Afghanistan: an agenda for catalyzing inclusive growth

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Senior Officials’ Meeting Side Event:
State of the Afghan Economy

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Taking stock

Much progress but a challenging transition
Development outcomes have improved substantially since 2001…

- **GDP per capita**: from USD 120 to USD 608
- **Revenue**: from 3.3% of GDP to 11.2% of GDP
- **Life expectancy**: from 44 years to 61 years
- **School enrollment**: from 0.8 million to over 8 million
- **Under-5 mortality**: from 137 to 55 deaths per 1000 live births
- **Gender equality: women in parliament**: from 0 to 27%
- **Connectivity**: from none to 18 million mobile phone subscribers
- **Public financial management**: from none to stronger systems than other fragile states and many low-income countries
But the ongoing transition to self-reliance has been challenging... The economy experienced a huge shock to demand...

► With the withdrawal of international troops, the decline in aid levels and the deterioration in security adversely affected consumer and investor confidence and resulted in a sharp decline in domestic demand...
But the ongoing transition to self-reliance has been challenging...

...and economic growth declined significantly

- Average annual real GDP growth fell from 9.4% between 2003 and 2012 to 2.1% between 2013 and 2016
...and slower progress on development outcomes, with some past gains eroded

<table>
<thead>
<tr>
<th>Poverty</th>
<th>Services</th>
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<tbody>
<tr>
<td>Poverty increased from 36% in 2008 to 39% in 2014.</td>
<td>Primary attendance rates declined by 1.2% overall, and by 2.2% for girls.</td>
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<table>
<thead>
<tr>
<th>Employment</th>
<th>Gender</th>
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<tbody>
<tr>
<td>Unemployment and underemployment increased from 25% in 2008 to 39% in 2014.</td>
<td>The gender gap in school attendance increased. For every 2 boys, less than 1 girl attends secondary education. The number of new investment activities declined by almost 50% between 2012 and 2015.</td>
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<thead>
<tr>
<th>Violence</th>
<th>Private Investment</th>
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<tr>
<td>Annual civilian casualties increased from 6025 in 2012 to 6791 in 2014.</td>
<td>Flows of returning refugees increased, exacerbating population pressures. The number of internally displaced reached 1.2 million.</td>
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<th>Migration</th>
<th>Displacement</th>
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<tr>
<td>Afghans seeking asylum in the EU increased from 38,000 in 2014 to 180,000 in 2015.</td>
<td>Flows of returning refugees increased, exacerbating population pressures. The number of internally displaced reached 1.2 million.</td>
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Looking ahead: an agenda for inclusive growth
A lot to be done in the near term...but the results will take time
An agenda for inclusive growth
*A lot to be done now...but results will take time*

**Action is required now...**

- Achieving peace and security are essential for a prosperous future...but military action and a political agreement will not by themselves bring about a durable peace.

- Maintaining confidence in the ability of the state to deliver services will be critical for stability

- Enhancing state effectiveness through improving governance, reducing corruption and strengthening institutional (implementation) capacity

- Boosting growth in the short-run through measures to enhance aggregate demand

- Laying the foundations for realizing Afghanistan’s long-term growth potential through prioritized public investments and catalyzing private investments

**...but results will take time**

- Given financing constraints and the lag before returns to investment—both institutional and infrastructural—materialize, results will take time...

- ...and so patience and a sustained commitment will be required and expectations have to be calibrated
Boosting growth in the short-term
Fiscal space is limited but the right reforms can help
Boosting growth in the short-run

Afghanistan’s fiscal room to maneuver is limited...

► Fiscal space is limited given imperatives of security spending and costs of basic service delivery for a growing population...

► Aid covers almost 60 percent of Afghanistan’s on-budget civilian expenditures and 80 percent of on-budget development expenditures

► But with the right combination of fiscal and policy reforms, there is potential for a boost to growth even in the short-run
Boosting growth in the short-run…
…with the right combination of fiscal and policy reforms

1. improve budget execution
2. reorient budget expenditures towards labor-intensive and community-based programs that directly reach the population with the greatest needs and most likely, the highest marginal propensity to consume
3. increase and improve quality of spending for basic service delivery
4. promote private investment and strengthen confidence of business community by forcefully implementing reforms and measures to reduce risks and costs of doing business
5. identify and selectively promote opportunities for import substitution (without distorting prices) and exports
6. move from narrowly-focused revenue collection to broader revenue mobilization by expanding the tax base
7. ensure Brussels aid commitments are met and more aid is delivered on budget
Boosting growth in the short-run
...with the right combination of fiscal and policy reforms

