



# Report and Recommendation of the President to the Board of Directors

Project Number: 37393  
November 2006

## Proposed Asian Development Fund Grants Islamic Republic of Afghanistan: Private Sector and Financial Market Development Program

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 20 November 2006)

Currency Unit	–	afghani/s (AF)
AF1.00	=	\$0.02
\$1.00	=	AF49.58

## ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
AISA	–	Afghanistan Investment Support Agency
DAB	–	Da Afghanistan Bank
GDP	–	gross domestic product
I-ANDS	–	Interim Afghanistan National Development Strategy
MOC	–	Ministry of Commerce
MOF	–	Ministry of Finance
MOJ	–	Ministry of Justice
PFM	–	public financial management
SOE	–	state-owned enterprise
TA	–	technical assistance

## NOTES

- (i) The fiscal year (FY) of the Government ends on 20 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2006 ends on 20 March 2006.
- (ii) In this report, "\$" refers to US dollars.

<b>Vice President</b>	L. Jin, Operations Group 1
<b>Director General</b>	J. Miranda, Central and West Asia Department (CWRD)
<b>Director</b>	N. Siackhachanh, Governance, Finance, and Trade Division (CWRD)
<b>Team leader</b>	S. Shrestha, Economist, CWRD
<b>Team members</b>	E. Canzio, Counsel, Office of the General Counsel
	E. Glennie, Senior Financial Governance Specialist, CWRD
	L. Raquipiso, Economic Officer, CWRD
	M. R. Fazil, Economics Officer, Afghanistan Resident Mission, CWRD

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## GRANTS AND PROGRAM SUMMARY

<b>Recipient</b>	Islamic Republic of Afghanistan
<b>Proposal</b>	Support to the Government of Afghanistan for the Private Sector and Financial Market Development Program (the Program) through (i) a program grant of \$56 million from the Asian Development Bank's (ADB's) Asian Development Fund (ADF), and (ii) a capacity-building grant of \$4 million for Supporting Private Sector and Financial Market Reforms from ADF.
<b>Classification</b>	Targeting classification: General intervention Sector: Finance Subsector: Finance sector development Themes: Governance, private sector development, capacity development Subthemes: Financial and economic governance, policy/institutional/legal/regulatory reforms, institutional development
<b>Environment Assessment</b>	Category C. The environmental implications were reviewed and no adverse impact was identified.
<b>Social Safeguard Assessment</b>	Involuntary resettlement: Category C Impact on indigenous people: Category C No involuntary resettlement or impact on indigenous people is expected from program implementation.
<b>Rationale</b>	<p>Afghanistan has made significant progress in achieving macroeconomic stability since the appointment of the post-Taliban administration in 2002. Gross domestic product (GDP) grew rapidly, averaging 17% during the past 4 years. Post-conflict reconstruction has supported growth in the construction, trade, transport, and communications sectors. Since the successful currency conversion in early 2003, prices and the exchange rate have remained broadly stable, reflecting widespread acceptance of the new currency and prudent macroeconomic policies.</p> <p>Despite strong economic recovery and progress made with structural reforms, the remaining challenges are enormous. Afghanistan is one of the poorest countries in the world, with a GDP per capita of \$300, and weak social indicators. Sustainable economic growth and poverty reduction will require a shift from reconstruction-driven recovery to private sector-led growth. A thriving private sector is also essential for providing alternative livelihood in the rural areas, and thereby to supporting Government efforts to eliminate the narcotics economy. Expanding the private sector will entail, inter alia, the Government's disengaging from commercial activities, strengthening the investment climate, improving private enterprises' access to credit, and developing human capital.</p> <p>The Interim Afghanistan National Development Strategy (I-ANDS) embodies the Government's development objectives for 2006–2010. Private sector development is one of the key outcomes envisioned in the I-ANDS. To this end, the I-ANDS includes programs to strengthen the investment climate, promote international trade, and develop the financial sector.</p>

The initial country strategy and program (CSP, 2002) emphasizes that Afghanistan's long-term economic development hinges on the growth of a dynamic private sector. The initial CSP identifies the weaknesses in the policy and regulatory framework and underdevelopment of the financial sector as key constraints on private sector development. The Program is included in ADB's *Country Strategy and Program Update (2006–2008): Afghanistan*.

<b>Impact and Outcome</b>	The Program aims to promote private sector-led growth by (i) strengthening the enabling environment for private sector development, (ii) disengaging the Government from business activity, and (iii) improving the private sector's access to financial services. The impact will be a more dynamic private sector and sound financial system supporting sustainable economic growth and job creation. The program outcomes will be larger contribution of the private sector to economic activity and improved financial intermediation. The program design builds on the Government's ongoing reform initiatives and complements other development partners' assistance.
<b>Program Grant Amount</b>	It is proposed that ADB support the Government's policy reforms by providing a grant of \$56 million to the Islamic Republic of Afghanistan. The grant will be from ADF.
<b>Program Period and Tranching</b>	The implementation period of the Program will be 3 years. It will be completed by 31 December 2009 and closed on 30 June 2010. The grant will be released in two tranches: the first (\$28 million) upon grant effectiveness, and the second (\$28 million) 24 months after Board approval, subject to the Government meeting the conditions specified for release.
<b>Executing Agency and Implementation Arrangements</b>	The Ministry of Finance (MOF) will be the Executing Agency for the grant. MOF, the Ministry of Commerce (MOC), and Da Afghanistan Bank (DAB) will be the implementing agencies. MOF will set up an interagency coordination committee headed by the deputy minister for finance and comprising representatives from MOF, MOC, the Ministry of Justice (MOJ), and DAB. The committee will meet every quarter to coordinate and ensure effective implementation of the proposed reforms. ADB will also be a member of the committee to oversee program progress.
<b>Procurement</b>	The grant proceeds will be used to finance the foreign exchange cost of items produced and procured in ADB member countries (other than the items specified in the list of ineligible items and imports financed by other bilateral and multilateral sources). The Government will certify that the volume of eligible imports exceeds the amount of ADB's projected disbursement under the grant for the given period. ADB reserves the right to audit the use of the grant proceeds and verify the accuracy of the Government's certification.
<b>Counterpart Funds</b>	The Government will ensure that the local currency funds generated by the grant will be used, first, to support the adjustment cost of reforms under the Program, and second, to finance expenditures for general development purposes.

<b>Capacity-Building Grant</b>	The objective of the capacity-building grant is to assist the Government implement the Program. Specifically, it will help the Government (i) strengthen the legal framework, (ii) remove market distortions, (iii) disengage the Government from commercial activities, (iv) strengthen financial intermediation, and (v) implement accounting and auditing standards. The grant will also develop and establish training programs in these areas to help sustain private sector and financial market development over the long term.
<b>Financing Plan</b>	A capacity-building grant of \$4 million will be provided from the ADF. The grant will be subject to conditions set forth in the grant agreement.
<b>Executing Agency and Implementation Arrangements</b>	MOF will be the Executing Agency for the grant. MOF, MOC, and DAB will be the implementing agencies. MOF will set up an interagency coordination committee headed by the deputy minister for finance, and comprising representatives from MOF, MOC, MOJ, and DAB. ADB will be a member of the committee to oversee implementation progress.
<b>Consulting Services</b>	Consultants will be recruited in accordance with ADB's <i>Guidelines on the Use of Consultants</i> . A total of 64 person-months of international and 132 person-months of national consultants will be required.
<b>Benefits and Beneficiaries</b>	<p>The Program will help develop the private sector through policy, legal, regulatory, and institutional reforms to improve the investment climate and to strengthen financial intermediation. A better investment climate will attract more domestic and foreign investments to create jobs. The entry of new businesses will reinforce competition and result in more efficient provision of goods and services.</p> <p>The development of the financial sector will further boost private sector activity and create jobs. Private enterprises and households will have access to more financial resources as financial institutions are able to mobilize savings for productive investment. Improved financial intermediation will reduce the borrowing costs incurred by private enterprises and households.</p> <p>Private sector development also brings about fiscal benefits. Increased private sector output will reduce the need for the Government to provide the fiscal impetus for growth. In addition, increased private sector activities will generate higher tax revenues, further creating fiscal space for expenditures to provide social services for the poor.</p> <p>Specific benefits are as follows:</p> <ul style="list-style-type: none"> <li>(i) By supporting the adoption of a commercial arbitration law, the Program will provide a recourse for settling disputes and help reduce the uncertainty and risks faced by business. Policy and legal measures to establish land ownership will help improve access to credit by providing assets that can be used as collateral.</li> </ul>

- (ii) By helping remove the distortions caused by price controls, the Program will allow prices to adjust to market conditions and encourage business activity. This reform, coupled with measures to streamline business registration and permit procedures, will deter rent seeking associated with evading price controls and securing business permits. These measures will also enhance market competition, thereby lowering the prices and improving the quality of goods and services.
- (iii) By helping liquidate inefficient state-owned enterprises (SOEs), the Program will reduce state presence in areas where the private sector can be more efficient. SOE liquidation will also facilitate the transfer of land to the private sector for productive use, including as collateral for borrowing.
- (iv) By strengthening financial sector regulation and oversight, the Program will enhance depositor protection and reduce systemic risk. This will, in turn, facilitate savings mobilization and enable financial institutions to expand their outreach.
- (v) By helping adopt accounting and auditing standards, the Program will enhance transparency and disclosure of private enterprises' financial conditions, thereby improving their access to financial services.

## **Risks and Assumptions**

Security concerns pose a key external risk to the Program. A worsening security situation could hamper reforms as the Government would have to focus its resources on security. Deteriorating security could also impede program progress as it would be more difficult to attract experts to Afghanistan to help the Government implement the Program.

Capacity constraints are the most significant internal risk to effective program implementation. For instance, weaknesses in the drafting of legislative proposals by the executive branch of the Government have delayed some key legal reforms. To ensure that the legal reforms called for under the Program meet the program objectives, the attached capacity-building grant will help the Government draft the legislation and related regulations in line with international standards, taking into account country-specific circumstances. The grant will also develop comprehensive training programs for bank supervisors and for banking, accounting, and auditing professionals to build capacity in these areas.

Vested interest groups could resist certain reforms. To minimize this risk, the grant will facilitate training, consultations, and public awareness campaigns needed to build consensus and solicit stakeholder buy-in.

Given the significant donor presence in Afghanistan, assistance might be duplicated and ineffective. The Program was prepared in close consultation with Afghanistan's development partners involved in private sector development and financial reforms. Continued coordination during program implementation will be required to avoid overlap and to maximize synergies.

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed program grant to the Islamic Republic of Afghanistan for the Private Sector and Financial Market Development Program (the Program), and (ii) a proposed capacity-building grant for Supporting Private Sector and Financial Market Reforms.

## II. THE MACROECONOMIC CONTEXT

2. Afghanistan has made significant progress in achieving macroeconomic stability since the appointment of the post-Taliban administration in 2002. Gross domestic product (GDP) grew rapidly, averaging 17% during the past 4 years. Post-conflict reconstruction efforts have continued to support growth, particularly in the construction, trade, transport, and telecommunications sectors. Since the successful currency conversion in early 2003, prices and the exchange rate have remained broadly stable,<sup>1</sup> reflecting widespread acceptance of the new currency and prudent monetary policies. Fiscal policy has likewise been prudent, with government spending kept within budget ceilings.

3. The share of agriculture (excluding opium production) in GDP fell from 49% in 2003 to 38% in 2005 while the shares of industry have increased from 20% to 24% and of services from 30% to 36%.<sup>2</sup> While agriculture remains largely subsistence-oriented, farmers are increasingly producing cash crops for sale in local markets. Agriculture accounts for close to 70% of total employment. Industry is mainly construction and small-scale agricultural processing and manufacturing. Trade, transport, and telecommunications comprise about 70% of the service sector. It is estimated that 80–90% of all economic activity is in the informal sector.

4. Medium-term growth prospects remain favorable, albeit more moderate than in recent years. GDP growth is expected to slow to 12% in 2007 largely due to the ongoing drought.<sup>3</sup> Telecommunications, transport, and trade are expected to continue to expand at a strong pace. While construction is likely to continue, its pace will be slower than in recent years.

5. Despite strong economic recovery and progress made with structural reforms, the remaining challenges are enormous. Afghanistan is one of the poorest countries in the world, with a GDP per capita of \$300 and weak social indicators. To ensure sustainable economic growth and poverty reduction, Afghanistan will have to shift from reconstruction-driven recovery to private sector-led growth. A thriving private sector is also essential for providing alternative livelihood in the rural areas, thereby helping the Government eradicate the opium economy, which has grown to record levels in recent years. Expanding the private sector will entail, inter alia, the Government's disengaging from commercial activities, creating an enabling environment through legal and regulatory reforms, and improving private enterprises' access to financial services.

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<sup>1</sup> The inflation rate declined from 52% in 2003 to 15% in 2005. The currency has remained stable over the past 4 years, ranging from AF44 to AF50 per dollar.

<sup>2</sup> International Monetary Fund. 2006. *Country Report No. 06/114, Statistical Appendix*. Washington, DC (p. 75).

<sup>3</sup> ADB. 2006. *Asian Development Outlook Update*. Manila.

### III. THE SECTOR: PERFORMANCE, ISSUES AND OPPORTUNITIES

#### A. Sector Description and Performance<sup>4</sup>

##### 1. The Private Sector

6. Pre-conflict Afghanistan had a vibrant private sector, with a long tradition of entrepreneurship, engaged in the production of agricultural products, small-scale industrial activities, and trading.<sup>5</sup> However, more than two decades of conflict (1979–2001) as well as strong state intervention have caused the private sector to contract significantly. Most industries were nationalized during the 1980s. Traditional manufacturing industries such as carpet weaving moved to neighboring countries during the conflict, and many businesses were forced to close down by lack of inputs.

7. Afghanistan's total industrial production fell by 95% from 1979 to 2002. Private industrial output was hit harder. The share of private sector industrial production fell from 60% in 1979 to 21% in 2002, and recovered modestly in 2005, reaching 26%. Private sector activity is concentrated in construction and services. Construction is thriving as post-conflict reconstruction continues. In services, the trade and transport sectors dominate. Enterprises engaged in basic services such as shops, tailoring, and repair services are also prevalent. Private sector activity has increased in relatively new service sectors such as telecommunications and banking.

8. Manufacturing is rudimentary and most factories are concentrated in Kabul and some major cities like Herat and Mazar-i-Sharif.<sup>6</sup> Manufacturing is largely limited to traditional products and small-scale activities such as carpet weaving and dried fruit production. Only a handful of moderately large enterprises and a few medium-sized enterprises are in the non-agricultural private sector.<sup>7</sup> A large part of the non-agricultural private sector consists mainly of informal family-owned microenterprises engaged in trading and basic services such as shops, sewing, and repair services.

9. It is estimated that 80–90% of economic activity is in the informal sector because of political uncertainty and the lack of rule of law during the conflict, as well as inefficient business registration procedures and the tax regime. Entrepreneurs in the informal sector typically remain small, avoiding investments in productive assets or technology that would enable them to achieve economies of scale and undertake higher value-added activities. The Government has therefore recognized that the informal sector is unlikely to drive sustained growth over the long term. The Government has also acknowledged that the informal sector serves as a cover and breeding ground for illicit activities and provides opportunities for rent seeking,

10. Historically, there has been strong state presence in formal business activity. A substantial number of large enterprises are state-owned or under state control. The commercial activities of the 65 state-owned enterprises (SOEs) organized under the Law on State-Owned Enterprises (1960) range from public utilities, construction, manufacturing, agricultural services, warehousing, to advertising and printing. State presence in business is also manifested in shareholdings by the Government in 13 joint stock companies organized under the Commercial

<sup>4</sup> A detailed sector description is in Appendix 1.

