

## Taxation, the prerequisite of state-building, an overview of tax system in Afghanistan

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### About the author

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Historically, Afghanistan has been unable to build a strong state based upon internally mobilised resources or a robust taxation system. Following the collapse of the last dynasty in 1929, which relied on direct taxation of agriculture, the Afghan states have never managed to exceed a domestic revenue share of 13.4% of GDP.<sup>1</sup> Successive Afghan governments experienced chronic fiscal deficits and addressed this problem by mobilising external resources, first from the British and subsequently from the US and Soviet Union in the Cold War context. Afghanistan became a rentier or “allocation” state, deriving over 40% of its revenue since 1958 from foreign aid.<sup>2</sup>

The government still suffers from this problem, its annual revenue is Afs.189.89 billion or approximately USD2.5 billion<sup>3</sup> yet the cost of security forces alone is roughly USD5 billion per annum or equivalent to more than 20% of GDP.<sup>4</sup> Despite the huge inflows of aid, there has not yet been improvement in state capacity to extract resources through taxation domestically. Over the past 13 years, Afghanistan has been unable to meet its fiscal needs in large part due to the absence of an effective tax management mechanism.<sup>5</sup> It has thus completely remained dependent on aid from other countries that have on average funded nearly the entire development budget and approximately 52% of the operating budget over the past 13 years.<sup>6</sup>

- 1 Central Statistics Office (CSO), “Afghanistan Statistical Yearbook”, (Kabul, Central Statistics Office, 1978, 1990), CSO, “National Budget Overview”, (Kabul, Central Statistics Office, 2005-2006, 2009-2010, 2010-2011, 2011-2012), Haqayeqee Abdullah, Siasat-e-Budja (Budget Policy), (Kabul, Baheer Publication, 2002), Manthri Manu, “Sector Financing and Fiscal Sustainability in Afghanistan”, (London, SPIRU Working Paper 20, Overseas Development Institute, 2008), Rubin Barnet R, “Political Elite in Afghanistan: Rentier State Building, Rentier State Wrecking” International Journal of Middle East Studies 24, no. 1 (1992), 77-99, Fry Maxwell J, The Afghan Economy: Money, Finance and the Critical Constraints to Economic Development, (Leiden Brill, 1974), Books Publishing Institution (BPI), “Afghanistan Dar Penjah Sale Akheer (Afghanistan in Last Fifty Years), (Kabul, Books Publishing Institution, 1968), World Bank, Building Confidence amid Uncertainty: Afghanistan Development Update, (World Bank, 2019), 25
- 2 Rubin, Political Elite in Afghanistan, 78
- 3 Afghanistan Revenue Department (ARD), “Revenue Report 1397 (2018)”, (Kabul, Afghanistan Revenue Department, 2018), 1
- 4 Byrd William A. Afghanistan’s Continuing Fiscal Crisis, No End in Sight, (Washington D.C., United States Institute of Peace, 2015), 1
- 5 Fazli, Sayed D. “Revenue Collection and Management: A Challenge to Afghan Government, (International Development Research Centre (IDRC), AGA Khan Foundation and University of Central Asia, 2016)
- 6 Wardak, Freshta, “Promoting the Effective Use of Aid in Afghanistan” (International Development Research Centre (IDRC), AGA Khan Foundation and University of Central Asia, 2016), 1, Fazli, Revenue Collection and Management

This research briefly explores how taxation was negotiated/decided in post Bonn era and what factors have influenced these negotiations. It is a comparative analysis comparing Karzai and Ghani's tax administrations.

## Bureaucrats and Exploitation of the Tax System

In the early days after the Bonn conference in 2001, there was not much attention on taxation. The only source of revenue recognised was customs which were in the hands of strong power brokers, the majority of whom were state bureaucrats.<sup>7</sup> Control of border resources and checkpoints created revenue streams and income-earning opportunities which sustained patron-client networks. Border revenues thus never reached the state.<sup>8</sup> They were rather used to fund the local administration wages as well as financing local militias outside the national budget process. Revenue generation ensured some relative stability and were easily used by governors and revenue officials to favour their own personal interests.<sup>9</sup>

The growing bargaining power of peripheral elites has led the state to exempt and evade tax collections in some cases leading to weakening tax compliance. Reports suggest that a potentially severe cash crisis was caused by widespread tax evasion abetted by government officials, the growing theft of customs revenues by provincial governors and declining economic growth. For instance, the estimated Afghan revenue for the first quarter of 2013 run short by 20 to 30% of the informal target the International Monetary Fund (IMF) had set for the state.<sup>10</sup> The UNODC's<sup>11</sup> findings suggest that over a quarter of all bribes paid to public officials were paid to officials in tax/revenue and customs.

