

**REVIEW OF AFGHANISTAN'S
FISCAL MANAGEMENT**

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February 2003

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CURRENCY EQUIVALENTS

(as of 5 April 2002)

Currency unit	-	Afghani (Af)
Af1.00	-	\$0.00003125
\$1.00	-	Af32,000

ABBREVIATIONS

ADB	-	Asian Development Bank
AIA	-	Afghan Interim Administration
ARTF	-	Afghanistan Reconstruction Trust Fund
ATTA	-	Afghan-Pakistan Transit Trade Agreement
CMEA	-	Council for Mutual Economic Assistance
CSO	-	Central Statistical Office
DAB	-	Da Afghanistan Bank
EC	-	European Commission
ESCAP	-	Economic and Social Commission for Asia and the Pacific
FY	-	fiscal year
GDP	-	gross domestic product
GNP	-	gross national product
IMF	-	International Monetary Fund
ITGA	-	Islamic Transitional Government of Afghanistan
MOF	-	Ministry of Finance
NDF	-	National Development Framework
TSA	-	Treasury Single Account
UN	-	United Nations
UNDP	-	United Nations Development Programme
US	-	United States
VAT	-	value-added tax

NOTE

In this report, "\$" refers to US dollars.

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I. INTRODUCTION¹

1. More than two decades of conflict, as well as droughts and earthquakes, have resulted in widespread destruction and human suffering in Afghanistan. The country is still in the midst of a humanitarian crisis, with a per capita gross national product (GNP) currently estimated to be only \$202,² and a ranking of 169 out of 174 countries on the human development index. The protracted war has resulted in depletion of human resources, erosion of social capital, interruption of productive activities, and destruction of infrastructure. Apart from badly straining the national unity, the civil turmoil has also weakened institutions and civil society. Adding the unexpected high number of returning refugees of between 1.4 and 2 million, and about 60-80% of the population living below the threshold of \$1 a day, famine would be widespread without extensive humanitarian assistance. According to a preliminary needs assessment prepared jointly by the Asian Development Bank (ADB), World Bank, and United Nations Development Programme (UNDP) (January 2002), the rehabilitation and reconstruction costs of Afghanistan until the election in 2004 are estimated at \$4.9 billion. The estimated required total investment over the next decade is \$14.6 billion. This assessment does not cover the cost of about \$1 billion over the same period for humanitarian needs (food, shelter, provision and medicine).

2. Afghanistan is an arid, mountainous, and landlocked country, with an ethnically diversified population estimated at 18-21 million (25 million with all Afghan refugees included). Prior to the conflicts in the late 1970s, the Afghan economy was based on agriculture, animal husbandry, and some light industry. It was also characterized by mainly food self-sufficiency, predominance of agricultural exports, relatively low debt burden, macroeconomic stability, and free-floating exchange rate. Destruction of human capital and physical infrastructure, and negative effects on trade, business confidence and tourism, followed the violence and armed conflicts since the late 1970s. Very little of Afghanistan's federal revenues could be extracted from its economy, which led to a weak fiscal position. The adversely affected economic growth further diminished fiscal revenues, and the decline of revenues contributed to large budget deficits for many years. The higher spending for security affected the composition of public spending and decreased outlays for productive factors like education and health.

3. A new opportunity for peace and renewal in Afghanistan emerged with the fall of the Taliban regime in late 2001, and the political agreement reached between the various Afghan factions in Bonn in December 2001. The inauguration of the Afghanistan Interim Administration in December 2001, the Emergency *Loya Jirga* (Grand Assembly) in June 2002, the installation of the Islamic Transitional Government of Afghanistan (ITGA, or Government) in June 2002, and the currency reform in October 2002, represent significant milestones in the transition process. However, the lack of government revenues limit the country's ability to respond to the need for rehabilitation and reconstruction, like provision of adequate social safety net and repair of infrastructure. A key part of the reconstruction process of the country is the building and enhancing of the capacity to collect domestic revenues. Under normal circumstances, domestic resources would play an important role in financing the total investment requirements, but for

¹ This report was prepared by Ms. Helena von Seth and submitted to the Afghanistan Desk, Asian Development Bank (ADB), which sponsored her internship during July–September 2002. Preparation was guided by Messrs. Craig Steffensen (Senior Programs Specialist), Manabu Fujimura (Economist), and Mohiuddin Alamgir (Staff Consultant), South Asia Department. While their comments and suggestions were incorporated in this report, any errors and misrepresentations are the responsibility of the author alone, and should not be attributed to ADB. In preparing this report, various economic statistics that were available for the last forty years on government finance, balance of payments, national accounts, production, monetary development, components and direction of trade, transport, tourism, population and labor force, education, and media were compiled. These statistics are available upon request.

² ADB, 2002.

Afghanistan at this stage, the Government has very limited capacity to mobilize resources to meet anticipated current expenditures. External assistance will therefore play a dominant role during the first years of Afghanistan's rehabilitation, reconstruction, and development.

4. Given Afghanistan's small private sector and limited availability of technical, financial, and managerial skills, the Government has assumed a key role in promoting national economic development. For this purpose, the main instrument available to the Government is the budget, as the central instrument available to the Government to promote necessary policy and institutional reform measures. However, 23 years of economic and political instability resulted in a near collapse in budgetary management. Indeed, when the AIA assumed office in December 2001, full implementation of the legally mandated budget preparation process had not been carried out for more than a decade. Hence, one of the first economic tasks for the Government was the preparation of an operating budget. A fiscal policy was also developed, which included an evaluation of the capacity of the Ministry of Finance's (MOF's) resources and structures to deliver the new policies. To mobilize adequate financial support, the Interim Administration presented an Ordinary Budget — covering recurrent expenditures. — for FY 2003 of \$460.3 million, to the first meeting of the Implementation Group in Kabul in April 2002.³ A development budget, including donor-funded investment projects, covering both the current and next fiscal year, was presented at a subsequent meeting of the Implementation Group in Kabul in October.⁴ For financing, the Government projected \$83 million or 18% of total expenditures in domestic revenue.⁵ To finance the budget gap, it was indicated that \$377.3 million or 82% of total expenditures would be required in the form of external assistance.

5. Transmittal of revenues by provincial offices to the central Government has fallen short of expectations. Support for improved fiscal management is considered essential to help ensure macroeconomic stability. Therefore, improvement of financial management capacity and revenue mobilization are considered priority areas for technical assistance. Considering the central Government's limited control over the provinces and weakness in tax and customs administration, the fairly modest revenue target will require considerable effort to achieve.

6. Due to the lack of reliable official statistics, continued warfare, population movements, and communication problems, providing an accurate general economic profile is inevitably difficult (Appendix 1). Consequently, the absence of sufficient available relevant information has prevented the provision of an exhaustive picture of government finances. The data should be treated as indicative and at best rough estimates. For example, since the estimates of quantity and value of trade have a low confidence and are subject to "guesstimate," the actual figure of annual trade could be 25% higher or lower.

7. The prevailing economic situation in Afghanistan, with generally poorly functioning economic systems, provides a rare opportunity to rethink and implement appropriate institutional arrangements and economic reconstruction.

II. FISCAL POLICY IN CONFLICT AND POSTCONFLICT COUNTRIES

8. "Conventional wisdoms" of general development that can be applied in postconflict settings are: the importance of client ownership, beneficiary participation, the policy and

³Fiscal year starts on 22 March. FY 2003 refers to 22 March 2002–21 March 2003.

⁴While the Development Budget will need to be largely foreign financed for the foreseeable future, the Ordinary Budget will eventually be financed from domestic revenues. As the authority of the central government extends over the entire country, revenue collections from both direct and indirect sources should increase substantially.

⁵ Assumed exchange rate is Af34,000=\$1.

institutional environment including a positive enabling environment for the private sector, and cost-effectiveness. However, some characteristics of postconflict settings—fragility of the political environment, easily frightened private investment, thinness of financial sector markets, and severely reduced governance capacity—make some “conventional wisdoms” not applicable, at least not in the short run. Tax policy, despite its importance for stabilization and public finance, has been considerably more controversial than stabilization measures employing the instruments of monetary policy. The political environment in which a new postconflict government finds itself may still be very fragile and unstable, limiting its ability to win acceptance of a reform program that goes beyond stabilization.⁶

9. A study by the International Monetary Fund (IMF) (August 2002) on fiscal effects of armed conflict and terrorism in low- and middle-income countries⁷ found that there are three main ways in which armed conflict and terrorism can affect the fiscal account: (i) changing the composition of government spending; (ii) adversely affecting both the tax base and the efficiency of the tax administration; and (iii) influencing real economic activity or the gross domestic product (GDP) and thereby government revenues. More specifically, the share of government revenue in GDP tends to fall during the conflict period, and to pick up in the immediate postconflict period (Appendix 2). Despite the collapse of tax bases following outbreaks of armed conflict in the 1990s in two African countries, after some years of peace and normal production, tax revenues actually exceeded preconflict levels. On the expenditure side, compared to the preconflict period, government expenditures and net lending as a percentage of GDP appear to increase significantly during the conflict period. The fiscal consequences of these decisions have repercussions on economic growth, which further affect public finances. High defense spending during the conflict and in the years immediately preceding this period tend to be at the expense of macroeconomic stability, reflected in higher budget deficits and increased inflation. If provision of internal security succeeds, defense spending can have a positive resource mobilization effect through augmented savings and investment. Since conflict is associated with lower real GDP growth, however, an implication is lower real per capita government spending on education and health.

10. Following the cessation of violence, conflict- and terrorism-affected countries are likely to pick up in government tax revenues, and albeit with a lag, reduce military spending. Therefore, the ending of armed conflict can result in several different “peace dividends,” releasing fiscal resources to be used for lowering deficit, raising the allocation for spending in social sectors, or reducing taxes. The IMF (August 2002) also concludes that this process will help in restoring macroeconomic stability. In addition to building damaged infrastructure and institutions, a successful reconstruction after conflict involves improving the trust among the warring parties, renewing the social contract, and addressing grievances due to economic disparities and to perceived biases in fiscal policies.⁸ As a result, successful postconflict reconstruction is complex

⁶ World Bank, 1998.

⁷ The study analyzed a sample of 15 low-income countries, 3 lower-middle-income countries, and 2 upper-middle-income countries where conflict had begun or was ongoing after 1985 and had ended by 1999. Conflict period refers to the period over which a country experienced armed conflict (as defined by The Stockholm International Peace Research Institute); preconflict refers to the average of 3 years preceding the conflict, and postconflict refers to the average of 3 years following the conflict. Bearing in mind that no single definition of terrorism has so far gained universal acceptance, the *Columbia Encyclopedia*, 6th Edition, 2001 defines terrorism as “the threat or use of violence, often against the civilian population to achieve political ends. Terrorism involves activities such as assassinations, bombings, random killings, hijackings, and skyjackings. It is used for political, not military purposes, and by groups too weak to mount open assaults.”

⁸ Perceived inequities in the distribution of the tax burden and the pattern of public spending can affect conflict and violence. However, the limited scope of this paper has not permitted a study of the relationship between Afghanistan’s fiscal policy and its armed conflicts.

and takes time. Consequently, it is highly critical, especially in countries that have experienced prolonged conflicts, that the involvement of the international aid community is sustained and goes beyond simple one-shot assistance.^{9, 10}

11. To maximize the impact of external assistance, it is essential that the government and the aid community itself consider, and act thereafter, that funding agencies have different respective comparative advantage in providing fiscal support. Furthermore, experience in the past reconstruction efforts has shown that the preferred approach is for one funding agency to provide support for a well-defined project, such as tax administration, expenditure management, or customs administration. Relative to a situation where the resources are cobbled together from a variety of funding agencies, a single funding agency approach to a specific component encourages ownership and leaves no question about funding agency oversight to ensure the desired outcome. This strategy worked very well in Kosovo where the United States (US) Government provided the resources to establish an institution that has the same function as MOF. In contrast, the same institution in East Timor was funded by many different sources, prompting concerns about responsibility and resulting in difficulties in securing sustained assistance.¹¹

12. Generally, the reform of fiscal policies and institutions lies at the heart of structural adjustment in developing countries, with the immediate aim to reduce fiscal imbalances to achieve macroeconomic stability. The long-term goal of fiscal reforms is to secure more lasting improvements in fiscal performance. Targets for overall levels of revenue and expenditures and their individual components (mainly as a percentage of GDP) are compared with the outcome of the overall fiscal performances, including fiscal deficit. Efficient revenue mobilization can fund needed public goods and services and help cut fiscal imbalances. It can also promote investment and growth by reducing the adverse allocation effects of the tax system. Moreover, sound fiscal policies prevent inflation, which is important given the developing countries' relatively limited financial intermediation and the associated potential for budget deficits to be monetized.