<sup>5</sup> Bennett, A, Bruno de Schaetzen, Louis Dicks-Mireaux, Felix Fischer, Thierry Kalfon, and Ron van Rooden. 2005. *Reconstructing Afghanistan*. Washington, DC: International Monetary Fund.

<sup>6</sup> World Bank. 2005. *Afghanistan—State Building, Sustaining Growth, and Reducing Poverty*. Washington, DC (p. 72).

<sup>7</sup> World Bank. 2005. *The Investment Climate in Afghanistan*. Washington, DC (p. 7).

Code (1955). Four ministries<sup>8</sup> have ownership of these companies, which engage in a wide range of commercial activities such as airlines, telecommunications, hotels, textile manufacturing, trading, shipping, and warehousing. A number of ministries also directly or indirectly conduct commercial activities such as leasing, production and marketing of agricultural products, garment manufacture, operation of sports facilities, media, and cement and coal production.

11. To establish the policy framework for SOE divestiture, the Government adopted the Privatization Policy in 2005, reiterating its commitment to privatize enterprises and outlining the different privatization and liquidation modalities. The policy designates the Ministry of Finance (MOF) as responsible for SOE reforms and privatization. The Law on State-Owned Enterprises (1960) was amended in 2005 to allow private participation in SOEs. The Government issued liquidation procedures in 2006, detailing the key steps involved in the disposal of SOE assets. Of the 65 SOEs, 56 are targeted for divestiture, and the remaining 9, mostly public utility companies, are to be restructured and retained as SOEs.

12. The Government has designated the Ministry of Commerce (MOC) to lead private sector development. MOC is guided by the Cabinet Economic Sub-Committee, and liaises with the 18-member Economic Committee of Parliament. MOC is rationalizing its structure to meet its private sector development mandate. The Government is taking steps to improve the investment climate for private enterprises. The Law on Private Investment in Afghanistan was adopted in 2005. The High Commission on Investment, chaired by the minister of commerce was established in 2002 to set the overall policy directions for investment promotion. The Afghanistan Investment Support Agency (AISA) was established in 2003 as the High Commission's implementing agency.

13. The Government has initiated tax reforms supportive of private sector development. The Income Tax Law was amended in 2005 to expand the tax base and streamline the tax regime. Customs duties have likewise been rationalized. Further reforms are ongoing to remove "nuisance" taxes imposed by various government entities.<sup>9</sup> The Government has adopted labor regulations governing hiring, firing, and working hours to facilitate private enterprises' business operations.

## 2. The Financial Sector

14. The financial sector is small, consisting of commercial banks, microfinance institutions, credit unions, foreign exchange dealers, money service providers, an insurance company, and a leasing company (Table 1). Commercial banks dominate the formal financial sector, representing 95% of assets in the formal sector. Given that much of the economic activity occurs in the informal private sector, the informal financial sector is estimated to be at least as large as the formal financial sector.

15. Since the passage of the Law of Da Afghanistan Bank (DAB) (2003) and the Law of Banking in Afghanistan (2003), the central bank, DAB, has supervised commercial banks. More recently, DAB has issued regulations for depository microfinance institutions, money service providers, and foreign exchange dealers.<sup>10</sup> Insurance activities are supervised by MOF. To promote the stability and integrity of the financial system, the Government has adopted the Anti-

<sup>8</sup> Commerce, Communications, Finance, and Transportation and Civil Aviation.

<sup>9</sup> There are close to 100 different taxes, and the administrative costs of many are likely to outweigh the revenue gains.

<sup>10</sup> Under the law, DAB also has regulatory authority over payment system operators and securities service dealers.

Money Laundering and Proceeds of Crime Law (2004) and Law on Combating the Financing of Terrorism (2004). To implement these laws, a financial intelligence unit has been established in DAB.

**Table 1: Financial Sector Overview**  
(end of 2005)

Item	Number	Assets (AF million)	Assets (% of GDP)
Licensed commercial banks <sup>a</sup>	12	28,985	8.8
State-owned banks	3	11,764	3.5
Domestic private banks	4	10,763	3.3
Foreign banks	5	6,584	2.0
Microfinance institutions	5	499	0.2
Credit unions	7	500	0.2
Insurance company <sup>b</sup>	1	385	0.1
Leasing company	1	—	—

GDP = gross domestic product.

<sup>a</sup> The list of commercial banks excludes one bank which was established in June 2006.

<sup>b</sup> Data estimated as of end of March 2005.

Sources: Da Afghanistan Bank and Asian Development Bank estimates.

16. By the end of the conflict in 2001, the banking system had been reduced to a shell. The six state-owned banks—Bank Millie Afghan, Pashtany Tejaraty Bank, Export Promotion Bank, Agriculture Development Bank, Industrial Development Bank of Afghanistan and Mortgage and Construction Bank—were non-operational. Of the six, only the first three were relicensed by DAB. DAB has licensed 10 private banks (5 domestic banks and 5 foreign bank branches), bringing the total number of commercial banks to 13 as of June 2006. Despite rapid growth in recent years, the banking sector is small relative to the economy, and bank assets account for less than 9% of GDP (Table 1). Commercial banks operate fewer than 60 branches nationwide, almost a third of which are in Kabul. The banking system is heavily “dollarized”, with 77% of total deposits and 84% of total loans denominated in dollars.

**Table 2: Banking System, end of 2005**  
(AF million)

Item	Assets	Loans	Deposits	Capital
State-owned banks	11,674	1,775	2,896	7,949
Bank Millie Afghan, Pashtany Tejaraty Bank, Export Promotion Bank				
Private banks	10,763	4,737	7,461	1,629
Afghanistan International Bank, Arian Bank, First Microfinance Bank, Kabul Bank				
Branches of foreign banks	6,548	339	5,866	—
Standard Chartered Bank, Punjab National Bank, National Bank of Pakistan, Habib Bank Ltd, Bank Alfalah				
<b>Total</b>	<b>28,985</b>	<b>6,852</b>	<b>16,224</b>	<b>9,579</b>

Numbers may not sum precisely because of rounding.

Source: Da Afghanistan Bank.

17. Business access to formal credit is limited. Loans granted by commercial banks at the end of 2005 amounted to AF6.9 billion, comprising only 30% of banking sector assets (Table 2). First, the weak operational capacity of the three relicensed state-owned banks constrains their lending capacity. Their lending is limited to 15% of their total assets and only 26% of total bank loans. Second, a number of private sector banks are focused primarily on selected markets. For example, First Microfinance Bank was established to focus on microfinance, and Arian Bank focuses almost exclusively on trade finance. Third, the five foreign banks have not been lending to private enterprises and instead have collectively focused on transactions with embassies, nongovernment organizations, development partners, and a few large corporate entities. Bank lending is mostly short term and therefore not conducive to productive long-term investment.

18. Despite a steady increase in recent years, bank deposits remain low at 3.6% of GDP and are mostly short term. State-owned banks, despite their size and geographic reach, generate only less than 20% of aggregate deposits in the banking sector.

19. Total lending by the five microfinance institutions and seven credit unions account for 13% of the lending by the financial sector. Women comprise over 75% of microfinance borrowers, and more than half of outstanding loans support small retail, trading, and agricultural enterprises. The Government launched the Microfinance Investment Support Facility for Afghanistan (MISFA) in 2002 to provide an umbrella organization to support microfinance development. MISFA's primary role is to provide technical assistance (TA) and wholesale funding to microfinance organizations by channeling aid agency funds. Lending by aid agencies through MISFA amounted to about \$21 million to 160,000 borrowers in January 2006. Although growing rapidly, microfinance outreach is significantly below the estimated client base of 5 million.

20. The money dealers (*hawaladars*) have long provided financial services in Afghanistan. They may number as many as 2,000 country-wide and offer a well-organized, convenient, and cost-effective system for making international and domestic payments.<sup>11</sup> They provide a range of services such as foreign exchange trading, fund safekeeping, domestic and international fund transfers, and trade finance. Over 20% of businesses are estimated to borrow from *hawaladars* (footnote 6, page 23).

## **B. Issues and Opportunities**

21. Despite significant progress, much remains to be done to transform the private sector into the main engine of economic growth. Conflict and civil strife have not only damaged the physical infrastructure but also substantially weakened the institutional basis and human capital necessary to support private sector activity. Private sector-led development will therefore be a challenging and gradual process. Consequently, the Government will have to prioritize the areas of reform over the medium term as well as build human capital to sustain reforms over the long term.

### **1. Lack of Enabling Environment**

#### **a. Weaknesses in the Legal Framework for Commercial Activities**

22. The weaknesses in the legal framework for commercial activities and financial transactions are fundamental impediments to private sector development. First, a number of existing laws are outdated. For example, the Commercial Code was enacted in 1955 and does

<sup>11</sup> Estimates vary from 500 to 2000. World Bank. 2003. *The Money Exchange Dealers of Kabul*. Washington, DC.

not reflect current economic and business conditions. Second, the absence of an efficient mechanism for resolving commercial disputes compounds the high level of uncertainty and risks faced by private enterprises. All business disputes need to be settled in court and there is no legal basis for out-of-court dispute resolution. However, court procedures are cumbersome and costly. Third, the lack of legal basis for land titling also constitutes a major impediment. Specifically, lack of clarity in property rights prevents the use of land as collateral to secure loans, thereby constraining business establishment and expansion.

#### **b. Existence of Price Controls and Market Entry Restrictions**

23. The Kabul municipal government has administered price controls on a wide range of goods and services since 1985 to benefit low-income households. A 2005 International Monetary Fund (IMF) survey indicates most goods and services are sold significantly above administered prices, suggesting that the price controls are not binding. Businesses are often reported to bribe local authorities to avoid penalty for evading price controls. The cost of rent seeking is passed on to the consumers, hurting the poor the most as goods and services under price control are largely those consumed by them.

24. The Cabinet issued a resolution in April 2006 instructing Kabul municipality to remove all price controls. While this is an important step forward, it is essential that the municipal government enforce the resolution and that prevailing prices reflect market conditions.

25. Inefficiencies in the business registration and permit system constitute a significant barrier to market entry by private enterprises. In particular, municipal authorities exercise undue discretion, and the decision to grant or deny business permits is not necessarily based on business principles. The lifting of price controls must therefore be accompanied by the removal of market entry restrictions to prevent undesirable sharp increases in prices. Facilitating business formation by removing this barrier would reinforce competition, further lowering the prices and improving the quality of goods and services.

### **2. Need to Accelerate Government's Disengagement from Commercial Activities**

26. The majority of large enterprises are either state-owned or under state control. Prolonged conflict has caused most SOEs to become nonfunctional or to operate at low levels of capacity utilization. Some SOEs no longer engage in their core business, relying solely on revenues from leasing real estate. A number of SOEs have historically been vested with collection of certain fees and taxes, and regulatory functions such as licensing and quality control of imported pharmaceuticals and petroleum products. However, the SOEs have not effectively performed these functions because they lack human and financial resources.

27. Greater private sector involvement would encourage more efficient production and delivery of goods and services. SOEs have ownership of land estimated at nearly 10,000 hectares covering 636 sites. The divestment of SOEs would facilitate the release of land to the private sector for productive use, and ease one of the binding constraints on private enterprises. With more land available as collateral for borrowing, private enterprises would have more access to bank credit.

28. However, MOF has limited capacity to manage SOE privatization and liquidation. Its SOE Department has thus far focused entirely on financial management oversight of SOEs. Divestiture of SOEs is a new task that will require additional budget and qualified staff.

### 3. Underdeveloped Financial Sector and Limited Access to Finance

#### a. Remaining Gaps in the Regulatory and Supervisory Framework

29. A basic legal framework for financial supervision has been put in place with the passage of the Law of Da Afghanistan Bank (2003) and the Law of Banking in Afghanistan (2003). DAB has issued prudential regulations covering large exposures, foreign exchange positions, capital adequacy requirements, and loan-loss provisioning. DAB has initiated on-site and off-site supervision of commercial banks. However, there are remaining gaps. DAB has yet to issue detailed regulations and compliance guidelines for banks' management of credit, operational, and market risks. The adoption of adequate risk management system has become more urgent as banks expand credit and extend operations to new business areas. With the entry of five foreign bank branches, it is also crucial that DAB develop a structured program of information sharing and cooperation with the home-country supervisory agencies. DAB has no access to information that will enable it to comprehensively evaluate the financial positions of branches of financial institutions outside its jurisdiction. As these branches expand operations, or more foreign banks establish presence in Afghanistan, establishing mechanisms for cross-border supervision becomes increasingly important.

30. Systemic risk management requires an effective mechanism for monitoring compliance with regulatory requirements and taking enforcement actions if warranted. DAB's ability to take swift action against distressed banks to mitigate systemic risks is limited by the absence of policies and procedures on conservatorship, receivership, and forced liquidation of banks.

31. Building depositor confidence in the banking sector is vital to expanding the deposit base. This requires improved transparency and disclosure by banks. While the submission of audited financial statements is required under the Law of Banking in Afghanistan (2003), it is not enforced as the implementing regulations have not been developed. Moreover, there is no mechanism to disseminate information on banks' financial conditions to the public.

32. The outreach of the microfinance sector is growing rapidly, with its lending accounting for 13% of total financial sector loans. However, the licensing and regulatory requirements for microfinance are not yet enforced. The orderly development of this sector requires regulation and supervision of microfinance institutions, particularly those that accept deposits.

33. The relative inaccessibility of the formal financial sector to the public encourages the continued use of *hawaladars*. However, as registration requirements were introduced only recently, little is known about this sector. Given that financial transactions with *hawaladars* do not entail legally binding contracts, clients must be protected through enhanced transparency. Better information about *hawaladars* will also help combat money laundering and financing of terrorism.

## **b. Absence of Accounting and Auditing Standards**

34. Timely and reliable disclosure based on sound accounting and auditing standards is essential to improve private enterprises' access to financial services. Afghanistan has yet to adopt accounting and auditing standards and has no legal and institutional framework to set them. There is an acute shortage of qualified accountants and auditors because of the absence of professional associations and of curricula in formal educational institutions. As a result, most private enterprises do not keep any accounting records or financial statements. The absence of national accounting and auditing standards impinges on private enterprises' ability to access credit, as financial institutions are reluctant to lend to enterprises that do not have reliable financial statements.

## **C. Government Strategy**

35. The Interim Afghanistan National Development Strategy (I-ANDS) embodies the Government's development objectives and strategies for 2006–2010. The I-ANDS covers a broad spectrum of development concerns, including security, governance, rule of law and human rights, and economic and social development.<sup>12</sup> The I-ANDS is consistent with the country's commitments to the 2006 Afghanistan Compact, which represents the framework for cooperation between Afghanistan and its development partners.

