



# Technical Assistance Report

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Project Number: 37393  
December 2005

## Technical Assistance Islamic Republic of Afghanistan: Preparing the Financial Market and Private Sector Development Program

## CURRENCY EQUIVALENTS

(as of 14 November 2005)

Currency Unit	–	afghani(s) (AF)
AF1.00	=	\$0.02
\$1.00	=	AF48.90

## ABBREVIATIONS

ADB	—	Asian Development Bank
BDS	—	business development services
DAB	—	Da Afghanistan Bank
MOF	—	Ministry of Finance
PSD	—	private sector development
SME	—	small- and medium-sized enterprise
SOE	—	state-owned enterprise
TA	—	technical assistance

## TECHNICAL ASSISTANCE CLASSIFICATION

<b>Targeting Classification</b>	–	General intervention
<b>Sectors</b>	–	Multisector: finance; law, economic management, and public policy
<b>Subsectors</b>	–	Finance sector development, economic management
<b>Themes</b>	–	Sustainable economic growth, private sector development
<b>Subthemes</b>	–	Promoting economic efficiency and enabling markets, policy/institutional/legal/regulatory reforms

## NOTE

In this report, "\$" refers to US dollars.

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## I. INTRODUCTION

1. The Government of Afghanistan (the Government) in its strategic plan, *Securing Afghanistan's Future*, adopted in March 2004, committed itself to creating an attractive investment climate for domestic and foreign entrepreneurs by establishing an enabling business environment. Accordingly, the Government requested the Asian Development Bank (ADB) assistance to develop a strategic framework for financial sector development and private sector promotion. As outlined in the technical assistance (TA) design and monitoring framework (Appendix 1), this project preparatory TA<sup>1</sup> will help design and prepare the Financial Market and Private Sector Development Program (the Program) scheduled for 2006. The proposed program is included in the Country Strategy and Program Update for 2004.<sup>2</sup> This TA report reflects the understanding of the Fact-Finding Mission, fielded in March 2005, reached with the Government on the objectives, scope, cost, implementation arrangements, and terms of reference for the TA.

## II. ISSUES

2. One of the key challenges facing Afghanistan in meeting its development objectives is establishing an enabling environment for the country's large and mainly informal<sup>3</sup> private sector. The private sector is estimated to control as much as 89% of the gross domestic product.<sup>4</sup> It is further estimated that the active labor force employed in private sector activities is 1.7 million compared with 250,000 employed by the Government.<sup>5</sup> However, the private sector contributes just 6% of the economy's gross domestic capital formation while accounting for 92% of total consumption. This reflects limitations in capacity as well as an absence of incentives for the private sector to expand and formalize its activities. The limited capacity and lack of incentives, which stem from Afghanistan's history of conflict and instability, can be attributed to the following factors: (i) absence of a comprehensive legal and regulatory framework for businesses, (ii) ineffective financial sector regulation, (iii) weak service delivery by the financial sector, (iv) lack of business development services (BDS) for small- and medium-sized enterprises (SMEs), and (v) monopoly and unfair practices by state-owned enterprises (SOEs).

3. **Legal, Regulatory, and Institutional Framework.** Afghanistan lacks an effective framework and institutional infrastructure to govern markets, encourage investment, and prevent monopoly abuse. Security issues and the weak legal and financial governance systems substantially increase business risk and are the principal factors driving investors to require minimum rates of return far in excess of what they would demand in other countries.<sup>6</sup>

4. The regulatory framework for businesses currently under development requires introduction of new laws and revisions to existing laws and regulations governing enterprise creation, investment, and operations with particular emphasis on eliminating monopoly practices. Regulatory regime improvements undertaken thus far include streamlining business registration, customs procedures, and the trade licensing regime although further progress is still required in this respect. Since 2002, over 40 new laws have been drafted including over a dozen business-related laws on partnerships, companies, contracts, bankruptcy, mediation, patents/trademarks, anti-trust, banking, investment, secured transactions, telecommunications, and customs and tax, in addition to around 100 laws in the pipeline. However, the pace of approving draft legislation is slow due to the difficulties in adapting laws to the Afghanistan context.

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<sup>1</sup> The TA first appeared in *ADB Business Opportunities* on 16 February 2005.

<sup>2</sup> ADB. 2004. *Afghanistan: Country Strategy and Program Update (2004–2006)*. Manila.

<sup>3</sup> Estimated to control around 85% of economic activity.

