



THE AFGHANISTAN RECONSTRUCTION TRUST FUND

Guidance Notes Series:

The ARTF Incentive Program

1. What is the Incentive Program?

The Incentive Program (IP) was set up in 2008 to support a policy reform agenda under the ARTF Recurrent Cost Window with the objective of improving the fiscal sustainability of Afghanistan's national budget with the ultimate goal of reducing the country's dependence on financial aid. Activities under the IP aim at increasing domestic revenue mobilization as well as strengthening expenditure management.

The IP provides budgetary aid based on the achievement of agreed and pre-defined targets for reforms in different areas. IP funds can be used to flexibly finance recurrent, civilian public expenditures. In this respect IP funds differ from other ARTF funds, which – for the most part – finance public investment in specific areas.

2. How does the IP work?

Generally, the IP is defined as a 3-year program and consists of three components that determine disbursements: (i) the Revenue Matching Grant; (ii) the Structural Reform Scheme; and (iii) the Operations and Maintenance Facility (launched in 2013). Each modality has an indicative financing envelope (table 1):

IP Components	2012/ 1391	2013/ 1392	2014/ 1393
Revenue Matching Grant	\$12.5 m	\$38 m	\$45 m
Structural Reform Scheme	\$37.5 m	\$112 m	\$130 m
O&M Facility		\$32 m	\$100 m
Total	\$50 m	\$182 m	\$275 m

Component 1: Revenue Matching Grant

The Revenue Matching Grant under the IP rewards improved performance in public revenue mobilization and collection. Annual revenue targets agreed between the Ministry of Finance and the IMF are set as the benchmarks which the Government must strive to meet in order to receive the incentivized funds. The IP requires the Government to meet a minimum of 90% of the revenue targets to release funding, with payments in accordance with a calibrated portion of the target achieved. Funds earned can exceed the indicative funding envelope if the revenue target is surpassed.

THE ARTF INCENTIVE PROGRAM

What is the ARTF Incentive Program?

The Incentive Program (IP) was set up in 2008 under the Afghanistan Reconstruction Trust Fund (ARTF) to support policy reforms aimed at improving fiscal sustainability by enhancing domestic revenue mobilization as well as strengthening expenditure management. The IP rewards performance and progress towards agreed policy targets and is set up for a period of three years.

The IP is part of the Recurrent Cost Window and is, hence, subject to the same fiduciary controls. Like the Baseline ARTF Support, funds are disbursed into the Government's civilian operating budget to finance the operating costs of the budget.

