

SOAG Annex 1**Amplified Description****I. Introduction**

This annex describes the activities to be undertaken and the results to be achieved with the funds obligated under this Agreement. Nothing in this Annex 1 shall be construed as amending any of the definitions or terms of the Agreement.

II. Background

This amplified project description includes details of the three major technical areas covered under this Agreement for the Objective "A Thriving Economy led by the Private Sector." The three technical areas include, "Rehabilitating the Rural Economy", "Increasing Incomes through Economic Growth", and "Expanding and Improving Access to Economic Infrastructure".

A. Rehabilitating the Rural Economy

The Grantee has three core ministries tasked to implement agriculture related programs and projects. These are: the Ministry of Agriculture, Animal Husbandry and Food; Ministry of Energy and Water and the Ministry of Rural Rehabilitation and Development.

In addition, the World Bank, the Asian Development Bank, UNDP, UNEP, the Food and Agricultural Organization, European Commission, Australia, China, Denmark, Finland, France, Germany, Italy, Japan, Kuwait, Netherlands, Norway, Switzerland, Turkey, United Kingdom and U.S. are providing assistance in the agriculture and natural resources sectors of Afghanistan. These donors collaborate in addressing the emergency needs of drought stricken farmers, rehabilitation of damaged irrigation systems, development of alternative livelihoods and institutional reforms to enhance the capacities of the ministries to develop and implement programs and activities for the reconstruction of the country. External assistance has been and needs to continue to be allocated in accordance with the priorities of the government and worked out such that duplication is avoided.

In addition to the other agriculture related programs and projects, the Grantee considers the elimination of poppy growing and opium marketing a top priority.

B. Increase Incomes Through Economic Growth

The economic governance portion of this Agreement focuses on those aspects of economic reform considered to be most important in moving the economy towards competitive markets, focusing first on ministries in government that control essential economic functions, including fiscal policy and administration, central banking, trade policy, and regulation of industry, and then addressing private sector development more directly, through privatization of land and enterprises; development of industrial parks; identification of potential industry clusters; the initiation of more private sector friendly, pro-growth policies; the beginnings of a modern competition policy that reduces the role of government in the commercial sphere; the start of a program to remove and simplify administrative constraints to

establishing and operating a business; the provision of training and resources for establishing business networks and business associations; and, finally, increased resources targeted to expanding the availability of credit and to financial deepening.

Several goals underlie the Grantee's economic growth strategy. First, according to the National Development Framework (NDF), the government of Afghanistan envisages that growth of the non-drug economy should be nine percent per year to ensure that there is acceptable, visible economic progress. Second, government policy sees the private sector as the engine of growth and removing obstacles to private sector development is an urgent priority. Third, the need for development of the agriculture sector is paramount, since this sector represents 52 percent of the legal economy and provides livelihood for some 60 percent of the population.

As described in Afghanistan's constitutional Loya Jirga, there are three pillars of the National Development Framework: Trade and Investment, Public Infrastructure, and Rule of Law and Security. These three pillars emphasize the development of human capital, physical infrastructure, and good governance. Thus, developing Afghan human capital and the improvement of governance and transparency are inherent and integral parts of this program's economic growth strategy.

In addition to USAID, additional donors to the financial sector include, DFID, the Swedish International Development Agency, and Germany. Trade is addressed by, in addition to USAID, Germany and Japan. Finally, all of the donors are active in private-sector growth activities, which are represented by a wide range of projects, including women's employment, micro and SME promotion, privatization, business associations, industrial parks, and land titling and registries.

Five major constraints are obstructing Afghanistan's progress towards a competitive market economy: Security; lack of essential physical infrastructure; inadequate institutional framework; lack of modern, free-market policy commitments by the government (including transparency and accountability in government organizations); and lack of human capital.

C. Expand and Improve Access to Economic Infrastructure

1. Energy:

The primary fuel sources for providing power to the public power grids in Afghanistan are (1) hydropower; (2) imported power; and (3) thermal power. Gas in the northern part of the country has significant potential. Gas-powered generation for the north and transmission to Kabul is essential to assure alternative fuel sources for power. Diversification of fuel sources is critical, as singular reliance on hydro power has high risk in drought conditions. In the meantime, there has been an increasing use of generators that rely on imported diesel fuel to operate is apparent throughout the country, including all embassies, contractors, NGOs and Afghan government entities.

Government's primary energy support programs to date are supported with donor funding either directly or through the Afghanistan Reconstruction Trust Fund and the Ministry of Finance.

The power sector is managed by the Ministry of Energy and Water under which an autonomous enterprise, "Da Afghanistan Breshna Moassasa

(DABM)* is the power utility responsible for the operation and maintenance of the country's generation, transmission and distribution of power assets as well as for the sale of power/electricity produced. The power sector is closely linked to its fuel source and water counterparts at the Ministries of Energy and Water and of Mines and Industry.

The oil, gas and coal sector is managed by the Ministry of Mines and Industry under which the Afghanistan State Gas Enterprise is responsible for gas production.

Under the Ministry of Energy and Water, a Renewable Energy Department exists. In addition, the Ministry of Rural Development and Rehabilitation maintains a similar department. The Ministry of Foreign Affairs does not have a particular department for energy but houses an Asian Development Bank advisor on renewable energy and rural economic growth.

