AFGHANISTAN DEVELOPMENT BRIEF

Revenue Collection Amidst Elections in Afghanistan

November 2019 **Topic: Revenue Collection FY1398**

This note gives a brief overview of domestic revenue collection in Afghanistan. It provides an assessment of this fiscal year's revenue collection to date, looking at revenue shortfalls against targets, collections by tax type (including one-offs) and agency. We show that i) the Government of Afghanistan is unlikely to achieve the International Monetary Fund's revenue projection and may miss its own budget target, ii) core tax collections alone cannot close either revenue gap and effort is needed to prevent further decline, and iii) caution is required when setting next year's revenue targets.

Due to a large revenue shortfall in M8 of the fiscal year 1398 (Asad, July 23-August 22), total revenue collection for the first ten months fell short of the target by AFN 2.8 billion. For the remaining two months of the fiscal year, between AFN 43 billion remains to be collected, to meet the government's budget target. This corresponds to 21% of the fiscal year's total collections. It is unlikely that this target will be met. On current trends, we expect a shortfall up to 14 billion against the government revenue target unless additional one-off revenue collections can be realized.

FY 1398 Performance

Domestic Revenue Collection Against Targets

Revenue targets for FY1398 were initially set at AFN 188 billion, similar to the previous fiscal year's final collection level,[1] but were revised upwards during the mid-year budget discussions to AFN 200. This revision took place against an increased expenditure need because of impending elections and relatively on track performance of revenue collection the first half of the fiscal year (see Figure 1). The International Monetary Fund (IMF) has a separate revenue projection of AFN 209 billion.[2]

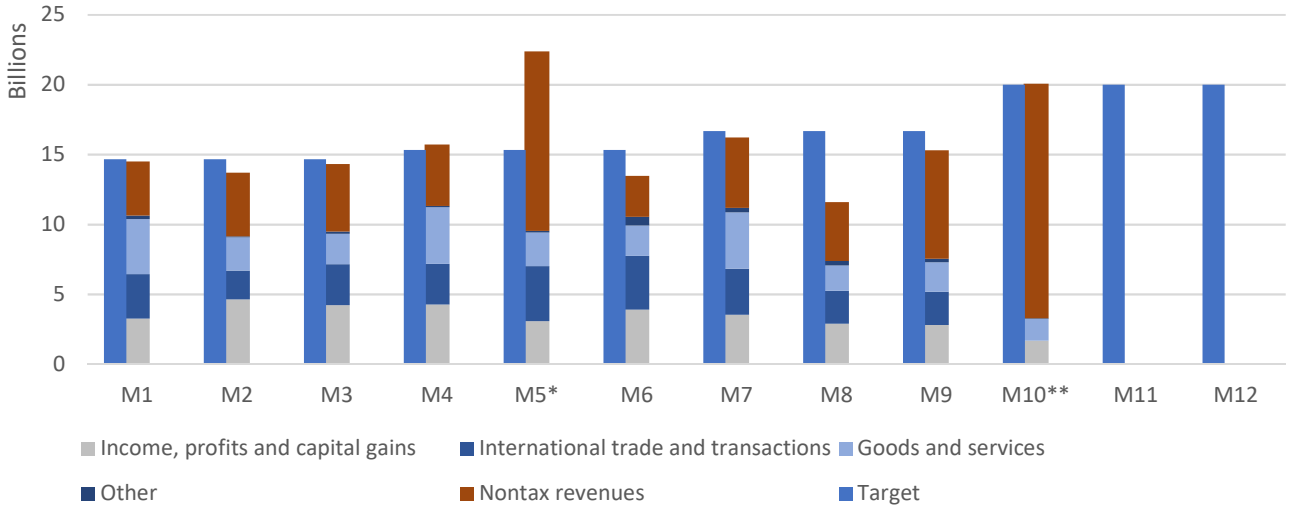
A total of AFN 157.2 billion revenue was collected at the end of M10 (Mezaan, September 23-October 22). These total revenues present a shortfall of AFN 2.8 billion against the YTD budget target, and AFN 11.7 billion against the YTD IMF projection (see Annex). While the budget target matters in terms of cash flow, the IMF projection matters in terms of fiscal credibility and sustainability.