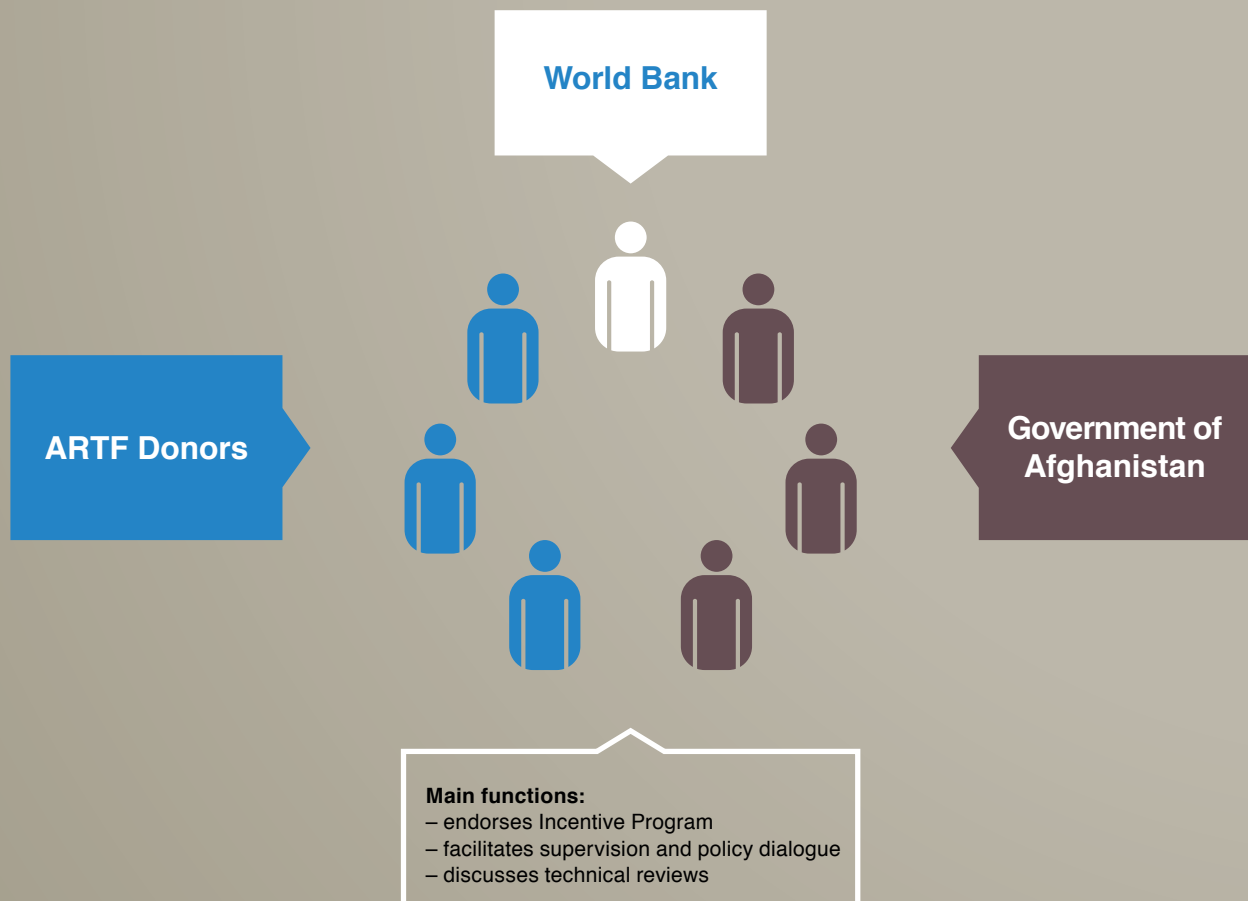
Indicative Financing of the IP

The IP consists of 3 different modalities

Recurrent Cost Window	2012	2013	2014
Baseline ARTF support	\$175	\$150	\$125
ARTF Incentive Program	\$50	\$182	\$275
– Revenue Matching Grant	\$12.5	\$38	\$45
– Structural Reform Scheme	\$37.5	\$112	\$130
– O&M Facility	0	\$32	\$100
Potential Recurrent Cost Support	\$275	\$332	\$400

How is the IP governed?

The ARTF IP Working Group is a technical advisory body which is accountable to the ARTF Steering Group and represents the wider group of ARTF donors. It is a forum for technical discussions between donors, the Government and the World Bank.



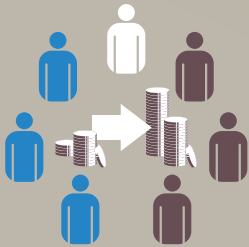
How does the IP work?

1

The Revenue Matching Grant Facility:

The Revenue Matching Grant Facility rewards improved performance in revenue collection against annual targets agreed between the Ministry of Finance and the International Monetary Fund.

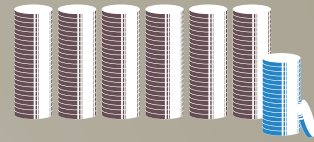
Fiscal revenue targets are adopted



Government collects revenues over the year



IMF confirms performance towards target, World Bank disburses funds



% of Revenue Target achieved

ARTF matching grant

> 91 %

between 25% - 80% of allocated funds (calibrated)

99 % - 100%

full disbursement of allocated funds

> 100%

additional funds will be allocated and disbursed (calibrated)

2

Structural Reform Scheme:

The Structural Reform Scheme supports the implementation of reforms across four thematic areas:

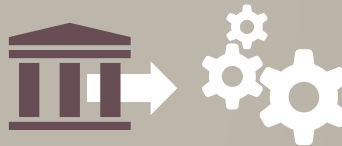
Public Financial Management, Governance and Civil Service Reform, Investment Climate and Trade Facilitation, Sub-National Finance

Benchmarks for structural reforms are agreed

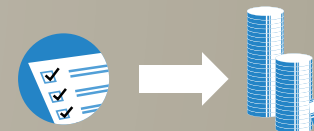


10 benchmarks per year, each with an indicative allocation of funds

Government implements reforms



World Bank reviews performance regularly and disburses funds into the budget according to the formula below



implementation of reforms

ARTF grant

within one year

full disbursement

each month delay

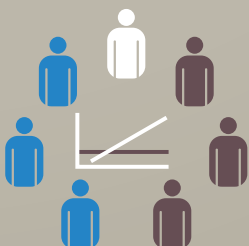
discount of 8.3%

3

Operations and Maintenance Facility:

The Operations and Maintenance (O&M) Facility provides an incentive to increase spending for O&M, as well as rewards prudent management of resources.

