UNITED STATES INSTITUTE OF PEACE
PEACEBRIEF 181
United States Institute of Peace • www.usip.org • Tel. 202.457.1700 • @usip
November 2014

TRENT RUDER
E-mail: trent.ruder@gmail.com

Donor Aid Challenges in Shaping Incentive Programs and Spurring Afghan Reform

Summary

- Donors have increasingly sought to condition assistance funds for Afghanistan, particularly as a result of inadequate reforms during the Karzai administration.
- Since its negotiation in 2012, the Tokyo Mutual Accountability Framework has been the basis of most donor incentive decisions on Afghanistan.
- Donors need to consider who benefits from incentives, how resources and requests align, Afghanistan's capacity to implement reform, and the consequences of success or failure.
- Donors should both temper their expectations and minimize the linkage between highly politicized issues and incentive programs.
- Incentive programming is not a magic bullet, but it can help shape dialogue with the new Afghan administration.

"Incentives are most likely to be effective when they are modest, linked to institutional capacity, and work in conjunction with other policy options."

Introduction

The inauguration of President Ashraf Ghani, with Abdullah Abdullah in the newly created position of chief executive, has raised hope that the new unity government will pursue a more forward-looking development and reform agenda.

The reluctance of the former Karzai administration to consistently pursue reforms and tackle corruption led to an increasingly contentious relationship between the Afghan government and international donors. Over the decade, donors increasingly turned to various forms of aid conditionality in an effort to leverage reforms. Such efforts, however, face serious constraints that will be further complicated by the power-sharing structure of the new government.

Attempts to provide incentives for more highly politicized objectives are both liable to be ineffective and best suited for diplomatic and policy-level discussions. At best, incentive programs have the potential to shape collective dialogue between donors and recipients and to advance modest and targeted reforms.

What Are Incentive Programs?

Broadly, incentive and conditionality schemes are policy tools that use aid funding to leverage implementation of reforms. Incentives take the form of a reward for implementing reforms; conditionality requires that benchmarks be met before funds are released. Aid in Afghanistan takes both forms. Indeed, a recent Senate Foreign Relations Committee (SFRC) report suggests increased use of incentives.[1]

Since its negotiation in 2012, the Tokyo Mutual Accountability Framework (TMAF) has been the basis of most donor incentive decisions on Afghanistan.[2] It links continued donor support to reforms across five goal areas and seventeen indicators; subindicators were developed during implementation. It reaffirms donor commitments to delivering half of their assistance through Afghan government budget mechanisms, thus addressing concerns that off-budget aid was bypassing the needs of the state.

In conjunction, individual donors have developed bilateral incentive programs. The United States established its $175 million Incentive Fund towards greater TMAF progress. Germany and the United Kingdom have similar programs. The World Bank's Afghanistan Reconstruction Trust Fund (ARTF) has operated its Incentive Program since 2008, targeting Afghan revenue mobilization, O&M spending, and financial policy reforms.[3] The program's narrow scope provides relatively specific and quantifiable benchmarks for disbursal decisions but does not offer a model for addressing the whole of TMAF or key items such as gender, anticorruption, or elections.

Ownership: Who Shares and Benefits from Incentive Programs?

Donors face a trade-off between broad and efficient engagement. Talks with a single executive agent, such as the Ministry of Finance (MoF), may be attractive in theory, but in practice Afghanistan's complex internal politics ultimately shape the speed and coherence of reform. Meaningful buy-in to an incentive program requires discussion with and ownership by local beneficiaries and stakeholders and cannot function solely as a donor-dictated set of conditions and reforms. Policymakers cannot simply match desired reforms with rewards or penalties in the same thematic area. For example, withholding funding for gender programs on the basis of limited progress on gender issues may prove counterproductive given that some actors may actually welcome cessation of such funds. Incentive schemes should target the specific decision makers capable of enacting reform and incorporate discussions with these audiences and the ministry. Issues requiring complex dialogue are likely to be overly political and thus more difficult to influence with incentive rewards.

The 2014 election yielded a long list of domestic priorities. Ghani, in particular, laid out a lengthy manifesto with ideas to reform essentially all elements of Afghan governance. Ghani's giving his wife a more prominent and public role and his reopening the Kabul Bank case may be positive indicators.[4] Although the new government might be more inclined to implement reforms generally, that it unites rival factions will likely make the details difficult to agree upon and implement. Doing so may require including additional ministries, civil society, business leaders, and provincial authorities beyond simple participation in annual conferences. Greater participation helps ensure that objectives guiding incentives represent comprehensive rather than limited interests.

