

Background Note on ARTF & Preferencing ARTF Quarterly Meeting; 29 July 2009

Reason for the Discussion

This background note sets out the key issues with regards preferencing in the ARTF. The Administrator, in discussion with the Government of Afghanistan, has chosen to raise the issue for discussion at the ARTF quarterly meeting owing to (a) the particular situation in SY1388 and (b) the ongoing trend towards greater preferencing through ARTF. It is expected that through discussion, some specific actions will be agreed that can lead to a pragmatic way forward that meets both donor and government needs.

Immediate challenges

Challenge 1: The current un-preferenced pledge for SY1388 is US\$282.9 million. This is the first time in the 7 years of ARTF operations that the un-preferenced pledge is less than the recurrent cost commitment (US\$290 million for SY1388). The roll-over of un-allocated and un-preferenced funds from SY1387 will help to fill the gap. Nevertheless, if pledges arrive late or do not materialize, preferences will need to be used to finance the financing gap in the recurrent cost window. Not meeting preferences would lead to donor distrust of the preferencing system and could result in less funding overall for the government through ARTF.

Challenge 2: The government has virtually no flexible funds in the ARTF with which to support priority investments such as the North East Power System and the national Higher Education program – both of which face critical financing gaps but do not attract donor preferences. ARTF is intended as a flexible mechanism by which government takes ownership of the development & reconstruction agenda. However, preferences can undermine that objective because they can lead to under or over-preferencing for particular areas.

Challenge 3: Some donors are pressuring the ARTF to accept more preferences - particularly as new projects are developed which have donor support. This can lead to some donors shouldering the burden of the recurrent cost window. The ARTF is designed to encourage and ensure equitable burden-sharing within a multi-lateral and consensual mechanism. Do the guidelines for / limits on preferencing need to be revisited?

Preferencing: Some Facts & Figures

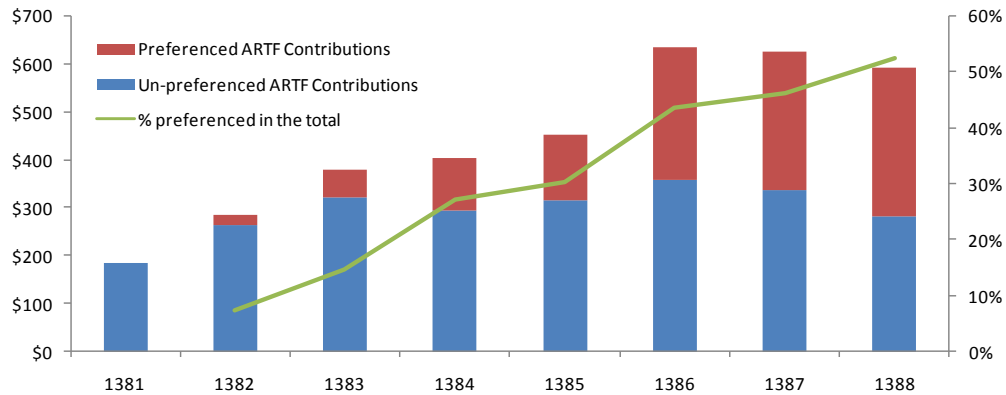
Preferencing - introduced in 2003 - is a system whereby the Administrator acknowledges a donor's wish to see funds allocated to a particular, ongoing national program.¹ All preferences finance national programs within the core development budget. Preferences thereby should allow for greater alignment

¹ It should be noted that a preference is not an earmark – and ARTF maintains a common pooled account for all donor funds (preferenced or not). Geographic preferences are not recognized by the Administrator; although some donors sign MoUs with line ministries to ensure their preferences are utilized in a particular province.

of donor funds with the budget as well as increased visibility for donors in particular areas of the development agenda.