2. Transport

The Ministry of Public Works is the primary entity for the Grantee responsible for road and bridge construction, operation and maintenance. The road and highway network includes national, provincial (secondary), rural (tertiary), district center and urban roads. In addition to USAID, other donors have participated in the rehabilitation and construction of the national road network. The World Bank-funded National Emergency Employment Program also uses labor-intensive projects to repair farm-to-market roads. The Grantee's Ministry of Civil Aviation and Tourism (MoCAT) is responsible for the nation's civil aviation infrastructure including operation and maintenance of the international airports at Kabul and Kandahar, four major domestic airports and seventeen regional airports, as well as owning the national airlines and major hotels. Afghanistan currently has no railways and the Amu Darya (Oxus) River is the only navigable river in Afghanistan. The Ministry of Transportation (MOT) also has responsibilities in the transport sector. The MOT manages the government-owned vehicle fleet and regulates the private sector transport industry.

As laid out in the Transport Sector Policy Statement and the Public Investment Program, the goal of the Grantee is to promote national and regional/sub-regional integration, development and security by restoring, expanding and improving roads and highways, civil aviation, and transport services that will allow efficient public and private sector operations in respective areas of competence, strengthen market and international linkages, and create opportunities for the poor to share in the benefits of growth and prosperity, thereby reducing poverty.

3. Water

Development and management of surface water resources is the responsibility of the Ministry of Energy and Water. This includes the development of policies concerning water use and the development of multipurpose water projects for power generation, irrigation and water supply. An independent water resource team of experts has been established to

advise the Grantee on broader water issues including trans-boundary water allocation issues.

The responsibility for identification and development of groundwater resources is spread through a number of ministries and government agencies including the Ministry of Mines and Industry, the Afghan Geological Survey, Ministry of Rehabilitation and Rural Development, and Ministry of Housing and Urban Development.

The two ministries that oversee water supply and sanitation in urban and rural areas are Ministry of Urban Development and Housing (for urban water) and the Ministry of Rural Rehabilitation and Development (for rural water). In addition, in urban areas the Central Authority for Water Supply and Sewerage has overall responsibility for water supply and sanitation.

In addition to USAID, water projects are also funded by the Afghanistan Reconstruction Trust Fund and other donor sources. An urban water supply and sanitation committee (UWSS) composed of donors and implementers also advises on the urban water system. The German-Afghan Financial Cooperation (through KfW) and the World Bank-IDA have also contributed to water projects.

III. Funding

Financial Plan. The financial plan for the Program is set forth in the table attached to this Annex 1. Changes may be made to the financial plan by representatives of the Parties without formal amendment to the Agreement, if such changes do not cause (1) USAID's contribution to exceed the amount specified in Section 3.1 of the Agreement or (2) the Grantee's contribution to be less than the amount specified in Section 3.2 of the Agreement.

IV. Results to be Achieved/Activities/Activity Selection

The objective of a thriving economy led by the private sector is supported by the six results described below, each of which is, in turn, supported by various sub- or intermediate results (each an "Intermediate Result").

A. Result #1: Accelerated market-led growth in agriculture

1. Development hypothesis. The economic growth of Afghanistan depends largely on agriculture. Agricultural growth stimulates employment growth in the non-farm sector, and has a vital role in employment growth, poverty reduction, and stimulation of market growth and narrowing of rural and urban income disparities. *The program will focus intensively on a few agricultural sub-sectors, with the objective of assisting those sub-sectors to achieve greater productivity, improved quality, and comparative advantages for Afghan products. In the domestic, regional and global economy, competition is ubiquitous; therefore, a full suite of agricultural services must be put in place, in particular, credit programs that meet critical needs for operating and investment capital.*

a. Intermediate Result 1: Domestic and international markets for agriculture crops expanded.

The focus for this intermediate result is on high-value crops. Exports of fresh and dried fruits is one of the biggest contributor to Afghan's economy

in the 1970's, contributing 40% to total export earnings, but due to years of conflict and prolonged drought cultivation of horticulture crops, areas under cultivation decreased. Moreover, production for local and international markets is constrained by poor post harvest facilities, lack of irrigation water supplies, lack of improved technical practices and inability to access rural financing and markets. Increasing markets for high-value horticulture crops is a priority.

b. Intermediate Result 2: Productivity of livestock sector increased and its market expanded.

Livestock is an integral part of Afghan rural households. However, the prolonged drought in the 1990s decreased livestock population by about 77% which diminished rural households' assets, food security and capability to generate income. Increasing the productivity of livestock would contribute to poverty reduction in the rural areas since the livestock industry is an important source of food, draught and transport power for agriculture as well as source of savings and income for most Afghan rural households.

c. Intermediate Result 3: Functional rural financial system established.

The country's farming system is characterized by small holders with limited access to credit primarily due to the dearth of capital available for the agriculture sector and the lack of collateral. The program intends to leverage funds from commercial banks, bilateral and multi-donor funds and the private sector. The mechanisms may include SME debt financing, leasing and equity participation.

d. Intermediate Result 4: More efficient agriculture support services (research and extension).

