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DOMESTIC RESOURCE MOBILIZATION

Case Study of Afghanistan, 2003-2016¹

Summary

Afghanistan’s domestic revenue mobilization (DRM) has made considerable progress over the past two decades. In 2002, the Afghan government collected a total of only \$10 million in total government revenue. By 2016, it collected \$2.4 billion, or about 12 percent of the gross domestic product (GDP).

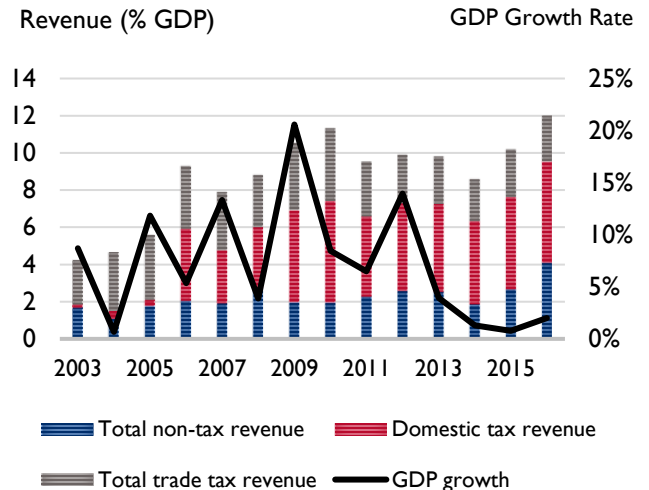
The government focused its efforts on the simplest taxes to collect, namely, import duties, a tax referred to as the business receipts tax (BRT), and simple income taxes for both individuals and companies. A simplified tax was developed for small businesses that could be paid in place of the corporate income tax (CIT) and the BRT. For import duties, the Afghans implemented a new, partially rationalized duty schedule, with fewer rates and a schedule following the Harmonized System of codes for classifying traded goods to enhance transparency and fairness.

On the administrative side, the Afghan government had to build both tax and customs administrations almost from scratch – developing their staff and equipping them with the tools to do their jobs. These included skills, procedures, equipment, facilities, and information technology (IT).

International donors provided training, materials, and technical assistance to rebuild the Afghan Revenue Department (ARD), design new procedures, construct or refurbish facilities, implement IT-based solutions, and extend ARD’s reach to all of the country’s provinces. International experts helped the Afghan government draft new laws and regulations, prepare manuals, and train staff to implement them.

Although much progress has been made, Afghanistan still faces many challenges -- to strengthen its tax and customs administrations, root out corruption, and facilitate taxpayer compliance. A value added tax (VAT) has been enacted into law and is planned for implementation starting in 2020. Common excises on products such as tobacco, alcohol, and fuel are also absent or under-developed.

Figure 1: Revenue Performance for Afghanistan, FY 2003– 2016



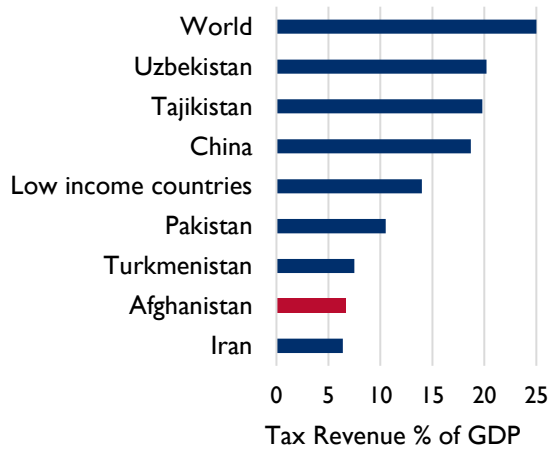
Sources: Government of Afghanistan, World Bank, World Development Indicators, 2016 GDP extrapolated by author.

Success in Mobilizing Domestic Revenue

DRM in Afghanistan has come a long way since 2002, when the tax administration collected only pennies per citizen. By 2003, the tax and customs departments were already collecting about four percent of GDP. The rise in government revenues continued quite steadily, peaking at almost 12 percent of GDP by 2010. With economic deceleration, political uncertainty, and impending troop drawdowns, government revenue performance deteriorated, dropping to eight percent of GDP in 2012. With the installation of the National Unity Government after September 2014 elections, efforts to reinvigorate DRM were initiated. These efforts, despite the continuing insecurity and the sluggish economy, have helped the country to regain its earlier peak revenue performance, with total government revenues reaching 12 percent of GDP in 2016.