<sup>4</sup> Excluding the estimated \$2.3 billion in opium production.

<sup>5</sup> World Bank. 2004. *Country Economic Report No. 295510-AF September 2004*. Washington, DC.

<sup>6</sup> Foreign investors reportedly require minimum rates of return of around 25% for investments in Afghanistan.

5. **Financial Sector.** Banking services in Afghanistan remain severely limited, and state financial institutions with extensive branch networks are largely nonfunctional.<sup>7</sup> The financial sector in the country consists of the Da Afghanistan Bank (DAB) which carries out central bank functions; commercial banks (3 state-owned banks and 8 new private banks);<sup>8</sup> microfinance institutions; foreign exchange dealers; money service providers; and one insurance company. However, the new private banks are likely to continue to limit their operations to Kabul and the larger cities in the medium-term, and also to high-quality customers including international organizations, nongovernment organizations, the diplomatic community, and large companies. Microfinance institutions have and continue to be established but to date, their operations are too small to be considered a mainstream financial intermediary for the private sector. A large portion of potential market participants rely on the informal (*hawala*) system for their banking needs in the absence of a functional banking system, contributing to the shortage of capital which severely constrains private sector development (PSD). The absence of a robust system of financial intermediation erodes the channels through which savings are translated into investment. A comprehensive medium- to long-term financial sector strategy including non-banking services like leasing, venture capital, and insurance,<sup>9</sup> along with an effective regulatory framework, will be required for enhancing confidence in financial institutions as well as their services.

6. **Business Development Services.** In addition to access to appropriate and affordable financing sources, the private sector also needs business development support for assessing market opportunities and supplementing skills deficiencies. Most of the SMEs, especially those in the informal sector, need access to information about markets and require substantial strengthening and capacity building in business planning, marketing, financial management, and business administration. The years of conflict have had a negative impact on human capital which has been exacerbated by the weak education system and skill migration, resulting in a loss in management talent.

7. **State-Owned Enterprises.** An additional element that has significant impact on PSD is the major role played by SOEs. The SOE sector consists of approximately 78 enterprises, including 6 banks, 1 insurance company, and 71 nonfinancial enterprises engaged in agriculture, manufacturing, and services.<sup>10</sup> Removing the unfair monopoly advantages of SOEs will be critical to making more sectors of the economy attractive to private investment. The Government is cognizant of this issue and has started a comprehensive SOE Economic Restructuring and Corporatization Program with support from the United States Agency for International Development in 2003. This program is intended to place SOEs on a commercial footing, seek private sector partners where feasible, and liquidate unviable SOEs. While there is no formal legal impediment to divestiture under the SOE Law, a comprehensive policy framework for SOE reforms is lacking, including a framework to deal with employee redundancies. The pace of implementation of the

<sup>7</sup> State-owned banks control an estimated 35% of total commercial bank deposits and an estimated 68% of assets while the banks as a whole control over 95% of the formal finance sectors' assets.

<sup>8</sup> The commercial banking system currently includes three licensed state-owned commercial banks: Bank Millie Afghan, Bank Pashtany Terjaraty, and Export Promotion Bank. Furthermore, there are eight private sector banks: Afghan International Bank, Aryan Bank, First Microfinance Bank, Habib Bank, Kabul Bank, National Bank of Pakistan, Punjab National Bank, and Standard Chartered Bank. Three other state-owned banks—Agricultural Development Bank, Mortgage and Construction Bank, and Industrial Development Bank—have not been licensed, and the Government of Afghanistan's decision on the resolution process is yet to be made.

<sup>9</sup> There is no equity or debt markets, venture capital is nonexistent, and the leasing industry has a single entrant. The state-owned and inactive Afghan National Insurance Company is a monopoly in the small insurance sector.

<sup>10</sup> The 71 nonfinancial state-owned enterprises (SOEs) have been designated as SOEs to participate in the Economic Restructuring and Corporatization Program, supported by technical assistance from the United States Agency for International Development. These SOEs do not include a number of other nonfinancial government-controlled commercial entities, including Ariana Airlines. They also do not include activities of a commercial nature, which are being undertaken by various government departments.

SOE reform program will depend on the political will necessary to implement reforms, enact much-needed legislation, and the ability of the Ministry of Finance (MOF) to contain vested interests. This process will require extensive support for its proper implementation.