As part of the program activities may continue the work of introducing and teaching improved technologies adaptable to local needs. A particular focus may be those engaged in the production of horticulture crops and livestock. Research and extension activities would, to the extent possible, include as many women and micro enterprises as possible.

e. Intermediate Result 5: Management of renewable natural resources enhanced.

The Parties recognize the importance of responsible use and conservation of natural resources to sustainable agriculture. Under this program environmental activities may be prioritized in areas where there are significant biological and economic values. Reforestation, establishment of tree nurseries for Afghan species, training on improved rangeland and watershed management and information campaign (to increase the understanding of resource users on the importance of protecting and conserving biodiversity to their livelihood) may be some of the activities considered. In each case, an emphasis will be made on community management of natural resources that will incorporate indigenous knowledge and skills in resource use planning and management. This may be accomplished through a multi-sector participatory approach intended to establish partnership with the communities and assuring their ownership of the activities planned and implemented.

B. Result #2: Accelerated broad-based, sustainable rural economic development in ways that provide new opportunities for the Afghan population to seek livelihoods in the licit economy

A large portion of the activities under this result will be focused on provinces in which poppy production is highest. In these provinces, the program will accelerate and intensify those components of the strategy that have a direct bearing on providing alternative livelihoods. These may include building infrastructure (power, transportation) and stimulating industrial development. It may also include the provision, in the immediate term, of a social safety net that keeps people in these provinces from falling into poverty as a result of lost income from poppy production.

1. Development Hypothesis. The most likely strategy for eliminating poppy cultivation is a broad, sound rural economic development strategy that promotes market-led economic growth, strengthens the rule of law and legitimate governance processes, and provides social services, including health and education. Alternative development aims to increase presence and responsiveness of government, community organizations and the private sector to promote the growth of licit economic activities and employment. Accomplishing these objectives requires improved and expanded public services, resource management, community involvement, and strengthened policy and legal frameworks. Activities should improve diversity of economic activity, encourage entrepreneurship and new business creation, attract investment and credit to rural enterprises, and improve the competitiveness and sustainability of economic growth whether the enterprise is agriculture or non-agriculture based. Other areas of improvement may include rural infrastructure, social capital, solidarity of communities in assessing their future, and amelioration of the impact of drought. Among the structural improvements necessary in Afghanistan's rural areas are roads, bridges, electricity, rehabilitation of irrigation systems, water and sanitation systems, and telecommunications. Improvements are also necessary in licit agricultural production, small and medium sized business creation or growth, credit and investment delivery, and market linkages leading to development of district marketing towns as manufacturing and service centers, and job creation.

a. Intermediate Result 1: Accelerate licit economic growth and business activity in selected provinces in which poppy cultivation is thriving.

Up to five categories of activities may be developed (listed here with illustrative activities):

- *Public works and infrastructure, to include market town development, access to clean water, electrification, road and transportation improvements, irrigation and irrigation rehabilitation;*
- *Small and medium-size business development, consisting of manufacturing, skilled crafts, natural resource based industry, agribusiness, and service enterprises in a diversified regional economy, including technical and managerial training, facilitating investment, business services, and market linkages;*
- *Identify the markets for high value or value added products and assist in their production and marketing.*

- Strengthen extension and rural credit systems and agro and small business development.
- Business-enabling environment, cataloging and removing provincial and district administrative constraints to opening and operating a business, such as removing unnecessary approvals, inspections, redundant taxes, difficulties in establishing good title to property, etc.;
- Production of marketable agricultural products by identifying high value crops, strengthening extension and agricultural credit systems, and agro-business development, and
- Credit and financing institutions strengthened or created to serve all economic sectors.

b. Intermediate Result 2: Provide an immediate alternative source of income to poor households whose livelihoods depend, directly or indirectly, on the temporary opium economy.

One of the potential activities under this Intermediate Result may be an immediate-needs program in the provinces targeted for opium poppy eradication. The activity could involve creating labor intensive cash-for-work employment opportunities for those who lose income as they cease to harvest poppies. Certain activities may be negotiated with community leaders and could include some of the following illustrative activities: small-scale village level activities such as repair of irrigation systems, tertiary road maintenance and repair, land leveling, cleaning of canals and other village identified activities, or employment activities for women in horticultural production, handicrafts, and community gardens. Additional activities may involve assistance with the distribution of food, seeds, tools, and fertilizer to farmers shifting away from poppy crops. A social safety net program may also be considered in order to help destitute households in the region. This component of the program should decline by 2007.

C. Result #3: Increased incomes through economic growth

1. Development Hypothesis: The underlying development hypothesis to achieve this result is that the best way to create prosperity and sustainable jobs and to reduce poverty is to promote growth of individual businesses, primarily through development of a competitive market economy. Policy reforms pursued in partnership between the public and the private sectors are more successful in identifying impediments and in designing reforms than will the provision of technical assistance directly only to state institutions. Included with this is the need to increase the private sector's role and decrease the government's role in the economy.

Second, improving financial institutions helps mobilize capital and increases access to financial services. Also, expanding and broadening the outreach of microfinance and rural finance spreads the benefits of growth to a broader range of the vulnerable population, especially women, in both urban and rural areas.