36. The I-ANDS aims to enable the private sector to be the engine of growth, improve economic opportunities for the poor, and progressively eliminate the narcotics economy. The overall strategy for economic and social development is to prioritize interventions in: (i) infrastructure development, (ii) institutional and human capacity development, (iii) social protection, and (iv) creation of an enabling environment for entrepreneurship and investment. The I-ANDS incorporates three programs specific to private sector development: (i) strengthening the investment climate, (ii) increasing international trade, and (iii) developing financial services. Strengthening the investment climate involves addressing infrastructure bottlenecks, improving the legal and regulatory environment, and reducing state presence in business activities. The Government has prioritized trade liberalization toward WTO accession, preferential trade agreements with major trading partners, and customs modernization. The program on financial sector development (i) aims to achieve a competitive, market-oriented, and privately-owned financial sector; (ii) underlines the need to strengthen financial supervision and to restructure state-owned banks; and (iii) calls for clarifying property rights and strengthening enforcement mechanisms to allow the productive use of land.

37. The Program will help achieve the Government's development goals by providing a detailed reform agenda that is in line with the I-ANDS. The Program will also propose a sequencing of policy actions, which is not explicit in the I-ANDS.

## **D. ADB Operations and Lessons Learned**

38. The primary focus of the 2002 initial country strategy and program (CSP)<sup>13</sup> was to support reconstruction and economic recovery. Accordingly, the initial CSP adopted a broad-based approach that aimed to build capacity at different levels of government, rehabilitate essential infrastructure, and promote social development. Private sector development was also a thematic focus of the initial CSP, which highlighted that Afghanistan's long-term economic development hinges on the growth of a vibrant private sector. The initial CSP identifies the

<sup>12</sup> Government of Afghanistan. 2006. *Interim Afghanistan National Development Strategy*. Kabul.

<sup>13</sup> ADB. 2002. *Initial Country Strategy and Program (2002–2004): Afghanistan*. Manila.

weaknesses in the policy and regulatory framework and underdevelopment of the financial sector as key constraints to private sector development. The Program is included in the 2005 CSP update.<sup>14</sup>

39. Asian Development Bank (ADB) assistance to Afghanistan resumed with the Postconflict Multisector Program loan covering the financial, transport, and energy sectors.<sup>15</sup> The program supported the introduction of the new currency in 2003, and the modernization of the payment system through the enactment of a payments law and establishment of clearing and settlement facilities for interbank transactions. Subsequent ADB operations have supported infrastructure projects such as roads, airports, energy, rural development, and fiscal and public administration reforms. ADB has supported the Afghanistan International Bank,<sup>16</sup> Afghanistan Investment Guarantee Facility,<sup>17</sup> Afghanistan Renewal Fund,<sup>18</sup> and Roshan Cellular Telecommunications.<sup>19</sup>

40. Lessons from ADB operations have been incorporated into the program design. A key lesson is that effective development assistance requires strong government ownership. To ensure Government ownership, the Program is formulated to be in line with the Government's own development agenda. In particular, the reform measures called for in the Program are closely aligned with those in the I-ANDS, which embodies the Government's medium-term development objectives and strategies.

41. Significant capacity constraints can undermine reform, and adequate TA must be provided to implementing agencies. To remove capacity constraints, the Program includes a capacity-building grant providing up to \$4 million to help the Government implement the Program. Capacity constraints likewise call for a more gradual phasing of reforms. The timing and the sequencing of the Program's policy actions, as well as the attached grant, take into account Afghanistan's capacity-building needs.

42. Another important lesson from ADB operations is the need to go beyond technical compliance with policy conditions to ensure that they achieve policy outcomes. Drawing on this lesson, extensive consultations were held with key stakeholders to clarify the rationale for and the underlying development objectives of the reform measures. These consultations need to be continued during program implementation. Effective program implementation requires not only urging the Government to comply with policy conditions but also maintaining intensive policy dialogue with the Government and stakeholders to evaluate the continued relevance of the policy measures and to assess their economic and social impact.

<sup>14</sup> ADB. 2005. *Country and Strategy Program Update (2006–2008): Afghanistan*. Manila.

<sup>15</sup> ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Islamic Republic of Afghanistan for the Postconflict Multisector Program*. Manila (Loan 1954-AFG[SF], approved on 30 May).

<sup>16</sup> ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Equity Investment in Afghanistan International Bank*. Manila (Equity 7199-AFG, approved on 13 May).

<sup>17</sup> ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Guarantee for the Afghanistan Investment Guarantee Facility*. Manila (Loan 2091-AFG[SF] and Private Sector 7201-AFG[SF], approved on 24 September).

<sup>18</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Equity Investment in Afghanistan Renewal Fund Limited*. Manila (Equity 7215-AFG, approved on 28 July).

<sup>19</sup> ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Islamic Republic of Afghanistan for the Telecom Development Company Afghanistan Limited for the Roshan Cellular Telecommunications Project*. Manila (Loan 2098-AFG, approved on 4 November); and ADB. 2006. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Political Risk Guarantee to the Islamic Republic of Afghanistan for the Roshan Phase II Expansion Project*. Manila (Loan 2241-AFG, approved on 29 June).

43. Sound macroeconomic policies are preconditions for successful reforms at the sectoral level. This implies the need for strong complementarity between the Program and projects supported by other donor agencies, particularly IMF. The Program was developed in close consultation with Afghanistan's other development partners.

#### **E. External Assistance to the Sector**

44. Since 2001, Afghanistan has received significant support to develop its private and financial sectors. ADB has coordinated closely with Afghanistan's other development partners, and the Program is designed to avoid overlap and to maximize synergies.

45. The Program complements the World Bank's Programmatic Support for Institution Building, which includes a wide range of structural reform measures. Specifically, the World Bank program has supported tax reforms, civil service reform, adoption of the Privatization Policy, and adoption of basic prudential regulations. The United States Agency for International Development's (USAID's) Economic Governance and Private Sector Strengthening (Phase II) includes support for the drafting of a number of commercial laws, and the institutional strengthening of DAB by providing in-house advisors. The USAID's Land Titling and Economic Restructuring Project supports the drafting of a land policy outlining the principles and policy directions for formalizing land ownership and improving land use. This project also supported the drafting of the Privatization Policy, amendments to the Law on State-Owned Enterprises (1960), and liquidation procedures to facilitate SOE divestiture. The United Kingdom's Department for International Development (DFID) is providing advisory support to the MOC's Private Sector Development Directorate, which is responsible for promoting business development services and for disseminating information on government policies and programs to the private sector. The German Technical Cooperation (Deutsche Gesellschaft für Technische Zusammenarbeit [GTZ]) is supporting the institutional strengthening of AISA, the government entity responsible for promoting domestic and foreign investment.

46. Starting June 2006, the IMF extended its support for macroeconomic reforms under the Poverty Reduction and Growth Facility (PRGF). In financial sector reforms, the PRGF focuses on restructuring or liquidation of the three state-owned banks that were relicensed in 2004. The Development Coordination Matrix is in Appendix 2.

### **IV. THE PROPOSED PRIVATE SECTOR AND FINANCIAL MARKET DEVELOPMENT PROGRAM**

#### **A. Impact and Outcome**

47. The Program aims to promote private sector-led growth by (i) strengthening the enabling environment for private sector development, (ii) disengaging the Government from business activity, and (iii) improving the private sector's access to financial services. The impact will be a more dynamic private sector and sound financial system supporting sustainable economic growth and job creation. The program outcomes will be larger contribution of the private sector to economic activity and improved financial intermediation. The program design builds on the Government's ongoing reform initiatives and complements other development partners' assistance.

48. The design and monitoring framework is in Appendix 3. The development policy letter and policy matrix are in Appendix 4.

## **B. Important Features**

49. A key feature of the Program is its two-pronged approach to promoting private sector development. First, the Program includes policy measures that directly affect the private sector. The Program will help create an environment conducive to private sector growth by providing a basic but essential legal framework for commercial activities. It will also remove price controls and facilitate market entry by simplifying business registration and permit procedures. It will reduce the size of the SOE sector and transfer productive resources to the private sector. Second, the Program will help improve depositor confidence in the financial system through better supervision and disclosure. This will, in turn, help financial institutions mobilize savings to meet the financing needs of households and private enterprises.

## **C. The Proposed Program**

### **1. Policy Framework and Actions**

#### **a. Strengthening the Environment for Private Sector Development**

##### **i. Establishing the Legal Framework**

50. A clear and comprehensive legal basis is fundamental for private sector development. To address the weaknesses in the Commercial Code (1955), the Government is drafting a core set of basic commercial laws, including those pertaining to the formation of business organizations. In line with the Program's recommendation, the Government has drafted a commercial arbitration law, which will provide a mechanism for business dispute resolution outside the court system. The draft law is being reviewed by the Ministry of Justice (MOJ) and is expected to be submitted to Parliament by early 2007. The alternative dispute resolution mechanism will reduce the uncertainty and costs associated with inefficient and lengthy court procedures. To provide the legal framework for land titling, the Program also calls for the Government to adopt an immovable property formalization law. To prepare the groundwork for this law, the Government is drafting a land policy outlining basic principles and policy directions for formalizing land ownership and improving land use.

##### **ii. Eliminating Price Controls and Streamlining Business Registration**

51. The two key market distortions include price controls and the inefficiencies in business registration and permit procedures. The existence of price controls on a wide range of goods and services in Kabul for over two decades has undermined market efficiency. Moreover, this has resulted in negative externalities associated with rent seeking to circumvent price controls. In line with the Program's recommendation, the Cabinet recently issued a resolution abolishing municipal price controls. To ensure that price controls do not continue to distort the market, the Program calls on MOC to monitor and enforce compliance by the municipal authorities. The Program further recommends that MOC, in coordination with municipal governments, streamline business registration and permit procedures to facilitate market entry by private enterprises. Removing this distortion will enhance market competition, thereby lower the price and improve the quality of goods and services. The combination of removing price controls and streamlining business registration will also minimize opportunities for rent seeking by the authorities.

## **b. Disengaging the Government from Business Activities**

52. Under the Program, the Government will accelerate SOE divestiture through liquidation and privatization through asset sales, which entails selling the core business in one package and separately selling any excess land not required for the core business.<sup>20</sup> The Program proposes that the Cabinet approve 20<sup>21</sup> out of the 39 SOEs that have been identified by the Government to be liquidated or privatized through asset sales. The Program also recommends that MOF establish for each SOE a liquidation committee comprising representatives from MOF, the relevant line ministry, the Ministry of Economy, MOJ, and the General Attorney's Office. The committees will be responsible for timely and transparent divestiture of the SOEs.

53. The Program also recommends that MOF's SOE Department be restructured to create a unit responsible for managing privatization. This will require the allocation of additional budget to recruit staff.

54. Minimizing the social dislocations from SOE liquidation by providing a safety net is a key program priority. The Program urges the Government to allocate adequate funds for severance packages for the employees affected by SOE liquidation. The Program also calls for the allocation of budget for and the provision of job counseling and retraining programs for retrenched workers of SOEs through the National Skills Development Program of the Ministry of Labor, Social Affairs, Martyrs and Disabled.

## **c. Improving Private Sector's Access to Financial Services**

### **i. Strengthening the Supervisory Framework for Financial Institutions to (a) Improve Depositor Protection and Confidence in the Financial System, and (b) Enable Provision of More Services to the Private Sector**

55. A better supervised and more transparent financial sector will build depositor confidence in financial institutions, which is crucial to mobilize savings. Improved regulation will result in a sound financial sector that can efficiently allocate resources and provide services to households and private enterprises.

56. **Banking Sector.** Given the growing presence of foreign banks, the authorities must establish a mechanism for cross-border supervision. The Program recommends that DAB sign a memorandum of understanding with home country supervisors outlining clear and workable protocols for information sharing and coordination on issues of licensing, ongoing supervision of cross-border establishments, on-site examinations, and protection of confidentiality.<sup>22</sup>

57. The Program recommends that DAB introduce comprehensive regulations and compliance guidelines for banks on the management of credit, operational, and market risks. The guidelines for credit risk management will provide banks with more details on the minimum necessary steps toward sound risk management, including establishing an appropriate credit

<sup>20</sup> Given the weak operational capacity of SOEs, these two divestiture modalities are deemed to be the most expeditious.

<sup>21</sup> Excluding the SOE to be divested under ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grant to the Islamic Republic of Afghanistan for the Agriculture Sector Program*. Manila (Loan 2083-AFG[SF] approved on 4 May).

<sup>22</sup> These are the minimum requirements established by the Basel Committee on Bank Supervision. Bank for International Settlements. 2001. *Essential Elements of a Statement of Cooperation between Banking Supervisors*. Basel.

risk environment, operating sound credit granting processes, and maintaining appropriate credit risk administration and monitoring processes. The guidelines for operational risk will prescribe detailed measures required to establish a robust operational environment and an internal control system, including clear lines of responsibility, segregation of duties, effective internal reporting, and contingency planning. The guidelines for market risk will reflect international best practices, focusing on the use of a standardized approach to risk measurement. DAB will also revise its on-site and off-site examination manuals in line with the enhanced risk management policies and procedures.

58. The Program supports the establishment of a uniform bank reporting system, including a database to enable DAB to systematically assess bank performance. The Program calls on DAB to establish a tracking system to manage its enforcement actions. To manage systemic risks posed by distressed banks, the Program will support the adoption of policies and procedures on conservatorship, receivership, and forced liquidation.

59. To improve transparency and disclosure by banks, the Program recommends that DAB (i) issue regulations on the external audit of banks and qualifications of bank auditors and take remedial supervisory actions to ensure the timely submission of audited statements by banks, and (ii) regularly publish banks' financial statements on its website.

60. The Program will help DAB make parallel efforts to strengthen supervisory capacity, particularly in internal control, risk management, enforcement actions, and back-office operations.

61. **Microfinance Sector.** The role of microfinance institutions in providing credit has increased significantly in recent years. However, the expansion is largely driven by aid agency funds, and unmet demand is significant. To promote the sustainable development of this sector, the Program calls on DAB to adopt and implement regulations on licensing and supervision of depository microfinance institutions to ensure depositor protection. This would strengthen depositor confidence in the institutions, enabling them to mobilize savings to expand their outreach.

62. **Informal Financial Sector.** The Program proposes that DAB implement regulations on *hawaladars* covering registration, customer identification, reporting of suspicious activities, and record-keeping. The regulations will use an approach that is effective, but not excessively burdensome to avoid driving *hawaladars* further underground. Given the large number of *hawaladars*, the Program recommends that DAB implement these regulations first in Kabul and then in major provincial capitals.

## ii. **Enhancing Disclosure Requirements to Improve the Private Sector's Access to Finance**

63. A key step to improve private enterprises' access to financial services is to strengthen their financial disclosure. Under the Program, the Government will prepare and submit to Parliament an accounting law and an auditing law consistent with the International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), respectively. The law will apply to public interest entities, which are those that, because of their business, size, number of employees, or corporate status, have a wide range of stakeholders. While the Government prepared the terms of reference for an accountancy board under the Postconflict Multisector Program (footnote 15), the board is not yet established. To ensure adequate oversight of the profession, the Program calls for the establishment of an accounting and

auditing board comprising representatives from MOF, DAB, MOC, the Control and Audit Office, and professional accountants and auditors from the private sector. To support the accounting and auditing board, the Program calls on MOF to create a unit, consisting of at least three qualified people, to act as its secretariat.

64. In addition to its oversight functions, the accounting and auditing board will be responsible for developing the capacity of the accounting and auditing profession. In particular, the board will develop certification requirements and ethical standards for accountants and auditors. The board will establish partnerships with formal educational institutions to provide training programs and courses in accounting and auditing.

