Public Disclosure Authorized

Report Number : ICRR0020413

1. Project Data

Operation ID	Operation Name
P118027	AF: Development Policy Prog. Series
Country	**Practice Area(Lead)**
Afghanistan	Macro Economics & Fiscal Management

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
IDA-H8740	15-Jun-2015	50,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
07-Aug-2013	15-Jun-2015	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	50,000,000.00	0.00
Revised Commitment	50,000,000.00	0.00
Actual	51,197,751.00	0.00

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2. Project Objectives and Policy Areas

a. Objectives

This was initially a programmatic series of two single-tranche development policy operations (DPOs). In the wake of security deterioration following the 2014 elections, the second operation was cancelled, and this review assesses the performance of the first operation.
The objective of this operation is "to support policy reforms in selected areas critical to strengthening revenue mobilization and improving the enabling environment for investment in sectors with a high growth potential" [Program Document, (PD), p.20].

This review assesses this operation using the following sub-objectives: (i) Strengthening revenue mobilization,

and (ii) Improving the enabling environment for investment in sectors with a high growth potential [Program Document, (PD)], p.21-23.

b. Were the program objectives/key associated outcome targets revised during implementation of the series?

No

c. Pillars/Policy Areas

There were two policy areas:

Policy Area I: Strengthening revenue mobilization

The operation intended to support the mobilization of additional revenue, and generate resources necessary to fund sustained public service delivery, through the reduction of existing leakages and opportunities for rent-seeking. The focus was exclusively on the Customs Administration. One prior action was completed in support of the Customs Department before the approval of the first operation; two further prior actions were scheduled to be completed before the follow-on operation to enhance Customs efficiency; one was completed, and the other partially implemented.

Policy Area II: Improving the enabling environment for investment in sectors with high growth potential

Under this policy area, the operation was to support the Government in building a strong foundation for growth through the provision of an appropriate set of incentives targeting four sub-sectors:

- **Mining:** One prior action was completed before the DPO's approval, but a trigger action for the follow-on operation could not be completed.
- **Information and Communication Technology:** Two prior actions were completed before the approval of the first DPO, but another trigger action for a successor operation has not been completed.
- **Land Management and Land Acquisition:** Two prior actions were implemented before the operation's approval. Two other policy actions were to be completed before the approval of a follow-on operation, but when the operation closed, only the first action had been completed.
- **Infrastructure Sharing:** Three prior actions were completed before the operation's approval.

d. Comments on Program Cost, Financing, and Dates

The Development Policy Grant (DPG) was approved on July 08, 2013 in the amount of US$50.0 million, became effective on September 26, 2013, and closed on schedule on June 15, 2015. The disbursed amount reached US$51.2 million equivalent, due to appreciation of the SDR against the US dollar.

3. Relevance of Objectives & Design

a. Relevance of Objectives

The reform program supported by the operation was part of the "Strategic Vision for the Transformation Decade" adopted in 2012 by the Government of Afghanistan, which called, among other things, for a sustainable economy underpinned by good governance and significant investment. The operation was also aligned with several of the Government's priority programs developed in the 2008 Afghanistan National Development Strategy, which emphasized financial sustainability through revenue streams, creation of an enabling environment for private investment, and reforming institutions for effective governance.

The reform program was also consistent with the Bank's 2012-2014 Interim Strategy Note (ISN), the latest Bank strategy document for Afghanistan, which focused on activities under three pillars, to all of which the policy reforms supported by the program were relevant. For instance, the reforms related to improving customs revenues relate to the first (building the legitimacy and capacity of institutions), and second pillars (equitable service delivery). In particular, the objective of strengthening revenue mobilization was highly relevant to Afghanistan's development challenges, given the decline in external assistance and the drawdown of the international security presence that increased uncertainty and strengthened incentives for corruption for elites struggling for position within an uncertain political environment. Reversing recent revenue decline was appropriately identified by the Bank team as a crucial priority. Similarly, improving the environment for investment has recently become a priority for Afghanistan.