8. The Government is also aware that sector strategies for establishing a robust and transparent legal, regulatory, and institutional framework; enhancing financial intermediation and BDS; and facilitating a competitive environment will enable the economy to enlarge the formal private sector and encourage the informal sector to formalize its activities. PSD will also be significantly enhanced by creating a level playing field by promoting competition, efficiency, financial discipline, and good corporate governance in SOEs. The Government's strategic approach is consistent with ADB's country program which includes support for the financial sector,<sup>11</sup> SOE reforms,<sup>12</sup> and enhancing private sector participation in infrastructure development.<sup>13</sup>

9. The TA is expected to significantly help the Government identify and prioritize areas that require support to promote the private sector. The strategic direction provided through the TA will be translated into policy and capacity-building initiatives that can help enhance the private sector's role in growth and poverty reduction. Experiences and lessons learned from other countries show that transparent governance and regulatory structures, well-functioning markets, and access to financing play a vital role in promoting private sector-led growth.<sup>14</sup>

### III. THE TECHNICAL ASSISTANCE

#### A. Impact and Outcome

10. The objective of the TA and the proposed Program is to enhance the role of the private sector in economic growth and poverty reduction through the development of supportive and enabling governance and regulatory structure and a well-functioning financial sector. The purpose of the TA is to help ADB and the Government in preparing a reform agenda to be financed by the Program. Through the TA, the strategic initiatives required to develop the financial market and promote the private sector will be identified. The TA will have the following outputs: (i) situation analysis with prioritized gaps in which to focus reform efforts; (ii) recommendations on policy, regulation, institutional, and capacity-building initiatives required for reform in the areas highlighted above; and (iii) design of the program.

11. The TA will help prepare a program of reforms designed to lead to sustained private sector growth by directly addressing the key issues that reduce incentives and capacity to invest. These include (i) a poor governance and regulatory framework, from a corporate governance and financial system standpoint; (ii) inadequate access to the formal credit system at market rates; (iii)

<sup>11</sup> ADB. 2004. *Report and Recommendation of the President on a Proposed Loan and Guarantee to the Islamic Republic of Afghanistan for the Afghanistan Investment Guarantee Facility Project*. Manila (Loan 2091-AFG, approved on 21 September 2004). In addition, ADB also has assisted in setting up a national payments system.

<sup>12</sup> ADB is assisting in the divestment of Fertilizer Trading Company and commercialization of Helmand Valley Construction Company 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, approved on 4 May 2004).

<sup>13</sup> (i) 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, approved on 4 December 2002); (ii) ADB. 2003. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Islamic Republic of Afghanistan for the Emergency Infrastructure Rehabilitation and Reconstruction Project*. Manila (Loan 1997-AFG, approved on 3 June 2003); and (iii) 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 Regional Airports Rehabilitation Project Phase I*. Manila (Loan 2105-AFG, approved on 23 November 2004).

<sup>14</sup> The initial poverty and social sector analysis is in Appendix 4.

absence of entrepreneurial capacity including management expertise in the private sector to take advantage of business and financing opportunities; and (iv) unfair business practices and exercise of monopoly power by SOEs. Further, the TA will help ensure that the program design is in line with the Government's strategic priorities. Finally, the TA will identify areas of support required to mitigate adverse impact of reforms such as employee redundancies.

## **B. Methodology and Key Activities**

12. The TA is designed to strengthen the enabling environment so that the private sector can flourish and play an increasingly important role in the economy. This is also the focus of a number of multilateral and bilateral development partners. Thus, stakeholder coordination must be ensured while focusing on the Government's strategic objectives. Accordingly, the TA will pursue a consultative approach not only with relevant central ministries, private sector, business associations, nongovernment organizations, and private enterprise, but also with other funding agencies. As detailed below and set out in the design and monitoring framework in Appendix 1, the TA will be implemented in two phases: (i) situational assessment and activity mapping in the first phase, (ii) policy framework development, and (iii) program development in the second phase.

### **1. Phase I**

13. **Situational Assessment and Activity Mapping.** A comprehensive analysis of the current policy, legal, and regulatory framework, and the ongoing reforms in these areas will be conducted. This analysis will identify gaps in the reform efforts and present options for taking the reform process forward in accordance with the Government's strategic priorities, and in coordination with the efforts of the development partners. Consultation during this phase includes workshops and seminars.<sup>15</sup> This initial phase is expected to take 1.5 months.