Finally, competitiveness can be stimulated by removing administrative barriers and constraints that prevent enterprises from entering the market and by focusing on products and services demanded by markets.

As part of this program efforts will be made to strengthen competitive markets and growth, which form the base upon which a stable and sustainable economy can be built. Paramount to the growth of Afghanistan's legal economy is the expansion in the sales, profits, and number of jobs provided by individual private enterprises. Businesses are the engines for the growth of the nation's economy. There will be a need for these activities to be communicated to the public, private, and civil sectors so that all understand the strategy and progress.

a. Intermediate Result 1: Legal and Regulatory Environment Improved

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Commercial laws modernized covering commercial code, secured transactions, commercial paper, collateral, bankruptcy, and laws on accounting and auditing of enterprises.
- Governance laws modernized covering Public Expenditure and Financial Management, Procurement, Civil Service, and corporate governance.
- Predictability and transparency of regulations enhanced through legal and regulatory reforms and the strengthening of regulatory bodies, including selected public utilities and the financial sector.
- Predictability and transparency of commercial dispute resolution enhanced by building the capacity of commercial courts and making available improved alternative commercial dispute resolutions, including establishing escrow accounts.
- Administrative barriers eliminated in Kabul and selected provinces and remaining administrative procedures simplified to reduce transaction costs and speed the establishment, operation, and reporting of private firms.
- Predictability and transparency of government taxes enhanced through legal and administrative reforms.

b. Intermediate Result 2: Monetary Policy and Central Bank (DAB) Operations Strengthened.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Sound monetary policies provided to enhance real economic growth, while holding inflation to moderate or low rates and providing for an orderly and stable foreign exchange market.
- DAB staff trained and introduced to analytic systems so as to achieve the accurate and timely provision of economic and financial data and analysis to inform and guide the DAB in making effective monetary policy.

- Scope and depth of financial supervision extended to include not only quality bank supervision compliant with the Core Principles of the Basle Committee on Banking Supervision, but also effective supervision over non-bank financial institutions such as foreign exchange dealers, money service providers, securities service providers, microfinance depository institutions, non-depository credit institutions, and insurance companies.

- Reach of international financial reporting and auditing standards extended from DAB and the commercial banks to nonbank financial institutions, thereby serving as an effective model for the economy as a whole.

- Early development of a National Payments System based upon a modern bank-wide information technology and communications structure to include a Real-time Gross Settlement and Bulk Clearing System.

c. Intermediate Result 3: Fiscal Policies and Ministry of Finance Management Strengthened.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- A modern customs and tax administration capable of collecting government revenues according to international standards.

- A transparent budget formulation and execution function in the Ministry of Finance able to efficiently allocate government resources.

- A Fiscal Policy Analysis Unit within the Ministry of Finance to conduct macroeconomic and fiscal projections and analyses necessary for the Ministry to manage effectively the fiscal system.

- A Training Department responsible for designing and implementing the necessary classroom and on-the-job training programs for all functions within the Ministry of Finance.

d. Intermediate Result 4: Access to Credit Increased.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Micro, small and medium enterprises have access to credit through risk-sharing credit mechanisms such as "on-lending" facilities to financial organizations, credit guarantees, and micro finance organizations.

- Small and medium enterprises have access to equity and venture capital facilities.

e. Intermediate Result 5: Financial Markets Deepened.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Broader range of financial services provided, such as insurance, leasing, investment, and private pension companies.

- Institutional development and training to facilitate sound lending, including a real property appraisal profession, collateral registry and credit information bureau.

- A national banking and financial services capacity created that provides a broad range of high quality courses to supplement the education from local universities/colleges.

f. Intermediate Result 6: Land Markets Development through Titling Improvements.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Provincial Makhzans (keepers of historical deeds and other civil documents) reorganized so that document search takes ten minutes instead of two months.

- The process of registering deeds is simplified and made transparent and deeds are made available in all accessible Afghan provinces.

- Deed systems are automated.

- Selected Makhzan's are rehabilitated or reconstructed.

- A Land Administration office for the Primary Courts in Kabul sited and built to house a One Stop Shop for registration, mapping, cadastre and storage of historical records (Makhzan).

- Standardized mapping cadastre in selected provinces.

- Predictability and transparency of land tenure dispute resolution coordinated between formal government code, Sharia civil code, and tribal council traditional law.

- A land tenure Business Transaction Titling system is in place within the Ministry of Finance providing clear title for transfer of all industrial and commercial property.

- Regularization of tenure in informal settlements is in place in Kabul and other major urban areas.

g. Intermediate Result 7: Human Resources and Business' Capacity Increased.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- A sustainable national business association network created that promotes business-related advocacy initiatives, provides business/leadership training, and promotes investment and exports by both domestic and foreign investors.

- Business training and services provided to businesses and entrepreneurs throughout Afghanistan that includes accounting, auditing, development of business and marketing plans and other business skills leading to professional certification.

