

TAR: AFG 37493

# Technical Assistance to the Islamic Republic of Afghanistan for Capacity Building for Economic Management (Cofinanced by the Government of Australia)

August 2005

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 28 June 2005)

Currency Unit	–	afghani/s (AF)
AF1.00	=	\$0.02
\$1.00	=	AF49.82

## ABBREVIATIONS

ADB	–	Asian Development Bank
FMPAR	–	Fiscal Management and Public Administration Reform Program
FPU	–	fiscal policy unit
IMF	–	International Monetary Fund
IT	–	information technology
MOF	–	Ministry of Finance
NDS	–	National Development Strategy
PRR	–	priority reform and restructuring program
SMP	–	Staff-Monitored Program
TA	–	technical assistance

## TECHNICAL ASSISTANCE CLASSIFICATION

<b>Targeting Classification</b>	–	General intervention
<b>Sector</b>	–	Law, economic management, and public policy
<b>Subsector</b>	–	Public finance and expenditure management
<b>Themes</b>	–	Sustainable economic growth, Governance
<b>Subthemes</b>	–	Promoting macroeconomic stability, Financial and economic governance

## NOTES

- (i) The fiscal year (FY) of the Government and its agencies ends on 20 March. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2000 ends on 20 March 2000.
- (ii) In this report, "\$" refers to US dollars.

This report was prepared by M. Prokop.

## I. INTRODUCTION

1. Following the presidential elections in late 2004, the new administration of the Islamic Republic of Afghanistan has been emphasizing the importance of moving from postconflict emergency management to a more medium-term sustainable development framework and increasing government ownership of policies. The Ministry of Finance (MOF) is currently developing a Five-Year Strategic Plan to assist the ministry in its transition from managing emergency needs toward operating a modern and effective financial management organization. The strategy will guide and assist in identifying actions required for strengthening current functions and capacities. To facilitate the transition, the Government set up a Fiscal Policy Unit (FPU) within MOF.

2. MOF requested Asian Development Bank (ADB) assistance to support the newly established FPU during the Reconnaissance and Fact-Finding Missions for the proposed Fiscal Management and Public Administration Reform Program (FMPAR). The technical assistance (TA) was subsequently included in the 2005 pipeline of projects.<sup>1</sup> During the TA Fact-Finding Mission in June 2005, understanding was reached with the Government on the scope of the proposed assistance. The TA builds on and complements ongoing ADB-financed TA to MOF.<sup>2</sup> Several policy actions proposed under the FMPAR also relate to FPU which the TA will assist in implementing. The TA's goals, purpose, and scope are summarized in the TA design and monitoring framework (Appendix 1).<sup>3</sup>

## II. ISSUES

3. The transition from emergency response to long-term sustainable development will need to be underwritten by a robust economic development strategy. At present, the Government is preparing the National Development Strategy (NDS) that will also form the basis of an Interim Poverty Reduction Strategy. To strengthen the Government's ownership and involvement in this process, it will need to develop capacity for (i) macrolevel economic forecasting and analysis, and (ii) deepening sectoral analysis. This capacity will enable the Government to better assess policy interventions and link its development policies with expenditure and investment priorities, fiscal policies, etc., thereby improving the effectiveness of public resource management and service delivery mechanisms.

4. The need is urgent to ensure that fiscal implications of ongoing and proposed reforms are considered in policy development. In this regard, the fiscal implications of the civil service reform are of particular concern. The Government's objective, according to *Securing Afghanistan's Future*, is to cover the wage bill in FY2008/09 and all operating expenditures in FY2013/14. Achieving this ambitious objective will require careful macroeconomic and expenditure management and substantial efforts to increase revenues. Currently, growth in the overall wage bill far outpaces growth in domestic revenue generation. The wage bill (covering 70–75% of the operating budget) is expected to increase by 50% in FY2005/06 due to recruitment of teachers, civil service pay increases related to the implementation of the priority reform and restructuring program, and police pay increases. Moreover, it has been proposed that the budget of the Afghan National Army, currently funded by external grants (off the core budget), be incorporated into the core budget over the coming years.

---

<sup>1</sup> The concept paper was approved on 17 May 2005 by the Vice-President, Operations Group 1.

<sup>2</sup> ADB. 2002. *Technical Assistance Cluster to Afghanistan for Capacity Building for Reconstruction and Development. Subcomponent 4b*. Manila (TA 3874, for \$14,500,000, approved on 9 May 2002); ADB. 2004. *Technical Assistance to the Islamic Republic of Afghanistan for the Capacity Building for the Ministry of Finance*. Manila (TA 4502, for \$960,000, approved on 17 December 2004).