13. To make revenue mobilization more efficient, reforming the tax and tariff systems and their administration will be required. On the expenditure side, fiscal consolidation calls for reorienting public spending towards growth-promoting investment in physical infrastructure and in social and human capital. The success of revenue mobilization over the medium term depends significantly on implementing comprehensive reforms in tax administration. Improving the structure and administration of tax systems requires significant tax policy reforms, such as simplifying and rationalizing tariff and tax rates and introducing broad-based taxes on consumption, for example, value-added taxes (VATs). To increase both the total revenue and the tax revenue-to-GDP ratio through improved tax and customs administration, these tax policy reforms need to be reinforced by institutional reforms. Reforms of the tax administration typically include wider registration of taxpayers, simplification of procedures for taxing the informal sector, establishment of large-taxpayer units, computerization, and staff training. Most

⁹ In Rwanda and Cambodia World Bank has been engaged in projects to reaffirm trust in the government and enhance the government's legitimacy. With the aim to revitalize local economies and bring communities together through local decision-making, the authority for expenditures and decision-making were transferred from the central to community level (World Bank, 2000).

¹⁰ Collier and Hoeffler (2002) find that during the first 3 postconflict years, absorptive capacity on average is normal, however, it doubles during the rest of the first postconflict decade. Thus, ideally, following the end of the conflict, donor involvement should be phased over several years. Historically, according to them, aid has not been higher on average to postconflict societies, and instead tended to decline over the course of the postconflict decade.

¹¹ IMF, February 2002.

often tax administration reforms have long gestation lags and, therefore, cannot be utilized as short-term revenue measures. For example, the introduction of a VAT can be implemented over an extended period and be the catalyst for other reforms in tax administration.

14. Appropriate sequencing of tax reform is important for the overall success of the reform strategy, especially given the limited administrative capacity in developing countries. The early focus on implementing a VAT, beyond its importance for revenue, may be justified in terms of motivating necessary improvements in overall revenue administration.¹² How much of these general observations may apply to Afghanistan will have to be tested in the next few years during the initial reconstruction phase.

III. FOUR DECADES OF ECONOMIC AND FISCAL MANAGEMENT IN AFGHANISTAN: A HISTORICAL REVIEW

A. The 1960s

15. With the establishment of the Banke Milli Afghan (National Bank) in 1932, successive governments in Kabul started to lay the foundation of a modern economic development in Afghanistan. The first three Five-Year Plans (for 1957-1961, 1962-1967, 1968-1972) did not really attempt to control the whole economy, although the Government described its policy for a “guided economy”, and later a “mixed, guided economy” (Table 1). The Plans focused basically on improving infrastructure.

Table 1: Second Five-Year Plan (1962-1967)
(Af million)

Agency	Total Investment	Sources of Finance			FA % of Total Inv.
		Budgetary Revenues	Private Sector	Foreign Assistance	
Ministry of Mines and Industry	10,475	2,595	146	7,734	74
Ministry of Public Works	10,116	3,223	n.a	6,893	68
Ministry of Agriculture	1,759	597	92	1,070	60
Ministry of Communication	371	98	n.a	273	73
Ministry of Education	2,190	187	n.a	2,003	91
Ministry of Health	537	57	n.a	480	89
Ministry of Commerce	40	n.a.	20	20	50
Ministry of Finance	255	76	n.a	179	70
Helmand Valley ^a	2,918	100	n.a	2,818	96
Department of Civil Aviation	802	86	n.a	716	89

^a The most important reclamation investment was the Helmand project, situated southwest of Kandahar and supported by US. The aim was to make 300,000 hectares desert prosper and to distribute a large acreage of state-owned land to nomads and landless people from the whole country. While the project had consumed the majority of the total public investments in agriculture, at the beginning of the 1970s the yield from the Helmand Valley was 100,000 tons wheat per year, providing only 4% of the total production.

¹² IMF, 1998.

Agency	Total Investment	Sources of Finance			FA % of Total Inv.
		Budgetary Revenues	Private Sector	Foreign Assistance	
Rural Development	54	11	n.a	43	79
Institute of Cartography	26	Negligible	n.a	26	100
Press Department	542	23	n.a	519	96
Govt. Monopoly Department	211	36	n.a	175	82
Silos	254	52	n.a	202	80
Municipalities	782	230	11	541	69
Auditing Department	21	21	n.a	n.a	0
Total	31,353	7,392	269	23,692	76

Source: Griffiths, *Afghanistan*, 1967.

16. The Ministry of Planning was established in the same year that the first Five-Year Plan was adopted. Drafting of the first plans was done by Soviet advisers. The goals in the first Afghan development programs were overly ambitious and turned out to be unrealistic; indeed, some analysts considered the Five-Year Plans to be little more than long lists of projects needing financial support. Foreign assistance constituted 89% of the revenues in the First Five-Year Plan, 76% in the Second Plan, and 72% in the Third Plan. The two super powers competed in exerting most influence on Afghanistan, helping the Afghan government to receive large loans and grants from the United States (US) and Soviet Union.¹³ According to the Afghan Central Statistical Office, between 1962 and 1967, Afghanistan received on average \$70 million each year in foreign loans and grants from mainly Soviet Union, US, Germany, France, People's Republic of China, United Nations (UN), and World Bank. About 67% of the total aid was paid by Soviet Union and 20% came from the US. While most of the American assistance consisted of grants, the composition of aid from Soviet Union was mostly loans.¹⁴ Augmented debt service ratio followed, reaching 25% in 1969 (Appendix 2).

17. Large investments were made in industry, communication, and agriculture. To augment the production of agriculture, the Government concentrated on large capital-intensive reclamation of land. Close to Kabul, Jalalabad, and Kandahar, large water power stations were constructed with assistance from Germany and the Soviet Union.^{15, 16} The investments in communication were concentrated on infrastructure within transport and telecommunication. The inadequate road network caused large regional economic differences. At the end of the 1960s Afghanistan had 1,900 km of concrete and asphalted roads. Soviet Union and the US financed the road construction,¹⁷ but maintenance had to be paid by the State, and soon the Government had to introduce road tolls.

18. Until the Soviet invasion, the government budget was divided into ordinary and development. The ordinary budget covered administrative activities, and the development budget that was incorporated into the national plans of development, covered the investment expenditures.¹⁸ Even though revenues more than doubled from Af2,099 million in 1960 to

¹³ Swedish Committee for Afghanistan, 1995.

¹⁴ Many of the loans from Soviet Union were planned to be repaid in form of goods, for example, natural gas (Swedish Committee for Afghanistan, 1995).

¹⁵ Because the power distribution system was inadequate, only half of what was produced was utilized, despite the fact that large parts of the country faced chronic power shortages.

¹⁶ Setbacks affected the project, for example, salting emerged because of insufficient drainage. Government resources for the project did nevertheless increase.

¹⁷ The US assisted with construction of the ring road including links with Pakistan and Iran (e.g., Kabul – Kandahar and Herat – Eslam Qaleh), while the Soviet Union provided support for roads in northern areas including links with Soviet republics.

¹⁸ *New Encyclopedia Britannica*, Vol. 13.

Af5,085 million in 1969 (Table 2), annual expenditures exceeded domestic revenues. Comparing with GDP that increased from Af51.1 billion in 1962 to Af60.8 billion in 1969,¹⁹ during the same period development expenditures amounted to 3%, total expenditures on average 15%, and revenues on average 7%. The budget deficit was covered by deficit financing and foreign loans and grants. Collection of taxes was hampered by deficient reliable statistics on which to base calculations, and the overall Afghan statistics were treated with reservation.²⁰ The national revenues from taxation were gathered with provincial responsibility. After the local revenues had been sent to Kabul, the projects in the provinces received their revenue from their respective ministry in Kabul.²¹

Table 2: Government Finance for 1960s

	(Af million)									
Item	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
Balance	(1,009)	(677)	(3,401)	(4,417)	(4,176)	(6,284)	(4,500)	(3,707)	(4,215)	(4,882)
Revenue	2,099	721	2,120	2,687	3,230	4,146	4,285	4,247	4,567	5,085
Expenditure	3,108	1,398	5,521	7,104	7,406	10,430	8,785	7,954	8,782	9,967
Development Expenditure	n.a.	n.a.	1,446	1,830	1,622	1,720	1,728	1,708	1,828	1,928

Source: *Key Indicators of Developing Member Countries of ADB, 1971.*

19. At the end of 1960s almost 75% of the total state investment went to large-scale industries, reflecting the growth of state-owned industries from 23% in 1961 to 42% in 1971. The Government controlled most of the mining, butcher and mill industry, printing houses, and production of cement and power, which provided revenues. The export of natural gas started in 1967. In the third Five-Year Plan the Government tried to shift the focus from infrastructure projects to smaller more productive investments. Since the external funding agencies required that the former projects should be shown to be successful, the new emphasis turned out to be hard to implement. Half of the budget for agriculture development went to projects that had already started, leaving little left for favorable credits to the farmers. In spite of the three Five-Year Plans' extensive investment in agriculture, there was no marked increase in grain production, and the low productivity of agriculture continued.²² On average 30% of exports in the 1960s were derived from fruits and nuts, 23% from karakul skins, and 9% from cotton. While total exports in 1960 were \$50 million, the value had increased steadily and in 1969 it was \$81 million. Trade balance was mostly positive, as the imports did not increase as much as the exports.²³

20. During 1962-1969 indirect taxation accounted for on average 50% of all domestic revenues, which inter alia included import duties providing about 30%, and commercial transactions. Only about 12% of the public revenues were obtained from direct taxes, including

¹⁹ *Key Indicators of Developing Member Countries of ADB, 1971.*

²⁰ Up to 1965 no census of population or agriculture data existed, and figures had at best to be based on sample surveys. However, the information on public expenditure, banking, foreign trade, and industrial production were more accurate.

²¹ In the Afghan Constitution of 1964 a declaration is made that every Afghan citizen is by law liable to pay tax. The Constitution states in Article 38: "Every Afghan is bound to pay tax and duty to the State. No duty or tax of any kind shall be levied without the provisions of the law. The rate of tax and duty as well as the method of payment shall be determined by law with considerations for social justice. The provisions of this Article are applicable to foreign persons as well." Griffiths (1967) also provides an example of one of many ethnic groups in Afghanistan who during this period lived remote enough to be inaccessible to tax collection. The Hazaras, a minority group, were reported in the 1960s to be isolated from all forms of central government in the mountainous areas where they occupied.

²² Swedish Committee for Afghanistan, 1995.

²³ *Key Indicators of Developing Member Countries of ADB, 1971.*

land and personal property taxes, and individual and corporate income taxes. The state revenues also depended on average 10% on commodity assistance, and up to the end of the 1960s to about 8% on sales of natural resources. Domestic revenues in 1962 amounted to Af2.2 billion and in 1969 to Af5.5 billion. A 47% increase of revenues in 1963 was mostly due to increased taxes on commercial transactions, and the revenue increase of 74% in 1965 reflected augmented commodity assistance and income from export duties and monopolies owned by the Government. In 1968 incomes from government enterprises grew 64%, and in 1969 revenues from import duties raised 20%, while commodity assistance more than halved.²⁴

B. The 1970s

21. The Fourth Plan was published in 1973, and as with previous plans, this proposed program of development depended on assistance from Soviet Union. A coup in July the same year disrupted the planning procedures, and the actual planning changed to annual basis. In 1976 President Daud inaugurated a Seven-Year Economic and Social Development Plan. It was ambitious and intended to make major advances towards solving the problems of poverty and underdevelopment. Through the new Constitution in 1977 the State increased its control over many industries, enacting that large industries, power plants and mines became state properties. On top of that, all banks were nationalized during 1975-1977. Following the Saur Revolution in April 1978 in which Daud was overthrown, the new ruler Nur Muhammed Taraki invited advisers from Moscow, since he wanted to remodel the economy. A renewed 5-year plan started in 1979. Socialist countries were expected to contribute 66% of the foreign aid in the 1979-1984 Plan.

22. Until the late 1970s, a modest degree of economic development was experienced in Afghanistan. Government services had nevertheless limited reach in rural areas, and hence, modernization was largely concentrated to major cities.²⁵ Compared with 1960s the level of development expenditure was relatively high; however, when compared with GDP 1977 (Af133.8 billion), 1978 (Af143.5 billion), and 1979 (Af141.6 billion),²⁶ capital expenditures for the same years amounted to on average 6%, current expenditures to 10%, and current revenue to 11%. Revenue share thus increased 4% during the 1970s, and if equalizing current expenditures with development expenditures, the amount tripled (Table 3).

²⁴ Afghan Central Statistical Office.

²⁵ Swedish Committee for Afghanistan, 1995.

²⁶ Afghan Central Statistical Office, 1358.

