ADB

Policy Paper

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Afghanistan: Proposed Suspension of the Post-Conflict Assistance Phaseout

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
IDA	–	International Development Association
MFF	–	multitranche financing facility
PBA	–	performance-based allocation

NOTE

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

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I. INTRODUCTION

1. The purpose of this paper is to seek the approval of the Board of Directors of the Asian Development Bank (ADB) to suspend the phaseout of the Asian Development Fund (ADF) post-conflict assistance to Afghanistan for 2 years (2011–2012).

2. Since the conclusion of ADF X discussions, which had guided post-conflict assistance to Afghanistan, the economic situation and operational conditions in Afghanistan have worsened. As a result, the country has little chance to return swiftly to a pre-conflict development trajectory. Financing under the 6-year post-conflict assistance phaseout, which was considered sufficient to help restore the economy to a normal development track, has turned out to be less than needed to keep up essential support for reconstruction. A sharp drop in assistance from ADB—one of the largest development partners in Afghanistan—and the ensuing disruptive effects on ADB operations would put the country's nascent economic recovery at risk.

3. To sustain ADB operations in the face of hard-won but still precarious progress in post-conflict reconstruction and recovery, various options to maintain Afghanistan's current ADF allocation level could be considered. A 2-year suspension of the current post-conflict assistance phaseout would allow the most stable operational level in 2011–2012. By maintaining the same ADF allocation level as in 2009–2010 for the next biennium, ADB would be able to keep essential reconstruction and economic recovery support on track. This would also provide an opportunity to revisit the post-conflict phaseout issue during the ADF XI discussions when more accurate assessments would be available regarding the pace of the post-conflict recovery and the duration of ADB's exceptional engagement.

4. The financing mechanism to cover the additional resource requirements for 2011–2012 could be considered during the ADF X midterm review. However, for operational planning purposes, it is desirable that the framework of the post-conflict phaseout assistance for 2011–2012 be determined before the ADF X midterm review.

II. POST-CONFLICT ASSISTANCE TO AFGHANSITAN

A. ADB APPROACH TO POST-CONFLICT ASSISTANCE

5. ADB has harmonized its approach to work in post-conflict countries with that of the International Development Association (IDA).[1] ADB's allocations from the ADF to post-conflict countries were agreed upon with donors during ADF replenishment negotiations. ADB began its post-conflict reengagement in 2002 with a disaster and emergency relief program in Afghanistan.[2] The 2004 Performance-Based Allocation (PBA) Policy provided a framework for ADF allocations to post-conflict countries.[3] In the case of Afghanistan, ADB set aside $400 million during two biennial periods, 2005–2006 and 2007–2008.

[1] The IDA framework provides exceptional post-conflict assistance to eligible countries in three stages: an initial allocation, followed by exceptional allocations linked to performance norms, and then a phased return to regular performance-based allocation (PBA). In the third stage, the country receives a declining portion of the post-conflict premium every year until the premium is fully phased out.

[2] ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila. Following the pledge made at the 2002 Tokyo Conference, ADB provided $167 million in ADF assistance to Afghanistan in 2002, followed by $150 million in 2003 and $170 million in 2004.

[3] ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources.* Manila.

6. During the ADF X negotiations, donors agreed that ADF post-conflict country allocation arrangements would generally follow those of IDA. They also agreed that Afghanistan would begin a phaseout from the exceptional post-conflict assistance beginning in 2009–2010.[4] Accordingly, ADB revised its PBA policy in 2008 and introduced a 6-year post-conflict phaseout.[5]

B. POST-CONFLICT ASSISTANCE PHASEOUT

7. ADB started implementing the Afghanistan post-conflict phaseout in 2009.[6] Under the new arrangement, Afghanistan receives its PBA formula-based allocation plus a portion of the post-conflict premium, which declines every year during the phaseout period. ADF X donors agreed to determine the post-conflict premium for Afghanistan under ADF X based on the following formula:

(Post-Conflict Premium) = ($670 million) – (PBA Formula-Based Allocation)

The $670 million corresponds to the exceptional biennial allocation to Afghanistan under ADF IX scaled up in proportion to the increase in the overall size of ADF from ADF IX to ADF X.[7]

8. For the first year of the phaseout, Afghanistan received its PBA formula-based allocation plus six-sevenths (6/7) of the post-conflict premium. For the second year, it received its PBA formula-based allocation plus five-sevenths (5/7) of the post-conflict premium. The 6-year phaseout period covers three biennial allocation periods. In the biennium following the 6-year post-conflict phaseout period, Afghanistan's allocation will be entirely driven by the PBA system.