Alignment: How Do Afghan Requests Link with Donor Resources?

Despite years of partnership, Afghan policymakers and their donor partners naturally face different political constraints and incentives. The result is an alignment gap—mismatches between the type of reforms donors seek and the rewards Afghan counterparts request. Looking at the development agenda, the Karzai administration prioritized tangible outputs such as infrastructure and direct budget support. Despite short-term security concerns or differences within the international community, donor priorities generally focused on social reforms and strengthening institutions, including anticorruption, gender, and representative governance. Although the TMAF reinforces donor commitments to channel half of their aid through the Afghan government budget, concerns about misuse of funds persist, and the overall reduction in assistance will limit the opportunity for large-scale projects. Furthermore, increasing the budget amount allocated to incentives, as the SFRC recommends, will require donors to make cuts elsewhere, thus reducing options for the rest of the portfolio and potentially politicizing development decisions.

The London conference presents an opportunity to narrow the alignment gap through consensus on priorities for institutional reforms, anticorruption, and economic growth. Incentives may prove most effective in channeling discussion on development goals.

Capacity: What Is the Capacity to Implement Reforms?

Ownership and alignment are moot if Afghan institutions lack the capacity to implement reforms. From building a road authority to tracking violence against women, Afghan institutions require financial, human, and political capacity. Donors may seek more fundamental reforms, but such efforts require time, political capital, and investment.

Funding is the first hurdle. According to the MoF, Afghanistan faces a $537 million budget shortfall in the current fiscal year.[5] Whether driven by the prolonged election crisis, an inflated election year budget, or continued corruption, MoF customs receipts have declined by as much as 20 percent in 2014.[6] Donor budgets are also shrinking. USAID's fiscal year (FY) 2013 budget was one-third of its 2010 peak, and Congress plans further reductions for FY 2014 and 2015.[7] However, reform priorities need not require hefty financial input, and many TMAF objectives focus on legislative progress or items requiring only modest financial investment. Revising mining legislation and passing anti-money laundering and countering terrorist financing legislation are two examples.

Human resources are a second hurdle. Despite great strides in education and training, Afghanistan still has only a few capable technocrats. This is in part due to short-sighted donor policies. In using foreign contractors, donors have often substituted for rather than built local capacity, a point Ghani is strident about in his manifesto.

Donors would do well to minimize distortions in the local labor market and ensure that support for civil service salaries follows a steady path toward financial sustainability for the Afghan government.

Enforcement: What Are the Consequences of Success or Failure?

The consequences donors impose on Afghan officials will dictate the degree to which incentive schemes influence decision makers. Political considerations shape the trade-offs between "getting tough" and "enduring partnership" responses on incentives. An overly firm reaction to inadequate performance may set the wrong tone with the new government and risks decreasing its political capital to implement reforms. It may also result in a vicious circle in which the Afghan government receives less funding, reducing its capacity, resulting in even less support. However, if donors overlook larger performance questions, they may reinforce a pattern of Afghans' exploiting donor desire to maintain a relationship or ensure stability, blunting the impact of incentive programming.

For future enforcement decisions, policymakers would be wise to be predictable yet firm with the new administration. Using the 2014 transition and the London conference to cement priorities based on reasonable long-term development goals will help donors pursue incentive benchmarks more consistently, even amid staff turnover or political flare-ups. Consistent adherence to standards not only makes donor objectives for the unity government more clear but also creates space for the government to work the reform process on its own terms. Indeed, Minister of Finance Omar Zakhilwal, currently acting in the Ghani administration, suggested that donor demands helped him argue for reforms with Parliament and other ministries. Donor incentives should be sensitive to the internal battles between reformers and spoilers within the government.

Conclusions

Donors should temper their expectations for the extent to which aid can reshape the constraints that Afghan political leaders face and should minimize the linkage between politicized issues and incentive programs. When issues are politically charged, donors are more likely to avoid tough enforcement calls and offset the impact of incentives. Large, highly politicized issues, such as Kabul Bank, gender reform, or power sharing, are better suited for diplomatic offices. Indeed, political conversations on overall assistance levels should be separate from formal incentive programs. Incentives are most likely to be effective when they are modest, linked to institutional capacity, and work in conjunction with other policy options, such as percentage of on-budget programming, reprogramming into different sectors, or adjusting ARTF contributions.