- Market-based clusters developed with selected industries to allow Afghanistan products and services to better compete in regional and international markets.
- Dialog promoted between the private and public sectors through new institutional structures that address inhibitors and enablers of competitiveness.
- Value added activities, such as processing and export sale of selected Afghan products enhanced to promote the development of an internationally competitive private sector.
- Business women prepare their own business and marketing plans, their handicraft and manufactured products are designed to meet high quality local and international standards, and they have access to micro, small and medium scale loans.
- The economics and business faculties at universities strengthened so that business and government capacity in accounting, management, marketing, economics, and business law is enhanced.

h. Intermediate Result 8: State-Owned Enterprises (SOE) Evaluated and Restructured, Sold or Liquidated.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Displaced workers from State Owned Enterprises provided options for training, new jobs, or voluntarily redirected to other activities and compensated for their time in State service, utilizing proceeds from sale of public entities.
- Marketing effort to attract foreign and local investment in high priority industries such as cotton ginning, cement, silos, advertising and aviation and to fill in gaps in cluster value chains, based on satisfying customer needs in industries such as carpets and agricultural products.
- Excess government land sold and plans undertaken to manage some of the excess land for the general public, i.e. parks, recreation centers, etc.
- Non-functioning and economically ineffective SOE's liquidated.
- Privatization completed for Baghlan Sugar Enterprise and Cotton Ginning operations in Mazar and Kunduz. Prioritize SOE silos for privatization.

i. Intermediate Result 9: Trade and Competition Policy Improved

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- Accession to the WTO.
- National Export Promotion Agency established capable of effectively increasing the volume of Afghanistan's exports regionally and internationally.

- Regional trade and transit agreements ratified to promote the free and efficient flow of goods and services.
- International Trade and Transit Units within the Ministry of Commerce capable of effectively negotiating and implementing agreements and participating in regional trade initiatives.
- Import/Export administrative procedures reformed and made consistent with WTO requirements to promote the international competitiveness of Afghanistan's industry and exports.
- *Transportation and transit regulations harmonized with the region to allow for foreign transporters to transit international shipments through Afghanistan establishing Afghanistan as an East/West and North/South trade transit and communication corridor.*
- Trade brokerage established to expedite the clearance of import/exports in a transparent manner consistent with international best practices.

j. Intermediate Result 10: International Standards and Best Practices Adopted.

In order to help achieve this Intermediate Result, activities may be selected to help accomplish one or more of the following sub-results:

- International Financial Reporting Standards (IFRS) established as the national standard; public and private units converted.
- National Institute of Standards and Metrology established capable of adopting and effectively implementing international safety and health standards in high priority areas of pharmaceuticals, construction materials, fuel, and food products.
- Uniform standards adopted for trade consistent with WTO requirements and international best practices.

2. Activities/Activity Selection. Activities under this Result may be focused in one or more of the following areas: currency conversion; fiscal reform; banking reform; trade policy; regulatory and legal reform; and privatization. Such activities may include, without limitation, (a) the reform of public-sector institutions and policies necessary to support a market economy, (b) fiscal reform to address customs and tax policy and administration and budget formulation and execution, (c) banking activities that address central and commercial bank laws, the operating and regulatory functions of the Central Bank, and developing a national payments system, or (d) legal and regulatory reform such as commercial law reform (for example, company law; bankruptcy; collateral; commercial paper; and alternative dispute resolution) and regulatory frameworks for public utilities. In addition there may be activities designed to promote women entrepreneurs and support a human resources restructuring activity at the Ministry of Commerce in support of the GOA's public administration reform program.

The program is intended to improve the policy framework for the private sector and build its human capital. Emphasis may be placed on training programs and capacity building within government organizations and in the private sector.

Activities designed to achieve an improvement of the land registry system and development of a process for establishing land tenure may take place. Other activities may include one or more of the following: (i) the restructuring of the 71 state-owned enterprises, (ii) refurbishment of industrial parks, (iii) provision of business advisory services in conjunction to the establishment of the \$20+ million Afghanistan Renewal Fund (Venture Capital), (iv) development of a training network and curricula for the use of computer and telecom equipment, (v) integration of the development and operational budgets of the national government along with coordination of donor agencies' grants and loans so that these may be included in Afghanistan's National Development Framework, (vi) the creation of a network of business associations to provide technical assistance and advocacy support, (vii) development of networks to support the creation of industry clusters, (viii) provision of technical assistance on the issues of privatization, land titling, accounting, and auditing, (ix) the strengthening of prioritized civil aviation physical assets and the Afghan Ministry of Civil Aviation and Transportation as essential components of the country's economic infrastructure, and (x) helping the central bank in building its capacity to guide and supervise the country's financial system.

D. Result #4: Stabilized Energy Services and that Are More Affordable and Accessible.

1. Development Hypothesis. Energy is a fundamental, cross-cutting driver of economic development and social stability. Limited access to energy is impeding economic development and social welfare improvements in Afghanistan. National government is constrained in its ability to conduct day-to-day operations, business and industry are commonly unable to function. New and refurbished hospitals, schools, clinics and businesses are stalled in their ability to become viable and fully functioning institutions. The lack of access to basic power also has political repercussions as citizens begin to demand improved services. Given the scope and complexity of problems in the sector, priorities and adequate funding must be committed for both immediate and longer-term activities. Donor coordination and the coordination among donors and the Ministries of Energy and Water and Mines and Industry as well as relevant state-owned enterprises will contribute to achieving progress in implementing the highly complex systems that deliver energy for economic growth.