<sup>3</sup> The TA first appeared in *ADB Business Opportunities* (internet edition) on 1 July 2005.

5. A recent Public Financial Management Performance Report<sup>4</sup> by the World Bank stressed the significant fiscal risks arising, among others, from the lack of a more explicit multiyear framework. The International Monetary Fund (IMF), as part of its Staff-Monitored Program (SMP), also emphasized the importance of improving the consistency of the budget presentation and developing a realistic medium-term fiscal framework to manage growing demands and expectations.<sup>5</sup> While significant progress in improving the budget process has been made over the last 3 years, budget programming is still at its early stages. There is a need to develop a medium-term fiscal program that attempts to project expenditure and revenues over a medium-term horizon. Multiyear aggregate fiscal forecasts are updated annually and the budget circular makes reference to them. However, expenditure estimates are only at the aggregate level. Domestic revenue projections represent mere targets rather than being based on forecasting models that would take into account the economic assumptions of results of specific policy actions. For FY2005/06 there will be a first attempt at requiring line ministries to prepare multiyear projections as part of budget preparation. Currently, there is limited analysis of how policy decisions (i.e., wage increases, pension commutation) or external factors (i.e., oil price shocks, or security constraints) can affect spending plans.

6. FPU will be tasked to prepare a consistent and reliable macroeconomic framework that is linked to the budget process. Its responsibilities will include analyses of a general budget year, medium-term fiscal trends, and the fiscal implications of government policies and proposed reforms. The current budget process does not include allocation mechanisms to identify the distribution of the budgeted resource envelope across provinces. This raises several issues that FPU will address through the reassessment of the current allocation system, including social welfare and efficiency considerations with a view to integrating these considerations into the budget process. FPU will also be responsible for identifying, managing, and monitoring revenue transfers to provinces.

7. Initially, FPU will comprise a small number of core staff, but it will progressively be enlarged as priorities become clearer and staff capacity improves. FPU will have two subunits: an External Analysis and Liaison Unit and a Fiscal Analysis and Liaison Unit. Appendix 2 outlines the structure of FPU. FPU will have a strong linkage with the Budget Department and will coordinate closely with the Debt Management Unit within the Treasury, the Ministry of Economics, and the NDS process.

8. The External Analysis and Liaison Unit will be primarily responsible for liaising with ADB, IMF, Islamic Development Bank, World Bank, and bilateral agencies. It will focus on external financing issues; monitoring of loans, programs, and project negotiations between aid agencies and line ministries; and analytical issues of country strategies and programs. The subunit will review and analyze program loans/grants and the policy issues associated with benchmarks and medium-term fiscal scenarios as well as follow up on the IMF-led SMP. MOF can then better coordinate and take the necessary actions to advance and support the reform process. The Fiscal Analysis and Liaison Unit will be responsible for fiscal analysis of (i) medium-term and NDS issues; (ii) provincial issues, including monitoring of equity questions; and (iii) policy analysis. The subunit will work closely with the Budget Department and will liaise with Parliament and other stakeholders as well as with the NDS process in relation to fiscal developments. With the convening of Parliament after the September 2005 elections, this function will become increasingly important.

---

<sup>4</sup> World Bank. 2005. *Afghanistan Public Financial Management Performance Report*. Draft for Discussion. Kabul.

<sup>5</sup> IMF. 2005. *Islamic Republic of Afghanistan—Fourth Review under the Staff-Monitored Program—Concluding Statement of the IMF Mission*.

### III. THE TECHNICAL ASSISTANCE

#### A. Impact and Outcome

9. The overall goal of the TA is to strengthen the macroeconomic management capacity of the Government of Afghanistan.

10. The expected impact is to strengthen MOF's capacity for fiscal analysis. This capacity will enable the Government to better assess policy interventions and link its development policies with expenditure and investment priorities, fiscal policies etc., thereby improving the effectiveness of public resource management and delivery mechanisms.

11. The TA is expected to lead to the following outcomes. MOF will be able to (i) conduct analyses of (a) a general budget year and medium-term fiscal trends, (b) fiscal sustainability of government policies and reforms, and (c) provincial budget allocations in relation to social equity and efficiency concerns; and (ii) review and monitor policy actions associated with benchmarks under program lending modalities. MOF will also have established a regular information flow with Parliament and relevant stakeholders on fiscal issues as well as an effective liaison with the NDS process.