### **2. Phase II: Subphase I**

14. **Policy Framework Development.** Based on the analysis during phase I, the TA will develop a policy framework with specific reference to (i) financial sector reforms and measures to improve supervision and the range and coverage of financial sector services offered; (ii) measures to improve private sector/SME access to finance; (iii) measures to enhance availability and quality of BDS; and (iv) measures to encourage private sector participation, corporatization, restructuring, and privatization of public sector commercial activities and SOEs. Consultation will continue during this phase and options presented for the consideration of the Government and other stakeholders. This subphase is expected to take 2.5 months.

### **3. Phase II: Subphase II**

15. **Program Development.** Subphase II will concentrate on program design including (i) scoping the program and capacity and institution building support required to support the program,<sup>16</sup> (ii) identifying implementation arrangements and coordination mechanisms required, (iii) developing a policy matrix with indicators to assess performance, and (iv) estimating the costs of structural adjustments. This subphase is expected to take 2.5 months and includes consultation with stakeholders and the Government.

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<sup>15</sup> The Ministry of Finance in consultation with ADB will select workshop participants.

<sup>16</sup> Based on requirements, capacity building could potentially include training, information technology systems implementation, and network expansion for enhanced service delivery.

### **C. Cost and Financing**

16. The cost of the TA is estimated at around \$1,060,000. ADB will provide about \$1 million equivalent on a grant basis from ADB's TA funding program. The Government will contribute about \$60,000 in kind. The detailed cost estimates and financing arrangements are in Appendix 2. The Government has been informed that approval of the TA does not commit ADB to finance any ensuing program.

### **D. Implementation Arrangements**

17. MOF will be the Executing Agency for the TA. A high-level steering committee headed by Secretary, MOF will be established to oversee implementation. It will include, among others, representatives of MOF, Ministry of Commerce, and DAB. During implementation, inputs from development partners, private sector representatives, and other stakeholders will be sought.

18. The TA will be implemented over a 7 month period, from January 2006, and will require an estimated 65 person-months of consulting services (25 international and 40 domestic). The following international experts (person-months in parentheses) have been identified: (i) financial sector development specialist and team leader (7), (ii) legal/regulatory specialist (4), and (iii) SME financing and BDS specialist (4). The following domestic consultants will be engaged: (i) financial sector specialist (7), (ii) legal expert (6), and (iii) SME and BDS specialist (7). In addition, about 10 person-months of international and 20 person-months of domestic consulting services will be defined during the TA inception phase for priority activities as determined in consultations between ADB and the Government. ADB will engage the consultants through a firm or individually, in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. In the selection and engagement of a firm, the quality and cost based selection method with a simplified technical proposal will be used. The outline terms of reference for consultants are in Appendix 3. All procurement under the TA will be done in accordance with ADB's *Guidelines for Procurement*. Equipment procured in accordance with ADB's procurement guidelines will be turned over to the Government upon the completion of the TA.

19. The TA consultant will prepare (i) an inception report including a detailed work program to be submitted within three weeks from the start of the TA and to be discussed at the initial tripartite review meeting, (ii) phase 1 draft report (1.5 months from start of the TA) and phase 2 draft reports (3.5 and 5.5 months from the start of the TA), (iii) draft final report (6.5 months from start of the TA), and (iv) final report (7 months from start of the TA).

## **IV. THE PRESIDENT'S DECISION**

20. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$1,000,000 on a grant basis to the Government of Afghanistan for preparing the Financial Market and Private Sector Development Program, and hereby reports this action to the Board.

