries' difficulties to execute expenditure, in particular large infrastructure projects, and its low capacity of absorption.

On the revenue side, efforts are equally important. We encourage the authorities to make progress in broadening the tax base and in strengthening tax administration. A structural tax reform is needed, as the authorities recognize it, to sustain revenue collection.

We encourage donors to maintain aid flows that are critical for the strategy and we support the authorities' call to increase aid-effectiveness. The whole strategy would be more successful if donor funding is aligned with the countries priorities and if resources are channeled through the budget. However, the authorities are encouraged to increase fiscal transparency and to have in place an effective anticorruption strategy as those are prerequisites to channel efficiently aid funds.

With these remarks, we wish the authorities success in dealing with the difficult challenges that lie ahead.

Mr. Lushin made the following statement:

We did not issue a gray, but would like just to say a few words. We very much welcome the Poverty Reduction Strategy Paper before us today. We concur that the ANDS provides a reasonable basis for Afghanistan to move forward, to answer the basic question in paragraph 46. We agree with many Directors who called for better prioritization across and within sectors in ranking the projects that were put forward in the ANDS.

Ultimately, the success of the program will hinge importantly on two key issues: improvements in the security situation and the development of organizational and human capacity in the government. Both of these two issues have a great deal to do with the third major

issue we would like to touch upon, the still-high reliance of the Afghan economy on opium production. Progress in this area would help facilitate progress in the area of drug reduction. Replacing opium production with other legal activities would both contribute to better security and improve the capacities of the government.

With these remarks, we wish the Afghani government every success in the implementation of this program.

Mr. Bannerji made the following statement:

We welcome the Afghan National Development Strategy and we are prepared to support it, as it reflects the authorities' best efforts going forward. Like many others who have issued grays, we would also emphasize that fiscal sustainability should be the major bedrock of policy going forward. To this end, improved tax compliance and better collections remain key in providing fiscal space and allowing development expenditures to take place.

In the Poverty Reduction Strategy, we are cognizant of the fact that there are a lot of difficulties going forward, including related to absorptive capacity and weak institutions. Perhaps the kind of emphasis that the Afghan authorities are now putting on these sectors, including on capacity-building, is the right way to go.

Unfortunately, we do not see any clear-cut strategy for weaning Afghani farmers off the cultivation of opium poppy or replacing this with other more productive forms of farm output. If there is a single weakness in the Joint Paper, which is excellent, it is that the opium problem has not been dealt with the kind of rigor it deserves. Nonetheless, this is a difficult task, and the Joint Paper by the World Bank and the IMF is a first rate paper.

We trust that the authorities will have enough guidance in the set of papers to go forward. We wish the authorities all the best.

Mr. Fayolle thanked the staffs of the Fund and the World Bank, and Mr. Elhage in particular, for being able to meet the deadlines for a very tight schedule to have a Joint Staff Advisory Note on such a complicated case. It was extremely important for the success of the Donor's Conference next week that the PRSP and JSAN were completed. The framework of the relationship between Afghanistan and the Fund in terms of the PRGF-supported arrangement was going to be an important

issue for the weeks ahead. What was the status of the prior actions which were required to be completed by the time of the next review?

The staff representative from the Middle East and Central Asia Department (Mr. Elhage), in response to questions and comments from Directors, made the following statement:

I will start with the questions that fall within the Fund mandate, then I will say a few words on the questions related to areas that are covered by the World Bank. As Directors know, the World Bank Board discussion will be held tomorrow.

I will start with the question on whether staff envisaged modifying the macro framework underlying the PRGF-supported program and the program more generally in light of the finalization of the ANDS. The macroeconomic framework underlying the PRGF arrangement is updated on a regular basis to reflect the latest economic developments, new information, and to incorporate new policies. A revised framework will be presented later this month in the context of the fourth review of the PRGF arrangement.

However, given staff's concern about the absorptive capacity, the macro framework underlying the PRGF-supported framework does not reflect fully the envisaged scaling up of expenditures in the ANDS. It only reflects the potential amount of donor assistance based on donor financial reviews conducted by the Ministry of Finance staff and the Fund staff's assumptions, which reflects discussions we had with donors.

Regarding the PRGF-supported program more generally, it should be noted that the arrangement will expire in March 2009 and that this year's budget, which covers the remainder of the program, has already been approved. This means that any scaling up of expenditure will be done during the last four years of the implementation of the ANDS. Therefore, we do not see scope for major modification of the current arrangement at this point.

Regarding Mr. Fayolle's question on the prior actions, we were in Kabul and returned from there in early May with an understanding and agreement on the prior actions. The three prior actions are in the revenue area. Two of the prior actions have to do with custom reform and collection of taxes on petroleum products. We are in discussions

with the authorities on this issue. We are still waiting for confirmation of the implementation of the prior action. We are in contact with the authorities on this issue and we are urging them to implement them before the Paris Conference.