#### B. Methodology and Key Activities

12. One of the key lessons learned from TA 3874 and TA 4502 (footnote 2) is the importance of a flexible approach to TA providing for capacity building, given the political and economic circumstances and the evolving institutional structures and government capacity. The TA scope therefore outlines broad areas of activities. All activities will be closely coordinated with ongoing ADB-supported TA in MOF, assistance provided by other development partners, and the TA component and policy actions proposed under the FMPAR.

13. Under TA 4502, ADB engaged an advisor to the deputy minister of finance in June 2005. The advisor will oversee the establishment of FPU and provide overall guidance. The Government has already recruited a small number of fiscal analysts for FPU. TA 4502 is also funding the recruitment of a budget specialist/macroeconomist who will conduct the initial training and provide capacity-building inputs. The proposed TA will provide for the continuation of this assistance. The consultant will work closely with the Budget Department and FPU, and focus on capacity building in fiscal analysis in close coordination with assistance provided by other development partners.

14. The advisor to the deputy minister and the budget specialist/macroeconomist under TA 4502 will assist in identifying further training requirements in close consultation with the Budget Department, other TA providers, and ADB. TA funds will be made available for short-term training for staff and domestic consultants of FPU and, if required, the Budget Department and line ministries. Where possible, the training will use local facilitators. TA funds will also support international consultants as facilitators.

15. The training will cover basic information technology (IT) skills, basic Excel training, as well as guidance in developing a simple Excel-based model for the medium term with revenues and expenditures, and training in general analytical skills and report writing and communication skills. By the end of the training, participants should be familiar with (i) using existing data and preparing analysis of revenue scenarios; (ii) building a "base case" and incorporating risk assessments, (iii) conducting "what if" analyses, (iv) including medium-term priorities in the budget, (v) linking the budget with the NDS, (vi) incorporating approximate costing of expenditures of the NDS, and (vii) the linkages among the real sector, external sector, monetary

sector, and fiscal sector. Staff of FPU should also be able to undertake simple multiplier analysis, i.e., direct and indirect impact of the Government's spending in the provinces, and identify policy implications.

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

16. The total cost of the TA is estimated at \$480,000 equivalent, comprising \$263,000 in foreign exchange and \$217,000 equivalent in local currency. The Government has requested ADB to finance \$390,000 equivalent on a grant basis, of which \$200,000 will be financed by ADB's technical assistance funding program, and \$190,000 by the Government of Australia and to be administered by ADB. The Government of Afghanistan will finance the balance of the local currency cost for counterpart staff salaries and office accommodation. Indicative cost estimates and the financing plan are in Appendix 3.

### **D. Implementation Arrangements**

17. MOF will be the Executing Agency as well as the Implementing Agency for this TA. It will assign counterpart staff to work with the consultants and provide the latter with suitable office space, utilities, and logistical and administrative support. The TA will be executed over 29 months, and is expected to start in September 2005 and be completed by December 2007.

18. The TA will finance 43 person-months of consulting services: 8 international and 35 domestic. Sufficient flexibility will be allowed in determining the actual number of experts and the duration of inputs by international consultants, based on periodic progress assessment and the evolving needs of the Government. Efforts will be made to ensure that the salaries of the domestic consultants would be in a range similar to that provided by the Government on special pay scales (PRR, lateral entry program). It is proposed that a budget/macroeconomist (international consultant) be engaged for a period of 8 person-months on an intermittent basis (4 person-months renewable based on a performance review and assessment of requirements). The TA will also support three domestic fiscal analysts for 10 person-months each. The TA will allow for the engagement of a domestic IT training specialist for 5 person-months on an intermittent basis. Outline terms of reference for the consultants are in Appendix 4. All consultants will be engaged by ADB in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory for selecting and engaging domestic consultants. Consultants will be engaged on an individual basis.

19. Computers, printers, a scanner, and software as well as other office equipment to be purchased for the TA will be allocated and turned over after to FPU at completion of the TA. Equipment for the TA will be purchased in accordance with ADB's *Guidelines for Procurement* and procedures acceptable to ADB.

20. The outcomes of the TA will be shared with government officials, ADB staff, and other agencies through regular meetings in MOF, as part of the SMP missions and meetings, FMPAR discussions, and other fora.