[1] Although a slight recovery in growth is expected in FY1398 (to 2.5 percent of GDP), revenue collections in FY1397 relied on significant one-off revenues. Such one-offs are typically not taken into account when projecting revenue growth.
[2] This includes a AFN 9 billion transfer of Afghanistan's Central Bank (DAB) profits to the Treasury.

As Figure 1 illustrates, while M8 showed a big drop in revenue, M5 and M10 recorded a significant increase. The increase for M5 and M10 seems largely due to non-tax revenue[3], and even M9 records a relatively large portion of non-tax revenue. It is important to note here, however, that revenues for the last three months are not yet reconciled. The non-tax revenue category includes significant 'miscellaneous' or unclassified revenues, the majority of which will eventually be classified under tax and customs. For example, in M9, around AFN 3.5 billion is still marked as miscellaneous or unclassified revenues in AFMIS, while for M10, AFN 16.5 billion is still marked as such. The pattern for core tax collections for these past 3 months can thus not yet be fully deduced. However, the total amount of revenues recorded in AFMIS only charge marginally after reconciliation.

For the remaining two months of the fiscal year, between AFN 43 billion and AFN 52 billion remains to be collected to meet budget target and IMF projection respectively. This corresponds to 21-25% of the fiscal year's total collections and represents an unprecedented amount to be collected in just 60 days (see Figure 2). At the same time, core tax collections have suffered in recent months as a result of uncertainty surrounding the elections.

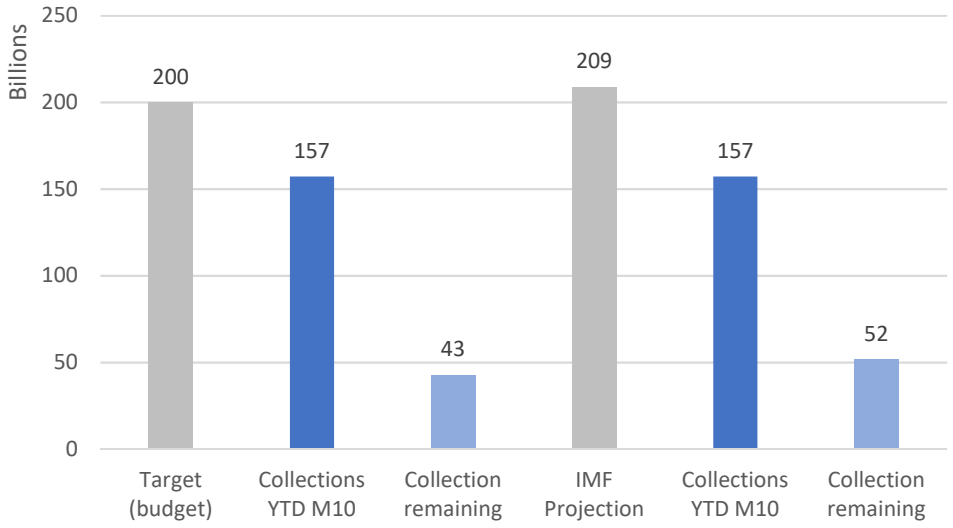
Figure 1: Monthly Budget Targets and Actual Collections (FY1398)



Source: AFMIS, Staff Calculations. * M5 includes AFN 8.9 billion in DAB dividends. ** For M8, M9 and M10 AFMIS entries are not yet fully allocated: a large portion is still labeled as 'miscellaneous' and 'unclassified' revenue, which falls under nontax revenues. Allocation to appropriate categories occurs with roughly one month delay.

[3] M5 includes a AFN 8.9 billion in operating income from currency depreciation (also referred to as dividends) that were collected from Afghanistan's Central Bank (DAB), a significant one-off revenue collection. For M9, at the time of writing this brief AFMIS still had a significant portion of revenue marked as miscellaneous or unclassified revenues.

Figure 2: Annual Targets, Collections YTD M10 and Collection Remaining (FY1398)



Source: AFMIS, Staff Calculations.

Core Tax Performance and One-Offs

Based on revenue performance in recent months, core tax collections – tax and customs revenue – alone cannot meet the outstanding targets. Afghanistan's domestic revenue can be divided into tax and non-tax revenues.[4] Tax revenues are collected by the Afghanistan Customs Department (ACD) and Afghanistan Revenue Department (ARD) and Mustofiats, while non-tax revenues are collected by ACD, ARD and other ministries. Recall that AFMIS records core tax collections with a delay. Revenue data directly obtained from the ACD and ARD provides a useful alternative source of data.