2. Intermediate Results.

a. Intermediate Result 1: Build a sustainable operating system.

Under this Intermediate Result activities may be planned that intend to (i) provide support for the emergency power supply for Greater Kabul and Kandahar, Lashkar Gah and Qalat in Zabol, and Kandahar and Helmand provinces; (ii) stabilize the public power supply by rehabilitating/rebuilding the system to serve formerly connected areas; (iii) immediately initiate building of indigenous capacity through technical, management and vocational training applying market-based management practices, (iv) establish sector norms and standards and initiate sector restructuring and reform to promote improved efficiency, cost recovery and sustainability and (v) support the development and expansion of regional energy trade linkages with the Central Asian Republics and the South Asian countries.

Under the program the intent will be to try to achieve a sustainable system operations for provision of reliable, affordable power. The system may include a natural gas-fired thermal plant, hydro, micro-hydro and solar facilities that are sustainable based on cost-recovery. Additional activities may include the production of spare parts and micro-hydro and solar water heating/pumping systems to create small business opportunities in country.

Longer term priorities (2-5 years) are to (i) identify and support priority power sector development initiatives to supply power in market-based conditions; (ii) promote indigenous capacity and sustainability to manage the power sector; (iii) help posture Afghanistan strategically in both the Central Asia and South Asian regions to the benefit of long-term energy relationships; (iv) promote the development of Afghanistan's power sector so that it is integrated into the water and energy nexus to comprehensively support sound economic growth and quality of life.

b. Intermediate Result 2: A shift to indigenous sources of power.

The result will be a reduction and removal of emergency fuel procurement program and diversification of Afghanistan's The least cost supply may include a blend of economically priced electricity imports from Uzbekistan, Turkmenistan and Tajikistan as well as expanded domestic hydropower and gas-fired generation sources for grid-connected supply. Off-grid, the development of mini-hydro, wind and solar power may be promoted through the development of renewable energy data base. Activities may be designed to promote the use cost-efficient, safe, indigenous fuel sources and create domestic employment opportunities (gas, coal, oil).

c. Intermediate Result 3: Strengthened human and system resources.

Activities under this Intermediate Result are intended to help ensure that the country will eventually have the institutional capacity to maintain sustainable operations including market-based operations, technical expertise, legal and regulatory safeguards, transparent audit and accounting practices, billing and collections, environmental standards and viable labor-management relations.

Activities may include support for the Afghanistan Energy Information Center as the primary repository for all historic and updated energy sector data, mapping, analysis and library of assessments, reports including government projects and donor participation and improved regional linkages between institutions to enhance power import opportunities, cross-border trade, contracting and sound regional energy resource management practices.

d. Intermediate Result 4: Improved policy, legal and regulatory frameworks.

In collaboration with other donors, activities under this Intermediate Result may include sector restructuring, establishment of technical, safety and environment codes to assure safe and sustainable operation of systems. These may include grid code, electricity code, health and safety and environmental regulations. In addition, there may be activities to improve sector efficiency, institutional and regulatory support to enforce sector standards. Support of legal and regulatory standards including institutional

operations and oversight to assure transparent and predictable operations, sound use of energy resources and strategic planning for future resource development and use throughout the country may also be part of this intermediate result.

e. Intermediate Result 5: Improved private-sector support for the energy sector.

Activities may include support for the development of Afghanistan-based production, where possible, of spare parts, micro-hydro, solar water heating, solar pumping and solar drying systems to create small business opportunities throughout the country. In addition, there may be activities designed to improve technical capacity to provide installation, operations and maintenance of transmission and distribution. The intent will also be to improve technical capacity to support gas field services, exploration and production capability and pipeline maintenance and repair through private sector contracting.

E. Result #5: Expanded and Improved Access to Transportation

1. Development hypotheses. Development of the Afghan transport infrastructure is critical to revitalizing and expanding Afghanistan's economy. Transport infrastructure is a conduit for ideas, as well as people and goods. The rebuilding and improvement of Afghanistan's transport sector and the capacity of the responsible Government of Afghanistan ministries will lower transportation costs, *promote more efficient import and export of goods, increase access to education and health care, improve international travel to and from the country, decrease ethnic divisions between regions, re-activate the agriculture sector, reduce unemployment, and improve the security and stability of the country.* It will serve to bind the various regions of the country together, improve the internal flow of goods and services, and *create economic opportunities. Externally, it will enable Afghanistan to serve as a land bridge between resource-rich Central Asia and the producers of South Asia.*

Expanded and improved access to transportation requires significant progress in five areas:

- Restructuring of involved ministries into planning, policy making and management organs of the central government;
- Facilitating development of private sector capability to execute the construction, maintenance and operation of the transportation infrastructure through contracts awarded and administered by the government;
- Continued transport sector infrastructure development;
- Coordination and facilitation across the donor and development community; and
- Cost-recovery mechanisms to support economic sustainability of the transport sector.

Transport sector infrastructure projects require large capital investments and continued donor commitment and execution.