Despite this progress, Afghanistan remains a low-revenue country. Afghanistan has the second-lowest

Figure 2: Tax Revenues* to GDP: Afghanistan versus Neighboring Countries, 2014



Note: Oil and gas extraction receipts excluded

Sources: Government of Afghanistan for Afghanistan data. World Revenue Longitudinal Database of the IMF for all others.

tax-to-GDP ratio among neighboring countries; its ratio is also lower than that of the average level for low-income countries worldwide (see Figure 2).

For taxpayers, ARD and Afghan Customs Department (ACD) administrative procedures continue to impose substantial costs to business. *The World Bank's Doing Business* distance-to-frontier (DTF) score for Paying Taxes actually declined between 2006 and 2016 from 77 to 52 percent. Conversely, modernization efforts at the ACD, such as automating systems, streamlining processes, and instituting risk management programs, have contributed to making it easier to do business. Afghanistan's DTF score for Trading Across Borders rose from 16 to 31 percent between 2006 and 2016.

How Afghanistan Achieved These Results

Tax policy

The Income Tax Law of 2005 amended the pre-Taliban tax system and consolidated all changes into a single law. The Income Tax Law of 2009 simplifies the definition of the fixed tax, a type of levy on persons and small businesses not subject to the CIT and the BRT. It also introduces clearer, more comprehensive rules specific to the taxation of the extractives sector. Indeed, an entire chapter is dedicated to the topic.

The law also extends the practice of withholding taxes and makes small changes in the BRT. It does not change the CIT rate and makes small changes in the structure of the personal income tax.

In January 2017, the VAT law was enacted and will take effect in 2020. The VAT rate is 10 percent on most goods and services, with a zero rate for exports and for some basic goods, such as staple foodstuffs (limited to wheat, flour, rice, sugar, edible oil, tea, onion, potato, and salt) and some household goods (namely, coal, fuel wood, liquid gas, and soap). The VAT includes the normal exemptions, such as those for diplomatic missions, humanitarian aid, and religious establishments.

Tax administration

In 2003, Afghanistan began rebuilding its tax administration. This included the reorganization of the ARD, the registration of taxpayers, and the issuance of taxpayer identification numbers. The ARD reorganized along functional lines, away from a tax-type structure.

The ARD also established an official presence both in Kabul as well as in other provinces around the country. The ARD now has established Large Taxpayers Offices (LTOs) as well as Medium Taxpayer Offices (MTOs) in several parts of the country, an effort that continues to expand. This taxpayer segmentation enables the ARD to better provide services to these taxpayers, while better encouraging taxpayer compliance. At the same time, the ARD has trained many staff in audit, taxpayer services, and general tax administration; moreover, it has also installed a new, commercial-off-the-shelf (COTS) e-tax administration system that supports streamlined processes and procedures.

In 2010, the ARD started up activities that would lead to the eventual implementation of the Standardized Integrated Government Tax Administration System (SIGTAS), a COTS software solution that supports data management and facilitates tax return processing, enforcement, and audit. SIGTAS implementation is expected to eventually pave the way for automation of ARD frontline taxpayer services, leading to e-filing and e-payment.²

At the same time, the ARD has introduced a modern risk-based compliance framework in Kabul and five key provinces. Risk-based compliance will help the ARD optimize the deployment of internal resources through comprehensive audit procedures and manuals

² E-services at the time of publication were still not widely used among the country's taxpayers.

aimed at focusing on high-risk sectors and improving transparency to taxpayers. The intent of introducing risk management in these tax processes is not only to conserve ARD's own resources, but also to encourage voluntary compliance by allowing ARD to focus on likely fraudulent or non-compliant taxpayers while sparing taxpayers who are complying with tax regulations.

More recently, ARD has been preparing for VAT implementation -- now scheduled for December 2020 -- including developing procedures and processes, and conducting taxpayer information and outreach activities. Processes and regulations are now ready to be put into operation, requiring only minimal adjustments once the VAT law is enacted.

As of this writing, SIGTAS and almost all automated processes are operating throughout most of the country. Skills and capacity of all ARD staff members throughout the country have been vastly improved. Regulations, rulings, manuals, forms, and procedures have been developed, based on the 2015 Tax Administration Law. In addition, ARD formally supports voluntary compliance through constant taxpayer outreach and education.

