

The Impact of Tax Reforms on Economic Growth of Afghanistan

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Abstract: *Afghanistan's taxation system is improving but remains one of the greatest impediments to economic growth and foreign direct investment the economy of Afghanistan is fully dependent on international assistance and foreign aid, with 47.5% of Afghanistan's general budget and 28% of its development budget subsidized by the international community. This is aggravated by the fact that the government of Afghanistan has been unable to meet the country's fiscal needs for the past thirteen years, due in large part to the absence of an effective tax management mechanism. Accordingly, the government of Afghanistan should revisit its approach to revenue management and mobilize domestic revenues more Effectively to limit its dependency on international support. The research put lights on different edges and proposing improvement and positive change in tax administration. The tax reform is necessary in the current challenging situation to determine the government collect its revenue and meet the domestic expenditure in medium terms. The research design is a systematic plan to study a scientific problem in tax administration in the ministry of finance of Afghanistan. The design of the study is exploratory method. The exploratory research methods chose to study the emerging factors in the tax administration in the current situation in afghan revenue directorate.*

Keywords: Taxes (tax policy) Economic Growth, Afghanistan

1. Introduction

Taxation is an important fiscal policy instrument at the disposal of governments to mobilize revenue and promote economic growth and development. Governments use tax revenue to carry out their traditional functions such as the provision of public goods and services; maintenance of law and order, defense against external aggression, and regulation of trade and business to ensure social and economic maintenance. Effective tax revenue mobilization reduces an economy's dependence on external flows, which have been found to be highly volatile. Taxation also allows governments' greater flexibility in designing and controlling their development agenda, conditions states to improve their domestic economic policy environment, thus creating a conducive environment for the much-needed foreign direct investments and strengthens the bonds of accountability between governments and the citizens. The global financial and economic crises provided useful lessons for countries on the need to direct more attention to domestic resources mobilization efforts, including through increasing tax revenues, and shift away from over-dependence on external financial flows and export revenues.

Although tax structures vary considerably across countries, the primary objective of any tax structure is to attain maximum revenue and economic growth with minimum distortions. Different countries have different philosophies about taxation and different methods of tax collection. In the same manner, countries have different uses for their revenue, which affect growth differently. The different uses of total government expenditure affect growth differently and a similar applies to way tax revenue is raised. Romer emphasizes factors such as 'spill-over effect and learning by doing' by which firms' specific decisions to invest in capital and research and development, or investment in human capital, can yield positive external effects that benefit the rest of the economy. Solow was the first to examine how taxation affects growth. He argued that steady state growth

is not affected by tax policy that is tax policy regardless of distortion has no impact on long-term economic growth rates even if it reduces the level of economic output in the long term. On his part, argued that the different uses of total government expenditure affect growth differently and a similar argument applies to the way tax revenue is raised. The economic growth of Singapore for instance can be attributed to low rates of corporate and personal income taxes. Relatedly, argue that there exists a structural difference in taxation in developing countries and developed countries. For developing countries, they established that roughly two-thirds of tax revenue is derived from indirect taxes while for developed countries two-thirds comes from direct taxes. They suggested however, that tax structure could change over time to maximize the economic growth.

2. Afghanistan's Economic Performance Since 2001

Afghanistan's post-2001 economic performance has juxtaposed sharp growth and expansion, yet with growth driven primarily by international spending creation of great wealth, yet the persistence of grinding poverty and the shifting of the composition of the economy from agriculture to services, yet with the persistence of low-productivity agriculture.

GDP

Influenced significantly by high levels of donor spending and the recovery typically seen in post-conflict situations, Afghanistan's GDP growth averaged at or near double digits for the first decade of reconstruction. Between 2001 and 2012, per capita GDP increased more than five-fold, from \$117 in 2001 to a peak of \$669 in 2012 in the run-up to the 2014 drawdown. This included the period of the 2007–2012 global economic recession. Since 2012, total GDP has been stagnant or even falling. Moreover, per capita GDP has fallen each year since 2012, dropping to \$562 in 2016. Due

to the volatility of weather-dependent agriculture, GDP growth varied greatly from year to year