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b> Enhanced role of the private sector in economic growth and poverty reduction through an enabling governance and regulatory structure and well functioning financial system</p>	<ul style="list-style-type: none"> <li>• Size of the formal sector</li> <li>• Coverage of the financial system</li> <li>• Positive perception with regard to ease of access to financial services</li> <li>• Effective regulatory and governance mechanism for businesses and financial system</li> <li>• Reform of the financial sector and SOEs</li> </ul>	<ul style="list-style-type: none"> <li>• TA steering committee meetings</li> <li>• Industry surveys</li> <li>• Perception surveys of businesses</li> <li>• Tax and other public finance data</li> <li>• Data from business registry</li> <li>• Consultations with business association and entities</li> <li>• Tripartite review meetings</li> <li>• Reports submitted by TA consultant</li> </ul>	<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>• Enhanced security environment</li> <li>• Macroeconomic stability</li> <li>• Political will to pursue reforms and effective implementation of reform recommendations by the Government</li> <li>• Adequate resources for implementation including mitigation measures</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Deteriorating security situation</li> <li>• Political instability</li> <li>• Resistance to reforms from vested interests</li> </ul>
<p><b>Outcome</b> A comprehensive program design for ADB financing for development of the financial market and private sector</p>	<ul style="list-style-type: none"> <li>• By the end of the TA, a rigorously designed and implementable strategy, and focused and sequenced reform and development plan in the areas of interest</li> <li>• The Government and ADB's acceptance of the plan and ADB's commitment to financing the agreed reforms</li> </ul>	<ul style="list-style-type: none"> <li>• TA steering committee meetings</li> <li>• Tripartite review meetings</li> <li>• Reports submitted by TA consultant</li> </ul>	<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>• Political commitment to the reform process</li> <li>• Acceptance of reform recommendations by the Government</li> </ul> <p><b>Risk</b></p> <ul style="list-style-type: none"> <li>• Ability of the Ministry of Finance to coordinate effectively with all the agencies involved</li> </ul>
<p><b>Outputs</b> <b>Phase I</b></p> <ul style="list-style-type: none"> <li>• Situational assessment</li> <li>• Mapping of current activities</li> <li>• Identification of gaps in the reform process</li> </ul> <p><b>Phase II: Subphase I</b></p> <ul style="list-style-type: none"> <li>• Policy framework for PSD based on identified gaps in <ul style="list-style-type: none"> <li>(i) financial sector reforms and measures</li> <li>(ii) measures to improve private sector/SME access to finance</li> <li>(iii) measures to enhance BDS</li> <li>(iv) measures to encourage private sector</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Adherence to timelines</li> <li>• Quality of recommendations for reform process as measured by <ul style="list-style-type: none"> <li>(i) rigor of analysis</li> <li>(ii) applicability to Afghanistan</li> </ul> </li> <li>• Clarity and specificity of recommendations provided</li> <li>• Satisfaction expressed by the Government and ADB with reform recommendations</li> <li>• Quality of recommendations with regard to mitigation mechanisms</li> </ul>	<ul style="list-style-type: none"> <li>• Public consultation with businesses on recommendations</li> <li>• Feedback received from all relevant stakeholders</li> <li>• ADB review missions</li> <li>• TA monitoring unit reports</li> <li>• Report of TA consultants</li> </ul>	<p><b>Assumptions</b></p> <ul style="list-style-type: none"> <li>• Commitment of the Government to implement reforms</li> <li>• Availability of counterpart staff</li> <li>• Availability of data</li> <li>• Adequate resources to undertake studies</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Lack of will to cooperate in sharing data and information</li> <li>• Absence of reliable data</li> <li>• Cooperation of other development partners</li> </ul>

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
participation  <b>Phase II: Subphase II</b> <ul style="list-style-type: none"> <li>• Program development for implementation of recommendations</li> </ul>			
<b>Activities with Milestones</b> <b>1. Mapping of current activities and identification of gaps</b> 1.1. Collect and analyze relevant information and data 1.2. Hold consultations with all stakeholders 1.3. Understand the strategic priorities of the Government 1.4. Identify gaps in the reforms currently being undertaken and map donor support 1.5. Suggest options for further policy reform and capacity development 1.7. Conduct consultative workshop to receive feedback from stakeholders  <b>2. Develop policy framework for PSD</b> 2.1. Consult with all relevant stakeholders including private sector representatives and business associations 2.2. Based on identified options, suggest policy and capacity building initiatives required in the areas of (i) financial sector reforms and measures, (ii) measures to improve private sector/SME access to finance, (iii) measures to enhance BDS, and (iv) measures to encourage private sector participation 2.3. Suggest options for policy development to be undertaken that maximize impact 2.5. Conduct consultative workshops with stakeholders  <b>3. Develop program framework</b> 3.1. Based on options identified, suggest scope of intervention required including capacity and institution building support 3.2. Suggest implementation mechanisms required for undertaking proposed reforms 3.3. Develop policy matrix including indicators to assess effectiveness of the reform process 3.4. Identify social consequences of the reform process and suggest mitigations  The following are the expected deliverables: (i) an inception report to be submitted within three weeks from the start of the TA, (ii) phase 1 draft report (1.5 months from start of the TA) and phase 2 draft reports (3.5 and 5.5 months from the start of the TA),; (iii) draft final report (6.5 months from start of the TA), and (iv) final report (7 months from start of the TA).			<b>Inputs</b> <b>ADB.</b> Inception and midterm reviews  <b>Government.</b> Provision of necessary information to consultants, and carrying out EA functions including availability of the counterpart staff  <b>Consultants.</b> A total of 65 person-months of consulting services (25 international and 40 domestic) and funding of various TA activities, as outlined (\$1.0 million)

ADB = Asian Development Bank, BDS = business development services, PSD = private sector development, SOE = state-owned enterprise, TA = technical assistance.