Table 3: Government Finance for 1970s
(Af million)

Item	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Current Revenue	5,084	5,713	5,821	6,110	7,017	10,250	12,025	13,950	14,924	16,455
Taxes	2,960	3,285	3,459	3,556	4,436	7,166	6,821	7,872	9,104	9,448
Taxes (\$M)	66	73	77	79	98	159	152	175	202	210
Non-Taxes	2,124	2,428	2,362	2,554	2,581	3,084	5,204	6,078	5,820	7,007
Current Expenditures	4,732	5,156	4,887	5,283	5,799	6,244	9,680	11,168	11,938	n.a.
Current Surplus/Deficit	352	557	934	827	1,218	4,006	2,345	2,782	2,986	n.a.
Capital Expenditures	3,945	2,981	3,279	4,326	3,672	4,648	6,498	8,427	12,389	n.a.
Overall Surplus/Deficit	(3,593)	(2,424)	(2,345)	(3,499)	(2,454)	(642)	(4,161)	(5,645)	(9,403)	n.a.
Financing										
Domestic Borrowings, Net	1,089	546	1,448	39	1,046	(598)	(130)	(113)	1,069	n.a.
Foreign Borrowings and Grants	2,505	1,878	1,562	2,634	1,377	1,645	4,291	5,758	8,334	n.a.
Use of Cash Balance	n.a.	n.a.	(665)	826	31	(405)	n.a.	n.a.	n.a.	n.a.

Source: *Key Indicators of Developing Asian and Pacific Countries, 1980*.

23. The average GDP growth rate for 1975–1979 was 2.3%,²⁷ and between 1970 and 1978 the export value increased from \$81 million to \$314 million, respectively. During the same period, imports increased from \$72 million to \$328 million, resulting in a positive trade balance for five out of nine years; however, the trade balance ranged from -\$45 million to \$43 million.²⁸

²⁹ In 1979, natural gas constituted 21% and dried fruits 36% of the \$494 million in export income.³⁰ Corruption, deficient administrative capacity, with occasional armed threats to the tax collectors by the local inhabitants, implied difficulties for levying taxes. Due to the war, in some parts of the country where the Government had lost control, no tax collection at all occurred, and neither any development projects.

24. As before, revenues from customs and duties, with their simple administration, had an essential share of the state income. The imposition of taxes on agriculture was negligible, despite the fact that agriculture still contributed for 50% of the national income.³¹ The tax on livestock and agriculture also needed to be revised to follow up the inflation.

25. The Government's domestic resource mobilization was mainly reduced to income from export customs, sales of natural resources, commodity assistance, and indirect taxes on commercial transactions. The contribution in 1970-1972 of indirect taxes and direct taxes to the state revenues was on average 44% and 7%, respectively, with the low level of revenue from direct taxation implying a weakness of the economy.³² Estimates from Table 3 conclude that in 1970-1979 taxes contributed 60% and non-taxes (i.e., revenues from state-owned enterprises) 40% to the total revenue, and in 1970-1978 foreign borrowings and grants were on average

²⁷ *Key Indicators of Developing Asian and Pacific Countries, 1990*.

²⁸ *Key Indicators of Developing Member Countries of ADB, 1980*.

²⁹ These figures are different from those representing the same item and year in Balance of Payments from 1960s, 1970s and 1980s (Appendix 2), despite the fact that the source is the same. The discrepancy might reflect different results when counting according to year or fiscal year.

³⁰ Afghan Central Statistical Office, 1360.

³¹ *Key Indicators of Developing Member Countries of ADB, 1980*.

³² Afghan Central Statistical Office.

36% of current revenues. Furthermore, for several years an almost exclusive dependence on foreign borrowing prevailed for capital expenditure.

26. The official statistics on trade do not include the widespread smuggling that for a long time has occurred along the border to Iran and Pakistan. Calculating the extent of the smuggling is difficult, nevertheless, the illegal import and export were estimated to amount to 20-30% of the total Afghan foreign trade before the coup in 1978. Considering and comparing with the amount of the increasing poppy production during and after the conflicts and war since 1978, the scale of poppy cultivation before 1978's annual production of about 250 tons, was relatively small.³³

C. The 1980s

27. The fiscal and economic development following the April 1978 coup, when the communist regime of the People's Democratic Party overthrew Daoud's nationalist regime, was marked by the war and by higher dependence on Soviet Union.³⁴ In 1987 the financial contribution from the Soviet Union was estimated by the Government to constitute 40% of the country's civilian budget. Since foreign aid from the West began to disappear, and other countries other than Soviet Union were either unwilling or unable to export their products to Afghanistan, the dependency on Soviet Union increased.³⁵ In the late 1970s official development assistance per year was about \$100 million, and in 1982 it had declined to \$9.3 million, staying rather low until 1987.³⁶ In an Afghan government report prepared in 1983 in connection with Substantial New Program of Action, the needed external project assistance estimated for 1980s amounted to \$3.3 billion. Because of the suspension of external assistance by multilateral institutions and the Organization for Economic Co-operation and Development (OECD) countries, most of those projects could not be carried out.³⁷

28. Annual plans were being applied in the beginning, but in 1985 the Government transformed the plans to five-year plans. One of the goals was to increase the public sector share of GDP. In January 1986 the Government announced a Five-Year Economic and Social Development Plan (March 1986-March 1991), involving a proposed expenditure of Af115 billion (\$2.3 billion). The Government declared that a large amount of external assistance was necessary for the planned high spending. The main emphasis of the Plan was on increasing investment in industry³⁸ and on improving the infrastructure. As before the Afghan Government suffered from its lack of qualified people to implement the Plan.³⁹ The ambitious targets of the Plan, including a 25% growth in the economy over the Plan period, were unlikely to be attained.

29. According to government estimates, the economy expanded by less than 2% annually between 1980 and 1986, and in 1990 GNP per capita was only \$130, compared with \$155-160 in 1986/87. However, due to a wide margin of error that may be expected in the estimates for

³³ Swedish Committee for Afghanistan, 1995.

³⁴ Soviet Union and Afghanistan concluded in 1981 a mutual trade agreement for the period 1981-1985. In return for industrial equipment and machinery from Soviet Union, Afghanistan agreed to supply its partner with natural gas, food products, and raw material. For the same period trade augmented sharply between the two countries. In 1985 the share of Afghan export to Soviet Union was 56%, and the import share from Soviet Union constituted 58% (35% and 28% respectively before the war started). A further 5-year agreement was signed in 1986, under which bilateral trade was to expand by 30%.

³⁵ Europa Publications, 1989.

³⁶ *Key Indicators of Developing Asian and Pacific Countries, 1990.*

³⁷ Government of the Republic of Afghanistan, 1990.

³⁸ The industry employed 12% of the working population in 1979.

³⁹ Swedish Committee for Afghanistan, 1995.

the centrally planned economy of the 1980s, and the high ratio of subsistence production to Afghanistan's total GNP, the data on GNP and GNP per head may be used only as a general guide.⁴⁰ Mostly as a result of increased defense expenditures, the doubling of expenditures in 1980-1984 caused large deficits. Despite the Government's policy of national reconciliation that was introduced in 1986, and the withdrawal of Soviet troops that was completed in early 1989, the economy as a whole showed no real signs of improvement.⁴¹ Both imports and exports decreased sharply between 1984 and 1989, from \$1,205 million to \$623 million for imports, and from \$788 million to \$252 million for exports. The average trade deficit for these years was \$388 million, with the highest deficit in 1986 of \$604 million.⁴²

30. In 1988/89, foreign assistance to Afghanistan totaled \$223.3 million, which was an increase of 14.5% compared with 1987/88.⁴³ The contribution of the foreign aid from Soviet Union and other member countries of the Council for Mutual Economic Assistance (CMEA) was 97% in 1988/89, of which Soviet Union's share was 81%.^{44, 45} The UN launched an appeal in June 1988 to raise \$1.16 billion for the implementation of a large-scale 18-month program for rehabilitation and reconstruction in Afghanistan. In October the same year Soviet Union pledged to contribute \$0.6 billion in humanitarian aid.⁴⁶

31. During the 1980s the violence and insecurity in the country caused economic downturns, leading to a decline in tax revenues.⁴⁷ Particularly since the armed conflicts were prolonged, the tax administration became weaker and part of the tax base got destroyed (for example because of destruction of business firms and fall in agriculture production). In addition, many public enterprises and industries had severe problems with their performance, and incurred losses that drained the budget. Even though the Government had difficulty in raising revenues from tax and non-tax sources, the domestic revenues rose by 49% in 1980/81 to an estimated Af26.3 billion (Table 4). Indirect taxes constituted about 50% of the revenues, and direct taxes accounted for 10%, which was almost the exact same proportion as that during the 1960s. Revenues from natural gas were the next largest contributor, in 1979 totaling 21% and in 1980 providing 34%.

⁴⁰ The government figures of Afghanistan's GNP in 1986/87 amounted to \$3.16 billion, which was an increase of 5.2% compared with 1985/86. The estimated GNP for 1988 increased by 22.3% to \$3.86 billion, giving a GNP per capita of about \$207. In 1987 the population was estimated at 18.6 million, reflecting an average population increase of 2.6% per year between 1980 and 1988. Between 1980 and 1985 the life expectancy at birth was 37 years.

⁴¹ Europa Publications, 1989, 1990, and 1992.

⁴² Europa Publications, 1989, *The Far East and Australasia*, 2002.

⁴³ In 1987 Afghanistan's total external debt was \$1,499 million.

⁴⁴ The assistance to Afghanistan from the CMEA countries in the 1980s was on highly concessional terms, particularly the project assistance. Virtually all non-project assistance from the CMEA countries was provided in the form of grants.

⁴⁵ Government of the Republic of Afghanistan, 1990.

⁴⁶ Europa Publications, 1989 and 1990.

⁴⁷ A trend of household savings could not be presented since no data on household and private corporate savings were available.

Table 4: Government Finance
(Af million, at constant 1978/79 prices)

Item	1980	1981	1982	1983	1984
Current revenue	26,295	29,978	33,624	34,744	37,615
Taxes	9,926	9,041	10,808	13,952	17,081
Taxes (\$ million)	220	201	240	310	380
Non-taxes	16,369	20,937	22,821	20,792	20,534
Current Expenditures	19,575	26,831	30,064	37,760	43,177
Current Surplus/Deficit	6,720	3,147	3,565	(3,016)	(5,562)
Capital Expenditures	4,978	5,579	5,262	5,433	8,000
Capital Account					
Surplus/Deficit	(4,978)	(5,579)	(5,262)	(5,433)	(8,000)
Overall Surplus/Deficit	1,742	(2,432)	(1,697)	(8,449)	(13,562)

Source: *Key Indicators of Developing Asian and Pacific Countries*, 1990.

32. In 1984 revenues increased by 8.3% compared with the previous year to Af37.6 billion, of which 45% constituted of taxes and 55% was provided from non-taxes. Together with an increased expenditure for administration, defense, police and wages, the Government raised subsidies to keep down prices.⁴⁸ Expenditures increased by 18.5% to Af51.2 billion (current 84%, capital 16%), causing a budgetary deficit of Af13.6 billion. The deficit was financed through foreign aid and by borrowing from the Afghan Central Bank that printed money, causing inflation.^{49, 50}

D. The 1990s (Until the Taliban Takeover)

33. The Afghan Government estimate in 1990 of the total development budget during the 1990s was about Af385 billion. About 26% of the financing to the development program, or Af100 billion, was planned be provided from domestic sources. The balance of 74%, or Af285 billion (\$5.7 billion), was expected be provided from external sources through project and non-project assistance.⁵¹ When deciding the amount of proposed external assistance, consideration had been taken to the growing deficit in merchandise trade and the gap in budgetary resources. A plan was made on how to make the enterprises increasingly finance their investments from their own resources. The plan would therefore help the budgetary resources to be increasingly devoted to financing new government projects. It was also planned to focus more on profitability as a performance criterion, adopt rational pricing policies for the goods and services produced by public enterprises, improve the accounting practices, and repair and rehabilitate damaged and idle industrial plants.⁵²

⁴⁸ Europa Publications, 2002.

⁴⁹ The main method used by the Afghan Government to gain loyalty was to raise the wages of the soldiers and the civil servants, and to give big amounts of money to tribe leaders and military commandants. Consequently, the money in circulation increased and was calculated to be Af2,227 billion in 1990, compared to Af178 billion in 1978. (During 1981-1985 the estimated annual rate of inflation remained at about 20%.) Besides, the effects of the war, particularly higher risk of transportation and degradation of the communication system, led to raising the price level (Swedish Committee for Afghanistan, 1995).

⁵⁰ Government of the Republic of Afghanistan, 1990.

⁵¹ The planned required annual level of external assistance would increase from \$480 million in 1990/91 to \$750 million in 1999/2000. The emphasis for the first 5 years in the 1990s was planned to be rehabilitation and reconstruction of the economy. The share of non-project assistance would decline from 62.5% in 1990/91 to 20% in 1999/2000.

⁵² Government of the Republic of Afghanistan, 1990.

