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Revenue Growth in Afghanistan Continues Strong but Future Uncertain

Summary

- Afghanistan's government revenue grew rapidly for the second year in a row in 2016, by more than 18 percent, following the impressive 22 percent increase in 2015. If one-time receipts and arrears collections in both years are excluded, underlying revenue growth in 2016 was even higher—more than 25 percent.
- About one-fifth of this underlying growth reflected currency depreciation, another one-eighth modest inflation, and more than two-fifths the full-year impact of tax and fee increases introduced in 2015. The remaining nearly one-quarter is attributable mainly to stronger revenue collection efforts in 2016.
- The outlook is for slower revenue growth in 2017. More generally, sustained rapid revenue growth in coming years will be impossible in the absence of a stronger economic revival.
- Squeezing more revenue from Afghanistan's relatively small tax base is running into diminishing returns and will be counterproductive by discouraging the private investment that would stimulate economic growth.
- The weak performance of customs duties is a long-standing concern. Systemic improvements, better governance, and capacity development will be required to reverse adverse trends, and specific targets and tracking for customs revenue would help achieve more sustained revenue growth.
- Finally, the impressive revenue increases of the past two years, even if augmented by future growth, will not significantly reduce Afghanistan's aid requirements if current trends continue. Without major progress toward peace, resulting in a durable reduction in violence, the economic and revenue outlook will remain weak and aid requirements high.

Overall Revenue Performance

Building on its extraordinarily rapid growth in 2015 (22 percent) and in the first half of 2016, Afghanistan's total government revenue increased to Afs 144.56 billion in 2016, equivalent to about $2.1 billion and representing a robust increase of more than 18 percent from Afs 122.35 billion in 2015.[1] As a share of Afghanistan's gross domestic product (GDP), government revenue has risen from a low of 8.7 percent in 2014 to 10.3 percent in 2015 and well over 11 percent in 2016. Few countries, let alone those facing protracted conflict and fragility, such as Afghanistan, could achieve back-to-back annual revenue increases of more than one percentage point each as a share of GDP.

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The strong revenue performance in 2016 is especially striking because it occurred despite continuing low economic growth—per capita GDP has been stagnating or declining for the past three years. Moreover, the deteriorating security situation and continuing political tensions have continued to adversely affect revenue directly as well as the economy more generally (and thereby revenue indirectly).

Key Contributing Factors

To what extent did rapid revenue growth in 2016 reflect better collection efforts and new or increased taxes rather than other factors? First, one-time collections from the sale of state-owned assets by the Ministry of Urban Development (Afs 1.085 billion) and a receipt from the Ministry of Agriculture (Afs 1.0 billion) need to be subtracted from the revenue figure, yielding adjusted total revenue of Afs 142.475 billion. For consistent comparison, similar collections in 2015, amounting to Afs 8.83 billion, must be subtracted from revenue for that year, resulting in adjusted revenue of Afs 113.52 billion for 2015. Thus, underlying revenue growth in 2016 (excluding one-time receipts and arrears collections) was Afs 28.956 billion (25.5 percent), even higher than the unadjusted growth rate.

Revenues denominated or collected in foreign exchange increase automatically in terms of Afghani value as the currency depreciates and do not reflect any revenue mobilization efforts. Rough calculations indicate that the impact of the 11 percent depreciation of the Afghani against the U.S. dollar in 2016 was about Afs 6.165 billion, accounting for more than one-fifth (21.3 percent) of the total underlying revenue increase.[2]

The contribution of inflation to higher prices and associated higher revenues cannot be attributed to better revenue mobilization either. Afghanistan's consumer price index (CPI) rose by an estimated 4.6 percent in 2016 (based on the December 2015 figure of 104.2 and the December 2016 figure of 109.0), and the estimated impact of CPI inflation on revenue was Afs 3.537 billion (12.2 percent of the underlying increase).[3]

Finally, a significant portion of revenue growth in 2016 reflects the full-year impact of new measures introduced in the latter part of 2015, including the doubling of the rate of business receipts tax (BRT) from 2 to 4 percent, increased levies on imported fuel and gas, a 10 percent tax on mobile phone top-ups, and an increase in the overflight fee for commercial aircraft. This is estimated at Afs 12.155 billion (42 percent of the underlying increase).[4]

Subtracting all of these factors, the residual revenue value of Afs 7.099 billion (24.5 percent of the underlying increase) represents a rough estimate of the revenue attributable to increased collection efforts in 2016, as well as to any modest economic growth that occurred. Because GDP growth in 2016 by all indications was low (forecasts have been around 2 percent), most of this residual can be attributed to stronger revenue mobilization, ranging from better systems in place to intensified measures to collect taxes from existing taxpayers.

Overall, this analysis confirms that revenue growth in 2016 continued at a robust rate following the impressive turnaround achieved in 2015. Given that one-offs and arrears collections were lower than in 2015, underlying revenue growth was even more rapid.

Current and Future Issues

The weak performance of customs duties is a long-standing issue and remains problematic. Customs receipts have fallen well short of targets and have grown slowly or stagnated for a number of years. Total customs duties and fees increased by 7 percent in nominal terms in 2016, but after subtracting the estimated impact of depreciation actually fell by 3.6 percent.[5] Part of this shortfall may be explained by occasional border closures in response to insecurity (affecting trade with Tajikistan to the north, for example) and deteriorating relations with Pakistan.[6] Nevertheless, leakages are widely considered substantial, though impossible to quantify. Systemic improvements and better governance as well as capacity development will be required to reverse these adverse trends.