9. By applying the post-conflict premium formula, Afghanistan received $548 million during 2009–2010. This was a major increase from the $400 million allocation in the previous biennial periods, which is attributed to the sizeable increase in ADF X.

10. A provisional estimate based on the 2009 country performance assessment ratings indicates that Afghanistan will receive $386 million for 2011–2012.[8] The final allocation will be decided after the completion of the 2010 country performance assessment, due at the end of 2010.

11. Assuming the ADF replenishment size and other country indicators remain constant, Afghanistan would receive $224 million for 2013–2014 based on the current formula. In 2015–2016, following the post-conflict phaseout, Afghanistan would receive its ADF allocation through the regular PBA system.

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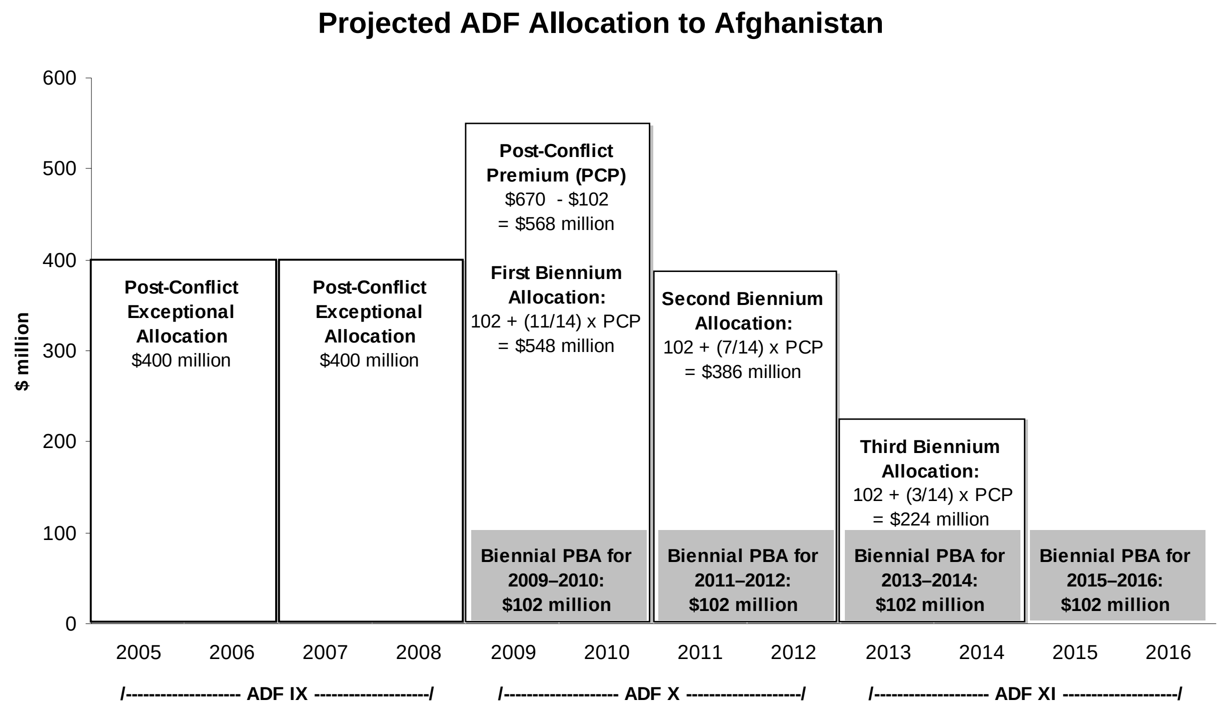
[4] ADB. 2008. *Asian Development Fund X Donors' Report: Towards an Asia and Pacific Region Free of Poverty.* Manila (para. 71). This document stipulates that the treatment of post-conflict countries—in particular, the plans to phase out exceptional assistance—is supposed to be reassessed during the ADF X midterm review.

[5] ADB. 2008. *Refining the Performance-Based Allocation of Asian Development Fund Resources*. Manila.

[6] IDA began its post-conflict phaseout to Afghanistan in FY2008.

[7] The exceptional post-conflict allocation to be used in calculating the premium for the third biennium would depend on the outcome of the ADF XI replenishment discussions.

[8] This estimate is based on the ADF commitment authority used for the 2009–2010 allocation.



ADF = Asian Development Fund, PBA = performance-based allocation.
Source: Asian Development Bank staff estimates.