## **2. Program Grant Size**

65. It is proposed that ADB support the Government's policy reforms by providing a grant of \$56 million. The program grant will be from the Asian Development Fund (ADF). The following factors have been taken into account in determining the grant size: (i) the importance of the private and financial sectors for sustaining economic growth and poverty reduction, (ii) the strength of the Program and the financial and political cost associated with its implementation, and (iii) the overall development financing needs of the Government.

## **3. Implementation Arrangements**

### **a. Program Management**

66. MOF will be the Executing Agency for the Program. MOF, MOC, and DAB will be implementing agencies. MOF will set up an interagency coordination committee headed by the deputy minister for finance and comprising representatives from MOF, MOC, MOJ, and DAB. The committee will meet every quarter to coordinate and ensure implementation of the reforms. ADB will be a member of the committee to oversee the program progress.

67. MOF will (i) oversee the liquidation of SOEs and the accounting and auditing reforms, including the drafting of an accounting law and an auditing law, and the establishment of an accounting and auditing board; and (ii) coordinate and monitor the drafting of an immovable property formalization law. MOC will (i) oversee the drafting of a commercial arbitration law and (ii) coordinate with municipal authorities in streamlining business registration processes and lifting municipal price controls. DAB will oversee the financial sector reforms.

### **b. Implementation Period**

68. The implementation period of the Program will be 3 years. The Program will be completed by 31 December 2009 and closed on 30 June 2010.

### **c. Procurement and Withdrawal Procedure**

69. The grant proceeds will be used to finance the foreign exchange cost of items produced and procured in ADB member countries (but not of items in the negative list of ineligible items [Appendix 5] and imports financed by other bilateral and multilateral sources). The Government will certify that the volume of eligible imports exceeds the amount of ADB's projected disbursement under the grant for the given period. ADB reserves the right to audit the use of the grant proceeds and verify the accuracy of the Government's certification. The disbursement of the grant will be in accordance with *Simplification of Disbursement Procedures and Related Requirements for Program Loans*.

#### **d. Counterpart Funds**

70. The Government will ensure that the local currency funds generated by the grant will be used, first, to support the adjustment cost of reforms under the Program, and second, to finance expenditures for general development purposes.

#### **e. Monitoring and Tranching**

71. The Government and ADB will continue to engage in policy dialogue on sector issues, policy reforms, and other measures during program implementation and on additional reforms that may be considered necessary or desirable. ADB will field regular missions to confirm compliance with conditions for the second tranche and advise on actions to maintain implementation on course.

72. The grant will be released in two tranches. All first tranche release conditions have been fulfilled. The first tranche (\$28 million) will be released upon grant effectiveness. The second tranche (\$28 million) will be released 24 months after Board approval, provided that ADB is satisfied that the Government has made sufficient progress in implementing the Program, particularly that all the second tranche release conditions set forth in bold in the policy matrix have been met. All the monitorable actions listed in the policy matrix must be taken by the Government during the program period. While these actions are not conditions for the release of the first or second tranche, they are crucial to achieving the program objectives.

#### **f. Accounting, Auditing, and Reporting**

73. The Government will submit to ADB (i) semiannual reports on program implementation and accomplishments of the measures set forth in the development policy letter and the policy matrix, which will describe progress made and any problem encountered and remedial actions taken; and (ii) a program completion report within 3 months of program completion.

#### **g. Program Performance Monitoring and Evaluation**

74. The Government, through MOF, will establish and maintain a program performance monitoring system that will include a database on the status on policy measures and program indicators based on the policy matrix and the design and monitoring framework.

#### **h. Program Review**

75. ADB will monitor implementation through regular reviews and progress reports. Based on these reviews, modifications and improvements will be considered. About 6 weeks before the anticipated withdrawal of the second tranche, or such other time as the Government and ADB may agree, ADB will review the Government's progress in implementing the policy reforms under the Program set out in the development policy letter and the policy matrix, including fulfillment of the conditions for the second tranche release listed in the policy matrix.

### **D. The Capacity Building Grant for Supporting Private Sector and Financial Market Reforms**

#### **1. Objectives**

76. The objective of the capacity-building grant is to assist the Government implement the Program. Specifically, it will help the Government (i) strengthen the legal framework, (ii) remove

market distortions, (iii) disengage the Government from commercial activities, (iv) strengthen financial intermediation, and (v) implement accounting and auditing standards. The grant will also develop and establish training programs in these areas to help sustain private sector and financial market development over the long term.

## **2. Methodology and Activities**

### **a. Component I: Strengthening the Legal Framework**

77. Activities include

- (i) supporting the drafting and finalization of a commercial arbitration law and an immovable property formalization law,
- (ii) drafting implementing rules and regulations for the above laws, and
- (iii) facilitating consultations and dissemination seminars to solicit stakeholder buy-in and ensure timely and proper implementation of the above laws and regulations.

### **b. Component II: Removing Market Distortions**

78. Activities include

- (i) developing monitoring and enforcement mechanisms to ensure municipal authorities' compliance with the Cabinet resolution abolishing price controls,
- (ii) identifying the inefficiencies in the business registration and permit systems and developing a streamlined system to facilitate business establishment, and
- (iii) facilitating consultations and dissemination seminars to solicit stakeholder buy-in and ensure the timely and proper implementation of the above.

### **c. Component III: Liquidating State-Owned Enterprises**

79. Activities include

- (i) assisting liquidation committees in the asset valuation of each SOE approved by MOF for liquidation or privatization through asset sales;
- (ii) providing advisory support to liquidation committees to develop liquidation plans for each SOE;
- (iii) helping liquidation committees organize the asset sales, including calls for creditors and claimants, and prepare bidding documents;
- (iv) supporting the restructuring of MOF's SOE Department to strengthen its capacity to manage privatization; and
- (v) supporting the development and implementation of the social safety net programs.

### **d. Component IV: Strengthening Financial Intermediation**

80. Activities include

- (i) helping DAB prepare agreements on protocols for cross-border supervision;
- (ii) facilitating the establishment of a system to monitor commercial bank performance and manage DAB's enforcement actions;
- (iii) supporting the development of policies and procedures on conservatorship, receivership, and liquidation of banks;

- (iv) supporting the preparation of risk management regulations and compliance by banks;
- (v) developing and conducting training programs for DAB staff; and
- (vi) developing banking accreditation and training programs and curricula in educational institutions.

**e. Component V: Implementing Accounting and Auditing Standards**

81. Activities include

- (i) drafting an accounting law and an auditing law and implementing regulations;
- (ii) supporting the establishment of an accounting and auditing board to regulate the profession;
- (iii) providing training on the implementation of the accounting law and auditing law;
- (iv) developing (a) an accreditation and licensing system for professional accountants and auditors, (b) a code of ethical standards for accountants and auditors, and (c) accounting and auditing curricula in educational institutions; and
- (v) developing a strategy and time-bound action plan to establish a professional association for accountants and auditors.

**f. Component VI: Unallocated Pool of Funds**

82. An unallocated pool of funds will be established to engage consultants as additional needs for advisory support and capacity building are identified during program implementation.

**3. Cost Estimates and Financing Plan**

83. The total cost for the capacity-building grant is estimated at \$4.3 million equivalent (Table 3). ADB will provide \$4 million financed on a grant basis from the ADF (Table 4). The Government's in-kind contribution of \$0.3 million equivalent will cover counterpart staff, training and workshop facilities, and office accommodation. The beneficiary of the grant will be the Islamic Republic of Afghanistan (Table 3). Detailed cost estimates and financing plan is in Appendix 6.

**Table 3: Grant Investment Plan**  
(\$'000)

<b>Item</b>	<b>Amount</b>
A. Component I – Legal Framework	290.0
B. Component II – Market Distortions	158.0
C. Component III – SOE Liquidation	1,065.0
D. Component IV – Financial Intermediation	702.0
E. Component V – Accounting and Auditing Standards	745.0
F. Component VI – Unallocated Pool of Funds <sup>a</sup>	750.0
G. Contingencies	290.0
H. Government Financing <sup>b</sup>	
1. Office Accommodation, Training, Workshop Facilities	100.0
2. Remuneration of Counterpart Staff	200.0
<b>Total</b>	<b>4,300.0</b>

<sup>a</sup> This amount will be used to engage consultants as additional advisory support and capacity-building needs are identified.

<sup>b</sup> ADB. 2005. *Extension of the Waiver of the Cost-Sharing Limits for Loans and TA Operations for Afghanistan*. Manila.

Source: Asian Development Bank estimates.

**Table 4: Financing Plan**  
(\$'000)

<b>Source</b>	<b>Total</b>	<b>%</b>
Asian Development Bank <sup>a</sup>	4,000.0	93
Government of Afghanistan	300.0	7
<b>Total</b>	<b>4,300.0</b>	<b>100</b>

<sup>a</sup> Exclusive of local taxes and duties.

Source: Asian Development Bank estimates.

#### **4. Implementation Arrangements**

##### **a. Capacity-Building Grant Management**

84. MOF will be the Executing Agency for the grant. MOF will be the Implementing Agency for components I, III, and V. MOC will be the Implementing Agency for components I and II. DAB will be the Implementing Agency for component IV. The implementation agency for Component VI will be designated when additional needs for advisory support and capacity building are identified. MOF will set up an interagency grant coordination committee headed by the deputy minister for finance and comprising representatives from MOF, MOC, MOJ, and DAB. ADB will be a member of the committee to oversee the implementation progress. The committee will meet every quarter to coordinate and ensure effective implementation of the reforms.

##### **b. Period of Implementation**

85. The grant implementation period will be 3 years. The grant will be completed by 31 December 2009 and closed on 30 June 2010.

### **c. Consulting Services and Disbursement**

86. The grant will support the engagement of consultants, including legal experts, business economists, SOE liquidation experts, bank regulatory and policy experts, commercial banking experts, and accounting and auditing specialists. This represents 64 person-months of international and 132 person-months of national consulting services. All international and national consultants will be selected and engaged by ADB in consultation with the grant coordination committee. The team of consultants for components I–V will be recruited by ADB through a firm by quality-based selection (QBS) since capacity constraints pose significant risks to program implementation and, therefore, quality-based consulting inputs are critical in capacity-building initiatives and need to override other considerations. The consultants for component VI will be recruited by ADB as individuals in accordance with ADB's *Procedures for Recruiting Individual Consultants* or through a firm by QBS. All international and national consultants will be engaged in accordance with ADB's *Guidelines on the Use of Consultants*.

87. All disbursement under the grant will be in accordance with ADB's *Loan Disbursement Handbook* (January 2001).

### **d. Accounting, Auditing, and Reporting**

88. MOF will provide quarterly progress reports on grant implementation to ADB within 1 month of the end of each quarter in accordance with the program performance monitoring system. The Government will maintain records and accounts for the grant expenditure in accordance with sound accounting principles and will have such accounts and records audited annually by auditors acceptable to ADB. The Government will ensure that the progress reports, audited accounts, and financial statements comply with ADB's guidelines. Audited annual accounts, by independent auditors acceptable to ADB, will be submitted to ADB within 6 months of the reporting period.

### **e. Capacity-Building Grant Review**

89. The Government and ADB will periodically review grant implementation. The reviews will include evaluation of the grant scope, implementation arrangements, progress of the policy reform agenda, and capacity-building measures. ADB will field regular review missions, including a midterm review mission, and project completion review missions.

## **E. Anticorruption Measures**

90. ADB's policy document *Anticorruption* (1998 as amended) was explained to and discussed with the Government. Consistent with its commitment to good governance, accountability, and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the Grants. To support these efforts, relevant provisions of ADB's *Anticorruption* document are included in the Grant Regulations. In particular, all contracts financed by ADB in connection with the capacity-building grant shall include provisions specifying the right of ADB to audit and examine the records and accounts of the Government and all consultants and other service providers as they relate to the grant.

91. ADB, together with the World Bank and United Nations Development Programme are supporting the development of a national anti-corruption strategy. The strategy will help identify areas that are most prone to corruption, sequence necessary interventions, and define institutional mandates to effectively implement various anti-corruption measures.

92. In addition, the Government has taken concrete steps to improve public financial management (PFM). The Procurement Law (2005) establishes transparent and competitive procurement procedures, and specifies the responsibilities and accountabilities of government officials. The Public Finance and Expenditure Management Law (2005) aims to improve PFM by strengthening reporting requirements and requiring independent audit of financial statements. With ADB support,<sup>23</sup> the Government is taking further measures to strengthen PFM by improving fiduciary controls and establishing an integrated public financial management information system. ADB will closely monitor program implementation to ensure that the outputs envisaged under the Program are achieved.

## V. PROGRAM BENEFITS, IMPACTS, AND RISKS

### A. Benefits

93. The Program will help develop the private sector through policy, legal, regulatory, and institutional reforms to improve the investment climate and to strengthen financial intermediation. Improved investment climate will attract more domestic and foreign investments, which will create jobs. With the entry of new businesses, competition will be reinforced and result in more efficient provision of goods and services.

94. The development of the financial sector will further boost private sector activity and create jobs. Private enterprises and households will have access to more financial resources as financial institutions are able to mobilize savings for productive use. Improved financial intermediation will reduce the borrowing costs incurred by private enterprises and individual households.

95. Private sector development also brings about fiscal benefits. Increased private sector output will reduce the need for the Government to provide the fiscal impetus for growth. Increased private sector activities will generate higher tax revenues, further creating fiscal space for expenditures to provide social services for the poor.

96. Specific benefits are as follows:

- (i) By supporting the adoption of a commercial arbitration law, the Program will provide a recourse for settling disputes and help reduce the uncertainty and risks faced by business. Policy and legal measures to establish land ownership will help improve access to credit by providing assets that can be used as collateral.
- (ii) By helping remove the distortions caused by price controls, the Program will allow prices to adjust to market conditions and encourage business activity. This reform, coupled with measures to streamline business registration procedures, will deter rent seeking associated with evading price controls and securing business permits. These measures will also enhance market competition, thereby lowering the prices and improving the quality of goods and services.
- (iii) By helping liquidate inefficient SOEs, the Program will reduce state presence in areas where the private sector can be more efficient. SOE liquidation will also facilitate the transfer of land to the private sector for productive use, including as collateral for borrowing.

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<sup>23</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Cluster of Loans to the Islamic Republic of Afghanistan for the Fiscal Management and Public Administration Program*. Manila (Loan 2215-AFG[Sf] and Grant 0030-AFG(SF), approved on 14 December).

- (iv) By strengthening financial sector regulation and oversight, the Program will enhance depositor protection and reduce systemic risk. This will, in turn, facilitate savings mobilization and enable financial institutions to expand their outreach.
- (v) By helping adopt accounting and auditing standards, the Program will enhance transparency and disclosure of private enterprises' financial conditions, thereby improving their access to financial services.

## **B. Risks and Safeguards**

97. Security concerns pose a key external risk to the Program. Worsening security could hamper reforms as the Government would have to focus its resources on security. Deteriorating security could also impede program progress, as it would be more difficult to attract experts to Afghanistan to help the Government implement the Program.

98. Capacity constraints are the most significant internal risk to effective program implementation. For instance, weaknesses in the drafting of legislative proposals by the executive branch of the Government have delayed some key legal reforms. To ensure that the legal reforms called for under the Program meet the program objectives, the attached capacity-building grant will help the Government draft the legislation and related regulations in line with international standards, taking into account country-specific circumstances. The grant will develop comprehensive training programs for bank supervisors and for banking, accounting, and auditing professionals to address capacity constraints in these areas.