Employment

According to the Afghan government's Afghanistan Living Conditions Survey (ALCS), unemployment was 7.1 percent in 2008, 8.2 percent in 2012, and 22.6 percent in 2014, the only available data points. Drawing conclusions about true levels of employment is difficult, in part, because data in Afghanistan are notoriously poor. For example, Afghanistan has never had a full census, and therefore all population numbers and percentages are estimates. Also, ALCS counted anyone who did any agricultural, nonagricultural, or occasional paid work for even one hour in the previous 30 days as "employed," a situation that does not represent sufficient employment. In fact, a large majority of the population is underemployed, a problem considered as serious as unemployment. Furthermore, 90 percent of employment in Afghanistan (including day laborers and unpaid family workers) has been classified as "vulnerable." The extent to which employment depended on international spending was illustrated by a 2016 International Monetary Fund (IMF) country report that estimated 500,000 jobs had been lost in the two years after the 2014 drawdown, a number roughly equivalent to the number of jobs that were created in the 2009–2012 surge years preceding it. Moreover, the World Bank estimated that approximately 80 percent of the jobs that had been created were informal day labor jobs that were not sustainable. The challenge of creating jobs for the existing labor force was exacerbated by the return of refugees from neighboring countries, especially during the early years of reconstruction. In 2002 alone, 1.96 million refugees voluntarily returned to Afghanistan. Returnees added to the number of people looking for work and needing services from the state. Finally, with one of the highest population growth rates in the world and nearly half of its population under the age of 15, Afghanistan will need to add 400,000 jobs annually just to meet the needs of labor market entrants—a situation described as a "socio-economic time bomb."

Poverty

From 2002 to around 2012, workers benefited from the substantial rise in wage rates and salaries for all types of work that were driven by international spending. Remuneration paid to office personnel and lower-skilled workers by international agencies and contractors was often up to 11 times the civil service wage rate. Beginning in 2014, the availability of employment and the wages of both office workers and casual laborers began to level off or decline. Even though Afghanistan saw strong growth in GDP between 2002 and 2012, benefits did not accrue equally to the rich and the poor, widening the inequality gap in the country. Poverty levels remained extremely high, largely due to unemployment and underemployment. Around one-third of the population has remained below the poverty line since at least 2007, when the first consistent indicators were available. At the same time, however, poverty is hard to measure because data in Afghanistan are notoriously inadequate.

Trade

Afghanistan's trade imbalance increased consistently over the past 16 years as domestic industries were unable to compete in regional and world export markets and consumption fueled by the inflow of civilian and military funding attracted imports. Afghanistan reported substantial growth in imports from Pakistan, Iran, and China, three of Afghanistan's largest trading partners, between 2008 and 2016, the only years for which Afghanistan reported trade data. Analysts attribute part of the trade imbalance to competitive advantages, but also to predatory or unfair trade practices by these nations, who saw Afghanistan as a market for their own production. Especially concerning for Afghanistan were the rising imports of competing products from its neighbors, for example, stone, carpets, dried fruits, and nuts. Recent transit and trade issues between Pakistan and Afghanistan due to political tensions reportedly have led to a substantial decrease in imports from Pakistan from 2016 to 2017.

Tax Reform

To generate sufficient revenue streams to fund the operating budget, it was necessary to reform the tax system. This reform needed to make compliance easier and taxes less subject to evasion, while simultaneously limiting any negative impact on economic activity. Tax reform was primarily supported by USAID's AEGP. Working with the MOF, AEGP advisors sought to amend existing tax laws, including drafting legislation to bring Afghanistan up to international standards, and provided extensive training for MOF staff so they could effectively administer the new regulations. Advisors also sought to improve tax administration capacity and support both the private sector and government revenue generation. Between March and July 2004, a number of new taxes were put into place, including rental services, business receipts, and wage withholding. USAID also supported the development of a fixed tax schedule on moneychangers and the establishment of various tax compliance and education programs. An income tax law in 2005 attempted to encourage businesses by reducing the top marginal tax rate from 60 percent to 20 percent, plus an additional fixed amount of 8,750 Afghani (\$175 at the 2005 exchange rate). The law also provided certain license-based tax privileges for the extractive industry to attract investment in the sector. In 2007, taxpayers were differentiated into small, medium, and large. In order to make it easier for the Afghanistan Revenue Department (ARD) to "best manage the risks associated with the different characteristics, compliance behaviors, and risks to the revenue each segment presents." Still, despite significant reforms, poor governance, confusion, and a lack of information regarding the tax system plagued the formal business sector. Above all else, corruption among tax officials made it more difficult and costly for businesses to comply, which discouraged them from participating in the formal economy. In many cases, the time taken up by the actual filing and paying of taxes was even more onerous than what was owed in the taxes themselves. A 2008 UK review attributed a significant part of the post-2005 decrease in foreign and domestic private investment to a 2004 tax reform and the subsequent aggressive rent-seeking behavior of officials in the MOF Revenue Department's Large Taxpayers' Office, which the review labeled an "economic