2. Intermediate Results:

a. Intermediate Result 1: Construct and develop the transport infrastructure; physical rehabilitation of roads, civil aviation and rail facilities.

Intended activities may include the execution of major transport infrastructure projects as a key component of its economic development. Improved transportation infrastructure will help to build an environment conducive to economic development. Internally, improved transportation will bind Afghanistan together through the movement of people, commodities, and ideas. Externally, it will allow Afghanistan to serve as an economic land bridge between resource-wealthy Central Asia and producers in Iran, Pakistan, and India.

b. Intermediate Result 2: Support coordination activities and unified standards.

One of the proposed activities under this Intermediate Result may be to help develop a framework for policy and planning for longer-term projects. As part of such an activity, the Parties would coordinate and synchronize with the donor community through activities under the Transport Sector Consultative Group. The program will support standards and feasibility / project packet development to ensure that Afghanistan receives additional infrastructure, executed to one standard. It will also help establish a comprehensive National Regulation Code and Standards for transport infrastructure construction. This will further bind the country together and anchor it within regional trade regimes.

Additional sub-results under this Intermediate Result include:

- Increased donor collaboration and synchronization to eliminate competition and duplication of efforts and ensure coverage of the most pressing Afghan needs.
- Development of project turnover procedures;
- Master planning to determine requirements and standards;
- Development of feasibility studies and project packets for future planning and donor or Government of Afghanistan execution.

c. Intermediate Result 3: Build capacity in the sector to plan, execute, and operate and maintain the transport infrastructure.

Activities under this Intermediate Result may include support for the Ministry of Public Works to privatize the bulk of its highway maintenance units and the entire roadway construction requirement. It is intended that an activity may help establish a Project Implementation Unit similar to the World Bank plan for installation of a managing firm in the ministry for at least three years. Such a unit would function in the framework of the ministry, leading the effort to privatize, and leaving behind a strong team of project managers, contract administrators and construction inspectors.

To the extent possible, activities will be designed to support the development of cost-recovery mechanisms that will ensure that Afghanistan can sustain the transport sector infrastructure and support the future planning, execution, and maintenance of Afghan-executed projects.

Additional sub-results under this Intermediate Result include:

- Provision of training in managerial and technical skills; and
- Development of cost-recovery measures to ensure economic sustainability.

F. Result #6: Expanded Access to Water Supplies and Sanitation

1. Development hypotheses. Management of water resources in an arid country such as Afghanistan is critical to the success of the development goals in the country. A national water resources strategy would help identify and prioritize the available water resources while also enabling management of competing uses for water to avoid waste and contamination of water resources. Participation in regional water allocation issues is important since most of Afghanistan's surface water resources are a part of international treaty rivers. Activities under this Result may include support for the development of a national water resources strategy by an independent water resource team of experts. Under this Result, the Parties may also focus on issues such as watershed management plans, international water issues, water use policies and nationwide stream monitoring.

In addition, improvement of the water supply system is necessary to break the cycle of waterborne diseases and reduce the time-consuming burden of water transport. The water supply systems in Afghanistan are dispersed and varied around the country, and even within the urban areas residents use a mixture of approaches to obtain water. The usage rate per capita in Afghanistan is relatively low because water is scarce, far away from dwellings, and of poor quality. There is a range of solutions to this problem, each of which requires different inputs from the user and the supplier.

- The short-term solution, which is being used now, is to carry water to specified locations on a regular basis using tanker trucks.
- The medium-term solution is to establish water points, which are filled regularly and that people can access using hand pumps.
- The long-term solution is to pipe water directly into homes.

In a water supply and sanitation program one priority may be to improve hygiene behavior and sanitation; next, to increase the quantity of available water; and last, to improve infrastructure for water quality. This suggests that a priority of the program may be on hygiene behavior and sanitation. For the next five-year planning period, the focus may include on-site disposal of excreta. Progress may also be made on recharge of liquid waste to the subsurface. Also, part of the program may include techniques for the efficient and economical collection and disposal of nightsoil. Hygiene education in the schools and habits encouraged that promote proper hygiene may also be considered.

2. Intermediate Results. This result is supported by four Intermediate Results:

a. Intermediate Result 1: Increased access to safe drinking water.

In terms of national water resources, the Intermediate Result may include activities intended to rationalize and prioritize the development of water resources.

In terms of water supply, progress will be measured in terms of (1) the percentage of the total population with safe drinking water and (2) available liters per capita per day (lpcd).

b. Intermediate Result 2: Expand sanitation services.

This Intermediate Result may be achieved in part through the construction and maintenance of improved latrine systems. Progress will be measured in terms of the percent of the population with access to sanitary systems.

c. *Intermediate Result 3: Development of the technical and institutional foundation for sustaining the water and sanitation programs.*

This Intermediate Result may include activities that build the capacity of relevant ministries and private sector companies to manage programs and provide services.

V. Indicators, Monitoring and Evaluation

A list of indicators, including precise descriptions that include, among other details, quantity, periodicity and the appropriate source for obtaining data may be further detailed in Implementation Letters. Targets will be based on current trends at the time and the estimated impact of USAID and other donor interventions. Targets will be re-examined and adjusted, if necessary, as additional data become available.