Real GDP growth: historical and projected

Projected growth: baseline and the potential boost from the right combination of fiscal and policy reforms
Realizing Afghanistan’s long-term growth potential
Investments are critical but have to be prioritized
Realizing Afghanistan’s long-term growth potential

*Growth must achieve multiple objectives*

1. Growth has to be inclusive—must create jobs and reduce poverty…
   - to provide livelihoods for the poor and opportunities for the 400,000 young Afghans coming of working age every year

2. Growth has to help close the external financing gap
   - with aid declining, alternate sources of financing imports will be required—e.g., export earnings, FDI or remittances

3. Growth has to generate revenues to enhance fiscal self-reliance
   - aid currently finances 60 percent of the government budget
Realizing Afghanistan’s long-term growth potential…

...will require significant investment

► Afghanistan has substantial growth potential, particularly in agriculture and extractives…
  ► …and realizing this potential could deliver average annual growth of 6.5 percent over 2017-2030

► …and cities, if well-managed, can become growth poles

► …but public investment requirements are significant
  ► up to USD 2.6 billion per year through 2030

► …a robust budget and PIM-PPP prioritization process will be critical
Realizing Afghanistan’s long-term growth potential…
…and investment options need to be carefully prioritized

**AGRICULTURE & AGRIBUSINESS**
...to support income opportunities and job creation

- Growth
- Jobs & poverty reduction
- Revenue
- Balance of payments
- Risks
- Public investment

- Low risk and robust to changes in security
- Could contribute 1.4 percentage points to growth annually and produce 1.2 million jobs over the next 10 years
- Low revenue potential
- Good potential for import substitution

**HUMAN CAPITAL**
...to increase productivity and promote equity

- Growth
- Jobs & poverty reduction
- Revenue
- Balance of payments
- Risks
- Public investment

- Low risk and relatively robust to insecurity
- Strong focus on women empowerment and youth (skills and employment)
- Opportunities for managed migration
- Investment in adult literacy could significantly improve productivity in agriculture
Realizing Afghanistan’s long-term growth potential…
…and investment options need to be carefully prioritized

**EXTRACTIVES & ENERGY**
…to generate government revenues and foreign exchange earnings

- Growth
- Jobs & poverty reduction
- Revenue
- Balance of payments
- Risks
- Public investment

- High governance risks but very attractive for private investment
- Large growth impact: could add 1.6 percentage points to GDP growth
- Modest job impact: 100,000-125,000 jobs but could catalyze more.
- High fiscal revenue potential: 3 percent of GDP annually through 2030

**REGIONAL CONNECTIVITY**
…to maximize economic opportunities

- Growth
- Jobs & poverty reduction
- Revenue
- Balance of payments
- Risks
- Public investment

- High economic risks due to strategic interdependencies
- Large financing needs and potentially high but uncertain returns
- Revenue potential of transit trade: USD260 million annually but slow to materialize
Afghanistan: an agenda for catalyzing inclusive growth
...for government and international partners

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<th>REALIZING THE POTENTIAL FOR LONG-TERM GROWTH</th>
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<td>► improve budget execution</td>
<td>► Investments—in institutions and in high-</td>
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<td>► reorient budget expenditures</td>
<td>potential areas—will be critical</td>
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<td>towards labor-intensive and</td>
<td>► Agriculture and agri-business, human</td>
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<td>community-based programs that</td>
<td>capital, extractives and regional</td>
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<td>directly reach the population</td>
<td>connectivity offer the greatest promise</td>
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<td>with the greatest needs and</td>
<td>► But public investments—particularly for</td>
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<td>most likely, the highest</td>
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<td>marginal propensity to consume</td>
<td>have to be clearly prioritized and carefully</td>
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<td>► increase and improve</td>
<td>selected</td>
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<td>quality of spending for basic</td>
<td>► And given financing constraints, crowding-</td>
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<td>service delivery</td>
<td>in private capital—through reforms, PPP’s</td>
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<td>► promote private investment</td>
<td>and innovative financial solutions—will be</td>
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<td>and strengthen confidence of</td>
<td>tremendously important</td>
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<td>business community by</td>
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<td>forcefully implementing reforms</td>
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<td>and measures to reduce risks</td>
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<td>import substitution and exports</td>
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<td>(without distorting prices)</td>
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<td>► move from narrowly-focused</td>
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<td>► Maintain, and ideally, increase on-budget financing</td>
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<td>► Align off-budget and on-budget financing to respond</td>
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<td>to shared priorities</td>
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<td>► Strengthen institutional (planning, coordination</td>
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<td>and implementation) capacity within government</td>
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<td>► Implement anti-corruption strategy and strengthen</td>
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<td>civil service reforms</td>
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<td>► Strengthen national and sub-national governance</td>
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<td>structures</td>
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