'shock' which has, to a significant extent, caused a reduction and stagnation in foreign and domestic private investment since 2005." Transparent tax collection was further complicated by revisions to the tax law in 2005, 2009, and again in 2015, which confused businesses and often increased their tax burden. For example, a lack of clear information about a 2005 tax holiday, intended to encourage businesses to expand their operations and join the formal economy, resulted in some firms improperly applying and therefore not qualifying, or applying when they were not eligible, with the end result being firms having to pay several years of back taxes to the government all at once. Along with the back taxes, additional "fees" were paid to officials to avoid legal consequences. Further, in some cases, firms followed the correct procedures for getting the exemption, but did so through officials who did not have the authority to grant it. Tax reforms were intended to maintain and increase government revenue streams, especially following the drawdown of international financing. While necessary for the government to generate revenue, increasing taxes on businesses became a double-edged sword, in effect encouraging businesses to remain informal and further shrinking the tax base. As discussed below, there were similar issues in the customs administration, where despite early and continued reforms to clarify customs values and procedures, corruption at the borders continued to encourage smuggling in order to evade payment. At the end of 2015, new rules increased the business receipts tax from 2 percent to 4 percent, a move vigorously opposed by the business community, in part because they considered the receipts tax a form of double taxation. As one report noted, while "absolute levels are not high by international standards, compliance imposes a heavy burden for a sector where many had been used to paying no tax at all." In 2014, the IMF also pushed heavily for the addition of a value added tax (VAT) in order to move some of the tax burden off businesses, while still generating additional revenues. While VAT implementation was tabled after substantial delays in negotiation, it has not been ruled out for the future.

3. Afghanistan Revenue Department

The Afghanistan Revenue Department (ARD) is responsible for the administration and collection of tax and non-tax revenue for the Government of Afghanistan. The revenue is used to fund public infrastructure, including the construction of roads, schools, and health facilities, and to provide social services, including health and education. In addition, the revenue is used to fund Government functions.

During the past ten years, with the support of the international donor community, considerable gains have been made by the ARD in its ability to collect tax revenue. These efforts include a wide range of reforms and restructuring within the ARD, particularly the segmentation of taxpayers into Large, Medium and Small offices and the roll-out of these offices to regional provinces.

Professionalization of the tax service is a key priority for the ARD. This includes reorganizing the organizational

arrangement (civil servant staff) based on simplified and improved business processes. In addition, it includes computerizing tax functions, which will support ARD's efforts to streamline business processes and maintain accurate tax records. Moreover, computerizing tax functions can reduce the potential for corruption. As part of its computerization program, the ARD has implemented the Standard Integrated Government Tax Administration System (SIGTAS) to automate current processes.

Regional tax reforms are an important means to increase revenue. Large and Medium Taxpayer Offices have been established in five regional locations, and two additional regional locations will be added. When the Large and Medium Taxpayer Offices were introduced in Kabul revenue increased significantly. At present, tax officials in provinces report to the Mustofy, while in the future they will report directly to the ARD. This change will aid in the development of accurately coasted revenue and budget forecasts.

The ARD has implemented human resource, automation, process simplification and risk-based compliance reforms to improve taxpayer services and enhance the efficiency and effectiveness of the ARD. In the future the ARD plans to introduce a Value Added Tax, which is now in effect in neighboring countries.

Table 1: The composition of national tax revenues of Afghanistan, 2014

Domestic Revenue Sources	Amount in Million Afg	Percentage of contribution
Tax revenue	9147730	73%
Tax on income, profit, property and capital gain	32581.89	25%
Tax on international trade & transactions	31,058.47	25%
Domestic tax on goods & services	2051835	16%
Other taxes	71318.59	6%
Non tax revenue	2513.00	25%
Revenue from oil transit	2388.61	2%
Revenue from railways	1794.28	1%
Other non tax revenue	27339.81	22%
Other domestic revenue	2513.00	2%
Revenue from mining and petroleum	2000.00	2%
Other domestic revenue	512.00	0%
Total domestic revenue	125513.00	100%

(Source: Afghanistan National Budget, 2014)