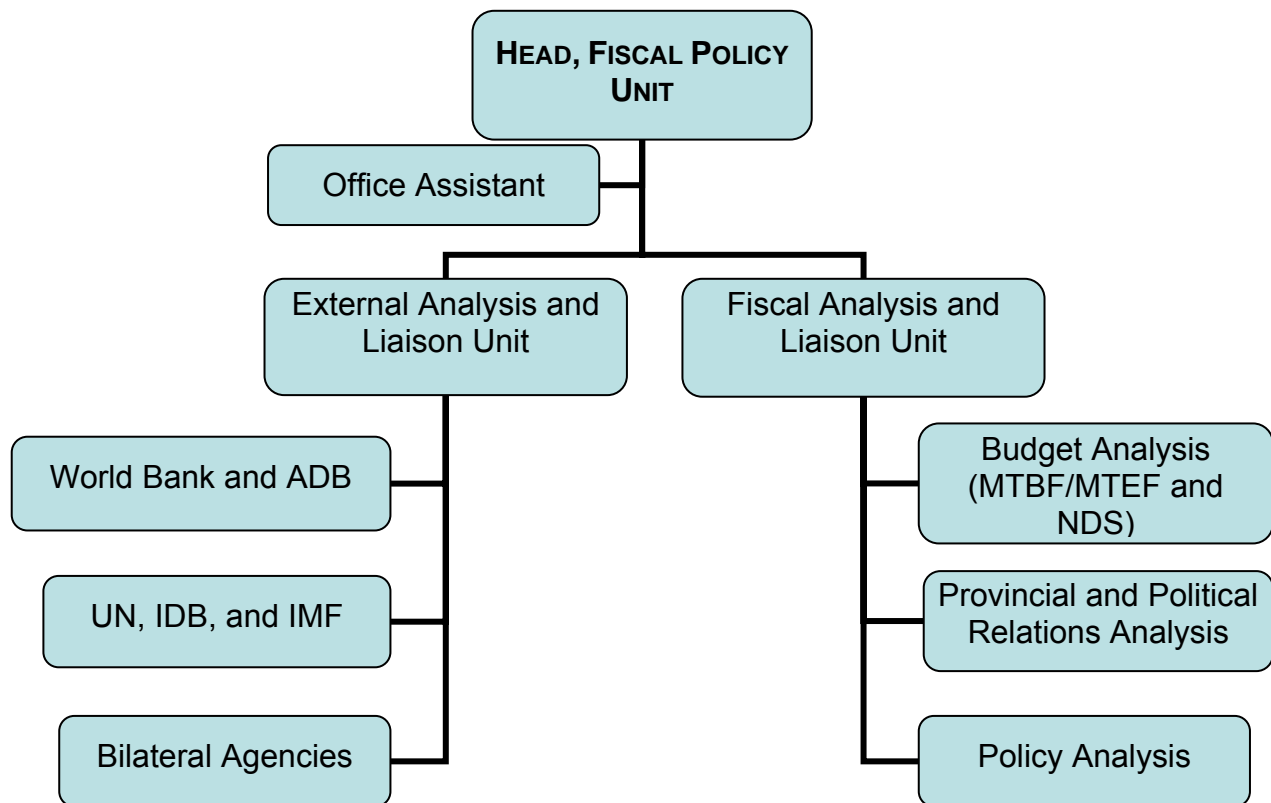
## **IV. THE PRESIDENT'S DECISION**

21. The President, acting under the authority delegated by the Board, has approved (i) ADB administering a portion of technical assistance not exceeding the equivalent of \$190,000 to be financed on a grant basis by the Government of Australia, and (ii) ADB providing the balance not exceeding the equivalent of \$200,000 on a grant basis, to the Government of Afghanistan for Capacity Building for Economic Management, and hereby reports this action to the Board.