99. Vested interest groups could resist certain reform measures. To minimize this risk, the grant will facilitate training, consultations, and public awareness campaigns needed to build consensus and solicit stakeholder buy-in.

100. Given the significant donor presence, assistance might be duplicated and ineffective. The Program was prepared in close consultation with Afghanistan's development partners involved in private sector development and financial reforms. Continued coordination during program implementation will be required to avoid overlap and to maximize synergies.

101. The detailed poverty reduction and social strategy of the Program is in Appendix 7. The Program will help the Government implement the I-ANDS, which highlights the importance of the private sector in attaining sustainable economic growth. The Program is pro-poor in its direct effect on creating business and jobs through private sector development. Providing a social safety net for workers affected by the liquidation of SOEs is a key program priority. No involuntary resettlement or impact on indigenous peoples is expected from program implementation (category C). Overall, the environmental implications of Program were assessed and no significant adverse impact was identified. The Program is under category C in ADB's environment classification system.

## **VI. ASSURANCES**

### **A. Specific Assurances**

102. Without limiting the scope, identified assurances in addition to the standard assurances and the policy conditions set forth in the Policy Matrix, will include:

- (i) The Government will advise ADB of the outcomes of policy discussions with other multilateral or bilateral agencies that have implications for the implementation of the Program.
- (ii) The policies adopted and actions taken prior to the date of the Program Grant Agreement, as described in the development policy letter (including the policy matrix), will continue in effect during the Program period and subsequently.
- (iii) The Government will promptly adopt the other policies and take the other actions included in the Program, as specified in the development policy letter (including the policy matrix), and ensure that such policies and actions will continue in effect for the duration of the Program and subsequently.
- (iv) The Government will ensure that sufficient counterpart staff and financing, needed to implement the objectives of the capacity-building grant, shall be provided.
- (v) The Government will ensure that in carrying out the policy measures and activities included in the policy matrix, due consideration shall be given to the findings and recommendations provided under the capacity-building grant.

#### **B. Conditions for Grants Effectiveness**

103. The following are additional conditions for the effectiveness of the program grant agreement (i) the capacity-building grant agreement will have become effective, (ii) the Government will have approved the liquidation or privatization through asset sales of 10 SOEs (excluding the SOEs to be divested under the Agriculture Sector Program), and (iii) MOF will have appointed the liquidation committees for the 10 SOEs to implement their liquidation or privatization through asset sales. The effectiveness of the program grant agreement will be a condition of the effectiveness of the capacity-building grant agreement.

### **VII. RECOMMENDATION**

104. I am satisfied that the proposed grants would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) the grant of \$56,000,000 to the Islamic Republic of Afghanistan, from ADB's Special Funds resources, for the Private Sector and Financial Market Development Program, and
- (ii) the grant of \$4,000,000 to the Islamic Republic of Afghanistan, from ADB's Special Funds Resources, for the Capacity Building Grant for Private Sector and Financial Market Reforms

on the terms and conditions as are substantially in accordance with those set forth in the draft Grant Agreements presented to the Board.

Haruhiko Kuroda  
President

22 November 2006

## SECTOR ANALYSIS: PRIVATE SECTOR AND FINANCIAL SECTOR

### A. Description of the Private Sector

1. Pre-conflict Afghanistan had a vibrant private sector engaged mainly in the production of agricultural products, small-scale industrial activities, and trading.<sup>1</sup> However, more than two decades of conflict (1979–2001) as well as strong state intervention have caused the private sector to contract significantly. Most industries were nationalized during the 1980s. Traditional manufacturing industries, such as carpet weaving, moved to neighboring countries during the conflict, and many businesses were forced to close down due to lack of inputs. Moreover, conflict resulted in the depletion of the country's physical capital.

2. Afghanistan's total industrial production fell by 95% between 1979 and 2002. Private industrial output was hit harder, and its share in industrial production fell from 60% in 1979 to 21% in 2002, and recovered modestly in 2005 reaching 26%. Private sector activities are concentrated in construction and services. Construction is thriving as post-conflict reconstruction continues. In services, trade and transport sectors dominate. Enterprises engaged in basic services, such as shops, tailoring and repair services are also prevalent. In addition, there is increased private sector activity in relatively new services sectors such as telecommunications and banking.

3. There is limited current information on the state of manufacturing activity in Afghanistan. Results of the 2005 World Bank's Afghanistan Investment Climate Survey indicate a gradual recovery in the manufacturing sector. Surveyed firms indicate substantial growth in employment (67% between 2001 and 2005) and capacity utilization (10% between 2004 and 2005). Median output per worker in Afghanistan is higher compared with Tajikistan and Uzbekistan but only a third of those in India or Pakistan. Capacity utilization by surveyed firms in Afghanistan is slightly lower than those in Tajikistan and Uzbekistan (Table A1.1).

**Table A1.1: Selected Manufacturing Statistics**

<b>Country</b>	<b>Median Output per Worker</b> (\$ for manufacturing firms with less than 100 workers)	<b>Average Capacity Utilization</b> <b>for Manufacturing Industry</b> (%)
Afghanistan	3,333	62
India	9,146	78
Pakistan	10,043	—
Tajikistan	1,859	91
Uzbekistan	567	73

Source: World Bank. 2005. *The Investment Climate Survey of Afghanistan*. Washington, DC.

4. There are only a handful of moderately large enterprises and a few medium enterprises in the non-agricultural private sector.<sup>2</sup> A large part of the non-agricultural private sector consists of very small mainly informal family-owned micro enterprises, engaged in trading and basic services, such as shops, sewing, and repair services. It is estimated that 80–90% of economic activity is in the informal sector. The large degree of informality stems from political uncertainty and lack of rule of law during the period of conflict. Inefficient business registration procedures

<sup>1</sup> Bennett, A, Bruno de Schaetzen, Louis Dicks-Mireaux, Felix Fischer, Thierry Kalfon, and Ron van Rooden. 2005. *Reconstructing Afghanistan*. Washington, DC: International Monetary Fund.

<sup>2</sup> World Bank. 2005. *The Investment Climate in Afghanistan*. Washington DC (p. 7).

and tax regime also contribute to the existence of the informal sector. Entrepreneurs in the informal sector typically remain small, avoiding investments in productive assets or technology that would enable them to achieve economies of scale and undertake higher value added activities. The Government has therefore recognized that the informal sector is unlikely to drive sustained growth over the long term. The Government has also acknowledged that the informal sector serves as a cover and breeding ground for illicit activities and provides opportunities for rent seeking.

## **B. Legal and Institutional Frameworks for Private Sector**

5. Commercial transactions are governed by the Commercial Code of 1955, which is based on Turkish law dating back to the early 1900s. There are also no laws to regulate mortgages and the use of negotiable instruments such as checks and promissory notes. Commercial courts exist but are too weak to effectively resolve commercial disputes. There are also no avenues of alternative dispute resolution such as arbitration or mediation.

6. To promote the development of the formal private sector, the Government has designated the Ministry of Commerce (MOC) to be the lead ministry responsible for private sector development. In this role, MOC is guided by the Cabinet Economic Sub-Committee, and liaises with the 18-member Economic Committee of the Parliament. MOC is in the process of rationalizing its structure to be able to effectively meet its private sector development mandate. In addition, the Government is taking steps to improve the investment climate. The Law on Private Investment in Afghanistan was adopted in 2005. The High Commission on Investment, chaired by the Minister of Commerce was established in 2002 to set the overall policy directions for investment promotion. The Afghanistan Investment Support Agency was also established in 2003 as the High Commission's implementing agency.

7. The Government has also initiated tax reforms supportive of private sector development. The Income Tax Law was amended in 2005 to expand the tax base and streamline the tax regime. Customs duties have likewise been rationalized. Further tax reforms are ongoing to remove "nuisance" taxes imposed by various government entities.<sup>3</sup> In addition, the Government has adopted labor regulations governing hiring, firing, and working hours to facilitate private enterprises' business operations.

## **C. State-Owned Enterprises and Other Government Commercial Activity**

8. Historically, there has been strong state presence in formal business activity. A substantial number of large enterprises are state-owned or under state control. The commercial activities of the 65 state-owned enterprises (SOEs) organized under the Law on State-Owned Enterprises (1960) range from public utilities, construction, manufacturing, agricultural services, warehousing, to advertising and printing. State presence in business is also manifested in share holdings by the Government in 13 joint stock companies (JSCs) organized under the Commercial Code (1955). Four ministries<sup>4</sup> have ownership of these JSCs that engage in a wide range of commercial activities such as airlines, telecommunications, hotels, textile manufacturing, trading, shipping and warehousing. A number of ministries also directly or indirectly conduct commercial activities such as leasing, production and marketing of agricultural

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<sup>3</sup> There are close to 100 different taxes, and the administrative costs of many of these taxes are likely to outweigh the revenue gains.

<sup>4</sup> Commerce, Communications, Finance, and Transportation and Civil Aviation.

products, garment manufacture, operation of sports facilities, media, and cement and coal production.

9. To establish the policy framework for SOE divestiture, the Government adopted the Privatization Policy in 2005 reiterating its commitment to privatize, and outlining the different privatization and liquidation modalities. The Privatization Policy also designates the Ministry of Finance (MOF) as the main ministry responsible for SOE reforms and privatization. The Law on State-Owned Enterprises (1960) was amended in 2005 to allow private participation in SOEs. Likewise, the Government issued liquidation procedures in 2006 detailing the key step involved in the disposal of SOE assets. Of the 65 SOEs, 56 are targeted for divestiture, and the remaining 9, mostly public utility companies, are to be restructured and retained as SOEs.

#### **D. Description of the Financial Sector**

10. The financial sector in Afghanistan is small, consisting of commercial banks, microfinance institutions, credit unions, foreign exchange dealers, money service providers, an insurance company and a leasing company. Commercial banks dominate the formal financial sector, representing 95% of assets in the formal sector. Given that much of the economic activity occurs in the informal private sector, the informal financial sector is estimated to be at least large as the formal financial sector. Since the passage of the Law of Da Afghanistan Bank (2003) and Law of Banking in Afghanistan (2003), the central bank, Da Afghanistan Bank (DAB), has supervised commercial banks. More recently, DAB has also issued regulations for depository microfinance institutions, money service providers, and foreign exchange dealers.<sup>5</sup>

11. By the end of the conflict in 2001, the banking system in Afghanistan was virtually a shell. The six state-owned banks—Bank Millie Afghan, Pashtany Tejaraty Bank, Export Promotion Bank, Agriculture Development Bank, Industrial Development Bank of Afghanistan and Mortgage and Construction Bank—were non-operational. Of the six, only the first three were relicensed by DAB with the remaining banks targeted for liquidation. In addition, DAB has licensed 10 private banks (5 domestic banks and 5 foreign bank branches), bringing the total number of commercial banks to 13 as of June 2006. Total bank assets grew by 50% during the last three quarters of 2005, with more than half of this coming from new private banks. Despite rapid growth, the banking system is still very small with banking assets, accounting for only about 8.8% of GDP in end-2005. Commercial banks operate less than 60 branches nationwide, almost a third of which are in Kabul. The banking system is heavily dollarized, with 77% of total deposits and 84% of total loans denominated in dollars (Table A1.2).

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<sup>5</sup> Under the law, DAB also has authority over payment system operators and securities service dealers.

**Table A1.2: Assets of the Banking System**  
(AF million)

Item	Mar 2005	Jun 2005	Sep 2005	Dec 2005
State-Owned Banks	10,515.1 (54.4)	11,133.7 (49.3)	11,407.0 (46.4)	11,674.0 (40.3)
Private Banks	4,051.1 (21.0)	5,708.4 (25.3)	7,639.0 (31.1)	10,763.0 (37.2)
Foreign Bank Branches	4,736.2 (24.6)	5,730.2 (25.4)	5,527.0 (22.5)	6,548.0 (22.5)
Banking System	19,302.4 (100.0)	22,572.3 (100.0)	24,573.0 (100.0)	28,985.0 (100.0)

Note: The figures in parentheses are the shares of the banking group to total banking assets. Private banks exclude one bank which was established in June 2006.

Source: Da Afghanistan Bank.

12. Business access to formal credit is limited. Loans granted by the commercial banks at end-2005 amounted to AF6.9 billion, comprising only 30% of banking sector assets (Table A1.3). Rather than lending, banks are investing in other financial assets offshore. There are several reasons for this. First, the weak operational capacity of the three relicensed state-owned banks constrains their lending capacity. Lending by these banks is limited to 15% of their total assets, and only 26% of total loans of the banking system. Second, most private sector banks are focused primarily on selected markets. For example, First Microfinance Bank was established to focus specifically on microfinance and Arian Bank focuses almost exclusively on trade finance. Third, the five branches of foreign banks have not been lending to private enterprises, and instead have collectively focused on transactions with embassies, nongovernment organizations (NGOs), development partners, and a few large corporate entities. Bank lending is mostly short-term and therefore not conducive to productive long-term investment.

**Table A1.3: Net Loans of the Banking System**  
(AF million)

Item	Mar 2005	Jun 2005	Sep 2005	Dec 2005
State-Owned Banks	1,051.4 (36.7)	1,233.3 (29.5)	1,588.0 (29.2)	1,775.0 (25.9)
Private Banks	1,551.9 (54.2)	2,604.1 (62.3)	3,061.0 (56.2)	4,737.0 (69.1)
Foreign Bank Branches	262.0 (9.1)	344.1 (8.2)	798.2 (14.7)	339.0 (4.9)
Banking System <sup>a</sup>	2,865.0 (100.0)	4,181.3 (100.0)	5,444.0 (100.0)	6,852.0 (100.0)

Note: The figures in parentheses are the shares of the banking group to total banking net loans. Private banks exclude one bank which was established in June 2006.

<sup>a</sup> Numbers may not sum precisely because of rounding.

Source: Da Afghanistan Bank.

**Table A1.4: Deposits of the Banking System**  
(AF million)

Item	Mar 2005	Jun 2005	Sep 2005	Dec 2005
State-Owned Banks	2,344.4 (25.8)	2,564.7 (21.4)	2,721.0 (20.2)	2,896.0 (17.9)
Private Banks	2,533.4 (27.9)	3,998.4 (33.4)	5,855.0 (43.6)	7,461.0 (46.0)
Foreign Bank Branches	4,217.3 (46.4)	5,399.0 (45.1)	4,861.5 (36.2)	5,865.7 36.2
Banking System <sup>a</sup>	9,095.1 (100.0)	11,962.0 (100.0)	13,437.0 (100.0)	16,224.0 (100.0)

Note: The figures in parentheses are the shares of the banking group to total banking deposits. Private banks exclude one bank which was established in June 2006.

<sup>a</sup> Numbers may not sum precisely because of rounding.

Source: Da Afghanistan Bank.

13. Despite a steady increase in recent years, bank deposits remain low at 3.6% of GDP and are mostly short term. State-owned banks, despite their size and geographic reach, generate only less than 20% of aggregate deposits in the banking sector (Table A1.4).