USAID may take corrective action based on the results of the monitoring and evaluation of the data or at the request of the Grantee. Corrective action may include, but is not limited to, discontinuing, reducing or otherwise modifying one or more ongoing activities, or adding new activities. Funds allotted to activities may be discontinued, reduced or shifted to existing activities or new activities in furtherance of the Objective.

VI. Roles and Responsibilities of the Parties

The Objective will be achieved through a partnership among USAID, the Grantee (represented primarily by the Ministry of Finance, and other Grantee ministries such as the Ministry of Agriculture, Animal Husbandry and Food, Ministry of Counter-narcotics, the Ministry of Rural Rehabilitation and Development, the Ministry of Urban Development and Housing, the Ministry of Commerce, the Ministry of Public Works, the Ministry of Energy and Water, and the Ministry of Transport, private voluntary organizations (PVOs), and non-governmental organizations (NGOs) (both U.S. and local), public international organizations, contractors, cooperating agencies, local communities, the Central Bank, and other donors. Other donors include the European Commission, World Bank, JICA and bi-lateral donors, such as

India, Great Britain, South Korea and others. Coordination occurs through Consultative Groups on transport, energy, private sector, counter narcotics, and agriculture, in addition to a number of coordinated Task Forces and working groups. The extended team will bring together the concerns opportunities and issues of other partners to ensure that Agreement activities are the most appropriate and effective to reach the desired Results. Roles and relationships among these groups may be more fully described in Implementation Letters, however, some general responsibilities are described below.

The most essential partner in the agriculture, alternative livelihoods, economic growth, transport, energy and water sector, is the target population itself. The Grantee will seek collaboration with local communities to ensure local ownership, direction and sustained support of agriculture, alternative livelihoods, economic growth, transport, energy and water services.

It is up to the Grantee to articulate clear policies and guidelines in all the mentioned sectors in accordance with its national priorities and ensure compliance with such policies and guidelines.

The private sector, PVOs and NGOs play an important role in the identification and implementation of agriculture, alternative livelihoods, economic growth, transport energy and water programs and provide technical expertise not always available within USAID or the Grantee. Grant proceeds may be provided by USAID directly to such implementing partners to carry out activities under this Agreement. USAID may select implementing organizations in accordance with its procurement and other relevant policies and procedures. The Grantee agrees to raise any issues related to implementing organizations on USAID-funded activities, including without limitation any issues related to inadequate or non-performance, directly with USAID rather than the implementing organization(s) in question.

Both USAID and the Grantee are responsible for coordinating strategy, resource programming and policy with other agencies operating in Afghanistan's agriculture, alternative livelihoods, economic growth, transport energy and water sector. Achievement of the expected results described herein is based on the assumption that certain results will be achieved by other donors, which are beyond the manageable interest of USAID. The Grantee is responsible for articulating national priorities to the entire donor community in the agriculture, alternative livelihoods, economic growth, transport, energy and water sectors.

In order to ensure full coordination and consultation, the Parties agree to meet at least twice each calendar year, beginning with the first full calendar year following the execution of the Agreement, to review all aspects of this Agreement, including both strategic and operational issues. In such meeting the Parties will discuss whether activities being carried out under this Agreement are leading to the results outlined in this Annex 1 or are achieving the indicators set forth in Implementation Letters. The Parties may discuss their views as to whether there may be a need to alter, increase or discontinue activities, plan new activities or alter the resource allocations to particular activities in order to meet the Objective and Results and achieve continued alignment with the Grantee's national development priorities. It is expected that the Parties will also discuss current and future resource requirements related to such activities and the overall estimated expenditures for activities over the remaining term of the Agreement.

In addition, as part of its internal planning process, USAID intends to develop concept papers with general cost estimates for new program areas it is considering in

furtherance of the mutual objectives set forth in this Agreement. USAID will consult and engage with the Grantee at the concept paper stage of development of new programs within the scope of this Agreement. Under internal procedures that are being developed, USAID will share each concept paper for a new program area with the Grantee. The Grantee will review the concept paper and participate in setting the direction and parameters for the subsequent stage of review and approval of the new program by USAID. It is possible that a concept may not advance to the subsequent stage of planning within USAID to the extent the Grantee has serious concerns that cannot be addressed after discussions between the Parties. Grantee review of concept papers will be carried out by the Ministry of Finance or the Ministry of Finance's designee. A similar consultative process will be followed during the project design stage.

USAID also intends to invite Grantee participation, as appropriate, in procurement evaluation panels for major activities. The Grantee will participate in such panels through the designation by the Ministry of Finance of an individual either from the Ministry of Finance or another appropriate Ministry to sit on such panel. The Grantee's representative shall comply with USAID's regulations governing participation on such panels as indicated by USAID.

VII. Other Implementation Issues

The Parties agree that with respect to the audit provisions set forth in Section B.5 of Annex 2 to this Agreement (Standard Provisions), to the extent USAID funds non-Grantee implementing partners directly for activities under this Agreement, USAID will include necessary audit provisions in its implementing agreements with such partners in lieu of the Grantee submitting the required audit plan described in that Section.