That is, incentives should focus on development objectives that require reasonable capacity and political will. Some TMAF-related reforms, such as development of road and air authorities, require minimal political will but higher investment. Others, such as legislative reforms, require more political will than institutional resources. Reforms that have thus far met with the most resistance, such as those regarding anticorruption or gender rights, require both significant political will and significant institutional investment. Incentives are not likely to be an effective policy tool in such areas because entrenched interests are not swayed by marginal funding shifts. Given the few areas in which low costs and low political impact overlap, donors will need to consider carefully the trade-offs in selecting targets for incentives.

Donors are likely to have few easy wins and need to ration their political and financial capital for areas they deem most critical to development. Incentive programming is no magic bullet to spur reform in Afghanistan. It can, however, help shape dialogue with the Ghani administration. Pragmatic expansion of stakeholder and press engagement can increase the influence of incentives. Even modest incentive programs will encounter political obstacles. At such points, donors should be reasonable, firm, and predictable in their interactions with the government.

Notes

1. "Afghanistan in Transition: U.S. Civilian Presence and Assistance Post 2014," Majority Staff Report, Senate Foreign Relations Committee, October 27, 2014, http://www.foreign.senate.gov/imo/media/doc/89860.pdf.
2. For more background, see William Byrd, "Mutual Accountability," Peace Brief no. 132, U.S. Institute of Peace, August 2012, http://www.usip.org/publications/mutual-accountability; Byrd, "'We Pretend to Work, and They Pretend to Pay Us,'" Peace Brief no. 148, U.S. Institute of Peace, May 2013, http://www.usip.org/publications/we-pretend-work-and-they-pretend-pay-us.
3. Afghanistan Reconstruction Trust Fund, "Policy Reform Program," World Bank, June 2014, http://www.artf.af/policy-reform-program.

About This Brief

Trent Ruder is an economic growth specialist who has worked in and on Afghanistan since 2011, advising Afghan firms in Wardak Province and serving as lead donor coordinator for USAID in Kabul. This Peace Brief reviews the complexities of using incentive mechanisms to encourage Afghan reforms in the context of the upcoming London conference.

4. Declan Walsh and Rod Nordland, "Jolting Some, Afghan Leader Brings Wife Into Spotlight," *New York Times*, October 14, 2014, http://www.nytimes.com/2014/10/15/world/asia/as-afghan-first-lady-rula-ghani-steps-into-public-role-celebration-and-criticism.html?_r=0; "Kabul Bank Fraud: Ghani Reopens Afghan Corruption Case," BBC, October 1, 2014, http://www.bbc.com/news/world-asia-29450821.
5. Tim Craig, "Afghan Official Says The Government Has Nearly Run Out of Money, Needs U.S. Bailout," *Washington Post*, September 16, 2014, http://www.washingtonpost.com/world/asia_pacific/afghan-official-says-the-government-has-nearly-run-out-of-money-needs-us-bailout/2014/09/16/73d9e0fe-3daa-11e4-b0ea-8141703bbf6f_story.html.
6. Kevin Sieff and Joshua Partlow, "Afghan Economy Facing Serious Revenue Shortage," *Washington Post*, April 15, 2014, http://www.washingtonpost.com/world/asia_pacific/afghan-economy-facing-serious-revenue-shortage/2014/04/15/6ddce38a-5be9-46ad-8f3b-1eb2ef4ed9bd_story.html.
7. Department of State, "Congressional Budget Justification Fiscal Year 2015," http://www.usaid.gov/sites/default/files/documents/9276/222898.pdf; USAID, "FY 2010 Total Foreign Assistance Profile," https://eads.usaid.gov/gbk/data/profile.cfm.

United States
Institute of Peace
2301 Constitution Ave., NW
Washington, D.C. 20037
www.usip.org

USIP provides the analysis, training, and tools that prevent and end conflicts, promotes stability, and professionalizes the field of peacebuilding.

For media inquiries, contact the office of Public Affairs and Communications, 202.429.4725