14. There are five microfinance institutions and seven deposit-taking credit unions operating in Afghanistan. Collectively, these institutions account for about 13% of total credit provided by the formal financial sector. At end-2005 the five credit unions had about 105,000 members with collective deposits of 130 million Afghani, equivalent to an average deposit of \$25 per member. Women comprise over three-quarters of microfinance borrowers, and more than half of outstanding microfinance loans support small retail, trading and agricultural enterprises. The Microfinance Investment Support Facility for Afghanistan (MISFA) was established in 2002 to provide an umbrella organization to support microfinance development. There are over 25 NGOs, donors and other international organizations active through MISFA, which provides technical assistance and wholesale funding for microfinance. Lending under MISFA amounted to about \$21 million to 160,000 borrowers in January 2006.

15. Although growing rapidly, the microfinance sector's outreach is limited. MISFA estimates total market for microfinance lending at approximately five million people. In addition to weak capacity of microfinance institutions, security concerns continue to constrain microfinance outreach.

16. The money dealers, referred to as *hawaladars*, have long existed in Afghanistan. These providers of financial services, which may number as many as 2,000 country-wide, offer a well-organized, convenient, and cost effective system for making international and domestic payments.<sup>6</sup> They provide a range of financial services such as foreign exchange trading, funds safe keeping, domestic and international fund transfers, and trade finance. It is estimated that over 20% of businesses borrow from *hawaladars* (footnote 2, page 23).

17. The *hawaladars* participate, along with financial institutions, in DAB's foreign exchange auctions. Prior to introduction of the new currency in 2003, the *hawaladars* played a key role in providing the local currency required for government expenditures through purchase of dollars provided by donor agencies and auctioned by DAB. Without the critical role and cooperation of

<sup>6</sup> Estimates vary from 500 to 2000. World Bank. 2003. *The Money Exchange Dealers of Kabul*. Washington, DC.

the foreign exchange dealers and money service providers in the banknote exchange undertaken in 2002, the introduction of the new Afghani would likely have failed. *Hawaladars* continue to be used by international agencies for payments services. Over time, the growth of the banking system and an efficient electronic payment system will provide viable alternatives to the informal *hawala* system, however, for the foreseeable future these providers of informal remittance services will be an integral part of financial activities.

18. Virtually all international remittances are routed through one of the Kabul dealers, which collectively account for the vast majority of *hawala* payments. Approximately 200 foreign exchange dealers and money service providers have been registered, which is viewed as sufficient to cover the bulk of the volume and value of transactions. However, it is too soon to determine whether the reporting requirements will be effective. A key challenge for DAB will be verifying the reporting and record-keeping of registered *hawaladars* in a cost-effective manner.

### **E. Legal, Supervisory, and Institutional Frameworks for Financial Sector**

19. When the Taliban regime fell in 2001, DAB and the state-owned banks operated under the 1994 Law on Money and Banking with the primary objectives of directing credit to various SOEs. The Law of Da Afghanistan, enacted in 2003, established the legal independence of DAB. DAB's primary mandate is to achieve and maintain price stability. DAB is also responsible for promoting the soundness and the stability of the financial system and payments system. The Law of Banking in Afghanistan was also enacted in 2003 to provide the basic framework for the operation of banks in the country. Based on these two laws, DAB has issued basic regulations on licensing, corporate governance, prohibited and authorized activities, large exposures, lending to related persons, liquidity, open foreign exchange positions, capital adequacy to asset classification and loan loss provisioning. Over the past 12 months, DAB has also (i) developed an on-site bank examination manual and procedures, (ii) completed on-site examination of five banks, (iii) initiated an off-site monitoring program, and (iv) conducted actions to enforce compliance to DAB regulations on reserve requirements and open foreign exchange positions.

20. To promote the stability and integrity of the financial system, the Government has adopted the Anti-Money Laundering and Proceeds of Crime Law (2004) and Law on Combating the Financing of Terrorism (2004). To implement these laws, a financial intelligence unit has also been established in DAB.

21. The Law of Banking in Afghanistan (2003) provides that DAB may apply part or all of the requirements of the Law to depository microfinance institutions. DAB has recently issued minimum prudential and reporting requirements for them. In 2006, DAB also adopted regulations on money service providers and foreign exchange dealers. The regulations cover, among others, registration, customer identification, reporting of suspicious activities and record-keeping.

22. The insurance sector is supervised by MOF. The Law on Insurance was amended in 2005 to remove the monopoly by the Afghanistan National Insurance Company. A comprehensive set of procedures has been developed to regulate the industry in line with international practice.

23. There are currently no regulations on leasing in Afghanistan.

DEVELOPMENT COORDINATION MATRIX<sup>a</sup>

Institution/Project	Amount	Implementation Period
<p><b>International Monetary Fund</b></p> <p>1. Poverty Reduction and Growth Facility (PRGF) PRGF seeks to foster macroeconomic stability and economic efficiency through fiscal and monetary reforms, including the introduction of excise taxes and capacity building for tax administration, refining the medium-term fiscal framework, and improving the monetary policy framework.</p> <p>Structural benchmarks specific to the private sector and financial market development include</p> <ul style="list-style-type: none"> <li>(i) Restructuring of two state-owned banks (Bank Millie Afghan and Pashtany Tejaraty Bank),</li> <li>(ii) Liquidation of one state-owned bank (Export Promotion Bank), and</li> <li>(iii) Restructuring/divestment plans for public entities and government agencies engaging in commercial activity but not covered by the Law on State-Owned Enterprises.</li> </ul>	SDR81 million	2006–2009
<p><b>World Bank</b></p> <p>1. Programmatic Support for Institution Building (PSIB) I and II</p> <p>PSIB I supported legal reforms in the areas of budget management and procurement.</p> <p>PSIB II seeks to deepen and broaden the reforms initiated under PSIB I. It covers public administration and fiscal management, particularly in strengthening the budget process, civil service reforms, and improving fiduciary standards in the public sector. In the areas of private sector and financial sector development, PSIB II supports</p> <ul style="list-style-type: none"> <li>(i) Strengthening the legal framework for private investment (including the drafting of the Law on Private Investment in Afghanistan, amendments to the Income Tax Law to provide tax incentives for private investment, and drafting of Business Organization Law),</li> <li>(ii) Capacity building of Da Afghanistan Bank (DAB) through the adoption of information technology and organizational restructuring;</li> </ul>	\$80 million (PSIB I); \$80 million (PSIB II)	2005 (PSIB I) 2006 (PSIB II)

Institution/Project	Amount	Implementation Period
<ul style="list-style-type: none"> <li>(iii) Relicensing and resolution of state-owned banks,</li> <li>(iv) Adoption of core prudential regulations, and</li> <li>(v) Identification of state-owned enterprises (SOEs) for divestiture.</li> </ul> <p>2. Afghanistan Investment Guarantee Fund<sup>b</sup> An investment guarantee facility to provide political risk guarantees to eligible investments.</p> <ul style="list-style-type: none"> <li>(i) Eligible forms of investment include <ul style="list-style-type: none"> <li>(a) equity; (b) shareholder loans, and loan guarantees issued by equity holders, which must have a term of at least 3 years; and</li> <li>(c) technical assistance, management contracts, franchising and licensing agreements, provided that investor's remuneration is tied to the projects' operating results.</li> </ul> </li> </ul>	\$5 million	2005–2009
<p><b>United States Agency for International Development (USAID)</b></p> <p>1. Economic Governance and Private Sector Strengthening (Phase II) Project The project aims to strengthen governance through regulatory and legal reforms, and institutional strengthening of DAB. Specifically, the project supports</p> <ul style="list-style-type: none"> <li>(i) Drafting a set of commercial laws (Arbitration Law, Corporations Law, Partnerships Law, Contracts Law, Competition Law, Mediation Law, Copyrights Law, Trademarks Law, and Patents Law);</li> <li>(ii) Institutional strengthening of DAB for basic on-site and off-site supervision development of an accounting system for DAB operations, and the consolidation of government accounts across all DAB provincial branches; and</li> <li>(iii) Drafting of financial laws (Secured Transactions Law and Negotiable Instruments Law).</li> </ul>	\$44 million	2005–2008

Institution/Project	Amount	Implementation Period
<p>2. Land Titling and Economic Restructuring Project The project aims to improve land tenure security in Afghanistan and assist the Government to undertake a comprehensive privatization program. Specifically, the project supports</p> <ul style="list-style-type: none"> <li>(i) Drafting of the land policy and land laws (Anti-eviction Law and Immovable Property Formalization Law);</li> <li>(ii) Liquidation of three state-owned banks through the provision of in-house advisors;</li> <li>(iii) Preparation of the policy, legal and institutional framework for privatization (Privatization Policy [2005], amendments to the Law on State-Owned Enterprises, and Liquidation Procedures [2006]) and the social safety net program for redundant workers; and</li> <li>(iv) In-house advisors in the Ministry of Finance to assist in the divestiture of SOEs.</li> </ul>	\$29 million	2005–2007
<p>3. Industrial Park Project The project supports construction of three industrial parks (Bagrami Industrial Park, Kandahar Industrial Park, and Maza-e-Sharif Industrial Park) to stimulate investment and minimize potential business risks.</p>	\$21 million	2004–2009
<p>4. Agriculture, Rural Investment and Enterprise Strengthening (ARIES) Project The project supports</p> <ul style="list-style-type: none"> <li>(i) Strengthening regional networks of farmers' associations, agriculture cooperatives, and rural credit unions;</li> <li>(ii) Expanding microfinance services to urban and rural communities; and</li> <li>(iii) Establishing a rural investment fund for agribusinesses and other rural SMEs.</li> </ul>	\$80 million	2006–2009
<p>5. Small- and Medium-sized Enterprise (SME) Development Project The Program supports SME development by</p> <ul style="list-style-type: none"> <li>(i) Providing advice on business development services,</li> <li>(ii) Establishing business associations, and</li> <li>(iii) Conducting market studies.</li> </ul>	\$45 million	2006–2009
<p>6. Afghan Renewal Fund The Fund is a venture capital fund designed to meet the financing needs of SMEs in Afghanistan.</p>	\$1.5 million	





Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanism	Assumptions and Risks
	<p>dispute resolution system established</p> <p>Immovable Property Formalization Law submitted to Parliament</p> <p>Effective land titling and management system in place</p>	<p>Dialogue with municipal governments, Bankers' Association, individual commercial banks and development partners</p> <p>ADB review missions</p>	<p>ADB</p> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Delays in identifying qualified consultants</li> <li>• Loss of qualified staff in executing and implementing agencies</li> </ul>
2. Key market distortions addressed	<p>Municipal price controls removed</p> <p>Business registration and permit system streamlined</p>		
3. State-owned enterprises (SOEs) liquidated	<p>Effective mechanism for SOE liquidation established</p> <p>Bidding Invitations for SOE assets issued</p> <p>Social safety net program for redundant workers implemented</p>		
4. Improved financial supervision	<p>Agreement on cross-border supervision signed with at least one home supervisory agency</p> <p>Detailed risk management regulations and guidelines in place</p> <p>System for managing enforcement actions established and implemented</p> <p>Policies and procedures on conservatorship, receivership and forced liquidation of banks adopted</p> <p>Regulations on banks' external audit issued</p> <p>Training on internal control, risk management, enforcement actions and back-office operations conducted.</p>		
5. Accounting and auditing standards adopted and the profession's capacity	<p>Accounting Law and Auditing Law adopted</p>		

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanism	Assumptions and Risks
strengthened	Accounting and auditing board established  Accreditation and training programs developed and implemented.		
<b>Activities with Milestones</b> <ol style="list-style-type: none"> <li>1.1 Land Policy adopted by March 2007</li> <li>1.2 Commercial Arbitration Law drafted and submitted to Parliament by April 2007</li> <li>1.3 Immovable Property Formalization Law drafted and submitted to Parliament by September 2009</li> <li>1.4 Seminars and trainings on the implementation of the Commercial Arbitration Law and Immovable Property Formalization Law provided intermittently during Program implementation.</li> <li>2.1 Resolution abolishing municipal price controls issued by Cabinet (completed)</li> <li>2.2 Report on business registration and permit system completed by August 2007</li> <li>2.3 Municipal governments' regulations streamlining business registration issued and implemented by December 2007</li> <li>3.1 Approval by Cabinet of 10 SOEs for liquidation by December 2006 and an additional 10 by October 2007</li> <li>3.2 Issuance by Liquidation Committees of bidding invitations for the 20 SOEs by September 2008</li> <li>3.3 Allocation by MOF of budget in line with approved restructuring plan for the SOE Department</li> <li>3.4 Appointment of director of MOF's SOE Department by the Government (completed)</li> <li>4.1 On-site and off-site examination of commercial banks initiated by DAB (completed)</li> <li>4.2 Policies and procedures on conservatorship, receivership and forced liquidation of banks developed by September 2008 and implemented by March 2009</li> <li>4.3 Agreement on cross-border consolidated supervision between DAB and at least one home supervisory agency by June 2009</li> <li>4.4 Adoption by DAB of detailed regulations and compliance guidelines on risk management by March 2009</li> <li>4.5 Establishment by DAB of uniform bank performance reporting system and enforcement action tracking system by December 2007</li> <li>4.6 Financial statements of individuals banks published in the DAB website by August 2008</li> <li>4.7 Regulations for <i>hawaladars</i> and depository microfinance institutions issued by DAB (completed)</li> <li>4.8 Training for DAB staff provided intermittently during Program implementation</li> <li>4.9 Training for banking professionals provided intermittently during Program implementation</li> <li>5.1 Accounting Law and Auditing Law submitted to Parliament by December 2007</li> <li>5.2 Accounting and auditing board and its secretariat established by October 2008</li> <li>5.3 Certification and training program for accounting and auditing established by October 2009</li> </ol>			<b>Inputs</b> <ul style="list-style-type: none"> <li>• Program Grant amounting to \$56 million</li> <li>• Capacity-Building Grant amounting to \$4 million (64 person-months international consultants, and 132 person-months national consultants)</li> </ul>

<sup>a</sup> Actual unemployment rate is estimated to be significantly higher than the official figure.

## **DEVELOPMENT POLICY LETTER AND POLICY MATRIX FOR PRIVATE SECTOR AND FINANCIAL MARKET DEVELOPMENT**

### **A. Development Policy Letter**

#### **Subject: Private Sector and Financial Market Development Program**

Mr. Haruhiko Kuroda  
President  
Asian Development Bank  
Manila, Philippines

Dear Mr. Kuroda,

The Government of Afghanistan is strongly committed to pursuing structural reforms to promote sustainable economic growth and the welfare of the Afghan people. Since the fall of the Taliban regime and the establishment of this Government, we have made significant progress in achieving political and macroeconomic stability. Building on these achievements, the Government seeks to further transform the economy that will allow the shift from reconstruction-driven recovery to private sector-led sustainable development.

Following extensive consultation with stakeholders, the Government has adopted the Interim Afghanistan National Development Strategy (I-ANDS). I-ANDS embodies the Government's development objectives and strategies for the period 2006–2010. Private sector development is one of the key outcomes envisioned in the I-ANDS as it is essential for sustainable economic growth and employment generation. A thriving private sector is also essential for providing alternative livelihood in the rural areas, thereby supporting the Government's efforts to eradicate the narcotics economy. In addition, it will allow the Government to generate revenues that will provide more services, particularly, for the poor.