We were asked to elaborate on the projected donor assistance incorporated under the ANDS. Based on historical rates of expenditure execution, it is our assessment that the \$50 billion in projected spending during the next five years currently exceeds Afghanistan's implementation and absorptive capacities. In addition, long preparation periods for sizable infrastructure projects imply that any increase in actual spending will take time and will require lengthy preparations. The weak infrastructure and lack of skilled domestic labor could also lead to delays in project completion and upward pressures on wages. There is already significant pressure on wages in Afghanistan. Since the beginning of this year, we see that consumer price inflation has picked up significantly.

However, our assessment of absorptive and implementation capacities could change if structural reforms and reform in the areas of public financial management and procurement system, as well as the budgetary process, are implemented at a faster pace in the period ahead than has been observed in recent years.

What does our assessment mean in actual figures? On average, if we look at actual expenditure, excluding security during the last two years, it was about \$4.1 billion. We are assuming in the macro framework underlying the PRGF-supported program that this amount will increase gradually to \$5.5 billion at the end of five years. The average annual rate will be about \$5.2 billion. An important assumption underlying this number is that more spending will be shifted from the external budget, which is financed and implemented by donors, to the central government budget. This is in line with the authorities' position that they can implement projects more cheaply if spending is shifted from the external budget to the central government budget.

If we use the \$50 billion quoted in the ANDS, the annual average security expenditure will increase to \$7.2 billion compared to \$4.1 billion in the last two years. We are talking roughly at about an increase of 75 percent. Clearly, this rate of increase will be difficult to

achieve, given the absorption constraints, and will have, in our view, implications on macroeconomic stability.

There was a question regarding the prospects for Afghanistan joining the Extractive Industries Transparency Initiative. The World Bank discussed this initiative with senior officials at the Ministry of Finance in 2006 and were informed that the government is willing to move ahead toward its adoption. Since then, there has been little opportunity to pursue the agenda further, and very little motivation to do so given the insignificant level of mineral development activity and negligible revenue flows from the sector until recently.

In November 2007, Afghanistan tendered the right for exploration of the first large-scale copper mine, which is considered to be the world's second largest untapped copper deposit with estimated reserves of up to 13 million tons. It is definitely time to put the Extractive Industries Transparency Initiative back on the agenda. The World Bank is planning to start discussions with the government on the next steps toward adoption of the Initiative during a mission scheduled for this month.

There was a question regarding the update of the 2005 Public Expenditure and Financial Accountability exercise. Recently, the World Bank updated the Public Expenditure Accountability exercise assessment. The report was published in March 2008 and shows some improvement across a broad range of number of indicators. However, these improvements are not yet in line with the challenge, especially in areas covered by the HIPC completion point conditionality, such as aligning budget and poverty reduction priorities and tracking expenditure progress against them.

There was a question on whether the goals set for the agricultural sector, especially related to food security, are achievable, and to what extent Afghanistan will remain vulnerable to food price shocks. The primary food grain consumed in Afghanistan is wheat. In normal years, Afghanistan is about 75 percent self-sufficient in wheat and imports around a quarter of its total consumption requirements. The country is reliant mainly on Pakistan for about 60 percent of its food imports. As a result of these factors, and keeping in mind that it is a very poor country where wheat constitutes a very large share of the consumption basket, in the short run Afghanistan is and will continue to remain vulnerable to food price shocks, whether they emanate from

global price developments or from neighboring countries' imposition of restrictions on wheat or flour exports to Afghanistan, as has occurred recently. However, there is scope to substantially increase domestic wheat production primarily through increased yields, and the Ministry of Agriculture and international partners are developing programs to achieving such an increase in food supply over the medium term.

Mr. Mojarad made the following concluding statement:

I would like to thank Executive Directors for their very helpful and constructive comments, which I will faithfully convey to my authorities. I also thank the staffs of the IMF and the World Bank for their thorough assessment of the ANDS, and would like to express my authorities' appreciation of the excellent work done by Mr. Elhage and his team. They are also grateful to Fund management for the time and energy devoted to supporting their efforts under the PRGF-supported program.

Mr. Elhage has addressed a number of questions and issues raised in Directors' grays, and I will not go over them. I would simply make a few brief comments and clarifications on cross-cutting issues that have emerged from the discussion.

We are pleased to note the recognition by Executive Directors that the authorities have put together an overall development vision that can anchor their Poverty Reduction Strategy and provide a medium-term framework for them and the international community to work together in partnership to achieve common objectives.

As noted by several Directors, the ANDS is comprehensive and touches on many sectors and issues which may give the impression that it lacks prioritization. The strategic priorities are clearly outlined in the ANDS and are designed to be mutually reinforcing. Economic developments and poverty reduction cannot take place in the absence of security, but also security depends on providing the most deprived regions and segments of the population with adequate and lawful means of livelihood.