## DESIGN AND MONITORING FRAMEWORK

<b>Design Summary</b>	<b>Performance Targets/Indicators</b>	<b>Data Sources/Reporting Mechanisms</b>	<b>Assumptions and Risks</b>
<b>Impact</b> The Government's macroeconomic management capacity is strengthened.	Government policies and reforms reflect fiscal implications and sustainability concerns.	Reviews of Staff - Monitored Program (SMP) of International Monetary Fund (IMF)	
<b>Outcome</b> Ministry of Finance (MOF) has the capacity to effectively analyze fiscal policy trends.	Multiyear perspective is integrated in fiscal planning, expenditure policy making, and budget.  Fiscal implications of priorities of National Development Strategy (NDS) are considered.	Budget documents  Review of indicators of public financial management performance review  SMP reviews  NDS documentation	<b>Assumption</b> <ul style="list-style-type: none"> <li>• The Government remains committed to economic management reforms and NDS process.</li> </ul> <b>Risk</b> <ul style="list-style-type: none"> <li>• MOF fails to attract skilled resources to Fiscal Policy Unit (FPU).</li> </ul>
<b>Outputs</b> 1. MOF regularly conducts: (i) general budget year and medium-term fiscal trend analyses, (ii) fiscal sustainability analyses of government policies and reforms, and (iii) analyses of provincial budget allocations in relation to social equity and efficiency concerns.  2. MOF reviews and monitors policy actions associated with benchmarks under program lending modalities.  3. Regular information flow with Parliament and other relevant stakeholders on fiscal issues is established.	Fiscal bulletin is published regularly by end-2005.  Provincial budget allocations reflect social equity considerations.  Compliance of policy actions under Fiscal Management and Public Administration Reform program (FMPAR) and the World Bank's Programmatic Support for Institution Building (PSIB) is monitored on a regular basis.	Fiscal bulletins  Budget documents  Consultations with World Bank, IMF, FMPAR review missions  Documentation on parliamentary debates/exchanges with MOF.	<b>Assumptions</b> <ul style="list-style-type: none"> <li>• MOF continues to implement reform agenda.</li> <li>• Flow of information from Budget Department, line ministries, and other stakeholders to FPU is smooth.</li> </ul>

<b>Activities with Milestones</b>	<b>Inputs</b>
<ol style="list-style-type: none"> <li>1.1 Develop a training methodology and training plan for FPU, including a time-bound action plan (by end-2005);</li> <li>1.2 Develop a simple Excel-based model for the medium-term with revenues and expenditures (by end 2005);</li> <li>1.3 Conduct training for staff of FPU and, if required, for staff of the Budget Department and line ministries;</li> <li>1.4 Familiarize staff of FPU with ideas and bases for calculating outcomes, outputs, and activities of programs (by June 2006);</li> <li>1.5 Illustrate and undertake simple multiplier analyses, i.e., direct and indirect impact of the Government's spending in provinces and identify policy implications;</li> <li>1.6 Prepare glossary and explain concepts and implications of fiscal terminologies (by June 2006);</li> <li>1.7 Monitor the medium-term budget/expenditure framework;</li> <li>1.8 Ensure that the priorities of NDS are included in the national budget;</li> <li>1.9 Analyze fiscal pressures arising from government policies and reforms; and</li> <li>1.10 Brief senior MOF management about potential fiscal pressures and areas of concerns in the provinces.</li>   <li>2.0 Review and analyze documents and agreements with international financial institutions;</li> <li>2.1 Undertake analyses of benchmarks for financing mechanisms;</li> <li>2.2 Undertake analyses of country assessment strategies; and</li> <li>2.3 Coordinate action plan with relevant departments and staff within MOF and other ministries and government agencies.</li>   <li>3.0 Liaise on a regular basis with various agencies, particularly the Parliament, regarding fiscal issues; and</li> <li>3.1 Prepare and disseminate fiscal bulletins on a regular basis to relevant stakeholders.</li> </ol>	<ul style="list-style-type: none"> <li>• ADB and Government of Australia Financing (\$390,000)</li>   <li>• Government (in kind) (\$90,000)</li>   <li>• International and domestic consultants with appropriate skills and expertise</li>   <li>• Government counterparts with appropriate skills and experience</li> </ul>

**ORGANIZATIONAL STRUCTURE OF THE FISCAL POLICY UNIT**

ADB = Asian Development Bank, IDB = Islamic Development Bank, IMF = International Monetary Fund, MTBF = Medium-Term Budget Framework, MTEF = Medium-Term Expenditure Framework, National Development Strategy (NDS), UN = United Nations.

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

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Asian Development Bank<sup>a</sup></b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	160.0	20.0	180.0
ii. Domestic Consultants	0.0	50.0	50.0
b. International and Local Travel	25.0	10.0	35.0
c. Reports and Communications	5.0	5.0	10.0
2. Equipment	30.0	10.0	40.0
3. Training, Seminars, and Conferences	30.0	20.0	50.0
4. Miscellaneous Administration and Support Costs	3.0	7.0	10.0
5. Contingencies	10.0	5.0	15.0
<b>Subtotal (A)</b>	<b>263.0</b>	<b>127.0</b>	<b>390.0</b>
<b>B. Government Financing</b>			
1. Office Accommodation and Transport	0.0	25.0	25.0
2. Remuneration and Per Diem of Counterpart Staff	0.0	60.0	60.0
3. Others	0.0	5.0	5.0
<b>Subtotal (B)</b>	<b>0.0</b>	<b>90.0</b>	<b>90.0</b>
<b>Total</b>	<b>263.0</b>	<b>217.0</b>	<b>480.0</b>

<sup>a</sup> \$200,000 financed by the Asian Development Bank's (ADB) technical assistance funding program and \$190,000 by the Government of Australia, administered by ADB.