Rating
High

b. Relevance of Design

The objectives of the DPO were clear, and there was a logical causal chain among the policy areas, the objectives, the prior actions and the indicative triggers. For instance, to improve fiscal sustainability, the reform agenda targeted four sectors (customs, mineral sector, ICT, and land) with a large revenue generating potential provided transparency and governance issues were addressed. Similarly, minerals and ICT are two key sectors that could both attract foreign investment and be strong drivers of economic growth. Targeting the Customs Administration was appropriate since the prospects for equivalent gains in other tax revenues were limited. Moreover, corruption was perceived as the primary driver for declines in Customs revenue, and it was considered that this trend could be reversed with appropriate policy measures.

Design, however, had two shortcomings: (i) it was skewed towards revenue collection at the expense of the expenditure side of public finance management, and (ii) it was overly ambitious. While the weakness of technical capacity in Government was recognized, the operation did not support reforms to upgrade expertise and systems for public expenditure management. Most importantly, the program design did not take sufficient account of the fragile and conflictual country context. The aim of making a substantive and simultaneous impact in the Customs Administration, business environment, mining, telecommunications, land management, and infrastructure sectors was unrealistic.

Afghanistan's macroeconomic situation was broadly satisfactory at the time of program preparation. Following large scale debt relief, external public debt was modest (6.1 percent of GDP at the end of 2013), although large expenditure needs and limited domestic revenue capacity meant a high dependency on donor financing. Debt was considered sustainable, but significant vulnerabilities included a slowing down of growth, a stalling in the reform program, deteriorating security, and a fall in grant financing below expected levels. The macroeconomic policy mix was considered appropriate (see IMF: 2014 Article IV Consultations), with fiscal policy supporting demand (financed by grants) and monetary policy focusing on inflation. This was predicated on donor flows continuing to finance the fiscal and external deficits: The key challenge was, and remains, managing the transition from aid dependency towards a more self-sustaining economy.

Rating
Modest

4. Achievement of Objectives (Efficacy)

Objective 1

Objective
Objective 1: Strengthening revenue mobilization

Rationale
Total Customs duties reached US$495 million by mid-2015, or 93% of the target of US$530 million at end-2015. The ratio of Customs duty revenues as a share of GDP increased marginally from 2.5 percent in 2013 to 2.6 percent in 2015, reversing the previous downward trend. Similarly, Customs revenues as a percentage of import values increased substantially, from around 3.9 percent in 2012 to 6.3 percent in 2015, but this trend is largely explained by the fall in imports following the withdrawal of international security forces and a substantial slowing of economic growth. Despite increased Customs revenue, total domestic revenues fell from 10.3 percent of GDP in 2012 to 9.7 percent in 2013, and again to 8.7 percent in 2014 due to insecurity and economic slowdown. Delays in implementing the broader structural reforms within the Customs administration that were triggers for the cancelled follow-on operation were among the reasons for the smaller-than-expected increase in customs revenue.

The detection of Customs non-compliance significantly improved (from 1 percent to 7 percent of total examinations), but fell below the target of 8 percent. The improvement was due to the roll-out of a computerized risk-based approach to Customs examinations, a shift from universal inspection to risk-based inspection, both supported by the program. The roll-out of the computerized risk-based approach to the Customs House in Jalalabad was key to the broader roll-out of the risk-based approach which contributed significantly to the overall outcome.

Rating
Modest

Objective 2
Objective
Objective 2: Improving the enabling environment for investment in sectors with a high growth potential

Rationale
Mining: Only one out of the three planned tenders for large-scale mines was launched and completed. The key obstacle was the absence of an adequate security of tenure for potential investors, which was to have been supported by the second operation. With the cancellation of the latter, several mining tenders were rolled out and bids opened, but evaluations could not be completed.

Information and Communication Technology: Achievements were as follows: (i) the prices for wholesale bandwidth decreased from US$900/mbps per month in June 2012 to below US$80 by June 2015, and (ii) the number of subscribers to Global System for Mobile (GSM) broadband services increased from zero to one million over the same period. As of mid-2015, the wholesale bandwidth price had fallen further to US$70/mbps per month and there were nearly two million broadband subscribers. These results were due to the impact of licensing of new technologies, open access, and the creation of an even-playing field for competition in the sector, all supported by the program. The introduction of new technologies in the context of active competition between providers was pivotal in reducing costs and expanding access.