**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

Item	Foreign Cost	Local Currency	Total Cost
<b>A. Asian Development Bank Financing<sup>a</sup></b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	600.0	0.0	600.0
ii. Domestic Consultants	0.0	100.0	100.0
b. International and Local Travel	50.0	10.0	60.0
c. Reports and Communications	5.0	0.0	5.0
2. Equipment <sup>b</sup>	25.0	0.0	25.0
3. Training and Workshops	0.0	103.0	103.0
4. Contingencies	82.0	25.0	107.0
<b>Subtotal (A)</b>	<b>762.0</b>	<b>238.0</b>	<b>1,000.0</b>
<b>B. Government Financing</b>			
1. Office Accommodation and Transport	0.0	20.0	20.0
2. Remuneration and Per Diem of Counterpart Staff	0.0	20.0	20.0
3. Others	0.0	20.0	20.0
<b>Subtotal (B)</b>	<b>0.0</b>	<b>60.0</b>	<b>60.0</b>
<b>Total</b>	<b>762.0</b>	<b>298.0</b>	<b>1,060.0</b>

<sup>a</sup> Financed by the Asian Development Bank's technical assistance funding program.

<sup>b</sup> Includes computer, printer, copier fax, other office equipment, and furniture.

Source: Asian Development Bank estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. **Context.** The Government of Afghanistan (the Government) has sought Asian Development Bank (ADB) assistance in developing an enabling environment for the private sector to grow and take an increasingly important role in the economy. The assistance will first be provided through a technical assistance (TA) that will map out design of the Financial Market and Private Sector Development Program (the Program). The TA, which will require 65 person-months of consulting services, will be conducted in two phases. The first phase will consist of an assessment of the current situation and a mapping exercise to identify gaps in the ongoing reform process. In the following phase, the precise nature and scope of the interventions required will be identified to concretize the Program.

2. The consultants will be required to work in close coordination with other development partners as well as with the Government. The consultants will also be required to take into account the relevant ADB guidelines and requirements in order to fulfill their mandate. The specific technical tasks for the consultants are outlined below.

3. At least three international and three domestic consultants will provide consulting services. Additional consultants will be recruited as needed.

**A. Financial Sector Development Specialist/Team Leader** (international, 7 person-months)

4. The financial sector development specialist/team leader will have postgraduate qualification in business, finance, or related field and up to 10 years experience in the areas outlined below. Experience in postconflict developing countries will be preferred.

- (i) Conduct a comprehensive review and assessment of the existing situation and ongoing and expected government reforms in the financial sector as well as to support private sector development (PSD). The review will build on the private sector assessment undertaken by ADB and relevant assessments and studies of other development partners.
- (ii) On the basis of para. 13 of this TA paper on phase I, structure reforms in a matrix format thereby mapping activities currently being undertaken or planned by development partners and identify and prioritize gaps. For prioritized gaps, collect and analyze relevant data to assess the current situation and identify remedial actions and areas of possible support.
- (iii) On the basis of paras. 14 and 15 of this TA on phase II, develop a policy program assessment. The assessment should include a summary presentation of clearly identified and assessed challenges, prioritized policy and regulatory reforms to be addressed including areas for potential ADB support, a sequenced roadmap of policy actions and support measures to support implementation of priority reforms and an outline of associated capacity and institution building support;<sup>1</sup> and an assessment of main program implementation risks and a preparation of a proposed risk mitigation strategy. Propose monitoring benchmarks for the implementation of the Program to determine the program's development impact.

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<sup>1</sup> Based on requirements, capacity building could potentially include training, information technology systems implementation, network expansion for enhanced service delivery.