## Reluctance for Tax Bargaining

Former President Karzai's administration did not conduct a systematic tax bargaining with citizen taxpayers and interest groups. There was limited continuity in the areas of tax reforms and officials in Kabul and the provinces had little incentive to implement reforms. Further, there was a lack of clarity in the 2005 Income Tax Law leading tax officials to feel that tax payments were voluntary and that they were under no obligation to apply tough measures against those who evaded tax payments.<sup>12</sup>

Lack of systematic tax bargaining was attributed to huge inflows of aid to Afghanistan. The government thus did not bother or take taxation seriously.<sup>13</sup> An official from the World Bank said that Karzai did not engage in taxation and let the technocrats including Ghani be responsible for tax collection.<sup>14</sup> Hence, a strong political will for enforcing taxation was lacking.<sup>15</sup>

The reluctance towards taxation policy encouraged a lack of tax compliance culture leading to tax evasion and tax corruption. Tax evasion and corruption became a daily challenge for tax and customs officers and thus, many factors led to the impairment of revenue administration which generated higher risks of revenue shortfalls.<sup>16</sup>

Karzai's government basically failed to motivate taxpayers since the people did not have any idea of whether officials at the top level had paid their taxes or not. The government's reluctance to promote taxation weakened the institutional cooperation required in the implementation of tax reforms. Instead, the interference by several supervision and monitoring institutions including the Attorney General's Office (AGO), the Directorate of Intelligence and government auditors have further complicated the tax efforts of the MoF. There were even occasional threats posed by these institutions on tax collectors forcing them to ensure their interests by expediting some cases while blocking others. AGO and the police interference in customs houses was highly criticised as a deterring factor for revenue collection.<sup>17</sup>

- 7 Interview with Former senior official from Independent Election Commission, 29.8.2018
- 8 Jackson, Ashley, *Politics and Governance in Afghanistan: The Case of Kandahar*, (Working Paper 34, Afghanistan Research and Evaluation Unit, 2015), 8
- 9 Bizhan, Nematullah, *Aid Paradoxes in Afghanistan: Building and Undermining the State*, (Routledge, 2018), 115
- 10 Rosenberg Matthew, "Afghan Leader Confirms Cash Deliveries by C.I.A", *The New York Times*, 29 April 2019
- 11 United Nations Office on Drugs and Crime (UNODC), *Corruption in Afghanistan: Summary Findings*, (UNODC, 2012), 10

- 12 Bizhan, *Aid Paradoxes in Afghanistan*, 110, 115, and 117, 118
- 13 Interview with Senior official from Afghanistan International Chambers of Commerce, 04.7.2018 and interview with a Freelance consultant on political issues, 15.7.2018
- 14 Interview with an official from World Bank, 28. 6.2018
- 15 Interview with a senior official from Ministry of Economy, 19.7.2018
- 16 Aslam Aqib, Berkes Enrico, Fukac Martin, Menkulasi Jeta and Schimmelpfennig Axel, "Afghanistan: Balance Social and Security Spending in the Context of Shrinking Resource Envelop" (IMF Working Paper, WP/13/133, International Monetary Fund, 2013), 20
- 17 Bizhan, *Aid Paradox in Afghanistan*, 121

## Shift to Domestic Resources

When Ashraf Ghani rose to power, there was a dramatic change in the nature of taxation. Contrary to Karzai's reluctance to systematically bargain with citizen taxpayers and interest groups, Ghani has imposed a number of new tax measures such as doubling the Business Rate Tax (BRT) from 2% to 4%, introducing a 10% tax on mobile phone top-ups, increasing the levies on imported fuel from Afs1 per litre to Afs2 per litre, and raising the over-flight fees for commercial airlines passing through Afghanistan's airspace.<sup>18</sup> Tariffs on a number of customs duties have also been increased.<sup>19</sup>

These measures which were introduced in 2015 had a positive impact on revenue increase which was estimated at Afs5.1 billion (23.5% of the total revenue).<sup>20</sup> In 2016, the value of revenue generated from the new taxes was estimated at Afs17 billion. However, part of the increase in revenue can also be attributed to improvements in revenue administration and enforcement. Total revenue collected in 2016 was 10.5% of GDP, which is slightly higher than the 10.1% of GDP in 2015 and yet lower than 11.5% recorded in 2011, the year with the highest revenue to GDP ratio.<sup>21</sup>

## The Impeding Factors behind Taxation

Despite the positive outcome, total domestic revenue at the aggregate level has never increased beyond US\$2.5 billion per annum.<sup>22</sup> Taxes were mainly resisted by strong power holders or by those with strong political ties such as parliamentary members, and those with close ties to government officials and tribal elders. Political affiliation has been a key challenge for tax officials in collecting taxes and customs revenue both at the capital and at the periphery. Amena Ahmadi,<sup>23</sup> former head of Middle Taxpayer Office (MTO), at the MoF said that of 23,000 middle taxpayers, only 9,955 paid Afs10 billion in 2015 while of the 25,5500 middle taxpayers, 13,000 paid Afs13 billion in 2016. Among every 10 middle level taxpayers six evaded tax between 2005 and 2017.<sup>24</sup>