34. After the Soviet troops had departed, and before the takeover by the Taliban, several problems existed with the fiscal management, especially on the revenue side. First, the tax and customs administration kept having significant difficulties in effectively administering the tax laws. Some of the explanations of the mismanagement were appropriation of revenue sources by warlords, vandalism of assets, high staff turnover, and absence of projects to increase the efficiency. Second, the tax administration was hampered and the tax base was reduced by the armed conflicts. The war made it impossible for the Government to control or continue the production of natural gas, which consequently eliminated the duty of exports of gas to the former Soviet Union countries. The duty on natural gas had before generated 26-33% of the total revenue. The duty on exports of other natural resources like salt, limestone, marble and emerald was in a similar way affected. Third, even before the deconstruction of state-owned enterprises (SOEs) during the civil war, a large number of the SOEs had become inefficient. Instead of making a positive contribution to the budget the SOEs required subsidies. These difficulties led to an overall revenue decline.⁵³ Expenditures kept on being financed through printing money, and in 1995 the value of the afghani had decreased to Af4,000 for one dollar compare to Af100 per dollar in 1977.⁵⁴

35. Compounded by the low annual per capita income of about \$130 in 1990, rising inflation and the expansive agrarian economy⁵⁵ meant domestic households had a small saving capacity. The capital market was unorganized, due to the small size of private sector enterprises and the narrow ownership. Regarding the saving institutions in 1990, in addition to the Da Afghanistan Bank, which acted both as central bank and commercial bank, three investment banks provided financial assistance for industry, agriculture, and construction.⁵⁶ The limited potential of domestic savings was tapped through the interest rate policy, which in 1990 had an interest on deposits of 1 year or more of 11%.

36. In 1990 the debt-service ratio was 15%. During the same year, the limited debt service capacity of the country caused funding agencies to provide project assistance through a combination of grants and highly concessional loans, while all commodity assistance would be extended through grants.⁵⁷ The official development assistance amounted in 1991 to \$512 million, resulting in per capita assistance of \$31 million. After the collapse of the Soviet Union in December the same year, the assistance decreased, especially from the Soviet Union and the US. The new Mujahidin government that came into power in April 1992 pleaded for economic support for budget reconstruction but did not gain much hearing. Funding agencies were reluctant to respond to the plea due to the ongoing civil war. In 1995 UN issued an appeal to nations and aid organizations to contribute humanitarian assistance. During the following year, 52% of the targeted \$124 million was given to Afghanistan.⁵⁸

37. The diminishing flow of assistance created new coping strategies for rural Afghans during the beginning of 1990s, including increasing the poppy cultivation. In 1994 Afghanistan had become the largest opium producer, according to a report of the UN International Drug Control Program (UNDCP), and in 1995 the yearly production amounted to 2,000-3,000 tons.⁵⁹

⁵³ IMF, February 2002.

⁵⁴ Swedish Committee for Afghanistan, 1995.

⁵⁵ During 1991-1993 on average 60% of GDP constituted of agriculture, hunting, forestry and fishing (*The Far East and Australasia 2002*).

⁵⁶ To encourage increased saving, establishment of more bank branches in subdistricts and rural areas was proposed by the Government in 1990.

⁵⁷ Government of the Republic of Afghanistan, 1990.

⁵⁸ Gardell, 2001.

⁵⁹ Despite the promulgation of ban on poppy production and use of drugs in 1992, the activity remained unabated and unrestricted.

Following the breakdown of the Soviet Union and the opening of the borders to Central Asia, the smuggling through Afghanistan rose sharply. Since Afghanistan lacked a central-power that controlled its borders, assessing the amount of the total smuggling was impossible. However, the most important item that was smuggled out of Afghanistan was without doubt opium. Other major trade goods that were smuggled were wood products, emeralds, and the blue half gem lapis lazuli.⁶⁰ When rulers in Kabul lacked power to control resources, warlords put up roadblocks and required duties.^{61, 62}

E. During the Taliban Regime

38. After economic stabilization for a few years in the mid-1990s, the misrule and increased isolation of the Taliban regime, together with 4 years of drought and disruptions from the land mines, caused an economic recession. Agricultural, horticultural, and livestock production diminished and cereal production declined by as much as 50% between 1998 and 2001, both the official and unofficial trade slowed, the macro economy came into imbalance, and the infrastructure deteriorated. Compared to the figures for 1990-1995, exports decreased and imports increased. According to figures from Economic and Social Commission for Asia and the Pacific (ESCAP) the average value of exports in 1996-1998 was \$138 million, while imports amounted to \$563 million for the same period.

39. Compared to the preceding years during the civil war, a formal taxation system was introduced. The Taliban authority started to require 10% of the farmer's income and charge each family, calling the duties an Islamic tax (*zakat*).⁶³ Because of the low level of remuneration of the civil servants, they were exempted from paying the income tax. However, indications from the *mustofiats* or provincial offices point at this ruling applying to all employees in the public and private sectors.⁶⁴ In addition, taxes were levied on imported goods, agricultural production, and landholdings.⁶⁵ The "effective" tax rates on goods were generally less than 6%. IMF (September 2002) found that during the Taliban regime personal income tax seemed to have been increased to 60% of the income level, and that a fixed tax on imports and exports of 4% and 2% existed.

40. The extent of revenue operations during the rule of the Taliban regime is unclear. Large difficulties kept hampering the implementation of revenue collection. The authorities were unable to control fiscal operations in all provinces, and individual commanders and province governors extracted tax to feed their own followers and soldiers. Furthermore, with the collapse of the provincial reporting network in 1995/96, the collection of primary data necessary for statistical compilation virtually ceased.⁶⁶ However, state revenues continued to decline in the mid-1990s, and between 1995/96 and 1996/97 the percentage of revenues of total expenditures declined from 5.2% to 2.6%.⁶⁷ The largest official source of income of the Taliban came from the transit trade through Afghanistan, even during the virtual breakdown of procedures of Afghan-

⁶⁰ Swedish Committee for Afghanistan, 1995.

⁶¹ During the summer 1994 traveling on the 100 km long road from Spin Boldak at the Pakistani border to Kandahar required passing through 42 checkpoints. The retreat of the superpowers eased the assistance to Afghan warlords from regional states, oil interests, and illegal networks.

⁶² Gardell, 2001.

⁶³ According to tradition, Muslims should give 2.5% of their disposable income in *zakat* to the poor. There are indications that the imposition of the *zakat* created hostility at the local level, and in response to the drought, the Taliban eased the tax burden in 2000.

⁶⁴ IMF, February 2002.

⁶⁵ Europa Publications, 2002.

⁶⁶ IMF, September 2002.

⁶⁷ IMF, February 2002.

Pakistan Transit Trade Agreement (ATTA).⁶⁸ The trade during 1997 was estimated to be \$2.5 billion, of which the larger part was unofficial exports to Pakistan. The imports of the country was estimated to amount to \$1.2 billion, and with the assumption of an average tax rate of 3%, the Government probably collected an annual tax revenue of about \$36 million (Appendix 3).⁶⁹

41. The unofficial economy expanded during the Taliban regime, smuggling and drugs constituting key components. The drug trade constituted the main source of unofficial revenue, and taxes from the export of opium constituted the pillar of the Taliban war economy. The annual revenues from the opium tax amounted to at least \$20 million. To increase the revenues of the State the Taliban formalized the drug trade. The Muslim wealth tax zakat was also imposed on all the opium dealers. The Taliban is reported to have levied a 20% zakat from drug dealers on the export of opium.⁷⁰ The ATTA is assumed to have induced the smuggling trade. Besides decreasing the revenues of the Taliban administration, the extensive illegal trade on goods, food, and fuel hurt the domestic industries' production.⁷¹ Available sketchy information indicates that the Taliban regime was incapable of even rudimentary management of the economy, let alone fiscal management.

42. When facts and figures on government expenditures are lacking, like in the case for the Taliban regime, a possible indicator of recent expenditure is the per capita income. Effectively, the income of the citizens is partly a result of the government expenditures. The limited extent of this paper and relevant data gathered do not permit such analysis in this paper. Nevertheless, the GNP estimate in 1997/98 was approximately \$6.7 billion, which means a per capita GNP of \$280, which is estimated to have declined to \$202 currently (ADB 2002).

IV. PRESENT AND FUTURE FISCAL DEVELOPMENT

A. Recent Budgets and Fiscal Development

43. As detailed in para. 4, on 6 April 2002, the Afghan Interim Administration (AIA), adopted an ordinary budget for FY2003 of \$460.3 million. The Government projected \$83 million or 18% of total recurrent expenditures⁷² in the ordinary budget will be covered by domestic revenue, while the remaining 82% would be financed by external assistance. In addition, a development budget, essentially a list of aid-funded investment projects, covering 2 fiscal years (FY1381 and FY1382 (22 March 2002 - 21 March 2004)), totaling \$3.18 billion was presented at a meeting of the Implementation Group in Kabul in October 2002. According to a report prepared by MOF in October,⁷³ domestic revenues in the first quarter amounted to \$22.7 million (mainly from customs duties) against planned revenues of \$16 million;⁷⁴ however, transmittal of revenues by provincial offices to the central Government have fallen short of expectations.⁷⁵ One reason is that reporting by Central Bank branches in provincial areas to headquarters is lacking, another

⁶⁸ ATTA permits Afghanistan to transport duty-free goods across Pakistan from Karachi for use in Afghanistan. See Appendix 3, *Transit Trade*.

⁶⁹ World Bank, 2001.

⁷⁰ Europa Publications, 2000 and Rashid, 2000.

⁷¹ World Bank, 2001.

⁷² Wage payments, including for the military, constitutes the bulk of the Government's operating expenditures. Ceilings on the number of civil service employees have been imposed under the budget. The budget also includes budget allocations for wage and pension reform, which however will only become available once a civil service reform program has been developed (IMF, September 2002).

⁷³ MOF, Islamic Transitional Government of Afghanistan, 2002. "Report on Donor Assistance for the Afghanistan Ordinary Budget," a report submitted to the Implementation Group Meeting, 12-13 October 2002, Kabul.

⁷⁴ ADB, 2002.

⁷⁵ Only \$500,000 in domestic revenues had been recorded at the Treasury Single Account at DAB in Kabul according to IMF (September 2002).

is that provincial branches may not have been the depository of some of the provinces' collected revenues. A third explanation for the discrepancy is the fact that the government accounts at DAB branches are required to be fully consolidated with the Treasury Single Account at DAB headquarters only at the end of the fiscal year.⁷⁶

44. Foreign assistance for recurrent expenditures fell short of the targeted amount in the beginning of FY 2002/03.⁷⁷ Only \$27 million in foreign grants, compared to \$60 million budgeted, were received to finance first quarter expenditures. The authorities have expressed a strong preference for grants over concessional loan assistance, and are sensitive to the need to avoid debt financing of current expenditures. As of September 2002, a total of \$234.2 million in grants from multilateral (e.g., AIA and Land and Order Trust Funds of UNDP and the Afghanistan Reconstruction Trust Fund [ARTF] comanaged by ADB) and MOF reported that bilateral sources⁷⁸ were forthcoming, against the required \$377.3 million; the revised budget for FY2003 faced a need therefore to close a net financing gap of \$143.1 million.⁷⁹

45. Compared with \$79 million of expenditures budgeted for the general government's first quarter of the fiscal year, recorded expenditures (including transfers to the provinces *inter alia* for wage payments) of the central Government amounted to \$22 million. The low level of budget spending reflects shortage of banknotes and limited administrative capacity. Furthermore, due to difficulties in reaching the provinces, and lack of adequate balances and checks to audit the payments, wage payments had a slow start. On the other hand, in the first quarter of 2002/03 budget year, the central Government paid an additional \$22.5 million in mostly wage payments that were related to the execution of the 2001/02 budget.^{80, 81}

46. With Afghanistan's low per capita income and subsistence economy, and commercial banks that have virtually ceased financial intermediation, the saving capacity of Afghan households is very small. Households and private businesses have saved in fixed asset acquisition, precious metals, and currency.^{82, 83} A consequence of the insignificant private savings and acquisition of assets is a reduction of the Government's resource collection. The present very weak fiscal situation has given the interrelationships between tax and expenditure policy huge economic, social, and political importance. Partly a result of the difficulty in mobilizing general budget support from the international aid community, the reconstruction and rehabilitation of the country is hampered.

⁷⁶ IMF, September 2002.

⁷⁷ The amount of donor assistance was limited in part by the Government's strong preference for grant assistance and reluctance to borrow from international financial institutions. In addition to the Government's budgeted \$460 million for expenditures, \$23 million was planned for wage arrears clearance. No comprehensive data are available on Afghanistan's public external and internal debt. Taking into account that virtually no debt service payments were made since the early 1990s, the stock of outstanding external debt is estimated at \$2 billion. While \$53 million is owed to internal financial institutions, about three quarters of the external debt is owed to the former Soviet Union. (IMF, September 2002).

⁷⁸ Of this amount, \$54 million is categorized as "Expected, Unannounced".

⁷⁹ ADB 2002.

⁸⁰ By mid-2002 the estimated civil service staff, excluding military and security personnel, amounted to about 210,000. Government employees' food allowances were raised by 37% in May 2002, reflecting the increased pressure to augment wages from their very low levels.

⁸¹ IMF, September 2002.

⁸² Currency has been saved mainly in Afghani, US dollars, Pakistani rupees, and Iranian rials.

⁸³ Various studies recently undertaken by international organizations indicate high levels of destitution, with a large proportion of the population having steadily over the years sold off their assets in their effort to survive.