- (iv) Carry out a comprehensive analysis of the institutional framework required to successfully implement the program and propose a capacity-building component to be funded under the program.
- (v) Prepare a comprehensive medium-term financial sector development strategy which includes measures to
  - (a) strengthen the regulatory framework and sector supervision,
  - (b) support expansion of services to provinces and rural areas, and
  - (c) improve credit assessment and risk management practices.
- (vi) Review the current state of the insurance (and pensions) and leasing industries in Afghanistan and propose development options.
- (vii) For state-owned banks, identify corporatization/restructuring options and develop outline implementation plans and draft terms of reference for possible assistance.
- (viii) Propose options for training and development for financial sector practitioners in Afghanistan and recommend possible project components in this regard. Possible components could include: (a) risk management, (b) credit assessment in relation to small- and medium-sized enterprise (SME) financing, and (c) financial sector marketing and PSD/SME business development.
- (ix) Prepare a stakeholder participation plan to be implemented under the TA and the ensuing program.

**B. Legal/Regulatory Specialist** (international, 4 person-months)

5. The specialist will at least have a graduate degree in law and up to 10 years experience in the areas outlined below. Experience in postconflict developing countries and familiarity with Islamic laws will be preferred.

- (i) Assist the Da Afghanistan Bank and Ministry of Finance in preparing a comprehensive list of (the existing and the status of the required) laws and regulations pertaining to the financial sector and PSD, and assist in prioritizing the critical laws.
- (ii) Review the current legal and regulatory environment related to insurance and leasing operations. Based on this review, propose a regulatory regime for the insurance and leasing industries, define legal requirements, and draft legal documents necessary for introducing a new legal and regulatory regime in this sector.
- (iii) Develop proposals for consolidating and enhancing the supervision of nonbanking financial institutions.
- (iv) As may be required, assist in developing and promulgating other priority legislation for the financial sector and PSD, including, but not necessarily limited to legislation related to (a) secured transactions law, (b) mortgage law, (c) bankruptcy law, and (d) nonbank financial institutions law.

**C. SME Financing and Business Development Services (BDS) Specialist** (international, 4 person-months)

6. The SME Financing and BDS specialist will have postgraduate qualification in business, finance, or related field and up to 10 years experience in the areas outlined below. Experience in postconflict developing countries will be preferred.

- (i) Prepare a summary description and synthesis of activities currently being undertaken or planned in these areas by other development partners and identify possible gaps.
- (ii) Conduct a comprehensive review of the issues and constraints affecting the availability of financing for domestic SMEs.
- (iii) Assess institutional arrangements in the country that are related to PSD/SMEs and recommend possible interventions or policy actions for the ensuing Program.
- (iv) Prepare a comprehensive framework outlining a sequenced set of reform and capacity-building measures aimed at enhancing the access of domestic SMEs to financing.
- (v) Propose and structure a possible project financing component aimed at enhancing SME access to financing including a possible credit line or partial credit guarantee scheme.
- (vi) Building on work already done in this area by other development partners, scope out the need for BDS (including market information, technical advisory services, and general entrepreneurial training) taking into account the stock of what is currently available.
- (vii) Propose options for developing sustainable BDS in Afghanistan and develop a proposal and structure for possible assistance from ADB.
- (viii) Assist the team leader in developing an overall framework for the financial market and PSD.

**D. Financial Sector Specialist** (domestic, 7 person-months)

7. The specialist will have up to 5 years relevant experience in the areas outlined below.

- (i) Assist the team leader in all aspects related to the tasks outlined in his terms of reference.
- (ii) Collect and analyze information and make it available in English to the team leader and other international consultants.
- (iii) At the request of the team leader, conduct research on topics assigned.
- (iv) Conduct capacity-building measures in relation to the ensuing program as may be requested by the team leader.
- (v) Organize workshops and seminars as requested by the team leader including translation of documents.

**E. Legal Expert** (domestic, 6 person-months)

8. The expert will have up to 5 years relevant experience in the areas outlined below.
- (i) Assist the team leader and international legal/regulatory expert with all aspects of their tasks as outlined in their terms of reference.
  - (ii) Collect and analyze information and data and make them available in English and in an organized, readable form under the guidance of the team leader and the international legal/regulatory specialist.
  - (iii) Conduct research on specific topics as assigned by the team leader and the international legal/regulatory specialist.
  - (iv) Prepare the capacity-building modules as assigned by the team leader.
  - (v) Arrange and organize discussions and workshops and help the team leader and international legal/regulatory specialist by preparing relevant materials, including translation of documents and interpreting discussions.