Development of infrastructure, energy, and agriculture are rightly identified as the sectors with the highest potential impact on economic developments and poverty reduction in Afghanistan. This

does not mean that ANDS cannot be changed and adapted to take into account the scarce resources and limited absorptive capacity. The authorities are willing to work with the staffs of the World Bank and the IMF to further translate their overall strategy into more disaggregated objectives and projects.

The preparation of the ANDS is an important first step in what the authorities consider to be work in progress. In this spirit, the authorities will carefully consider Executive Directors' comments and views, as well as the staff recommendations embodied in the JSAN.

Macroeconomic stability remains key to achieving the ANDS objectives, and the authorities are fully committed to working closely with the IMF staff to update their medium-term macroeconomic framework in light of the outcome of the Paris Conference, and monitor developments as progress is made in implementing the ANDS.

Mr. Chairman, absorptive capacity has been another recurring theme in our discussion and in the JSAN document. No one can deny that Afghanistan suffers from weaknesses in human and technical capacities to carry out an ambitious Development and Poverty Reduction Strategy. However, there are several ways to approach this issue.

One of them is to consider the limited capacity as a constraint, which would call for less ambitious targets. The second is to build into the strategy a more proactive approach that seeks to strengthen absorptive capacity as reforms and development programs are phased in.

The authorities favor the latter approach, and plan to step up implementation of wide-ranging reforms to strengthen their administrative and human resource capabilities. They also encourage donors to be more attentive to Afghanistan's needs in this area and to simplify and streamline their own procedures and processes.

Several groups have highlighted the need for steadfast progress in reducing corruption, which would enhance the effectiveness of aid and support the authorities' Poverty Reduction Strategy. This is well-recognized in the ANDS, which lays out a comprehensive strategy involving administrative reforms in reducing the incentives

for corruption, as well as action to strengthen accountability and reinforce the legal and judiciary systems. As is well-known in this area, implementation is the key determining factor, and the authorities are fully committed to making significant progress in this area.

Finally, Mr. Chairman, the authorities are grateful to the French authorities for the considerable efforts made in preparation of the Paris Conference for the Support of Afghanistan on June 12th. They look forward to this event to set the stage for more effective ways for the international community and Afghanistan to engage each other in a shared vision and shared responsibilities to help Afghanistan see through this difficult transition period. The authorities hope that their strong commitment to implementing the ANDS objectives can be matched by equally strong support by the international community.

The Acting Chair (Mr. Portugal) made the following summing up:

Executive Directors commended the Afghan authorities for their timely completion of the Afghanistan National Development Strategy (ANDS) through an extensive and broad-based consultation process that will build full national ownership of the strategy. Directors considered the ANDS to be a comprehensive and ambitious framework for tackling Afghanistan's immense development and macroeconomic challenges. Successful implementation of the ANDS will require a proactive communication and outreach strategy domestically, as well as the assistance of the international community at the Afghanistan Support Conference that will be held in Paris on June 12, 2008.

Directors noted that the substantial scaling-up of expenditure envisaged in the ANDS will require significant improvements in public financial management and fiscal transparency to ensure that resources are utilized efficiently. It will be important also to improve coordination of monetary and fiscal policies to avoid overheating of the economy and a loss of competitiveness. In addition, Directors called on the authorities to pursue domestic revenue efforts vigorously to ensure medium-term fiscal sustainability. Given the uncertainty surrounding the overall resource envelope and Afghanistan's limited absorptive capacity that constrain public spending, Directors encouraged the authorities to carefully prioritize sectoral spending programs based on growth and poverty impact assessments.

Directors welcomed the ANDS' emphasis on private sector-led economic growth and employment generation. They supported the priority given to policies and reforms to achieve macroeconomic stability and improve the business climate—including maintaining an open trade regime, strengthening the legal framework, increasing access to land, improving infrastructure, and developing a sound and efficient financial system.

Directors stressed that successful implementation of the ANDS will require effective monitoring and evaluation of the outcomes of spending programs. In turn, this will require improving the monitoring and evaluation framework through streamlining the large number of indicators outlined in the strategy, expanding the coverage and reliability of the statistical base, and strengthening the government institutions charged with monitoring implementation of the strategy.

Directors emphasized that continued financial and technical assistance from Afghanistan's development partners will be essential for the success of the ANDS. In this light, they considered it important to improve the effectiveness of aid—most notably through greater harmonization of donor policies, better alignment of donor and country priorities, effective and transparent utilization of resources by the authorities, and development of Afghanistan's institutional capacity for absorbing aid.

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SHAIENDRA J. ANJARIA
Secretary