B. Main Features of the Existing Public Administration and Tax Laws

47. The legal framework for budget preparation and execution, with extensive regulations and procedures of the public administration, is basically sound. Nevertheless, most of the practices have not been applied for many years, reflecting that the reporting by provinces had completely broken down. Due to the absence of communication facilities, and that only a few of mid-level and lower-level government employees remained in post, the limited number of basic administrative functions that have continued to be carried out were cumbersome and slow. The budget management framework is comprehensively documented in the Budget Law, Accounting Regulations, Treasury Manual, and the Chart of General Ledger Accounts. These documents together set out the policies and procedures for expenditure processing and revenue recording. Albeit in a fragmentary form, much of the information that is necessary for Government Financial Statistics (GFS) compilation exists. However, due to the breakdown of the manual financial reporting framework, no final GFS have been compiled since 1990.

48. The efficiency of a tax system, and concomitant administrative organization, are based and dependent on the tax legislation with its underlying laws and codes (Appendix 4). The present Afghan tax system is mainly based on the Income Tax Law of 1965 and the Customs Law of 1974.⁸⁴ The Income Tax Act and the Custom Law are considered to be generally operational, despite being altered by several administrative directives and decrees. The public administration is currently collecting revenue based on these laws, which includes individual and corporate income taxes, gross receipts, fixed presumptive taxes, and customs duties. The tax and customs organizational structure, with predominantly manual procedures, is considered to remain intact, however on paper.⁸⁵ According to the tax law, direct taxes are imposed on income and property, while indirect taxes are primarily levied on imports and exports. However, determining the precise nature of the tax laws is rendered more difficult because some provinces seem to have interpreted and enforced the tax laws differently.⁸⁶

49. The structure of Afghanistan's state budget by MOF is based on a comprehensive concept of general government (Appendix 5). The provinces function as deconcentrated entities of the unitary and centralized State, and except for a small number of municipalities, there are no local governments. Since there are no provincial budgets, the Ministries have appropriations allotted to the provincial offices of each Ministry. All activities, including those financed by foreign loans and grants, are included in the state budget and financed through the Treasury Single Account. There are 29 provincial offices, or mustofiats, that coordinate fiscal operations. Reports have to be submitted from the mustofiats to the headquarters, or the General Revenue Administration. The tax offices at the local and provincial levels also collect some non-tax revenue. Most fees and charges are collected by the ministries, departments, and agencies, and periodic reports are required to be submitted to the provincial revenue administrations.

⁸⁴ The Income Tax Law specifies provisions for individual and corporate income taxation, withholding taxes on imports and exports, various fixed (presumptive) taxes, and business receipts tax. With 18 separate decrees since 1965 amending the law, and not all amendments having been included in a comprehensive consolidated version, it is difficult to know all the details of the law and its application. Further, MOF tax administrators have different views about the applicable tax provisions. In addition, due to weak administrative capacities, income tax data is currently not classified according to the revenue classification of the Government. The customs law includes import duties, and fees and charges levied on international trade and transactions. In contrast to the income tax law, the current customs law is a consolidation of all changes to the law. Nevertheless, its application in practice varies significantly in different parts of the customs administration. Although there is no excise tax, certain excisable goods are subject to higher customs duties. It seems a "monopoly tax" on petroleum is being used equalling 20% of the import value (or 30% of the imports if the Government takes the tax).

⁸⁵ IMF, February 2002.

⁸⁶ IMF, September 2002.

50. In March 2003, MOF is expected to announce a unified and comprehensive government budget. Notwithstanding, the formulation and implementation of a responsible fiscal policy by MOF requires that it quickly develop its capacity. The Government has started to improve its administration capacity, however, its work has been constrained by lack of funds. Payment of salaries, procurement of goods and services, and training of computers and English have only been done in a very limited scope (see section below).

C. Components and Sequencing of Present Fiscal Reform Agenda

51. The Government has shown commitment, partly in the National Development Framework (NDF) from April 2002, to its strategy for recovery and reconstruction to institutional reforms. Improvement of financial management capacity—which will enhance the transitional authority’s administration of aid funds—and improvement of capacity of tax administration, are crucial aspects in meeting the country’s needs. The unified and comprehensive government budget in March 2003 demands that the transitional authority conceive the mobilization of domestic and external resources, laying out the new sources of revenue and streamlining old sources of tax and non-tax revenues. MOF has as well to put into place a smooth payment system and develop effective control measures for expenditure, accounting and auditing. Commitment recording or preaudit mechanism and internal controls on payments are still too weak.⁸⁷ In addition to the outline by MOF of an ambitious reform agenda, a Fiscal Policy Analysis Unit (FPAU) is being developed.⁸⁸ The fiscal reforms include improvement of budget preparation, administration, revenue policy, as well as expenditure management. Establishment of financial management capacity and the revenue mobilization are priority areas of technical assistance.⁸⁹

52. Short-term priorities include review of key procedures (e.g., the government accounting manual) and review of key legal instruments (e.g., the tax and customs law, procurement law, banking law, budget law, and audit law). Since at present key ministries and departments have no recurrent budgets to make key purchases and are barely operational, it is urgent to provide them with equipment and furniture. In addition, support for salaries and other recurrent items are also essential. Other short-term recommendations include computerization in both the revenue and expenditure areas within MOF. Computerization will greatly aid the ability to control cash flows and reconcile accounts. Besides, it will also provide reliable information and reports to the Government as well as to the aid community.⁹⁰

53. Hence, the augmented administrative capacity will promote transparency and accountability in the use of aid funds, an urgent requirement of various funding agencies. Significantly, the World Bank provided grant support for an Emergency Public Administration Project, that enabled the Government to hire qualified firms to carry out, on an interim basis, financial management, government procurement, and audit functions. Apart from developing the administrative capacity and assessing existing procedures, the selected firms are providing key support for fiscal improvement.⁹¹

⁸⁷ IMF, September 2002.

⁸⁸ The FPAU will analyze revenue (tax and non-tax) options, coordinate macroeconomic planning with the Central Bank and other government agencies, simulate policy changes, make recommendations on fiscal and tax policy, and provide input into the budgetary process. The institution could also aim to assume responsibility for policy coordination with international financial institutions, in particular IMF, World Bank, and ADB.

⁸⁹ IMF, September 2002.

⁹⁰ IMF, February 2002.

⁹¹ IMF, September 2002.

54. Moreover, MOF needs support in aid coordination, reflecting the importance that donors should not waste funds by overlapping their assistance program.⁹² The outreach to the provinces has to be strengthened, as the reform should address both central and provincial fiscal capacities. This requires addressing how provincial governors, with their existing structures and links to ministries, can be supported. Help is therefore needed to restore regular reporting by provinces on revenues and expenditure, requiring statistical capacity building.⁹³ Especially before more funding and resources become available, prioritizing of support to different provinces and areas of MOF has to be done.

55. Bolstering of the revenue base will, according to the NDF from April 2002, be done by the Afghan Government through collection of revenues at the central level. The revenues will be received from gradual cost-sharing in the government provision of services, mining, and over-flight rights and customs. In some cases Afghan communities pool resources and implement their own priorities of expenditure.⁹⁴ The improvement of the public administration is also crucial in achieving an efficient tax administration system.⁹⁵ MOF is expected to receive substantive external assistance in developing the tax administration capacity. The planned assistance include: taxpayer identification and registration, taxpayer services, tax auditing, enforcement of collection and other debt management (schedule payments), accounting, development of databases and management information system, specification on the structure of the tax administration organization, determination of human resource and training needs, and improvement of the tax law (Appendix 6).

56. Afghanistan's tax revenue will in the short to medium term be mostly derived from customs duties; therefore, designing and implementing a reformed customs administration is of utmost urgency. In addition to monitoring of goods in transit and clearance procedures and merchandise dispatch, the development of capacity focuses on modernizing the clerical systems. However, first the fiscal program should renovate the existing clerical systems, i.e., documentation and compiling of all tax and customs laws, decrees, and administrative directives, including those that came into force during the period of instability. This is necessary to institute the fiscal reforms on existing institutional arrangements (Appendix 4).

57. Part of the proposals for revenue-enhancing measures, through short- and medium-term technical assistance, has been to, instead of using an overly appreciated rate, use market exchange rate. This recommendation would lead to improved customs valuation, reduced tariff bands, and effective tariff rates partly offset by reduced customs tariffs. In addition, duty rates on excisable goods—generally cars, cigarettes, gasoline, and diesel—would increase. Suggestions to improve the efficiency of income taxation included restoring wage withholding on

⁹² Afghanistan Assistance Coordination Agency (AACA), 2002.

⁹³ See Appendix 1, *Rebuilding Capacity for Compiling Macroeconomic Statistics*.

⁹⁴ The Government is drafting a national community empowerment program, called National Solidarity. The program will deliver grants to communities to enable them to make decisions on their key priorities in a participatory manner. The aim of this approach is to supplement the resources provided by the Government, through strengthening of collective efforts in mobilizing their own resources. The implementation of the national community empowerment program would consequently bring about supplementary resources to the transitional authority in Kabul. At the same time, it will also give an opportunity for community members to choose their local leaders. One to two districts per province will be covered under this program (AACA 2002).

⁹⁵ At the beginning of FY1381 (March 2002) the state of the public administration was very limited as almost all ministries were dysfunctional. There was an almost total absence of computers, photocopiers, stationery, telephones, and other essential office tools. The unavailability or low standard of office equipment and furniture, and the dilapidated state of most government buildings have had a negative effect on staff productivity. Ministries have limited scope to undertake even the most basic functions, which restricts their implementation capacity (AACA, 2002).

higher-income employees, increasing the personal exemption, and reducing the top marginal tax rate from 60% to 25%.⁹⁶

58. A short-term need for the Afghan Customs is to improve cooperation with their Pakistani counterparts in reducing the level of smuggling of transit back to Pakistan. The medium-term improvement of introducing a simple computerized control and record system, will assist in strengthening the transit control system. This measure could reduce the possibility of manipulating the control of the transit system.

59. The mobilization of resources requires an enabling institutional and policy environment and eventual development of a capital market.⁹⁷ Mobilization of foreign private investment and domestic savings is important for financing investments. In order to promote financial sustainability of investment or service provision, and to reduce the burden on public resources, the principle of cost recovery needs to be followed. Other budget management measures of making both government recurrent expenditures manageable, and investment expenditures productive and sustainable, should be studied at an early stage.⁹⁸

60. Through the budget a wider public administration reform agenda is being discussed. In the interim, support has been provided on certain preparatory issues (e.g., civil service census) and policies (e.g., payment and currency system). With help from the Capacity Building Group, a functional review will be undertaken of the Ministry of Finance highlighting its priority needs and capacity constraints.⁹⁹

61. After all, the goal is to support the development of a modern Afghan government that is independent of foreign aid, and covers most of its own development expenditures from its own revenue resources. The long-term project of a public taxpayer awareness campaign will increase general public understanding regarding the changes needed to achieve modern taxation using modern fiscal instruments, and will thus have an impact on the success of the fiscal reforms.

D. Opportunities, Challenges, and Risks

62. Afghanistan is among the poorest countries in the world, ravaged by war and natural disasters. Since Afghanistan's economic and social structures have largely been destroyed, the tasks ahead in rebuilding the country are enormous. Given the very weak starting point, including limited administrative capacity and fragile political situation, progress in strengthening macroeconomic management will continue to be slow. However, since economic activities are slowly picking up, and as banking services become available, private savings will once again finance part of the investment required for Afghanistan's rehabilitation and reconstruction. The improvement of the private sector will be of great importance for the Afghan economy through its entrepreneurial resources, and also contribute with its financial resources. A sharp rebound in the economic growth is expected in 2002/03, and in 2005 Afghanistan's GDP could recover to the level estimated for 1997/98.¹⁰⁰ Nevertheless, the reconstruction cannot be achieved without strong support from the international community. Hope has been inspired by the opportunity of

⁹⁶ IMF, September 2002.

⁹⁷ The introduction of the new afghani is considered a necessary precondition for establishing an effective national banking system and was a major achievement of the Government in 2002. The currency exchange was expected to be completed in January 2003.

⁹⁸ ADB, 2002.

⁹⁹ AACA, 2002.

¹⁰⁰ ADB, 2002.

improving the Afghan economy through technical assistance, which has provided policy advice focusing on issues crucial to a quick restoration of macroeconomic stability, like preparation of government budget. The Afghan authorities have, despite the very difficult circumstances, made commendable efforts to put in place sound economic policies.

63. A prerequisite for realizing pledges of aid support has been stronger fiduciary assurances. Control over and effective utilization of government funds urgently require stronger capacity than existing within the administration. In addition, the amount of resources provided to the Afghan people, and the levels of domestic revenues captured by the authorities, are tied to domestic economic stability and improved security. The introduction of a unified new currency is mainly considered as an important step in establishing macroeconomic stability, even though its logistical and promotional challenges are enormous. The new afghani is expected to help in estimating revenues and budget preparation, and lead to an ease of the financial transactions by the external partners involved in the reconstruction of the country.¹⁰¹ On the other hand, the present revenue mobilization in Afghanistan is challenged and severely strained by the losses of labor and capital, and disruption in the trade and transport sectors.