This practice has led the tax and customs departments to be sources of rent creation and rent negotiation. While President Ghani did introduce new tax measures and new customs tariffs, tax resistance and tax evasion were inevitable. A culture of Jor Amad, a kind of arrangement between the taxpayer, tax/customs officials and tax brokers to corrupt the taxation system has persisted throughout the post-Bonn period in Afghanistan. Taxation has thus become very arbitrary, meaning that reclassifications and/or misclassifications of both customs tariffs and tax rates were a normal practice during tax assessments.<sup>25</sup> For instance, a shopkeeper whose tax due is Afs.10 thousand pays only three thousand Afghani to the government after he has bribed another two thousand Afghani to the tax collector thus paying only 50% percent of all taxes due.<sup>26</sup>

Lack of awareness about tax policies and procedures also leads tax collectors to use their power to ensure their interests. For instance, when tax officials visit a shop to assess the tax rate of the shopkeeper, they would say that a large sum of their capital is subject to appropriation when they have not yet paid their taxes. Such statement scares taxpayer to avoid taxation which consequently leads to corruption where the tax official makes a low assessment in favour of the shopkeeper in exchange for a bribe paid.<sup>27</sup> This is also the practice in almost all of the customs houses.

Automation is another challenge for poor tax performance. While automation and digitisation via the introduction of an Automated System for Customs Data (ASYCUDA) in customs and of a Standard Integrated Government Tax Administration System (SIGTAS) in tax did have a tremendous impact on improving tax administrations curbing corruption, flaws were yet unavoidable. The manual procedures are still dominant which influence and fuel corruption in customs and in tax offices further.<sup>28</sup>

18 World Bank, Afghanistan Development Update, (World Bank, 2017), 9

19 Fazli, Revenue Collection and Management, 5

20 Byrd William and Payenda Khalid, Afghanistan's Revenue Turnaround in 2015, (United States Institutes of Peace, 2016), 2

21 World Bank, Afghanistan Development Update, 9

22 Afghanistan Revenue Department, Revenue Report 1397 (2018)

23 Amena is currently the General Director for Afghanistan Revenue Department, MoF

24 Salehi, Zarghona, "6 in Every 10 Mid-Level Taxpayers Evade Taxes", Pajhwok, (5 June 2017)

25 Interviews with a researcher from Afghanistan Public Policy Research Organization (APPRO), 11.7.2018 and interview with a senior official from European Union, 12.7.2018

26 Bizhan, Identity, Norms, Narrative, and State Bureaucracy, 12

27 Ibid, 12-13

28 Interview with an official from Financial Intelligence Unit, Central Bank of Afghanistan, 24.6.2018

## Policy Recommendations

- Arbitrary taxation has fuelled corruption which leads to leakage and wastage of domestic revenue. MoF needs to focus more on fighting corruption than raising its tax rates or customs tariffs. It has to increase monitoring measures, where corrupt officials are identified and penalised. Part of corruption is also due to grievance where MoF should reconsider its staff salary scale for.
- Human capacity is a serious problem at MoF. While there is a training academy at ACD, majority of ARD and ACD staff still lack the required and relevant knowledge and expertise, particularly on taxation and/or fiscal policies. More human capacities based on merits than political ties and personal relations are required to improve tax administration.
- There is a poor culture of taxation in the country while complicated laws and legislation are enforced. There is an immediate need for MoF to run more public awareness campaigns including holding workshops, seminars and conferences, where people can have some basic knowledge about taxation and what they can expect by paying taxes in return. This will also help limit the misuse of tax collectors when assessing tax dues.
- There is a lack of trust among potential taxpayers who have no clue of where their tax goes or what it is spent on. With massive dependence on aid, MoF has been/is very engaged and in a sense accountable to donors than focusing on its prime responsibility. This is not only vital in improving the taxation system but will also play a crucial role in creating a fiscal social contract that has been absent or poor for a long time. MoF should create more reporting mechanisms to ensure transparency and accountability to public.
- We live in the age of information and technology. While ASYCUDA and SIGTAS do play a key role in improving tax administrations and curbing corruption, flaws are still dominant which need to be addressed. These systems need to be upgraded and revised. Further, highly developed technology would not work in the absence of highly educated users.



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## About the Afghanistan Research and Evaluation Unit

The Afghanistan Research and Evaluation Unit (AREU) is an independent research institute based in Kabul that was established in 2002 by the assistance of the international community in Afghanistan. AREU's mission is to inform and influence policy and practice by conducting high-quality, policy relevant, evidence-based research and actively disseminating the results and promote a culture of research and learning. As the top think-tank in Afghanistan and number three in Central Asia according to the Global Go To Think Tank Index Report at the University of Pennsylvania, AREU achieves its mission by engaging with policy makers, civil society, researchers and academics to promote their use of AREU's research-based publications and its library, strengthening their research capacity and creating opportunities for analysis, reflection and debate. AREU is governed by a Board of Directors comprised of representatives of donor organizations, embassies, the United Nations and other multilateral agencies, Afghan civil society and independent experts.

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