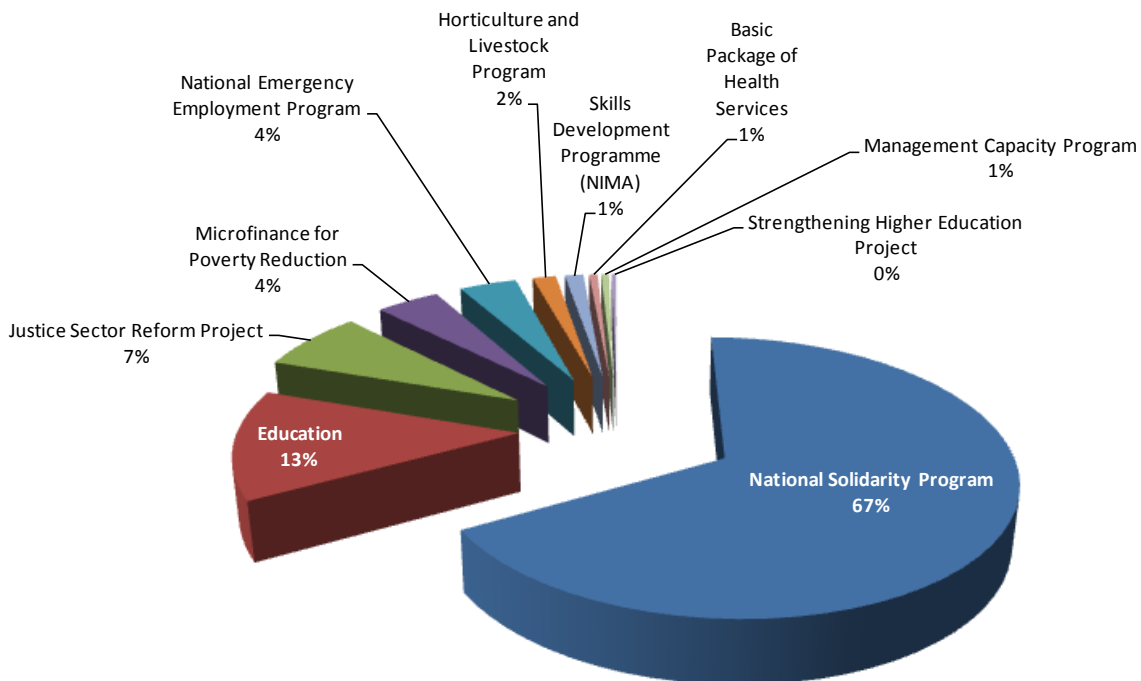
Since 2003, the mechanism has mobilized US\$ 1.1 billion in additional funds from donors for national programs. Preferences have increased every year until 1388, and have also increased as a share of ARTF pledges every year.

ARTF Contributions and Share of total preferred (US\$ m)

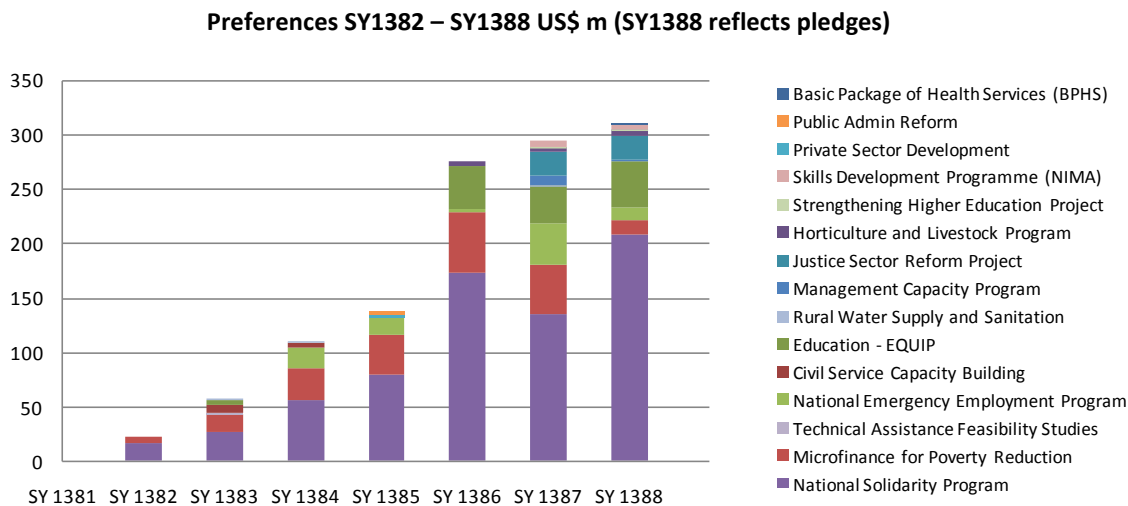


In SY1388, preferences have been pledged for 10 ongoing programs (see chart below). These pledges account for 52% of the total pledged amount for ARTF.

Preferences in SY1388



Over the last seven years NSP has accounted for 67 percent of total preferences pledged over the last 7 years; MISFA is the second largest recipient with 17 percent of the total.



However, from the outset donors agreed to a set of guidelines on preferencing which cap preferencing at 50 percent of a donor’s annual contribution to ARTF. The intention behind this cap was to minimize the risk that preferences ever crowd out un-preferenced funds leading to potential under-financing of the ARTF recurrent cost window.

Besides the specific risk, preferencing has three key generic disadvantages: (1) it *can* undermine efforts by the Afghan government to coordinate the reconstruction effort through the national budget process; (2) it *can* cause mis-allocation of ARTF resources through under-preferencing or over-preferencing; and (3) it *can* lead to inefficiencies in the management of ARTF cash, by introducing a bilateral approach to a multilateral mechanism. This is why government, the Administrator and certain donors advocate for less preferencing through ARTF.

Concluding points:

- Preferences can have positive impact - especially when they mobilize additional funding to support sound national programs.
- Preferences will not disappear in the near future because of donor needs for greater accountability for utilization of funds.
- However it can work against *government* ownership if it is not aligned with sector absorption capacity, need, and government priorities.
- The **ARTF Financing & Investment Framework** can provide a multilateral platform for discussing the most effective means for the ARTF to respond to the government’s core priorities.
- Preferencing needs to be and can be a part of that discussion.