64. Improving the Afghan fiscal situation and achieving macroeconomic stability will encounter substantial risks. The still fragile security situation and the authorities' lack of control beyond Kabul are the most prominent difficulties for the present and coming months' fiscal development. Given that the provinces collect most domestic revenues, the lack of control outside Kabul greatly hampers budget execution. Only a fraction of the customs duties demanded by the local warlords controlling the border passes to Iran and Pakistan has been received by the Government. Improvement of the reporting by provincial fiscal offices and central bank branches implies a great challenge and importance for monitoring of the budget execution. In addition, even though the transit trade with Pakistan continues to be a source of revenue for Afghanistan, the restrictions imposed unilaterally by Pakistan seem to have had increasingly negative effects on Afghanistan's revenues.¹⁰²

65. Due to pressures to raise government wages and to augment employment, particularly in defense and education, there is a risk that budget ceilings could be exceeded. Strengthening of current weak mechanisms to monitor and control government employment is hence needed. On the other hand, like in other postconflict countries, the weak capacity and inability to execute the budget creates a situation of underspending.¹⁰³ A fiscal crisis has so far been avoided; however, this is expected to change in the coming months, and financial resources are urgently needed. While the development budget will need to be largely externally financed in the foreseeable future, the ordinary budget will eventually have to be financed from domestic revenues.¹⁰⁴ As the authority of the central Government extends over the entire country, revenue collections from both direct and indirect sources should increase substantially. In addition, with more external contractors assisting the authorities with audit functions, procurement, and financial management, the administrative capacity was assumed to develop more rapidly during the second quarter. Therefore, fiscal management is just beginning to be strengthened from late 2002, indicating that time is needed for the Government to improve its fiscal apparatus.¹⁰⁵

¹⁰¹ The acceptance of the new currency is considered to be of crucial importance for the success of the Government's economic policies (IMF, September 2002). The currency reform is believed to also imply a unifying factor, and therefore will contribute to improvement of the social stability in Afghanistan.

¹⁰² IMF, May 2002.

¹⁰³ IMF, September 2002.

¹⁰⁴ The previous practice in which the Afghan Government had automatic and unlimited access to an overdraft facility through Central Bank financing, was explicitly prohibited through a budget decree (IMF, September 2002).

¹⁰⁵ ADB, 2002.

66. During the period up to the elections in 2004, the covering of the saving-investment gap will continue to rely mainly on external assistance. Revenue collection (especially its transmittal to the central government) and foreign assistance for recurrent expenditures fell considerably short of expectations in the beginning of FY 2002/03. Moreover, because a portion of domestic revenues will be needed to cover \$22.5 million in back salaries for civil servants for August – December 2001, the financing gap requiring donor support was larger than anticipated. The Ministry of Finance reported in September 2002 that \$234.2 million in grants from multilateral (e.g., AIA and Land and Order Trust Funds of UNDP and the Afghanistan Reconstruction Trust Fund, or ARTF, co-managed by the ADB) and bilaterals were forthcoming, against the required amount \$377.3 million. There was therefore a financing gap of \$143.1 million, or \$165.6 million if back pay for civil servants is included. By October 2002, therefore, the availability of sufficient aid financing to close the current budget gap was uncertain. For the authorities to overcome the challenges and risks ahead, support from the international aid community was needed. Otherwise, pressures may grow for Central Bank financing if donors cannot ensure timely and adequate budgetary support. To be sure, the Government has shown a remarkable commitment to maintain fiscal discipline in the face of mounting pressures to increase government spending, and to ensure that domestic revenue targets are met.

V. SUMMARY

67. The number of wars and coups over the last 4 decades in Afghanistan's history has caused discontinuance of budgeting, and worsened the structural and macroeconomic problems of the economy (Appendix 7). A considerable share of Afghanistan's budget has been financed with different forms of foreign assistance during the period under this study. The Government's budgets have sometimes appeared highly optimistic, especially during the 1980s when Afghanistan relied heavily on the Soviet Union and other communist countries in addressing all aspects of the faltering economy. Political and economic instability has caused backwardness of the economy and continued civil strife, and difficulties for Afghan governments in raising state revenues. To obtain revenues, the State depended during the 1960s, 1970s, and 1980s to about 50% on indirect taxes, derived from import and export duties, and commercial transactions. Direct taxes provided only 10% of the revenues, though substantial income came from foreign commodity assistance, government monopolies, and sales of natural resources. The many years of civil turmoil in Afghanistan affected the fiscal accounts by disrupting the economic activities, distorting the composition of public spending, eroding the tax base, and lowering the efficiency of the tax administration. Besides, the Afghan governments reduced the resources available to the economy for private investment and for public spending on sectors that have a strong and positive impact on growth. Consequently, the increase of defense expenditures has implied a "crowding out effect". Since the majority of defense spending was on imported armaments, there were no positive supply-side spillover effects of defense expenditure on the non-defense sectors of the economy. Due to the failure of providing internal security, the focus on defense expenditures did not boost private savings and investments or attract foreign investment, with a negative affect on the long-run sustainable growth rate.

68. Given the existence of functioning fiscal processes in the past, Afghanistan is not an institutional *tabula rasa*. Therefore, fiscal reforms should be built on existing institutional arrangements. In the short-to-medium term, Afghanistan's tax revenue will mostly be derived from customs taxes. Designing and implementing the reformed customs administration is therefore one of the most urgent needs. As the Afghan economy develops, there will be an increasing need of custom revenues for the high-value goods currently banned on the ATTA list by Pakistan authorities. The link between policy and budget needs to be strengthened. It is also

of great importance to improve the capacity of developing more robust financial control systems, and to implement budgets of both MOF and provincial governors. The still prevalent strong disconnect to the provinces prevents the Government from delivering effectively their services to the citizens in the provinces. Efficiency and effectiveness of project and reform implementation will be helped by the Capacity Building Group's coordination of funding agencies and government projects.

69. Essential not only for the rehabilitation, reconstruction, and fiscal reform process, but also for the aid community, is that the Government has shown commitment to fiscal and monetary policies, consistent with macroeconomic stability and non-inflationary growth. The Government's ability to deliver assistance should be improved by the introduction of the new currency. Together with the new payment system to be put in place, the new afghani will complement the implementation of new policies already initiated. Notwithstanding, the fiscal and financial policies of the Government will exert considerable influence on the outlook for the new Afghan currency. The increased economic assistance, together with the new currency, could reinforce government institutions, strengthen the confidence of the Afghans in their young national administration, and improve national security. Improving the security in Afghanistan is essential for many reasons. One of its crucial effects is on the international aid community, as funding agencies are generally very sensitive to the economic and social problems facing the Government. The unstable security situation and the associated difficulty of fund transfers in the country have been the major bottlenecks of implementing smoothly the pledge made in Tokyo in January 2002.

70. The lack of basic skills in the public sector demands that the fiscal reforms be carried out at a realistic pace. Government officials need to be able to absorb technical assistance provided to the ministries, adapt and incorporate them into their own programs, e.g., in provincial level capacity building. At this early reconstruction stage the implementation capacity within the Government has been limited, though it is improving partly through external assistance. It urgently needs to demonstrate accountability and responsibility in its use of aid funds. Accordingly, improvement of the administrative capacity, partly through assistance, is crucial in the short term. The gradually improving absorptive capacity of assistance by the Afghan authorities may provide an argument to phase external assistance over several years. Successful reconstruction of Afghanistan's fiscal management will take time, implying rebuilding fiscal institutions, generating a sense of trust among the fighting parties, and addressing possible perceived biases in fiscal policies. It is critical that the distribution of public spending and tax burden are not perceived unequal, as critical views might cause negative effects on the present armed conflicts in Afghanistan. Consequently, developing a good system of revenue collection should most likely have a positive impact on the process of improving the national unity.

71. Capacity building for developing a minimum of statistics is critical for fiscal policy formulation and monitoring. The absence of and inadequacies of its statistical system inevitably severely constrain the analyses of fiscal development in Afghanistan. The overall framework necessary for compilation exists, but the breakdown of the manual financing reporting chain has impeded the production of statistics. Once accounting procedures have been computerized and communications with the provinces are reestablished, production of government finance statistics could resume. With the need to develop new approaches for collection, compilation and dissemination of statistics following international standards and best practices, the Central Statistical Office has recently started the huge challenge to rebuild the statistical capability. When the present civil service census is ready, the new information needed will improve the ground for Afghanistan's fiscal reforms. The building of the new statistical system, suitable for a

market-oriented economy, cannot be done without substantial support from the international community, especially from multilateral agencies including ADB.

72. After decades of armed conflicts and relatively isolated and dysfunctional economy, continued and long-term commitment and involvement by the international community is critical. Considering the present limited capacity of the country to service its debts, the gap in budgetary resources, and the initial period's limited scope for raising revenues, Afghanistan will require extensive external assistance. Even though the international community is prepared to transfer a considerable amount of resources on a grant basis, to finance the present resource gap, borrowing by the Government seems necessary. Non-project assistance can add to budgetary resources and thereby reduce the need to borrow from the Central Bank and lower inflationary pressures. Given Afghanistan's small export base and the inelastic nature of many exports, provision of future assistance on highly concessional terms would help keep the debt-service burden manageable.

73. War and civil conflict have prevented the revenue agencies from controlling the sources of revenue, and has rendered tax collection difficult. Due to the limited established representation of the authority in the countryside, time is needed for the Government to bring about an apparatus for tax requirements. With the extension of the central Government's authority over the entire country, a substantial increase of revenue collections from both direct and indirect sources will follow. Finding funds to boost the limited flows from the budget to implement the fiscal policy will not only be focused on funding agencies, but also on how to increase the domestic resource mobilization. The dependency on external aid is not a sustainable development strategy, though it will have to remain for a long time. Following the anticipated recovery in agrarian production, industry, import, export and production of natural gas, government revenues are expected to improve over the years. When the civil conflict diminishes, an expected fiscal effect will be lower military spending and reduction of other related expenditures. Improvement of the security situation will hence lead to economic growth, encouraged by increasing capital formation and improving efficiency of utilized resources in the Afghan economy.

74. The Government's efforts to respond to the need for rehabilitation and reconstruction have been severely hampered by its extremely weak fiscal situation. Consequently, the reform process, implemented with support from funding agencies, cannot wait until the fiscal situation improves. On the contrary, acceleration of the reform process is, both directly and indirectly, an essential part of strengthening the fiscal position. Directly in that reform of the revenue system is critical to strengthening the central Government's fiscal position. Indirectly in that reform of the policy and regulatory framework is critical to creating a positive environment for private sector enterprises and investment. Unlike during the Taliban regime, the Government will not refer to religious reasons when requiring tax payments. To gain taxpayers' trust, the current Government will need to deliver advantageous economic results. Sustainable support to fiscal management from the aid community would not only help bring relative economic continuity, but might improve prospects for political stability, too.

REBUILDING CAPACITY FOR COMPILING MACROECONOMIC STATISTICS¹⁰⁶

1. After over 2 decades of war-related institutional disintegration in Afghanistan, the overall statistical landscape presents a dismal picture. Since the coup in 1978 until now, the persistent warfare has caused an extreme lack of financial and technical resources available to the statistical agencies. As a result the relevant institutions and departments have become inoperative. The provincial reporting network virtually collapsed, and the collection of primary data which is necessary for statistical compilation, was largely discontinued. Since 1995/96, almost no statistics were collected in Afghanistan. An additional factor making it difficult to interpret the economic data is the distortional nature of either conflict or postconflict Afghan economy during most of the period under this study. The absence of reliable economic data for Afghanistan permits only an approximation its past and recent economic performances.
2. In the absence of primary data sources, no reliable recent data exist for government finance, monetary accounts, balance of payments, national accounts, prices, or external debt statistics. The disruption of data from customs has severely hampered the compilation of foreign trade statistics at the Central Statistical Office (CSO). Provincial subtreasuries (*mustofiats*) have collected significant revenues since the inception of the Interim Administration of Afghanistan, but have not reported data on either income or its uses to the ministry of Finance. The Kabul-based consumer price index has continued to compile statistics on a regular monthly basis, and appears to be the only macroeconomic statistics that have not suffered from disruption. Since income of the citizens is partly a result of the government expenditures, when facts and figures on government expenditures are lacking, the per capita income could be used as an indication of recent expenditures. This kind of attempt was not made in this paper.
3. Developing key macroeconomic statistics is essential for the effectiveness of policy design, implementation, and surveillance. Apart from the need for technical assistance to improve the communications, training, and provision of equipment, there is also a necessity to streamline the data collection system. Assessments conclude that the development of statistics in all the areas mentioned above is possible in the medium term (2-3 years). Early results are expected regarding developing a good consumer price index and government financial statistics, and in constructing an adequate balance of payments and external debt data system.