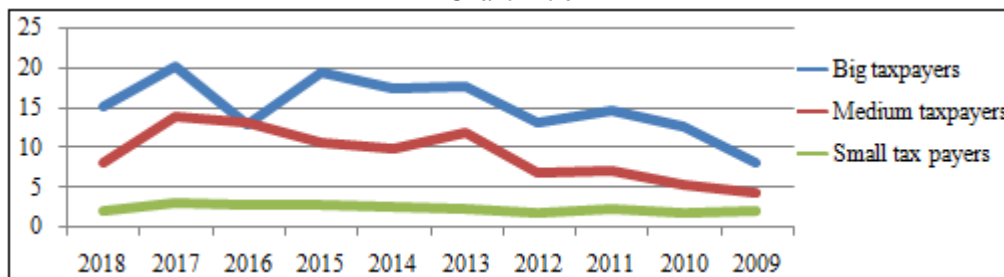
Table 2: New tax rate introduced.

Item	Previous tax percentage	Current tax percentage
Tax on profit	2%	4%
Mobile top up cards	0%	10%
Tax on fuel	1 AFS	2 AFS
Aviation tax	400 USD/per flight	500 USD/per flight

(Source: Afghanistan National Budget, 2014)

Table 3: Comparison of revenue (2018-2009) in milliard Afs

Fiscal Year	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Big/large taxpayers	15.10	20.28	12.90	19.56	17.43	17.64	13.10	14.71	12.56	8.11
Medium taxpayers	8.11	13.99	13.18	10.79	9.91	11.90	6.87	7.05	5.49	4.38
Small taxpayers	2.10	2.98	2.75	2.80	2.53	2.18	1.80	2.28	1.85	2.10

Chart Title

(Source: Afghanistan Revenue Department)

4. Research Methodology

This research is to focus on the emerging factors and requirement for taxReforms. The strategic reforms follow systematic change in the Afghan RevenueDirectorates (ARD) to bring positive change in the tax system. The recommendationfor reforms covering human resources restructuring, departmental restructuring, Simplification of income tax laws, simplification of work procedure, simplification ofdata recording, digitalization of the archives and centralized database. This researchalso helps in identification of new sources of revenue generation. The reforms also accompany tax law amendment, simplification of procedures policies and regulations. The reforms will strengthen institutionalization of the systemand reduce the corruption. The ministry of finance must focus on general publicawareness campaigns to create legitimacy of tax payment.

5. Suggestion

The government and international community invested enormous amount of money for the reform of revenue directorates and employees. The tax administration is still very weak and the government could not utilize the return on the huge investment. This research focuses on the scientific knowledge and methods to bring positive reforms in the revenue directorates. The impact will be positive and can lead to better tax administration and increment in the revenue. The main aim is to bring quality in the services and also increase quantity of taxes collection

The Tax Reforms consist of the variables as:

1) Current Organization Environment:

The Afghan Revenue Directorate has facilities, but it's not matching the current requirement and staff comfort. ARD should expand its facility base to employees expectation and bring matching convenience for better working situation and productivity.

2) Current Data Recording Facility:

ARD has decentralized archiving system its combination of computerized and more manual work. The documentation of taxpayers and records are available in books that are dated back to 35 - 40 year

old. The ARD cannot retrieve the tax payers' information on time, lengthy work process and communication difference as interdependence with Ministry of Commerce & Industries (MOCI), Afghanistan Investment Support Agency (AISA) for the clearance of tax return to renew business licensee.

3) Method of Better Data Recording:

The potential for computerization of the system, web based operations and online services. This will bring efficiency and effectiveness in the system and decline in the lengthy work processes

4) Competent Job Related Duties:

The primary step towards human resources is change management and implementing new reform policy on merit base recruitment must start reforms. Its main aim is to encourage new talents to compete for positions without exactly knowing of the posts. The important point is to consider the recruitment of professional people having relevant education, and knowledge of economic field.

5) Multidimensional Approach:

Multidimensional approach (Data recording, Data maintenance, data transfer, data feedback, reduction of manual work) is appropriate for simplification of the work procedures.

6) Tax Campaign Laid by Government:

The ARD rarely conduct public tax awareness campaigns. The ministry of finance website is not updating regularly to keep pace with changing situation. ARD has tax manuals and brochures, but the distribution is limited.

7) Framing New Tax Reforms Laws:

The current income tax law has many flaws. The ministry of finance must bring new amendments in the law and policies. The income tax law must be based on the social reality and economic sphere of the country and should not be copy of expired laws or foreign law imitated

8) Simplification of Tax Law:

The current income tax law has serious flaws that another amendment is necessary to cover the gaps and bring improvements. The proper tax categorization is required to fix certain tax rate flaws and tax according to the business revenue generation. The simplification in the income tax law will boost efficiency in the

operation of the tax system. The tax officials can easily understand the articles and prevent self-interpretation of the law. The simplification can also lead to the reduction in the current corruption rate.