III. ADB ASSISTANCE TO AFGHANISTAN

12. ADB's strategy in Afghanistan focuses on transport (road, rail, and regional airports), energy, and irrigation.

13. Project implementation and results have been improving steadily, although overall performance continues to be hampered by frequent security threats and low project management capacity of executing agencies. Attracting qualified project contractors is also very difficult. Most tenders only have one bidder, and several projects have none. Some contractors have abandoned projects because of security reasons, which has led to cost overruns and implementation delays. This has been reflected in slower disbursements compared to the ADB average. Cumulative disbursements total $620 million, which is 37% of the total net loan and grant amount of $1,679 million. The ADB average percentage is 42%. Nevertheless, disbursements are expected to accelerate in 2010 as a railway project is fast-tracked and portfolio management efforts continue.

14. The current ADB assistance program is structured mostly around three multitranche financing facilities (MFFs) covering transport, energy, and irrigation. A portion of the ADF envelope is also reserved for selected reform programs, including in the future a special scheme targeting access to finance in rural areas. The use of MFFs means that a large share of the program is well defined for the next 5–7 years, providing the government with predictability and establishing the basis for a long-term partnership in priority areas. The MFF also allows flexibility in terms of annual commitments and matches financing to project readiness, which helps cut the cost overruns that frequently occurred in the past.

15. Transport infrastructure is essential to improve connectivity, reduce transit fees, and increase trade. A flagship project in this area started in 2009: the construction of a railway line

from Hairatan to Mazar-e-Shariff.[9] More than half of the country's imports, including humanitarian assistance, pass through this border town. All cargo currently arriving at Hairatan is unloaded and reloaded at the border into trucks, leading to major time and product losses. A second project in the sector is the so-called national ring road, which has been completed except for a little more than 200 kilometers in the northwest near Herat.[10] The ring road, airports, and railway line are part of a multimode system that first links cities and towns within the country, and then Afghanistan with its neighbors. On the energy front, the main target is to increase regular supplies to people and businesses, and to increase energy efficiency. An energy transmission line from Uzbekistan to Kabul, the capital of Afghanistan, has extended the electricity supply from 2 hours to 24 hours a day.[11] This is having a transformational effect. Other ongoing energy projects include a transmission line from Tajikistan and the expansion of the distribution network in Kabul. The irrigation sector remains a key to raising farm productivity and achieving agriculture diversification. A series of irrigation investments are being prepared.

16. The 2011–2012 assistance program will be based mostly on MFF tranches in the three priority sectors. The financing plans of each tranche are being redefined to take into account project readiness and the size of the financial envelope during the period. While the program focuses on new investment, it also has to take into account cost overruns on some existing projects.[12] The first priority is the completion of the ring road, which will require $210 million in additional funding. Originally the uncompleted part of the ring road network was structured into two sections, one about 80 kilometers and the other 140 kilometers. The first section was awarded in August 2006 to an international contractor, but the government terminated the contract for poor performance. The second section was tendered three times in the past 3 years, each time without success. This long delay in engaging a contractor and the steep increase in security costs during this period have contributed to the cost overruns. ADB has redefined its approach by repackaging the entire unfinished section of the ring road into a single contract.

17. The rest of the 2011–2012 program includes three other operations: (i) irrigation, road, and energy subprojects in Helmand that were not envisaged when the MFFs were approved, but still fit within the strategic direction of the three MFF programs; (ii) budget support and rural credit schemes (part of the financial envelope was to be reserved for this purpose); and (iii) support for the cross-border initiative launched by the Group of Eight (G8), which includes projects in Pakistan and in southern Afghanistan.[13] These new operations, the projected MFF tranches, and the cost overruns in the ring road are estimated to cost $600 million. The current financing available under a phaseout from the post-conflict premium is $386 million, leaving ADB with a substantial shortfall. Besides reinstating the financing available during 2009–2010, other actions by ADB would be to drop some of the new project requests and/or reduce its share of their financing plans. Irrespective of the financing envelope, the assistance program remains focused with strong government ownership. The investments are highly visible, and many contribute significantly to regional cooperation.

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[9] ADB. 2009. *Report and Recommendation of the President to the Board of Directors on a Proposed Asian Development Fund Grant to Afghanistan for the Hairatan to Mazar-e-Sharif Railway Project.* Manila.

[10] ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to Afghanistan for the Qaisar–Bala Murghab Road Project.* Manila; and ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Asian Development Fund Grant to Afghanistan for the Road Network Development Project 1.* Manila.

[11] ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Afghanistan for the Emergency Infrastructure Rehabilitation and Reconstruction Project* (Segment 2). Manila.