The ACD also invested in significant improvements to its institutional structure, procedures, capacity, and systems. With support from donors, ACD has constructed customs and transit facilities in various parts of the country, developed and implemented the Automated System for Customs Data (ASYCUDA), which is the information technology backbone for automation of all customs operations. ACD has also worked with donors, notably USAID, to design and implement new e-payment services that not only facilitate more streamlined payment processes for taxpayers, but also better data management and control for the ACD and reduced incidence of corrupt practices.

Donor Support

Donor support has included the development of basic legal frameworks, including the regulations and the manuals needed for implementation. Donor assistance has also funded construction works, technical assistance, training, and the deployment of systems.

Several donors have been involved in strengthening DRM in Afghanistan. Starting in 2002 and continuing to 2016, the UK Department for International Development (DFID) has been the lead donor, providing about 2/3 of all assistance and covering a broad range of topics. USAID has provided complementary assistance in close collaboration with DFID and has even provided co-financing for some of

DFID's activities. USAID has made notable investments to expand the coverage of the tax administration including the implementation of SIGTAS, improve collections of non-tax revenues (NTR), and enhance customs administration. The International Monetary Fund (IMF) has provided overall policy and fiscal strategy guidance, while the World Bank has supported broader public financial management and customs modernization assistance. The Asian Development Bank has also provided technical assistance to the ARD in its modernization efforts.

Unfinished Business

Implement the VAT. VAT is a powerhouse of a revenue producer, does little harm to an economy, and is one of the most common taxes in the world. The VAT law has already been enacted, with implementation now scheduled for 2020, systems and processes for its administration developed, and ARD and ACD staff already trained. More training is planned.

Develop a coherent, revenue-productive set of excises. Excise tax revenue averages about two percent of GDP in many developed countries, and slightly less in many developing countries. But other than certain "fees" relating to fuels and telecom, Afghanistan does not yet use this tax instrument to mobilize revenue. Excises on tobacco, alcoholic beverages, bottled soft drinks, tires, gasoline and diesel, and other products should be investigated as potential contributors to DRM.

Make paying taxes easier. The country's DRM strategy has been to implement taxes that are easy to administer, but it has not paid enough attention to taxation that would encourage investment, job creation, and enhanced competitiveness. Compliance with the current system is difficult, and it creates undue administrative burden on taxpayers.

Measures to reduce corruption in the tax system can yield more revenue. Recent firings at ACD and ARD for corruption or incompetence have been credited, among other factors, with recent improvements in DRM. Much work remains as bribes, particularly those related to customs, remain common. Further reforms could help to reduce corruption and increase revenues.

Assess the Afghan tax system. After more than \$300 million in foreign assistance to DRM over almost two decades, no external agency has undertaken a comprehensive assessment of the Afghan tax system. Such a study should encompass tax and customs

policy, revenue performance, and tax and customs administration.

Lessons Learned

NTR, though often ignored by donors, has been a fruitful avenue for DRM in Afghanistan. NTRs contribute about one-third of all Afghan government revenues and in the last three years has seen the greatest growth. This was one of the focus areas of the USAID/ Economic Growth and Governance Initiative (EGGI) Project.

Senior political leadership has been key to carrying out reforms. Implementers report that many of the reforms they have supported faced considerable bureaucratic obstacles and that without top leadership support and push, the reforms would likely not have been implemented.

Value for money. From 2002 to 2016, donors have provided about \$300 million in assistance to enhance DRM in terms of creating new legislation and assisting in building and mentoring the ARD and the ACD. Total revenues (domestic tax, non-tax, and customs duties) from 2003 to 2016 amounted to about \$18 billion, or \$60 per \$1 invested by foreign donors.

Issues related to the SIGTAS. A few lessons can also be drawn from the implementation of SIGTAS. These issues are not specific to SIGTAS but rather relate to any purchase and implementation of COTS software solutions. First, the lack of adequate infrastructure impedes deployment. The rollout of SIGTAS to the provinces was hindered by a lack of infrastructure, including limited Internet speed and bandwidth, unreliable and unsteady electricity, lack of computers, and sometimes, inappropriate facilities. Second, there are challenges for the sustainability of SIGTAS beyond the end of donor assistance. ARD officials both in Kabul and in the provinces raised concerns beyond donor assistance due to a shortage of capable ARD technical staff able to resolve technical issues.

Figure 3. Timeline of Select Tax and Customs Reforms in Afghanistan (2003-2016)