Land Management and Land Acquisition: Afghan Land Authority (ARAZI) revenue reached US$1.99 million in 2015, but was short of the US$3 million target. 62,600 hectares of land had been surveyed by mid-2015, exceeding the target of 45,000 hectares. The above achievements show that ARAZI partially improved the State land administration and surveying as a consequence of policy actions supported by the program. However, the revision of the Land Management Law – an important element of the program -- had not been approved by the Cabinet by closure, due to political opposition.

Infrastructure Sharing: Only one shared passive infrastructure project out of a planned three had been implemented by closure, partly due to the slowing in the pipeline of infrastructure investment projects following the political disruptions of 2014. The case that was implemented involved the laying of communication ducts as part of the Salang-By-pass Road Project. No information is provided in the ICR concerning the amount of the investment.

Rating
Modest

5. Outcome

The relevance of objectives was high, and that of design modest. Despite some progress in modernizing Customs revenue collection and important achievements in telecommunications, efficacy was modest for both objectives, due in large measure to declining regional security, political uncertainty, and deteriorating domestic security.

a. Outcome Rating

Moderately Unsatisfactory

6. Rationale for Risk to Development Outcome Rating

Risk to development outcome achieved under this operation is rated as high because of ongoing elevated security and political risks, macroeconomic vulnerabilities and capacity constraints.

Political and security risks: The context of power-sharing arrangements in the country among key political players and constituencies is unstable, and the administration of the Government is difficult. The unity of action and coordination within the Government needed to shepherd difficult reforms are lacking, and the risk of reform reversal is high given existing political strife. Due to insecurity, parts of the country are not effectively governed by public servants and institutions. The security situation increases fiscal pressures, undermines investor confidence, and weakens the prospects of economic expansion.

Macroeconomic vulnerabilities, and capacity constrains: Afghanistan is an isolated country with limited trade and financial linkages with the global economy, and is strongly dependent on external aid. The country will not be able to pursue growth-generating activities and fiscal sustainability if external aid is curtailed. Moreover, weak technical capacity in key public administration departments undermines the sustainability of reforms.

a. Risk to Development Outcome Rating

High

7. Assessment of Bank Performance

a. Quality-at-Entry

The Bank's diagnostic and preparatory work before the operation approval was comprehensive. Prior actions and triggers reflected the conditions on the ground, and were drawn from the Bank's ongoing operations and the coordination with Government and the donor community. The operation targeted critical stumbling-blocks to development and clearly identified the associated risks. The operation coincided with the withdrawal of international security forces that threatened fiscal sustainability and the pursuit of economic growth. While the sectors identified for reforms were carefully chosen, many of the reforms to be supported were politically difficult to implement, because of strong vested interests. Associated risks were, however, clearly flagged, and appropriate mitigation actions strategies envisioned. Capacity constraints were well recognized and were to be addressed through technical assistance provided in parallel by the Bank and other donor partners. Implementation and M&E arrangements were, in general, adequate as detailed in Sections 8 and 9 below.

However, there were moderate shortcomings in Quality at Entry. The approved reform agenda was over-ambitious, and took insufficient account of the difficult country context. Aiming for a substantive and simultaneous impact in the customs, business environment, mining, telecommunications, land management, and infrastructure sectors of a fragile and post-conflict country was unrealistic.

Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

A multi-sector Bank team was present in the country at approval. It tracked progress with reforms and engaged in high-level policy dialogue with the Government and other external partners. When security worsened following contentious elections, part of the Bank staff was relocated from Kabul to Dubai and supervision intensity was reduced, but supervision missions continued to take place (albeit on a less regular basis),

Political factors (see Section 8a below) that stalled the reform progress were flagged. Unable to proceed with the second DPO, the Bank opted to play a stronger role in shaping the program supported by the Afghanistan Reconstruction Trust Fund (ARTF) Incentive Program. The decision to cancel the second operation reflected both underperformance against triggers, but also the Government's preference to streamline policy-based support through a single mechanism based on the alignment between the objectives

of the Incentive Program and the DPG series. The cancellation represented a pragmatic response to country circumstances not conducive for the success of a DPO, which allowed the pursuit of a more flexible reform program supported by the ARTF. Because of the relocation of staff, and as supervision missions became irregular, the findings and recommendations of the supervision missions were not systematically recorded through Aide-memoires and Implementation Status Reports.