9) **Simplification of Payment of Taxes:**

The incorporation of Electronic payment services linked to few trustworthy Banks in the country for better facilitation to tax payers. The taxpayers' choice of Payment should be open that make it easier and manageable. The small businesses should have more facilitation on the payment services. They mostly consist of illiterate people, and low educated. They all should have TIN no and payment slip in advance available with a choice of payment according to his/her ability

10) **Government Officials Bribes Reduction**

The simplification of the income tax law, work procedures and tax payment. The ARD succeeded in this goal will reduce the opportunity for bribe taking and deal making between tax officers and taxpayers

11) **Selection of Competent Employees**

The favorable attitude towards selection of competent employees on merit base through open fair competition. The promotion of talented employees to higher positions. The attraction of Economic & Finance university toppers, roaster of young talents for future vacancies.

12) **Simplification of Work Procedures:**

The system must be computerized and online base. The number of signatories must be reduced to minimum and system self-operation instead of heavily based on manual paper work. The need for client service in all tax departments to handle the documents and reduce personal interaction of taxpayers with tax officials.

13) **Newspaper**

Afghanistan has several printed newspapers. The newspaper readers are many. ARD must plan for taxpayers' awareness campaign in newspapers.

14) **Internet:**

Ministry of Finance and Afghan Revenue Directorate has website. The website is not updating on timely manner with new information, laws, policies and regulations. The Internet users are many and ARD have to consider the website promotion pace with changing situation.

15) **Outdoors Campaign:**

The ARD staff has to go to market places, offices and general public to conduct the outdoor campaign. The main aim of outdoor campaign is taxpayers' awareness and training future taxpayers.

16) **Tele Advertisement:**

Afghanistan has 38 television channels all over the country. The people are watching television and commercial advertisement is common. The ARD must invest on the Tele - advertisement campaign to reach taxpayers.

17) **Organization Tax Manuals:**

ARD has organization manuals in Dari, Pashto and English languages. But the distribution of the organization tax manual is very limited. The softcopy must be available online in the ARD website.

18) **Organization Tax Brochure:**

Organization Tax brochure is available in Dari, Pashto and English languages. This tax brochure should be distributed to people for awareness purposes

19) **Sources of Recruitment of Employees:**

The best sources of recruitment of employees are fair open competition, internal merit base promotion of employees. The talented university graduates recruitment and roaster young talents for future vacancies.

20) **Types of Tax Paid:**

The ARD has many tax departments like Large Tax Payers Office (LTO), Medium Tax Payers Office (MTO), Small Tax Payers Office (STO), and Rural Tax Department. The following kind of taxes are paid by tax payers

- Small businesses fixed tax
- Medium businesses fixed tax
- Large businesses fixed tax
- Restaurants
- Companies
- Large companies & corporations
- Income tax
- Rent tax
- Sales tax
- BRT & VAT (VAT is planned, but still has be implemented)
- Import & Export tax
- Road & toll tax

21) **Qualification of Employees**

The ARD tax employees are a mixture of high school graduates, Bachelors and Masters. The majority of tax employees are high school graduate. The training and development mechanism is limited.

22) **Average Length of Services of Tax Employees**

The Afghanistan Independent Civil Servants Commission Law permits five years of service tenure. There are many employees that serve for decade or higher. The favorable attitude towards employee tenure is maximum two years.

6. Conclusion

The government of Afghanistan should institute an appropriate tax system which emphasize the broadening of tax base and in some case, reviewing upwards the tax rates to enhance the contribution of taxation towards economic growth and development. In this respect, the tax administration system in Afghanistan should be strengthened to address some of the challenge presently clogging the wheel of progress as far tax administration is concerned. Furthermore, voluntary compliance should be encouraged through continuous taxpayers' education and the institutionalization of a functional tax administrative system. It also recommended that the tax execution agencies should forge good relationship with the professional association involved in tax matters to elicit their support in reducing tax malpractices and other forms of fiscal corruption. In addition, regulatory authorities charged with responsibility of collecting tax should further be strengthened to enforce compliance by taxpayers, there should be enhanced

accountability and transparency from government regarding the management of revenue derived from taxation in terms of provision of public goods and services as this will enhance tax compliance among the taxpayers.

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