**F. SME and BDS Specialist** (domestic, 7 person-months)

9. The specialist will have at least 5 years relevant experience in the areas outlined below.
- (i) Assist the team leader and international SME/BDS specialist with all aspects of their tasks as outlined in their terms of reference.
  - (ii) Collect and analyze information and data and make them available in English and in an organized, readable form under the guidance of the team leader and the international SME/BDS specialist.
  - (iii) Assist the international SME financing specialist in conducting a comprehensive review of the issues and constraints affecting the availability of financing for domestic SMEs.
  - (iv) Prepare the capacity-building modules as assigned by the team leader.
  - (v) Arrange and organize discussions and workshops and help the team leader and international BDS specialist by preparing relevant materials including translation of documents and interpreting discussions.

**G. Pool of International and Domestic Experts** (international, 10 person-months; domestic 20 person-months)

10. In addition, a pool of international and domestic experts will be engaged as required in consultation with the Government. Expertise is envisaged to be required in the following broad areas (but not necessarily limited to them): (i) commercial law and regulatory issues, (ii) banking restructuring, (iii) banking systems, (iv) insurance and leasing, (v) training of financial sector practitioners, (vi) state-owned enterprise corporatization and restructuring, and (vii) private sector accounting and auditing.

## INITIAL POVERTY AND SOCIAL SECTOR ANALYSIS

### 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>It is estimated that (excluding the estimated \$2.3 billion in opium production) the private sector contributes approximately 89% of total gross domestic product. The private sector also represents 92% of total consumption, but only 6% of gross fixed capital formation. It is further estimated that the active labor force employed in private sector activities is 1.7 million, compared with only 17,000–19,000 employed by state-owned enterprises and 250,000 employed by the Government of Afghanistan. In several policy statements, the Government highlighted that private sector-led economic growth will be the main engine for poverty reduction in Afghanistan.</p>			

### B. Poverty Analysis

**Targeting Classification:** General intervention

<p><b>What type of poverty analysis is needed?</b></p> <p>Poverty in Afghanistan is associated with low rates of economic growth and the collapse of livelihood opportunities due to the long period of conflict. Other factors contributing to widespread poverty are environmental degradation, land tenure status, absence of livestock ownership, lack of access to water and inputs, lack of opportunities for off-farm employment, poor agriculture productivity, refugee/displaced person status, gender discrimination, and physical disability. Under the consumption criterion of \$1/day, poverty incidence ranges from 60% to 80%. Most of the 22 million Afghans are poor, with over 50% of rural residents not being able to afford consumption of at least 2,100 calories. It is estimated that only 4 out of 10 Afghans have access to safe drinking water, adult literacy is a low 29%, and life expectancy is less than 43 years. The Government is in the process of preparing a national poverty reduction strategy paper that Asian Development Bank (ADB) and other development partners will support the implementation of. In its Afghanistan program, ADB operations focus on poverty reduction. ADB support<sup>a</sup> has assisted in establishing enabling environments for efficient production, trade, and market liberalization. Specifically, ADB technical assistance (TA) and pilot projects<sup>b</sup> are contributing to poverty reduction through employment generation, production increases, improved economic and social services, private sector development, increased household income, community development, gender development, environmental preservation, reintegration of refugees and internally displaced persons, and improved security.</p>
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### C. Participation Process

<b>Is there a stakeholder analysis?</b>	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
<p>While there has been no formal stakeholder analysis conducted, extensive consultation with relevant stakeholders have taken place.</p>		
<b>Is there a participation strategy?</b>	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
<p>During the implementation of the project preparatory TA, a plan for enhanced participation will be formulated and will be further implemented under the ensuing program.</p>		

### D. Gender Development

<p><b>Strategy to maximize impacts on women:</b></p> <p>The TA is not expected to have any negative impact on women.</p>		
<b>Has an output been prepared?</b>	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> 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	No resettlement is expected under the TA or ensuing program.	<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 type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	No negative impacts on labor are expected under the TA. If the decision is made to include any state-owned enterprise retrenchment component under the ensuing program, the issue will be further examined.	<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	No negative impacts on indigenous peoples are expected under the TA.	<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	Any social risks and vulnerabilities will be monitored in the course of TA implementation.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

<sup>a</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, approved on 4 December 2002); and 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, approved on 4 May 2004).

<sup>b</sup> ADB. 2003. *Report and Recommendation of the President to the Board of Directors of a Proposed Loan to the Islamic Republic of Afghanistan for the Emergency Infrastructure Rehabilitation and Reconstruction Project*. Manila (Loan 1997-AFG, approved on 3 June 2003).