Source: ADB estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. The technical assistance (TA) will require consulting services of one international and four domestic consultants.

1. **Budget/Macroeconomist** (international, 8 person-months on an intermittent basis; 4 person-months renewable based on performance and review of requirements)
2. The consultant will work under the overall guidance of the advisor to the deputy minister of finance, and consult closely with the director general of the Budget Department and other department heads. The responsibilities of the consultant will include the following:
  - (i) Develop a training methodology and training plan for FPU in close coordination with the advisor to the deputy minister of finance, the director general of the Budget Department, and other relevant staff for the areas outlined below. The training plan will include a time-bound action plan.
  - (ii) Develop a simple Excel-based model for the medium term with revenues and expenditures.<sup>1</sup>
  - (iii) Conduct training for staff of FPU and, if required, for staff of the Budget Department and line ministries in the following areas:
    - (a) how to use existing data and prepare analysis of revenue scenarios (e.g., as a percentage of Gross Domestic Product [GDP]);
    - (b) how to build a “base case” and how to incorporate risk assessments;
    - (c) how to conduct “what if” analyses;
    - (d) how to include medium-term priorities in the budget;
    - (e) how to link the budget with the National Development Strategy (NDS);
    - (f) how to incorporate approximate costing of expenditures of the NDS; and
    - (g) the linkages of the real sector, external sector, monetary sector, and fiscal sector.
  - (iv) Familiarize FPU staff with the ideas and calculation bases of outcomes, outputs, and activities of programs.
  - (v) Illustrate and undertake simple multiplier analysis, i.e., direct and indirect impact of the Government’s spending in provinces and identify policy implications.
  - (vi) Prepare a glossary and explain the concepts and implications of fiscal terminologies—operating balance, primary balance, debt-to-GDP ratio, net debt.

---

<sup>1</sup> Revenue estimates are now carried out by the Revenue Department, and the Fiscal Policy Unit needs to coordinate and be familiar with the assumptions.

- (vii) Prepare a brief progress report after 2 months and a final report after 4 months of his/her assignment.

2. **Fiscal Analysts** (domestic, 3 at 10 person-months each)

3. The analyst will work under the overall guidance of the advisor to the deputy minister of finance. They will consult closely with the director general of the Budget Department and other relevant departments. The responsibilities of the consultants will include the following:
- (i) Monitor the medium-term budget/expenditure framework by:
    - (a) building a simple model for the medium term with revenues and expenditures;
    - (b) undertaking risk assessments of revenues, expenditures, and examining fiscal sustainability; and
    - (c) undertaking “what if” analysis with existing revenue data and examining alternate revenue scenarios (e.g., increase/decrease of revenues as a percentage of GDP).
  - (ii) Ensure that the priorities of the NDS are included in the national budget by
    - (a) developing simple analytical methods of linking the budget with the NDS, including medium-term expenditures in the budget;
    - (b) liaising with relevant government agencies, particularly the Afghanistan Reconstruction and Development Services; and
    - (c) maintaining a profile of expenditures of the NDS.
  - (iii) Analyze fiscal pressures arising from government policies.
  - (iv) Liaise closely with the Budget Department.
  - (v) Develop a simple model for calculating costs of outcomes, outputs, and activities of line ministry programs.
  - (vi) Liaise with various agencies, particularly the National Assembly office, regarding provincial fiscal issues.
  - (vii) Brief senior management of the Ministry of Finance about potential fiscal pressures and areas of concern in the provinces.
  - (viii) Review and analyze documents and agreements with international financial institutions by
    - (a) undertaking analyses of benchmarks for financing mechanisms;
    - (b) undertaking analyses of country assessment strategies; and
    - (c) briefing senior management about the implications of such arrangements, including fiscal issues.

3. **IT Training Specialist** (domestic, 5 person-months on an intermittent basis)
4. The responsibilities of the consultant will include the following:
  - (i) Develop an Excel training program for FPU and, if required, the Budget Department and line ministries.
  - (ii) Prepare simple training manuals.
  - (iii) Conduct training workshops and on-the-job training.