[12] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to Afghanistan for the Road Network Development Investment Program.* Manila.

[13] The Group of Eight comprises Canada, France, Germany, Italy, Japan, Russian Federation, United Kingdom, and United States.

IV. SUSPENSION OF POST-CONFLICT ASSISTANCE PHASEOUT

18. In view of the phaseout from the post-conflict assistance and the consequent reduction in ADF allocations by $162 million in 2011–2012, several ADF donors have expressed concerns about the impact that this decrease would have on ADB operations. In response, ADB Management proposed to donors three options to maintain Afghanistan's current ADF allocation level:

(i) Option 1: Suspend the phaseout adjustment for 2 years (2011–2012).

(ii) Option 2: Extend the phaseout period from 6 to 8 years.

(iii) Option 3: Extend the phaseout period from 6 to 10 years.

19. The allocations that would result from these options are shown in the table below.[14] Under option 1, the 2011–2012 allocation would be maintained at the same level as in 2009–2010. The allocation projected for 2013–2014 onwards would be guided by the ADF XI discussions on the phaseout. Option 1 would allow a stable operational level in 2011–2012, which could help keep essential reconstruction and economic recovery support on track while providing an opportunity to revisit the post-conflict phaseout issue during ADF XI discussions.[15] Under options 2 and 3, the 2011–2012 allocation would fall short of the level under option 1, but they could provide a clearer picture of future allocation projections.

Projected ADF Allocations under Different Options
($ million)

Options	2009–2010	2011–2012	2013–2014	2015–2016	2017–2018
Current 6-year phaseout	548	386	224	102[a]	102[a]
Option 1 (2-year suspension of phaseout)	548	548 (162)	tbd	tbd	tbd
Option 2 (8-year phaseout)	548	476 (90)	323	197	102[a]
Option 3 (10-year phaseout)	548	534 (148)	386	283	179

ADF = Asian Development Fund, tbd = to be determined.
Note: Figures in parenthesis indicate the amount of additional allocations for 2011–2012 compared to the allocation under the current 6-year phaseout.
[a] This is the estimated allocation through the regular performance-based allocation system.
Source: Asian Development Bank staff estimates.

20. During the ADF X donors' annual consultation meeting in Tashkent on 2 May 2010, donors agreed that option 1—the 2-year suspension of the post-conflict assistance phaseout—

[14] The options in the table assume that the ADF envelope size for 2009–2010 will be constant for the entire phaseout period and that Afghanistan's performance-based allocation portion will also be the same as in 2009–2010. Actual allocations will be affected by the updated estimate for the ADF commitment authority in conjunction with the ADF replenishment size and the latest country performance assessment outcome when the biennial allocations are made.

[15] The framework for post-conflict phaseout is also being reviewed by IDA under its ongoing IDA 16 replenishment discussions. IDA is considering two options: (i) extending the phaseout period uniformly by 2 years, or (ii) extending the phaseout period for individual countries on a case-by-case basis. In the second meeting of IDA 16 negotiations held in Bamako, Mali on 16–18 June 2010, majority of IDA donors supported the case-by-case option.

is the best of the three options proposed by ADB Management. As this option would be a departure from the current framework on post-conflict assistance phaseout prescribed in the PBA policy,[16] its application requires the Board's approval. Meeting participants also stressed that the financing plan should not compromise ADF operations in other ADF-recipient countries and that sources for additional funding need to be identified.

21. The financing mechanism to cover the additional resource requirements for 2011–2012 will be considered during the ADF X midterm review. Additional contributions by donors will be explored within the ADF X period[17] or under ADF XI replenishment. In the latter case, partial and temporary utilization of the remaining $600 million in usable liquidity of ADF[18] would fill the financing gap.

V. RECOMMENDATION

22. The President recommends that the Board approve the suspension of the ADF post-conflict assistance phaseout to Afghanistan for 2 years, 2011–2012.

[16] ADB. 2008. *Refining the Performance-Based Allocation of Asian Development Fund Resources*. Manila

[17] Actual contributions by donors for the additional 2011–2012 allocations may be executed during 2011 to finance 2012 projects as the 2011 project approvals could still be within the $386 million of originally planned biennial allocation.

[18] The *ADF X Donors' Report* (footnote 47) indicates that under the new financing framework of ADF, an enhanced prudential liquidity policy was introduced in November 2007, which has led to the identification of an estimated one-time $2.30 billion (SDR1.45 billion) in usable liquidity. Donors agreed to use part of that liquidity for the ADF X replenishment and also agreed that further use of the remaining $600 million (SDR378 million) should be discussed during the midterm review.