The task ahead is formidable. Years of conflict devastated Afghanistan's industrial capacity and the previously thriving private sector was substantially weakened. At its current state, Afghanistan's private sector has neither the capacity nor the resources to be a growth catalyst. The financial sector likewise remains nascent, and does not yet play a meaningful role in promoting private sector development.

The Government's medium-term reform efforts will focus on creating an enabling environment for entrepreneurship and investment, reducing state presence in areas where the private sector would be more efficient, and improving private enterprises' access to credit. Developing the human capital base will also be fundamental to ensure sustainable development of these sectors. In line with this, the Government, with the support the Asian Development Bank (ADB) will undertake the Private Sector and Financial Market Development Program (the Program). The Program will focus on the following areas:

#### **A. Strengthening the Enabling Environment for Private Sector Development**

The weaknesses in the legal framework for commercial activities and financial transactions are a fundamental impediment to private sector development. A number of existing laws required for private sector development are outdated. For example, the Commercial Code was enacted in 1955 and does not reflect current economic and business conditions in Afghanistan. The absence of an efficient mechanism for resolving commercial disputes compounds the high level of uncertainty and risk faced by private enterprises. The absence of a legal basis for land titling

also constitutes a major impediment. Specifically, lack of clarity in property rights prevents the use of land as collateral to secure loans, thereby constraining business establishment and expansion. Under the Program, Government will prioritize legal reforms aimed at addressing these weaknesses.

The Government is aware that price controls and inefficiencies in the business registration procedures undermine private sector growth. The Government has recently issued a resolution abolishing price controls, and will take measures to ensure that municipal authorities enforce the resolution. While improving licensing procedures at the national level, the Government will also streamline the business permit system at the municipal level which mainly affects small businesses.

## **B. Disengaging the Government from Business Activities**

The Government recognizes that for Afghanistan to successfully transition to market economy, the state's involvement in business activities needs to be curtailed. Several years of central planning has resulted in the concentration of resources in state-owned enterprises (SOEs), which are either nonfunctional or operate at low levels of capacity utilization. The divestment of SOEs will facilitate the release of land to the private sector for productive use, and ease the private enterprises' binding access to land constraint. This will also improve private enterprises' access to financing with more land available as collateral for borrowing.

The Government's resolve to disengage from business activities is underlined in the Privatization Policy adopted in 2005. To facilitate this process, the Government has adopted amendments to the State-owned Enterprises Law, and has issued detailed liquidation procedures. The Government has identified 56 of the 65 SOEs to be targeted for divestiture through various modalities including liquidation, privatization through asset sales,<sup>1</sup> corporatization and sales of shares, management contracts, long-term leases and joint ventures, while the remaining nine, mostly public utilities, are to be restructured and retained as SOEs. Over the next 3 years, the Government will take measures to accelerate the divestiture of SOEs in a fair and transparent manner.

The Government is aware that the capacity of the Ministry of Finance (MOF) to manage the privatization process is limited. The Government will strengthen its institutional capacity to implement the divestiture of SOEs by restructuring and building capacity in the SOE Department of MOF. To this end, the Government will allocate adequate budget for staff recruitment and training.

To ensure that social safety net is provided to workers affected by the liquidation of SOEs, the Government will allocate a budget to support severance packages. The Government will also allocate sufficient budget and will provide job counseling and retraining programs for retrenched workers of SOEs through the National Skills Development Program of the Ministry of Labor, Social Affairs, Martyrs and Disabled.

## **C. Improving the Private Sector's Access to Financial Services**

The Government recognizes that to enable the financial sector to provide better financial services to private enterprises, it is crucial that the banking system is sound and that depositors are protected. The banking system as such must be adequately supervised and meet proper

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<sup>1</sup> Privatization through asset sales is selling the core business in one package and selling any excess land not required for the core business are separately.

transparency and disclosure requirements. Greater confidence in the banking system will allow banks to mobilize domestic savings to meet the financing needs of private enterprises. The banking system also needs human resources to effectively deliver services to both households and private business.

Given the growing presence of foreign banks in Afghanistan, it is crucial that the authorities establish an effective mechanism for cross-border supervision. Under the Program, the Da Afghanistan Bank (DAB) will sign a memorandum of understanding with relevant home country supervisors outlining: clear and workable protocols for information sharing and coordination on issues of licensing, ongoing supervision of cross-border establishments, on-site examinations, and protection of confidentiality.

To mitigate systemic risk in the banking, DAB will initially adopt regulation on minimum risk management requirements for banks, and gradually introduce more detailed guidelines for banks on the management of credit, operational, and market risks. To ensure compliance with the regulatory requirements, DAB will establish a system to manage enforcement action, which includes a tracking system for such actions. To manage systemic risks posed by distressed banks, DAB will also adopt policies and procedures on conservatorship, receivership and forced liquidation.

Improving public confidence in the banking sector requires transparency based on reliable and timely information. Accordingly, DAB will issue regulations on the external audit of banks and qualifications of bank auditors, and will take remedial supervisory actions to ensure the timely submission of audited statements by banks. DAB will also publish banks' financial statements on DAB's website.

DAB will conduct parallel efforts to build capacity among supervisors, particularly in the areas of internal control, risk management, enforcement actions, and back-office operations.

The role of the microfinance sector in meeting the needs of small borrowers and depositors has increased markedly in recent years. To promote the orderly development of this sector, DAB will adopt and implement the regulations of licensing and supervision of depository microfinance institutions. This would strengthen depositor confidence thereby enabling them to mobilize savings to expand their outreach. Likewise, to protect clients of money service providers and foreign exchange dealers (*hawaladars*), DAB will adopt regulations aimed at enhancing disclosure about the *hawaladars'* financial transactions.

The absence of national accounting and auditing standards impinges on private enterprises' ability to access credit. To address this, the Government will adopt an accounting and auditing law in line with international standards. To provide the needed policy and institutional frameworks for the timely implementation of the standards, the Government will establish an accounting and auditing board under MOF, comprising of representatives from MOF, DAB, Ministry of Commerce (MOC), Control and Audit Office and professional accountants and auditors from the private sector. In addition, to address the acute shortage of qualified accountants and auditors in Afghanistan, the accounting and auditing board will define accreditation and examination requirements for the licensing of accountants and auditors, and will issue standards for professional ethics.

The Government understands that successful Program implementation depends on the ability of the Executing and Implementing Agencies to undertake reform measures in a timely manner.

The Government has designated MOF as the Executing Agency for the Program. MOF will also be an implementing agency, together with MOC and DAB. MOF will set up an inter-agency coordination committee headed by the Deputy Minister for Finance, and comprising representatives of MOC, DAB, and Ministry of Justice. MOF will (i) oversee the liquidation of SOEs and the implementation of accounting and auditing reforms, including the drafting of an accounting and auditing law and the establishment of the accounting and auditing board; and (ii) coordinate and monitor the drafting of the Immovable Property Formalization Law. MOC will (i) oversee the drafting of the Commercial Arbitration Law, and (ii) coordinate with municipal authorities in the streamlining of business registration processes and lifting of municipal price controls. DAB will oversee the implementation of the financial supervision reforms and capacity building in central bank.

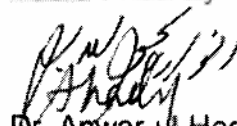
The Government will ensure that the local currency funds generated by the grant will be used, first, to support the adjustment cost of reforms under the Program, and second, to finance expenditures for general development purposes of Afghanistan.

#### **D. The Government's Request**

The Government firmly believes that a vibrant private sector and resilient financial market are fundamental to achieving economic development and poverty alleviation. The Government is fully committed to the policy actions called for under the Program as outlined in the Policy Matrix. The Government therefore seeks ADB's favorable consideration of its request for a proposed program grant of \$56 million to implement the Program as outlined above, and an accompanying \$4 million Capacity Building Grant for Supporting Private Sector and Financial Market Reforms.

In closing, let me extend my appreciation for ADB's continued support for Afghanistan's reconstruction and development.

Yours sincerely



Dr. Anwar-ul-Haq Ahady  
Minister of Finance

## B. Policy Matrix

The objective of the Program is to promote the development of the private sector as the main engine of economic growth by

- (i) strengthening the enabling environment for private sector development,
- (ii) disengaging Government from business activity through the liquidation of state-owned enterprises, and
- (iii) improving private sector's access to financial services.

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
<b>A. Strengthening the Enabling Environment for Private Sector Development</b>			
1. Establishing the legal framework	Ministry of Commerce (MOC) to draft a Commercial Arbitration Law to facilitate out-of-court settlement of business disputes.	Cabinet to adopt a Land Policy that outlines principles and policy directions for the formalization of land ownership.  <b>Cabinet to submit to Parliament the Commercial Arbitration Law, satisfactory to Asian Development Bank (ADB).</b>	In line with the Land Policy, Cabinet to submit to Parliament the Immovable Property Formalization Law, satisfactory to ADB.
2. Eliminating price controls and streamlining business registration	Cabinet to issue a resolution abolishing municipal price controls.	MOC to monitor Kabul municipality authorities' compliance with the resolution abolishing price controls.  <b>MOC, in coordination with the municipal governments, to streamline business registration procedures in the municipalities to facilitate market entry of private enterprises.</b>	MOC to monitor municipal authorities' compliance with the new business registration procedures.
<b>B. Disengaging the Government from Business Activity through the Liquidation of State-Owned Enterprises</b>			
1. Accelerating liquidation of state-owned enterprises (SOEs)		<b>Cabinet to approve liquidation or privatization through asset sales of 10 SOEs (excluding the SOE for divestiture)</b>	

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
		<p><b>under the Agriculture Sector Program).</b></p> <p>MOF to appoint Liquidation Committees for 10 SOEs to implement the liquidation or privatization through asset sales.</p> <p><b>MOF, through the Liquidation Committees, to issue liquidation/asset sales announcements for the 20 SOEs, including calls for creditors and claimants.</b></p> <p><b>MOF, through the Liquidation Committees, to issue bidding invitation for the assets of the 20 SOEs.</b></p>	
2. Building capacity in SOE Department of MOF	MOF to appoint the Director of the SOE Department.	<p>MOF to (i) draft a restructuring plan, including staff requirements, for the SOE Department to assist in the divestiture of SOEs; and (ii) obtain the Independent Administrative Reform and Civil Service Commission's approval of the restructuring plan.</p> <p><b>MOF to allocate budget in line with approved restructuring plan for the SOE Department.</b></p>	
3. Safety net program for redundant employees of divested SOEs	MOF to allocate adequate budget needed for the social safety net program (severance package and job training for employees affected by SOE liquidation) for 2006.	<b>MOF to allocate adequate budget needed for the social safety net program for 2007 and 2008.</b>	MOF to allocate adequate budget needed for the social safety net program in 2009.

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
	Ministry of Labor, Social Affairs, Martyrs and Disabled (MOL) to start implementing a program on job counseling and retraining for redundant employees of SOEs under the National Skills Development Program.	MOL to continue to implement the program on job counseling and retraining for redundant employees of SOEs under the National Skills Development Program.	MOL to continue to implement the program on job counseling and retraining for redundant employees of SOEs under the National Skills Development Program.
<b>C. Improving Private Sector's Access to Financial Services</b>			
<b>1. Strengthening the Supervisory Framework for Financial Institutions to (i) Improve Depositor Protection and Confidence in the Financial System, and (ii) Enable Provision of More Services to the Private Sector</b>			
<b>a. Banking Sector</b>			
(i) Banking Supervision	<p>Da Afghanistan Bank (DAB) to develop an on-site examination manual and a standardized report of examination.</p> <p>DAB to commence the on-site examination of commercial banks.</p> <p>DAB to commence off-site monitoring program of commercial banks.</p>	<p><b>DAB to (i) draft a Memorandum of Understanding (MOU) to be signed by DAB and foreign bank supervisors that includes clear and workable protocols for (a) ongoing supervision of cross-border establishments, (b) on-site examinations, (c) protection of confidentiality, and (d) the establishment of a system of regular and as needed meetings among supervisory authorities; and (ii) submit this draft MOU to its counterpart bank supervisors.</b></p>	<p>DAB to sign MOU, satisfactory to ADB, on cross-border consolidated supervision with at least one supervisor of countries with banks that have significant presence in Afghanistan either through branches or subsidiaries.</p>

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
(ii) Enforcement Action and Systemic Risk Mitigation		<p>DAB to establish a uniform bank performance reporting system, including a database, to systematically assess bank performance.</p> <p>DAB to establish a system for tracking its enforcement actions.</p> <p><b>DAB to draft policies and procedures on conservatorship, receivership, and forced liquidation of distressed banks.</b></p>	<p>DAB to adopt policies and procedures on conservatorship, receivership and forced liquidation of distressed banks.</p>
(iii) Risk Management		<p><b>DAB to draft detailed regulations on credit risk, operational risk, and market risk management.</b></p>	<p>DAB to adopt regulations on credit risk, operational risk, and market risk management.</p> <p>DAB to develop and implement on-site and off-site examination modules to verify the existence, adequacy and implementation of banks' risk management procedures.</p>
(iv) Disclosure		<p>DAB to issue regulations on the external audit of banks and the qualifications of bank auditors.</p> <p>DAB to exercise remedial actions, if warranted, to enforce the submission of audited financial statements as required under the Law of Banking in Afghanistan (2003).</p>	

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
		<b>DAB to enhance disclosure by publishing the financial statements of individual banks on DAB website.</b>	
(v) Capacity Building		DAB to design and conduct regular training programs in the areas of internal control, risk management, enforcement actions, and back-office operations.	
b. Informal Financial Sector	DAB to issue regulation on the licensing, registration and reporting requirement of money service providers and foreign exchange dealers ( <i>hawaladars</i> ).	DAB to start implementation of the regulation for <i>hawaladars</i> in Kabul and in major provincial capitals.	
c. Microfinance Sector	DAB to issue regulation on licensing and supervision of depository microfinance institutions.	DAB to start implementation of the regulations on depository microfinance institutions.	
<b>2 Enhancing Disclosure Requirements to Improve the Private Sector's Access to Finance</b>			
a. Adopting and implementing national accounting and auditing standards		<p>MOF to draft an Accounting Law. The Law should include, inter alia, a timetable for adopting International Financial Reporting Standards (IFRS) for public interest entities.<sup>a</sup></p> <p>MOF to draft an Auditing Law. The Law should include, inter alia, a timetable for adopting International Standards on Auditing (ISA) for public interest entities.</p> <p><b>Cabinet to submit to Parliament the Accounting Law and Auditing Law satisfactory to ADB.</b></p>	<p>MOF, through the Accounting and Auditing Board, to develop accreditation and examination requirements for certifying and licensing of professional accountants and auditors.</p> <p>MOF, through the Accounting and Auditing Board, to develop partnerships with formal educational institutions which will offer accredited accounting and auditing, and training.</p> <p>MOF, through the Accounting and</p>

Policy Objective	First Tranche Conditions	Second Tranche Conditions (in Bold) and Other Monitorable Conditions (Indicative December 2008)	Policy Actions to be Completed Before Program End (December 2009)
		<p>Cabinet to issue a decree establishing and defining the mandate and structure of an accounting and auditing board, under MOF and comprising representatives from MOF, DAB, MOC, Control and Audit Office, and professional accountants from the private sector, to regulate the accounting and auditing profession.</p> <p>MOF to establish a unit, consisting of at least three persons, to act as the secretariat of the accounting and auditing board.</p>	<p>Auditing Board, to adopt a code of ethical standards for accountants and auditors in conformity with International Federation of Accountants (IFAC) code of ethics.</p> <p>MOF, through the Accounting and Auditing Board, to development of a strategy and time-bound action plan for the establishment of a financially sustainable professional association for accountants and auditors.</p>

<sup>a</sup> Public interest entities are defined as entities that are of significant public interest because of their business, size, number of employees, or corporate status such that they have a wide range of stakeholders.