Quality of Supervision Rating
Moderately Satisfactory

Overall Bank Performance Rating
Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance
The Government showed commitment to most policy reforms supported by the operation until the 2014 election period. Thereafter, commitment was undermined by the formation of the National Unity Government. The disputed elections provoked uncertainty and delays, due to the incapacity of the Government to make decisions and fill key administrative positions in accommodating diverging interests of the executive office. A lack of coordination within Government, the exacerbation of vested interests among policy-makers, institutional weaknesses and capacity shortages further slowed down the pace of reform. Despite the disruptions caused by the post-election political crisis, Government's commitment to most policy reforms (land reform, tax and customs administration, ICT policy) was maintained, with the exception of the mining sector, which partly suffered from weaknesses in the Ministry of Mines arising from the difficulties of the political transition.

Government Performance Rating
Moderately Unsatisfactory

b. Implementing Agency Performance
Government as a whole was the implementing agency and there is therefore no separate assessment.

Implementing Agency Performance Rating
Not Rated

Overall Borrower Performance Rating

Moderately Unsatisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

Outcome indicators for the various policy actions were identified at appraisal, with a policy matrix linking the prior actions, the expected outputs and outcomes, and the program development objectives. While most indicators were well selected, some of them were output-oriented. For instance, one indicator to gauge progress in land management was the number of hectares of land surveyed, and an indicator to assess progress in infrastructure sharing was the number of projects with shared passive infrastructure, thereby giving no perspective on their economic importance. Some targets, notably those related to mining, were over-ambitious, while others were weakly aligned with the outcome being pursued, for example, the increase in ARAZI revenue as an indicator of better land management.
M&E implementation was to be overseen by the Deputy Minister of Finance, while on the Bank side, the work was handled by the Bank's cross-sectoral team, supported by input and advice from sector experts.

b. M&E Implementation

Oversight of the program benefitted from the parallel ARTF-Incentive Program, for which a formal monitoring and coordination mechanism had been established, bringing together relevant development partners and government agencies. However, for the operation under review, neither ISRs nor Aide memoires were prepared or filed, reflecting the security-related difficulties faced by the Bank team in supervising implementation.

c. M&E Utilization

The ICR did not report on M&E utilization.

M&E Quality Rating

Modest

10. Other Issues

a. Environmental and Social Effects

The ICR does not report on environmental and social effects.

b. Fiduciary Compliance

The ICR does not report on the fiduciary issues. However, additional information provided by the Bank team indicates that financial resources of the general government sector are tracked and reported within a budget which is processed in a manner conducive to aggregate fiscal discipline.

c. Unintended impacts (Positive or Negative)

None reported

d. Other

None reported

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Unsatisfactory	Moderately Unsatisfactory	---
Risk to Development Outcome	High	High	---
Bank Performance	Satisfactory	Moderately Satisfactory	There were moderate shortcomings including an over-ambitious program that did not take sufficient account of the country context.
Borrower Performance	Moderately Satisfactory	Moderately Unsatisfactory	Commitment to reform waned with the advent of the new Government following disputed elections in 2014.
Quality of ICR		Substantial	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

IEG draws two lessons from the experience of this operation:
(i) For difficult reforms in a fragile context to be fruitful, they would need to be measured and balanced. In this case, the operation attempted to address too broad a spectrum, covering a variety of sectors.
(ii) Unless full account is taken of the political context, including the possible impact of upcoming elections, there is a danger of the program being disrupted by lack of continuity. Incorporating more flexibility in the design and the implementation of the DPL instrument might increase its adaptability to fragile and post-conflict contexts.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR is candid. Its analysis is well-focused on the results framework. The assessment of results achievement is thorough and convincing. The lessons and findings are relevant and are derived from the experience of preparing and implementing the operation. However, there are some shortcomings: (i) the ratings are inconsistent – both Bank and Borrower Performance are rated above-the-line while outcome is rated below-the-line; (ii) the ICR could have stated more clearly that the proposed reform agenda was over-ambitious given the prevailing pre-electoral context; (iii) the attribution of the results was insufficiently discussed, given the significant inputs from the Incentive Program and other external partners, (iv) a better coverage of M&E implementation could have shed more light on supervision issues, and (v) given the weaknesses of the internal and external controls of the PFM system described in the PAD, an overview of fiduciary issues and their possible impact on the program would have been helpful.

a. Quality of ICR Rating

Substantial