The near-term outlook, in the absence of major new revenue measures introduced in 2016 or expected in early 2017, is for lower revenue growth in 2017. Moreover, Afghanistan's accession to the World Trade Organization requires tariff adjustments that will result in an estimated revenue loss of up to Afs 3.5 billion in 2017.[7] In light of these headwinds and the weak economy, revenue growth for 2017 is targeted at 5.6 percent (based on the budget target of Afs 152.6 billion).

More generally, squeezing increasing amounts of revenue from Afghanistan's relatively small tax base—imports and large and medium-sized businesses—is seeing diminishing returns and will be counterproductive by discouraging the private investment needed to stimulate economic growth.

Economic revival and sustained robust economic growth, combined with expanding the tax base, will be essential if revenues are to continue to increase rapidly over the medium term. Unfortunately, the economic outlook is for continuing slow growth, and efforts to broaden the tax base will continue to face serious obstacles in the current security, administrative, and political environment.

Nevertheless, there is scope for improvements and reforms that will, at least at the margin, help increase government revenues. These include

- disaggregating revenue targets into subcategories (such as between customs duties and BRT on imports within total customs receipts) and stricter monitoring of performance of subcategories against their respective targets;[8]
- collecting more revenue from ongoing exploitation of mineral resources, possibly through a border tax, and cross-checking minerals exports between the Customs Department and the Ministry of Mines and Petroleum to ascertain whether applicable taxes and royalties have been paid;
- expanding the tax base by better enforcement especially in the provinces, and vis-à-vis small and medium tax payers in the center, to reduce reliance on overtaxing a few large companies;
- integrating systems or creating interfaces for data sharing between customs and revenue to reduce leakages and improve collection;[9]
- simplifying and automating processes to minimize procedures and red tape, as well as moving away from pre-clearance of tax returns to randomized auditing of filed returns; and
- continuing and building on administrative reforms (such as mandatory training at the new customs and tax academy for all applicants for professional positions and regular monitoring and evaluations of professional personnel).

Finally, the impressive revenue increases over the past two years, even if augmented by future revenue growth, cannot make much of a dent in Afghanistan's aid requirements. The increase in revenue in 2016, for example, amounted to at most several hundred million U.S. dollars, whereas total pledges at the Brussels Conference on Afghanistan for civilian aid were $3.8 billion annually for the next four years and at the earlier Warsaw NATO Summit for security aid were $4.5 billion annually.[10] Moreover, the increase in revenue expected in 2017 will be smaller—less than $120 million, depending on exchange rate developments. Based on current trends, the country's dependence on aid will not decline significantly in the coming years. Without major progress toward peace, resulting in a durable reduction in violence, the economic and revenue outlook will remain weak and aid requirements high.

Notes

1. The 2016 revenue figure excludes paper profits of Afs 10.26 billion from revaluation of foreign exchange assets of Afghanistan's central bank and the Afghan government's gains on currency exchange from aid inflows (Afs 10.62 billion). Afghanistan's fiscal year runs from approximately December 21 to December 20; calendar years in this paper refer to the corresponding Afghan fiscal years, that is, 2015 = 1394 and 2016 = 1395. On the earlier revenue growth, see Byrd and Payenda, "Afghanistan's Revenue Turnaround in 2015," USIP Peace Brief No. 201, February 2016, www.usip.org/sites/default/files/PB201-Afghanistans_Revenue_Turnaround_In_2015.pdf, and "Afghanistan's Government Revenue: Continuing Robust Growth in the Face of Economic Weakness," Afghanistan Analysts Network, September 2016, www.afghanistan-analysts.org/afghanistans-government-revenue-continuing-robust-growth-in-the-face-of-economic-weakness/.
2. The average exchange rate of the Afghani against the U.S. dollar was 61.05 in 2015 and 67.77 in 2016. Revenue collected or denominated in foreign exchange was Afs 53.56 billion in 2015 and Afs 62.153 billion in 2016. Comparing the increase in revenue minus the increase deflated by the change in the average exchange rate yields the estimated revenue attributable to depreciation.
3. Revenue denominated and collected in Afghanis (not including one-time and arrears collections) was Afs 59.96 billion in 2015 and Afs 80.322 billion in 2016. The increase in revenue minus the increase deflated by the CPI change yields this difference.
4. The gross impact is estimated at Afs 13.1 billion, but this includes double-counting of the impacts of currency depreciation and inflation. So the revenue receipts denominated or collected in foreign exchange are deflated by the change in the average exchange rate, and revenues denominated in Afghanis are deflated by the CPI, resulting in the estimated net impact.
5. Customs receipts were Afs 30.42 billion in 2015 and Afs 32.55 billion in 2016.
6. Customs duty collections at the border crossing between Afghanistan and Tajikistan reportedly fell from around Afs 1 billion per year in previous years to Afs 380 million in 2016 (http://ariananews.af/latest-news/kunduz-security-threats-reduce-afghan-middle-asia-trade-deals-80/). Trade between Afghanistan and Pakistan reportedly fell from $2.5 billion in 2015 to $1.5 billion in 2016, undoubtedly hurting customs receipts (www.tolonews.com/business/afghanistan-pakistan-trade-value-takes-dive).
7. Afghanistan under its WTO accession agreement has to adjust 657 tariff lines to WTO bounded rates, including 336 that must be lowered to or near zero.
8. The Customs Department has missed its revenue target for the past five years and has achieved its target only twice in the past eleven years.
9. For example, some traders use one license to import goods and hide the import license when dealing with the Revenue Department on profit taxes at the end of the year, or use another one that does not fully capture their activities.
10. The U.S. dollar value of the Afs 22.2 billion revenue increase in 2016 is $330 million; however, if both 2015 and 2016 revenue are converted using average exchange rates in the two years, the gain is much lower—$132 million.

About This Brief

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