### LIST OF INELIGIBLE ITEMS

1. Grant proceeds will finance the foreign currency expenditures for the reasonable cost of imported goods required during the Private Sector and Financial Market Development Program.

2. No withdrawals will be made for the following:

- (i) expenditures for goods (included in the following Standard International Trading Commodity chapters or headings):

**Table A5: Ineligible Items**

Chapter	Heading	Description of Items
112		Alcoholic beverages
121		Tobacco, unmanufactured; tobacco refuse
122		Tobacco, manufactured (whether or not containing tobacco substitute)
525		Radioactive and associated materials
667		Pearls, precious and semiprecious stones, unworked or worked
897	897.3	Jewelry of gold, silver or platinum-group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971		Gold, nonmonetary (excluding gold ore and concentrates)
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), nonirradiated for nuclear reactors

Source: United Nations.

- (ii) expenditures in the currency of the recipient or of goods supplied from the territory of the recipient;
- (iii) payments made for expenditures incurred more than 180 days before the effectiveness date of the grant;
- (iv) expenditures for goods supplied under a contract that any national or international financing institution or agency will have financed or has agreed to finance, including any contract financed under any loans from the Asian Development Bank;
- (v) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;
- (vi) expenditures for narcotics; and
- (vii) expenditures for pesticides categorized as extremely hazardous or highly hazardous in classes I-a and I-b, Classification of Pesticides by Hazard and Guidelines to Classification.

**CAPACITY BUILDING GRANT FOR SUPPORTING PRIVATE SECTOR  
AND FINANCIAL MARKET REFORMS**

**A. Cost Estimates and Financing Plan (\$'000)**

Item	Total Cost
<b>A. Investment Costs<sup>a</sup></b>	
1. Consultants	
a. Remuneration and Per Diem	
i. International Consultants	2,190.0
ii. National Consultants	265.0
b. International and Local Travel	250.0
c. Unallocated Pool of Funds <sup>b</sup>	750.0
2. Workshops, Training/Seminars, and Conferences	155.0
3. Miscellaneous Administration and Support Costs (including translation)	80.0
4. Contract Negotiations	20.0
5. Contingencies	290.0
<b>Subtotal (A)</b>	<b>4,000.0</b>
<b>B. Government Financing<sup>c</sup></b>	
1. Office Accommodation/Training/Workshop Facilities	100.0
2. Remuneration of Counterpart Staff	200.0
<b>Subtotal (B)</b>	<b>300.0</b>
<b>Total</b>	<b>4,300.0</b>

<sup>a</sup> Financed by the Asian Development Fund; exclusive of local taxes and duties.

<sup>b</sup> This amount will be used to engage short-term consultants as additional capacity building needs are identified.

<sup>c</sup> ADB. 2005. *Extension of the Waiver of the Cost-Sharing Limits for Loans and TA Operations for Afghanistan*. Manila.

Source: Asian Development Bank estimates.

**B. Outline Terms of Reference for Consulting Services**

**1. International Consultants**

**a. Commercial Law Expert (3 person-months)**

1. The expert will be a commercial lawyer, with a strong background in commercial arbitration. The expert will have substantial practical knowledge of the Model Law on International Commercial Arbitration and Arbitration Rules of the UN Commission on International Trade Law (UNCITRAL). The expert will have substantial experience (at least 5 years) in drafting laws on commercial arbitration in developing economies. The expert will be responsible for coordinating the inputs of the national legal expert, and for the timely delivery of quality reports to the Government and the Asian Development Bank (ADB). The expert will

- (i) review the draft commercial arbitration law and proposed changes, if necessary;
- (ii) draft implementing rules and regulations for the above law, as needed; and
- (iii) design and conduct seminars and trainings to disseminate above laws and the corresponding implementing rules and regulations to facilitate the timely adoption and implementation of the law.

**b. Legal Expert on Immovable Property Formalization Law (3 person-months)**

2. The expert will have a degree in law, and will be an expert on land titling, legal issues on land tenure, and formalization of informal settlements. The expert will have substantial experience (at least 5 years) in drafting laws and implementing regulations on immovable property formalization in developing economies. The expert will be responsible for coordinating the inputs of the national legal expert, and for the timely delivery of quality reports to the Government and ADB. The expert will

- (i) draft legislation on immovable property formalization law;
- (ii) draft implementing rules and regulations for the above law, as needed; and
- (iii) design and conduct seminars and trainings to disseminate above law and the corresponding implementing rules and regulations to facilitate their timely adoption and implementation.

**c. Business Economist (3 person-months)**

3. The economist will have a post-graduate degree in economics. The expert will have substantial experience (at least 5 years) in providing policy advice on macroeconomic management, as well as technical expertise on the establishment and operations of small business in developing countries. The economist will be responsible for coordinating the inputs of the national economic analyst, and for the timely delivery of quality reports to the Government and ADB. The economist will

- (i) develop a system to help the Ministry of Commerce monitor and enforce compliance by municipal authorities with the Cabinet resolution abolishing price controls;
- (ii) prepare a report identifying inefficiencies in business registration and permit systems currently implemented by the municipal governments in Kabul and Herat, with a focus, among others, on (a) how the process restricts private enterprises' market entry, and (b) the consequence of market entry restriction to the pricing of goods produced by those affected by the business registration;
- (iii) prepare a model municipal regulation to guide municipal governments in streamlining business registration and permit system; and
- (iv) facilitate consultations and dissemination seminars to solicit stakeholder buy-in and ensure the timely and proper implementation of measures aimed at removing price controls and streamlining business registration and permit system.

**d. State-Owned Enterprise (SOE) Liquidation Expert (24 person-months, 3 experts)**

4. The expert will have practical experience (at least 10 years) in the privatization and liquidation of state-owned enterprises in transition or post-conflict economies, particularly, in the valuation of assets, design and implementation of liquidation plans, organizing asset sales, and resolution of claims. The expert will be responsible for coordinating the inputs of national SOE experts, and for the timely delivery of quality reports to the Government and ADB. The expert will

- (i) review the valuation of assets of SOEs approved for liquidation or privatization through asset sales, and provide advice to the liquidation committees;
- (ii) assist the Liquidation Committees in the design of liquidation plans;

- (iii) provide advice on the actions to be taken in response to creditors and claims on SOEs approved for liquidation or privatization through asset sales;
- (iv) assist in organizing asset sales;
- (v) design and implement training programs for the SOE Department to build their capacity to support liquidation/privatization through asset sales; and
- (vi) provide guidance for the effective implementation of the social safety net program.

**e. Bank Regulatory and Policy Expert (9 person-months)**

5. The expert will have extensive experience (at least 10 years) in financial regulation and supervision, and the implementation of international best practices in developing economies, preferably in transition or post-conflict economies. The expert will be responsible for coordinating the inputs of the international commercial banking specialist and national banking experts, and for the timely delivery of quality reports to the Government and ADB. The expert will

- (i) assist DAB in drafting a standard memorandum of understanding between Da Afghanistan Bank (DAB) and foreign banking sector supervisory agencies, that includes clear and workable protocols for (a) ongoing supervision of cross-border establishments, (b) on-site examinations, (c) protection of confidentiality, and (d) establishment of a system of regular and as needed meetings among supervisory agencies;
- (ii) prepare a detailed blueprint for a uniform bank performance reporting system and DAB's enforcement action tracking system;
- (iii) assist DAB in developing policies and procedures on conservatorship, receivership and forced liquidation of banks;
- (iv) assist DAB in preparing detailed risk management regulations and compliance guidelines; and
- (v) design and conduct training programs to improve bank supervision particularly on the areas of internal control, risk management, enforcement actions, and back-office operations.

**f. Commercial Banking Specialist (6 person-months)**

6. The specialist will have extensive experience (at least 7 years) in commercial bank operations, particularly in the areas of corporate and retail banking. The expert will also have practical experience in the development of private commercial banking operations in transition or post-conflict economies. The specialist will

- (i) assist the bank regulatory and policy expert in developing risk management regulations;
- (ii) assist the bank regulatory and policy expert in developing the uniform bank performance reporting system;
- (iii) develop a strategy and time-bound action plan in building the capacity in the banking profession;
- (iv) assist DAB and the Afghanistan Banks Association (ABA) in the design and conduct accreditation and training program for banking professionals;
- (v) facilitate discussions between DAB, ABA, and formal educational institutions in developing the appropriate curricula for the banking profession;
- (vi) provide advisory support to DAB, ABA, and partner formal educational institutions in the design of the appropriate curricula for the banking profession; and

- (vii) conduct training programs on modern banking practices to banking professionals.

**g. Accounting and Auditing Specialist (10 person-months)**

7. The specialist, certified public accountant or equivalent, will have extensive experience (at least 7 years) in developing accounting and auditing standards in developing economies (preferably in transition or post-conflict economies) and have substantive knowledge of International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA). The specialist will be responsible for coordinating the inputs of international and national legal experts and the national accounting and auditing expert, and for timely delivery of quality reports to the Government and ADB. The specialist will

- (i) coordinate with the legal expert in drafting an accounting law, and an auditing law consistent with IFRS and ISA;
- (ii) advise Ministry of Finance on the establishment of an accounting and auditing board to regulate the accounting and auditing profession;
- (iii) provide recommendations on qualification requirements for the issuing of certifications/licenses to accountant and auditors;
- (iv) develop and provide pilot training to facilitate understanding of international accounting and auditing standards among accounting professionals, regulators, businesses, and other providers and users of financial information;
- (v) draft a code of ethical standards for accountants and auditors;
- (vi) develop a strategy and time-bound action plan for the development of a professional association for accountants and auditors; and
- (vii) in coordination with the legal expert for accounting and auditing, design and conduct seminars and trainings to disseminate above laws and the corresponding implementing rules and regulations to facilitate the timely adoption and implementation of the laws.

**h. Legal Expert for Accounting and Auditing Law (6 person-months)**

8. The expert will have a degree in law, and will be an expert on international accounting and auditing standards. The expert will have substantial international experience (at least 5 years) in drafting laws on accounting and auditing standards for developing economies. The expert will

- (i) draft legislation on an accounting law and an auditing law;
- (ii) draft implementing rules and regulations for the above laws, as needed; and
- (iii) in coordination with the international accounting and auditing specialist, design and conduct seminars and trainings to disseminate above laws and the corresponding implementing rules and regulations to facilitate the timely adoption and implementation of the laws.

**2. National Consultants**

9. The capacity-building grant will require 11 national consultants for a total for 132 person-months. Ten consultants will each have background in the areas of (i) economic analysis, (ii) Afghanistan's legal system (3 experts), (iii) SOE reforms (3 experts), (iv) financial supervision, (v) commercial banking, and (vi) accounting and auditing. An additional national consultant will be engaged to provide overall administrative support for capacity-building grant implementation.

**3. Unallocated Pool of Funds**

10. An unallocated pool of funds to engage consultants as additional capacity-building needs are identified during Program implementation.

## SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

### A. Linkages to the Country Poverty Analysis

<b>Is the sector identified as a national priority in country poverty analysis?</b>	<input checked="" type="checkbox"/> Yes  <input type="checkbox"/> No	<b>Is the sector identified as a national priority in country poverty partnership agreement?</b>	<input checked="" type="checkbox"/> Yes  <input type="checkbox"/> No
<p><b>Contribution of the sector or subsector to reduce poverty in Afghanistan:</b></p> <p>The 2006 Interim Afghanistan National Development Strategy (I-ANDS) is the Government's Interim Poverty Reduction and Strategy Paper (I-PRSP). The I-ANDS covers a broad spectrum of development concerns, including security, governance, rule of law and human rights, and economic and social development. The I-ANDS aims to transform the economy to enable the private sector to be the engine of growth, empower the poor to participate fully in that growth, and progressively eliminate the narcotics economy. The overall strategy for economic and social development is to prioritize interventions in: (i) infrastructure development, (ii) institutional and human capacity development, (iii) protecting the rights of the poor and social protection, and (iv) creating an enabling environment for entrepreneurship and investment.</p> <p>Afghanistan is one of the poorest countries in the world, with per capita GDP of \$300, and weak social indicators. To ensure sustainable economic growth and poverty alleviation, Afghanistan must shift from reconstruction-related recovery to private sector-driven growth. The strengthening of the private sector will generate employment with the increase in both domestic and foreign investments resulting from better investment climate. With the entry of new businesses, competition is reinforced and will result in more efficient provision of goods and services. There are also fiscal benefits arising from private sector development. Increased private sector output will reduce the need for the Government to provide the fiscal impetus for growth. In addition, private business operations will generate higher tax revenues, further creating fiscal space for expenditures to provide social services for the poor. A thriving private sector is also essential for providing alternative livelihood in the rural areas, thereby supporting Government efforts at eliminating the narcotics economy.</p>			

### B. Poverty Analysis

**Targeting Classification:** General intervention

#### What type of poverty analysis is needed?

Up-to-date information on income distribution and poverty incidence is limited. The 2004 United Nations Development Programme's Human Development Report ranked Afghanistan 173 out of a sample of 177 countries, with a literacy rate of 29% , life expectancy at birth of 45 years, and infant mortality of 115 per 1000 live birth. The 2003 National Risk and Vulnerability Assessment (NRVA) conducted by the Ministry of Rural Rehabilitation and Development suggests that economic and social conditions in the rural area are significantly worse. An estimated 3.5 million out of the 17.5 million rural population live in extreme poverty, and an additional 10.5 million are vulnerable to extreme poverty. The assessment also indicates that malnutrition is widespread in rural Kabul, and only 9% of the rural population has access to a health facility.

An NRVA was conducted more recently in 2005. The Central Statistics Office, with assistance from ADB and World Bank, are processing the survey to obtain more updated poverty estimates. Results are expected by early 2007.

**C. Participation Process**

**Is there a stakeholder analysis?**  Yes  No

During program preparation, extensive consultations were undertaken with various stakeholders, including Government officials, financial institutions, nongovernment organizations, and other development partners.

**Is there a participation strategy?**  Yes  No

The attached capacity-building grant will support public awareness and outreach campaign and seminars to disseminate information and receive feedback from key stakeholders on key policy actions.

**D. Gender Development**

**Strategy to maximize impacts on women:**

Private sector and financial market development will enhance economic opportunities and create jobs, including those for women.

**Has an output been prepared?**  Yes  No

**E. Social Safeguards and Other Social Risks**

Item	Significant/ Not Significant/ None	Strategy to Address Issues	Plan Required
<b>Resettlement</b>	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	.	<input type="checkbox"/> Full <input type="checkbox"/> Short <input checked="" type="checkbox"/> None
<b>Affordability</b>	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>Labor</b>	<input type="checkbox"/> Significant <input checked="" type="checkbox"/> Not significant <input type="checkbox"/> None	The liquidation of SOEs will involve the retrenchment of SOEs employees. The Program incorporates a severance package and a job retraining and counseling program as social safety nets.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>Indigenous Peoples</b>	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

<b>Other Risks and/or Vulnerabilities</b>	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None		<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
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