¹⁰⁶Mainly based on the assessment of the International Monetary Fund (IMF) Statistical Department as of mid-2002. In 2003 ADB plans to collaborate with IMF, World Bank, and the Department for International Development (United Kingdom) in assisting the statistical capacity building of CSO, Da Afghanistan Bank, and Ministry of Finance.

BALANCE OF PAYMENTS, 1960s, 1970s, AND 1980s

Balance of Payments, 1963-1969 (\$ million)

Item	1965	1966	1967	1968	1969
EXPORTS	70.0	64.7	66.4	71.8	81.0
Traditional Exports	70.0	64.7	63.5	62.8	68.0
Natural Gas	n.a.	n.a.	2.9	9.0	12.0
IMPORTS	(124.0)	(144.8)	(138.3)	(124.5)	(135.0)
Commercial Imports	(56.5)	(66.7)	(62.9)	(65.6)	(70.0)
Aid-Financed Imports	(67.4)	(78.1)	(75.4)	(58.9)	(65.0)
Trade Balance	(54.0)	(80.1)	(71.9)	(52.7)	(55.0)
Adjustment between Exchange Surrender Records and Customs Records	2.7	0.6	(0.5)	6.5	(3.6)
Foreign Debt Servicing	(5.1)	(5.5)	(10.7)	(13.6)	(20.1)
Debt Service Ratio (%)	7	8	16	19	25
Travel	(1.5)	(1.0)	n.a.	1.0	2.5
Foreign Grants and Loans to Finance Imports	67.4	78.1	75.4	58.9	65.0

Source: *Key Indicators of Developing Member Countries of ADB*, 1971.

Balance of Payments, 1973-1979 (\$ million)

Item	1973	1974	1975	1976	1977	1978	1979
MERCHANDISE TRADE	(36.5)	(7.3)	(27.6)	(103.3)	(39.1)	(111.3)	(177.8)
Exports	120.6	157.0	218.7	224.5	282.5	322.0	339.8
Imports	(157.1)	(164.3)	(246.3)	(327.8)	(321.6)	(433.3)	(517.6)
Services, Transfers, and Nonmonetary Capital	46.7	39.1	43.1	103.6	92.2	179.5	188.9
Travel	7.0	16.4	20.0	24.0	30.0	38.0	28.0
Investment Income from Foreign Assets	n.a.	2.3	0.8	1.8	2.7	6.3	20.9
Embassies' Expenditures	n.a.	5.4	4.0	4.1	3.0	6.9	4.7
Service Component of Project Aid	(5.4)	(4.8)	(12.4)	(14.6)	(10.7)	(30.9)	(34.3)
Official Loans and Grants	77.2	51.0	71.2	114.4	103.9	206.2	229.9
External Public Debt Service	(32.1)	(31.2)	(40.5)	(26.1)	(29.2)	(46.0)	(54.2)
Debt Service Ratio (%)	27	20	18	12	10	14	16
IBRD and ADB Bond Purchase	n.a.	n.a.	n.a.	n.a.	(7.5)	(1.0)	(6.1)
Net Residual Transactions (incl. Errors and Omissions)	(8.0)	(18.0)	10.0	52.2	11.6	86.4	87.7
MONETARY MOVEMENTS (INCREASE IN ASSETS)	(2.2)	(13.8)	(25.5)	(52.5)	(64.7)	(154.6)	(98.8)

ADB = Asian Development Bank; IBRD = International Bank for Reconstruction and Development.

Source: *Key Indicators of Developing Countries of ADB*, 1980.

Balance of Payments, 1980-1983
(\$ million)

Item	1980	1981	1982	1983
Merchandise Exports, f.o.b.	705	691	708	729
Merchandise Imports, c.i.f., f.o.b .	(774)	(897)	(829)	(891)
Trade Balance	(69)	(207)	(121)	(162)
Other Goods, Services, and Income	(63)	(108)	(70)	(95)
Credit	88	76	90	77
Debit	(151)	(183)	(161)	(172)
Unrequited Transfer	164	85	99	107
Private	14	(5)	16	8
Official	150	90	82	99
Current Balance	32	(229)	(93)	(149)
Direct Investment	n.a.	n.a.	n.a.	n.a.
Portfolio Investment	n.a.	n.a.	n.a.	n.a.
Other Long-Term Capital	159	85	71	21
Other Short-Term Capital	(265)	(18)	66	163
Net Errors and Omissions	1	124	(52)	(90)
Overall Balance	(72)	(38)	(8)	(55)
Allocation of SDRs	6	6	n.a.	n.a.
Monetary Movements	66	32	8	55

SDRs = Special Drawing Rights.

Source: *Key Indicators of Developing Asian and Pacific Countries*, 1990.

Balance of Payments, 1984-1989
(\$ million)

Item	1984	1985	1986	1987 ¹	1988 ¹	1989 ¹
Exports of Goods, f.o.b.	787.7	628.2	537.0	538.7	453.8	252.3
Imports of Goods, f.o.b.	(1,204.7)	(921.4)	(1,141.5)	(904.5)	(731.8)	(623.5)
Trade Balance	(417.0)	(293.2)	(604.5)	(365.8)	(278.0)	(371.2)
Exports of Services	53.8	69.2	72.3	35.6	69.6	8.2
Imports of Services	(214.7)	(162.7)	(215.5)	(156.3)	(120.0)	(103.4)
Balance on Goods and Services	(577.9)	(386.7)	(747.7)	(486.5)	(328.4)	(466.4)
Other Income Received ^a	n.a.	n.a.	n.a.	19.2	23.3	20.1
Other Income Paid ^a	n.a.	n.a.	n.a.	(11.3)	(11.5)	(7.9)
Balance on Goods, Services, and Income^a	n.a.	n.a.	n.a.	(478.6)	(316.6)	(454.2)
Current Transfers Received	n.a.	n.a.	n.a.	311.7	342.8	312.1
Current Transfers Paid	n.a.	n.a.	n.a.	n.a.	n.a.	(1.2)
Unrequited Transfers (Net)	127.3	143.7	191.3	n.a.	n.a.	n.a.
Current Balance	(450.6)	(243.0)	(556.4)	(166.9)	26.2	(143.3)
Investment Liabilities	n.a.	n.a.	n.a.	(33.9)	(4.1)	(59.6)
Long-Term Capital (Net)	57.0	77.6	225.7	n.a.	n.a.	n.a.
Short-Term Capital (Net)	256.2			n.a.	n.a.	n.a.
Net Errors and Omissions	202.7	224.3	293.4	211.6	(47.7)	182.8
Total						
(Net Monetary Movements)	65.3	58.9	(37.3)	n.a.	n.a.	n.a.
Valuation Changes (Net)	(11.3)	7.6	0.6	n.a.	n.a.	n.a.
Changes in Reserves	54.0	66.5	-36.7	n.a.	n.a.	n.a.
Overall Balance	n.a.	n.a.	n.a.	10.8	(25.6)	(20.1)

^a *The Far East and Australasia 2002*.

Source: *The Europa World Year Book 1989*.

TRANSIT TRADE

1. As a landlocked country, Afghanistan's trade with the world has depended on the long borders with Iran and Pakistan, and Tajikistan, and relatively shorter borders with the People's Republic of China, Turkmenistan and Uzbekistan. The transit countries are primarily Pakistan, Iran, and Uzbekistan. The Afghan-Pakistan Transit Trade Agreement (ATTA) was signed between the two countries in 1965 and has more or less been functioning until today. Iran concluded a transit agreement with Afghanistan in 1974. After the collapse of the former Soviet Union, the establishment of Commonwealth of Independent States (CIS), and with the changes in political relations between these countries and Afghanistan, the use of transit routes has fluctuated. For instance, both Tajikistan and Uzbekistan closed border checkpoints to Afghanistan when the Taliban established control over areas in their vicinity. In 1997, after the Taliban took over Afghani provinces bordering Iran, Iran closed the main border checkpoint to Afghanistan. Estimates of trade flows in 2000 indicate exports and imports of about \$1.2 billion each, of which \$800 million in imports were reexported. There also remains a considerable amount of informal trade.¹⁰⁷

2. The ATTA includes exemption from all customs duties, taxes, duties, or charges of movement of goods under the treaty, not including transportation service. The treaty define two transit routes: Torkham (Afghanistan) – Peshawar (Pakistan) and vice versa, and Spin Baldak (Afghanistan) – Chaman (Pakistan). The agreement also includes transit goods that move under customs control between Afghanistan and the port of Karachi in Pakistan. The bulk of customs operations are performed in five major customs houses, with the Kabul Customs House as the largest. The five centers coordinate and monitor the work done in smaller customs offices spread throughout the country.¹⁰⁸ The breakdown of border surveillance, customs procedures, and a large part of infrastructure in Afghanistan have lessened the Pakistani authorities' confidence in the Afghan Customs application of transit controls. The Pakistani authorities have argued that traders have taken advantage of the instability in Afghanistan to smuggle transit items back into Pakistan over mountain roads, which is being done after the vehicles have been unloaded just after the Afghan controls, including duty payment. This has resulted in adverse consequences on the revenue and domestic production of Pakistan.¹⁰⁹ The smuggling of goods back to Pakistan has, according to Pakistani officials, increased because of Afghanistan's low duty rates which create an imbalance in the price of goods. As a result of the perceived lack of control, Pakistan took a unilateral action to curtail the flow of trade under the ATTA, and introduced a ban on 24 items that can no longer be imported to Afghanistan using the transit system. The Pakistani authorities now only accept evidence of export on the signature of the Pakistani Commercial Attaché based in Afghanistan. Pakistani restrictions on the transit system have had serious adverse revenue consequences for the Afghan economy. As a consequence of the restrictions on transit trade through Pakistan, a significant increase in the transit trade through Iran has occurred, diminishing the long-term impact of the banned list on revenue collection.¹¹⁰ It is argued that restrictions by an individual country are mainly ineffective because traders can use alternative routes.¹¹¹

¹⁰⁷ IMF, September 2002.

¹⁰⁸ World Bank, 2001.

¹⁰⁹ When 3 million telephones were supposed to be installed in 2000 in Pakistan, only 500,000 were legally produced or imported into Pakistan, according to the Pakistani authorities. The rest of the telephones were imported into Afghanistan through the transit port in Karachi.

¹¹⁰ IMF, May 2002.

¹¹¹ World Bank, 2001.

TAX REGIME
(As of June 2002)

Tax	Rate	Taxable Base	Remarks
Corporate income tax (CIT)	Flat rate of 20%	Net profits of corporations and limited liability companies	<ul style="list-style-type: none"> • Most expenses incurred to derive gross income are deductible. • Firms are allowed to deduct losses incurred in previous years. • The CIT is collected mostly in the form of withholding taxes on imports and exports creditable against the income tax.
Personal income tax (PIT)	Progressive schedule comprising 21 brackets, with rates varying from 4% to 60%	Income of employees (salaries and wages) and profits of most non-corporate entities	<ul style="list-style-type: none"> • The wage PIT that used to be collected from government's and private sector's employees (wage withholding tax) seems to have disappeared at the beginning of the 1990s. Most of the PIT is now collected in the form of fixed presumptive taxes levied on individuals engaged in business or commerce.
Business receipts tax (BRT)	Two rates: <ul style="list-style-type: none"> • 2%: gross receipts of legal persons engaged in domestic business • 2½%: receipts of legal persons engaged in imports and/or exports operations 	Gross receipts of corporations and limited liability companies	<ul style="list-style-type: none"> • The BRT comes in addition to the CIT on taxable profits. • The BRT must be paid within 6 months at the end of the fiscal year, irrespective of whether the business makes a profit or a loss. • Imports are not taxed under the BRT but exports are. • The BRT raises greater revenue than the CIT.
Fixed withholding taxes on imports and exports (creditable against the income tax)	<ul style="list-style-type: none"> • Imports: 4% for licensed importers and 3% for unlicensed importers¹¹² • Exports: 4% for licensed exporters and 2% for unlicensed exporters¹¹³ 	<ul style="list-style-type: none"> • Unincorporated exporters¹¹⁴ or importers • The tax is based on the duty-paid cost of imports/exports 	

¹¹² For unlicensed importers, this tax is not credible against the income tax.

¹¹³ For unlicensed exporters, this tax is not credible against the income tax.

¹¹⁴ If they are incorporated, they only pay the CIT.

Tax	Rate	Taxable Base	Remarks
Presumptive taxes in lieu of the income tax	<ul style="list-style-type: none"> • Retailers: based on a 170 categories classification of business Taxation depends on the types of goods sold, and the size and location of business • Limited list of specific businesses (e.g., cinema, theaters, mills). 10% on estimated turnover • Transportation business (taxis, buses, etc.) Lump sum depending on the type, size, and characteristics of the vehicle used • Government contractors. From 1% to 8% of the price of the goods and the service purchased by the governments. 	Estimated gross receipts of corporations and limited liability companies (except importers and exporters)	The major reasons for using presumptive taxation in lieu of income tax are simplification, reducing compliance costs for the taxpayer and the tax administration, and combating tax evasion. ¹¹⁵
Import duties	25 tariff bands with rates ranging from 7% to 150% allocated across 888 tariff headings	Cost, insurance, and freight (CIF) in Afghani, using an exchange rate of Af4,500 per US dollar (a lower rate is used in Herat)	<ul style="list-style-type: none"> • Customs tariffs currently in use were introduced in 2000. • Imports of petroleum, diesel, and kerosene for transportation purposes are exempt from duty (but not possibly to a “monopoly tax”). • The exchange rate used for valuation purpose is well below the open market rate (approximately Af38,000-40,000 per US dollar).