Baseline for O&M spending is agreed

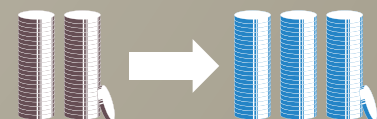


Baseline: 2012 - 2014: \$384 million

Government finances operation & maintenance activities throughout the year and provides oversight



World Bank reviews performance and disburses funds on a quarterly basis



O&M spending

ARTF grant

each \$ spent on O&M

earns \$1.5 ARTF monies

Component 2: Structural Reform Scheme

The Structural Reform Scheme supports the implementation of reform-oriented actions by setting structural benchmarks, which must be achieved in order for the incentivized funds to be released. The 1391 to 1393 Incentive Program supports reforms along four thematic areas:

- **Public Financial Management:** Advancing the implementation of the Public Financial Management road map, improving budget transparency and accountability, and strengthening pro-poor budgeting.
- **Governance and Civil Service Reform:** Reforms in this area address the issue of the wide variance of donor pay-scales for externally funded staff as well as the improvement of the legal and regulatory environment for the creation and recruitment of professional civil service cadres. Moreover, the program supports reforms, which aim at reducing the scope for money laundering by improving relevant legislations and regulations.
- **Investment Climate and Trade Facilitation:** Improving the enabling environment for private sector investment and trade, including streamlining of licensing processes and modernizing customs.
- **Sub-National Finance:** Reforms under this theme will be geared towards improving sub-national finance flows and strengthening the capacity for provincial administrations to prepare and execute budgets.

The implementation of reforms under the structural reform scheme is fully incentivized: The program rewards achievements of ten reform actions per year. Timely implementation, i.e. implementation within the assigned calendar year, leads to a full disbursement of funds allocated to the respective reform action. Delays in implementing reform action reduce funds available for disbursements.

Component 3: Operations and Maintenance Facility

The Operations and Maintenance Facility provides an incentive for increasing spending for operation and maintenance (O&M) activities to safeguard public investment and for improving fiscal flows to provinces while rewarding 'proper management' of resources. The latter includes i.e. established norms for O&M budget appropriations in Line Ministries, establishment of asset registries and formulating O&M policies and guidelines.

Similarly to the revenue-matching grant, the O&M facility rewards improved budget performance, in this case public spending for O&M. Departing from a pre-defined baseline, the O&M facility matches every incremental dollar in public resources spent on civilian O&M with 1.5 dollars in ARTF funds. This means that the ARTF fully finances the increase in spending and provides an incentive of 50 cents to the dollar in form of budgetary aid for more flexible use within the budget.

(EQUIP,SEHAT and the MoPW)...

3. Management & Governance

The IP is managed within the broader ARTF governance structure:

- The Ministry of Finance is the main implementation partner of the IP and coordinates the cooperation with participating Ministries;
- The World Bank, in collaboration with ARTF donors, provides technical support to the implementation of reforms under the IP;
- As Administrator of the program, the World Bank conducts technical reviews on a regular basis to assess the progress against agreed benchmarks and deadlines and establish the level of financing earned under the various incentive schemes. As part of the technical review, the World Bank also assesses the overall macroeconomic and fiscal framework to determine budgetary risks as well the viability of the program within the given economic and governance context;
- Technical reviews are shared and discussed with the ARTF IP Working Group, the Kabul-based technical advisory and official Governance body of the IP;
- As part of its mandate, the IP Working Group also participates actively in the formulation of the program and supports the policy dialogue underlying reforms under the program. This mechanism ensures a continuous information flow and feedback loop between the Afghan Government, the World Bank as well as the ARTF Donors group.

4. Public Financial Management Controls

IP funds are released through the Recurrent Cost Window (RCW) and disbursed into the Government's civilian operating budget to finance eligible expenditures, including teacher and health worker salaries and operation and maintenance (O&M) expenditures. This means that IP funds are covered by the fiduciary controls applied to all RCW funds and are subject to controls by the ARTF monitoring agent.