¹¹⁵ In a presumptive tax, the concept of income tax base is replaced by indicators that are more easily measured.

Tax	Rate	Taxable Base	Remarks
Fees and charges	<ul style="list-style-type: none"> Chamber of Commerce license and valuation of imports/exports: 2.5%. Red Crescent fee: 2.5%. Ministry of Commerce's permit fees (e.g., cars \$200-\$400, cigarettes US\$2.5 per case). 	For the Chamber of Commerce and the Red Crescent: CIF invoice value of exports or imports.	In addition to customs duties, there are numerous fees, charges, and other taxes levied on imports and exports that add significantly to the cost of international trade.

Source: IMF, September 2002.

1. The Income Tax Law is specified for individual and corporate income taxation, withholding taxes on imports and exports, various fixed (presumptive) taxes, and business receipts tax. As 18 separate decrees have amended the law since 1965, and not all amendments have been included in a comprehensive consolidated version, it is difficult to know all the details of the law and its application. Further, tax administrators at the Ministry of Finance have different views about the applicable tax provisions. Because of weak administrative capacities, income tax data is currently not classified according to the revenue classification of the Government. The customs law includes import duties, and fees and charges levied on international trade and transactions. In contrast to the Income Tax Law, the current customs law is a consolidation of all changes to the law. Still the application in practice does vary significantly in different parts of the customs administration. Although there is no excise tax, certain excisable goods are subject to higher customs duties. It seems a "monopoly tax" on petroleum is being used, equaling 20% of the import value (or 30% of the imports if the Government takes the tax).¹¹⁶

¹¹⁶ IMF, February 2002.

BUDGET EXECUTION, 2002/02–2002/03
(\$ million)

Item	Budget of 2001/02		Budget of 2002/03			Cash in 2002/03
	Actual, Paid-In		Budget		Actual	
	Q4	Q1	Annual	Q1	Q1	
	2001/02	2002/03	Annual	Allotment		
	(1)				(2)	(1) + (2)
Domestic Revenue reported to MOF	–	–	83.0	18.3	16.0	–
Customs Revenue	–	–	–	–	14.7	–
Central Ministries	–	–	–	–	0.7	–
Noncustom Provincial	–	–	–	–	0.6	–
Adjustment to Central Budget ¹	–	–	–	–	(15.5)	–
Domestic Central Revenue recorded in DAB	2.0	–	–	–	0.5	0.5
Expenditure (check issued)	5.4	28.6	482.8	78.7	28.8	57.4
Wages ²	5.4	16.4	126.8 ³	17.6	12.9	29.3
Central Government	5.4	9.2	–	–	9.2	18.4
Provinces	0.0	7.2	–	–	3.7	10.9
Other Expenditure ⁴	0.0	12.2	356.0	61.0	13.2	25.5
Central Government	0.0	12.2	–	–	13.2	25.5
Provinces	0.0	0.0	–	–	0.0	0.0
Transfers from the Center ⁵	–	–	–	–	2.6	2.6
Balance (checks issued)	–	–	–	–	(28.3)	–
Adjustment for Float	–	–	–	–	6.3	6.3
Balance (checks cashed)	(3.4)	(28.6)	(399.8)	(60.4)	(22.0)	(50.6)
Financing	3.4	28.6	–	–	22.0	50.6
External Financing (grants)	6.0	15.2	–	–	26.8	42.0
UNDP	6.0	15.2	–	–	16.8	32.0
Pakistan	–	–	–	–	10.0	10.0
Domestic Financing ⁶	(2.6)	13.4	–	–	(4.7) ⁷	8.6

– = Data not available; DAB = Da Afghanistan Bank; MOF = Ministry of Finance; UNDP = United Nations Development Programme.

Source: IMF, September 2002.

¹ The Government's Treasury Single Account (TSA) in DAB only shows the revenue of the center (Af18 billion), but not the provincial revenue. In fact, during the year, this account does not consolidate the provincial accounts of DAB local branches where the provincial revenues are deposited. It is only at the end of the year that the surpluses in these accounts are consolidated with the TSA. Information on the operations of the DAB local branches is either not available or of poor quality.

² Excluding defense, interior, and national security.

³ Including Af750 million for wage arrears.

⁴ Checks cashed in the DAB headquarters at the center.

⁵ Transfers from DAB headquarters to DAB local branches.

⁶ Figures in parenthesis indicate a surplus of the government account in DAB.

⁷ The "no overdraft rule" means that domestic financing for the execution of the 2002/03 budget should always be zero or below.

TECHNICAL ASSISTANCE IN FISCAL MANAGEMENT

Institution/Building and Reform Agenda	Period	Provider
1 Assessment of Existing Systems		
1.1 Preliminary Diagnostic	Jan 2002	IMF (Interdepartmental)
1.2 Review of budget preparation, budget execution, treasury, and revenue administration <ul style="list-style-type: none"> ▪ evaluation of current legislation and practices; ▪ assessment of current practices; and ▪ recommendations to improve budget execution and preliminary proposals to enhance revenue administration. 	Feb 2003	IMF (FAD)
1.3 Review of tax/customs policy and administration <ul style="list-style-type: none"> ▪ evaluation of current legislation and practices; ▪ recommendations to improve domestic revenues (including customs, excises, and income taxation); ▪ proposals to amend customs and income tax laws; and ▪ action plans to enhance tax and customs administration. 	June 2002	IMF (FAD)
2 Customs Reform		
2.1 Review customs law and regulations to: <ul style="list-style-type: none"> ▪ revise exchange rate for customs valuation; ▪ streamline customs tariffs; and ▪ introduce customs tariffs on petroleum products imports. 	Aug 2002/ Aug 2003	DFID (resident experts); USAID (1 short-term mission in Aug 02); IMF (FAD: short-term ad-hoc missions).
2.2 Customs administration <ul style="list-style-type: none"> ▪ ensure availability of updated customs regulations in all customs offices; ▪ establish model customs offices in Kabul, Jalalabad, and Torkham and gradually expand these pilots to all customs houses; ▪ develop a statistics database for trade information; ▪ create a fraud investigation function in the customs department; ▪ provide training to customs staff and establish a central training facility in the MOF; and ▪ provide basic infrastructure (including 5 computers) for effective operation of the customs service. 	Aug 2002- Aug 2005	Mostly DFID (resident experts); Possible future EU participation; GTZ (purchase of equipment and rehabilitation of training customs center); IMF(FAD: short-term missions). ADB-funded MOF advisor (Aug 02– Mar 04).
3 Tax Reform		
3.1 Tax policy Amend tax legislation and regulations to <ul style="list-style-type: none"> ▪ impose the criterion of residence as the basis of the individual income tax; 	Oct 2002- Oct 2005	USAID (resident experts); - IMF (FAD: short-term missions).

Institution/Building and Reform Agenda	Period	Provider
<ul style="list-style-type: none"> ▪ extend the loss carryover period; ▪ establish wage withholding on higher-income employees; ▪ expand the business receipt tax to cover services provided to higher-income employees; ▪ liberalize depreciation allowances to provide incentives for investment; ▪ introduce excises on tobacco, petroleum products and (possibly) automobiles; ▪ create a broad-based consumption tax; and ▪ define a fiscal regime for petroleum and mining sectors as well as any transit pipelines. 		-ADB-funded MOF Advisor (Aug 02–Mar 04).
<p>3.2 Tax administration</p> <ul style="list-style-type: none"> ▪ ensure availability of updated tax regulations in all tax offices; ▪ improve control and supervision of MOF and headquarters over tax operations in provincial offices; ▪ introduce Large Taxpayers Units (as well as model offices for medium taxpayers) in three pilot provinces, and gradually expand the pilots; ▪ establish unique Tax Identification Number (TIN) and simple PC-based taxpayer database; ▪ design risk-based and selective auditing procedures; ▪ improve collection and enforcement procedures at the center and in the provinces; ▪ reduce current manual procedures by gradually introducing tax software; and ▪ provide training programs for Treasury staff. 	October 2002/ October 2005	Mostly USAID (resident experts); IMF (FAD: short-term missions); ADB-funded MOF Advisor (Aug 02–Mar 04).
4 Public Expenditure Management Reform		
<p>4.1 Budget preparation</p> <ul style="list-style-type: none"> ▪ assist MOF in the preparation of current and development budgets; ▪ improve the budget preparation process in MOF and line ministries; ▪ introduce GFS-consistent economic and functional classifications; ▪ introduce a simple medium-term expenditure framework (medium term). 	Jan 2002, continuing	World Bank (resident experts); US Treasury (resident expert); USAID (specific program starting in Oct 02); ADB-funded MOF Advisor (Aug 02–Mar 04); IMF (FAD: short-term ad-hoc missions + STA resident expert for expenditure classification)
<p>4.2 Budget execution and Treasury functions</p> <ul style="list-style-type: none"> ▪ re-establish basic accounting functions at the center and in provincial treasury offices; ▪ develop a centralized reporting system to prepare monthly, quarterly, and annual consolidated 	Aug 2002- Aug 2004	Mostly World Bank (finances the services of an international private consulting

Institution/Building and Reform Agenda	Period	Provider
<ul style="list-style-type: none"> financial statements (center + provinces); ▪ ensure full reconciliation between budget execution data and central bank's accounts; ▪ enhance coverage of the Government's Treasury Single Account; ▪ establish new accounting model and chart of accounts; ▪ re-introduce expenditure controls (pre-audit and commitment recording/control); ▪ develop an integrated Financial Management Information system (GFMS) embracing all levels of government (longer term). 		firm); IMF (FAD: short-term ad-hoc missions)
4.3 Audit <ul style="list-style-type: none"> ▪ develop capacities of the Supreme Audit Institution (SAI). 	Aug 2002- Aug 2004	World Bank (finances the services of an International private consulting firm)
4.4 Procurement <ul style="list-style-type: none"> ▪ restore procurement functions in the MOF and line ministries 	Aug 2002- Aug 2004	World Bank (finances the services of an international private consulting firm)
5 Payroll and Civil Service Reform		
5.1 Payroll preparation <ul style="list-style-type: none"> ▪ build capacity in the central government and provinces to prepare ministerial and provincial payroll (training and basic computerization). 	Nov 2002 – continuing	ADB technical assistance
5.2 Payroll pre-audit and verification <ul style="list-style-type: none"> ▪ develop a data-base of legitimately employed staff; ▪ establish payroll recording systems in line ministries and provinces; and ▪ train comptrollers in line ministries and provinces. 	Sept 2002- Sept 2004	World Bank (payroll adviser); DFID (payroll database); Possibly the EU; ADB technical assistance (Nov 02, continuing)
5.3 Payroll processing <ul style="list-style-type: none"> ▪ prepare monitoring reports in MOF; ▪ identify separately police, military, and staff working in government enterprises; ▪ establish a specialized payroll unit in MOF (longer term); and ▪ move towards computerization (longer term). 	Sept 2002- Sept 2004	World Bank (through financial management and ARTF monitoring agents)
5.4 Payroll audit <ul style="list-style-type: none"> ▪ introduce ex-post audit to ensure that intended beneficiaries receive payments. 	Sept 2002 - Sept 2004	World Bank (through audit agent)
5.5 Civil service and pension reform <ul style="list-style-type: none"> ▪ decompress salary scale; ▪ implement pension reform; ▪ train comptrollers in line ministries and provinces. 	Sept 2002- Sept 2004	World Bank (payroll adviser)

	Institution/Building and Reform Agenda	Period	Provider
6	Payments System Support for the immediate operationalization of the payments system in Kabul; <ul style="list-style-type: none"> ▪ preparation of a master plan for the development of a national payments system. 	Oct 2002- Oct 2003	ADB-funded technical advisors
7	Macro-fiscal coordination <ul style="list-style-type: none"> ▪ establish macroeconomic projection and analysis capacities in MOF; and ▪ ensure coordination between DAB, CSO, and MOF on macro-economic analyses. 	Oct 2002, continuing	US Treasury, USAID, and ADB
8	Fiscal decentralization <ul style="list-style-type: none"> ▪ define tax and expenditure assignments between the different levels of government; and ▪ restore tax-sharing and equalization systems between provinces. 	Not yet determined	USAID; World Bank

ADB = Asian Development Bank, ARTF = Afghanistan Reconstruction Trust Fund, CSO = Central Statistical Office, DAB = Da Afghanistan Bank, DFID = Department for International Development, EU = European Union, GTZ = Deutsche Gesellschaft für Technische Zusammenarbeit, IMF = International Monetary Fund, MOF = Ministry of Finance, US = United States, USAID = United States Agency for International Development.

Source: ADB, 2002 and IMF, September 2002.

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