As Figure 3 illustrates, ACD's collection has been steady at around AFN 6-7 billion per month, with a drop in M8 to AFN 5.7 billion. While this is not very different from average monthly collections in previous years,[5] ACD's revenue collection is not sufficient to meet its collection target of AFN 88 billion. This is due to a combination of challenges in collection at selected major customs offices and an ambitious revenue target. ACD started to miss targets mid-year.[6] Moreover, two major customs offices – Herat and Balkh – are bringing in less revenue compared to last year. At the same time, ACD's overall collections still surpass last fiscal year's as some of

[4] The term 'tax' is used broadly to refer to "a *compulsory* contribution from a *person to the government* to defray the expenses incurred in the *common interest of all*, without reference to *specific benefits* conferred" (E.R.A Seligman). It typically includes tax on i) income, profits and capital gains tax, ii) international trade and transactions, and iii) tax on goods and services. Non-tax can be broadly seen as public income received from administrative fees and charges, gifts, fines and forfeits and public assets. Grants and social contributions are separate categories (not included in tax and non-tax revenue), as per the Government Finance Statistics Manual (GFSM) 2014 (accrual basis).

[5] Average month collection ACD in FY1397: AFN 6.4 billion; FY1396: AFN 6.2 billion; FY1395: AFN 5.4 billion. Staff calculations.

[6] Cash Management Committee, Meeting Minutes, October 15, 2019. https://mof.gov.af/sites/default/files/2019-10/CMC%20Meeting%20Minutes%20-%20October%2015%2C%202019.pdf

the shortfall is being compensated by increased collection in other customs offices.[7] This illustrates the ambition of the FY1398 target.

ARD's collection (focusing on the large, medium and small taxpayer offices), has been AFN 3-4 billion per month this fiscal year, with an increase to AFN 5.6 billion in M10 and a low point of AFN 2.2 billion in M8 (see Figure 4). Fluctuations in revenue collection are largely driven by the large taxpayer office (LTO) which represents roughly 60 percent of the three taxpayer offices – large, medium and small. The LTO experienced a large drop in revenue collection in M8, falling below AFN 1 billion that month. The LTO collections improved in M9 and M10, although not enough to make up for the revenue loss in M8. All three taxpayer offices have been underperforming vis-à-vis targets since early on in the year, [8] and total collections trail last fiscal year's collections since M9.

If collection were to continue at similar monthly rates, between AFN 18 to 26 billion in core taxes might be collected in the remaining two months of Afghanistan's calendar year.[9] This is well below the remaining AFN 43-52 billion required to meet the targets. In previous years, revenue collection has typically picked up in the last quarter and this may partially mitigate the shortfall. A shortfall can be further reduced if the government is able to identify additional one-off revenues. On October 15th, the government expected AFN 14 billion in additional one-off revenue for the remainder of the fiscal year.[10] Taking a relatively conservative overall monthly average of AFN 11 billion in core tax collections for the last two months, an additional monthly AFN 3.5 billion from Mustofiats and ministries[11], and one-off revenue of 7 AFN billion per month, the government could collect the remaining AFN 43 billion, precisely enough to meet the budget target. This remains subject to significant uncertainty, however, given the election process and the general fiscal risk surrounding one-off revenue collection. On current trends, the shortfall could be up to 14 billion against the government target – the size of the expected one-off revenue collections.

The Afghan Macroeconomics and Fiscal Policy Department (MFPD) has presented a revenue forecast for the last three months of the fiscal year in its minutes of the cash management committee (October 15th). In their forecast the shortfall varies between AFN 6 and 15 billion, compared to the budget target of AFN 200 billion (see Table 1). Note that their forecast is not yet updated with relatively improved collection in M10, totaling to AFN 20 billion, which may attenuate the shortfall.

In summary, the Government of Afghanistan may miss its own budget target unless additional one-off revenue collections can be realized. It is likely that the government misses the IMF projection by at least AFN 9 billion and possibly more.

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[7] FY1397 YTD collections M10: AFN 59.6 billion; FY1398 YTD collections M10: AFN 65.8 billion.

[8] Cash Management Committee, Meeting Minutes, October 15, 2019. https://mof.gov.af/sites/default/files/2019-10/CMC%20Meeting%20Minutes%20-%20October%2015%2C%202019.pdf

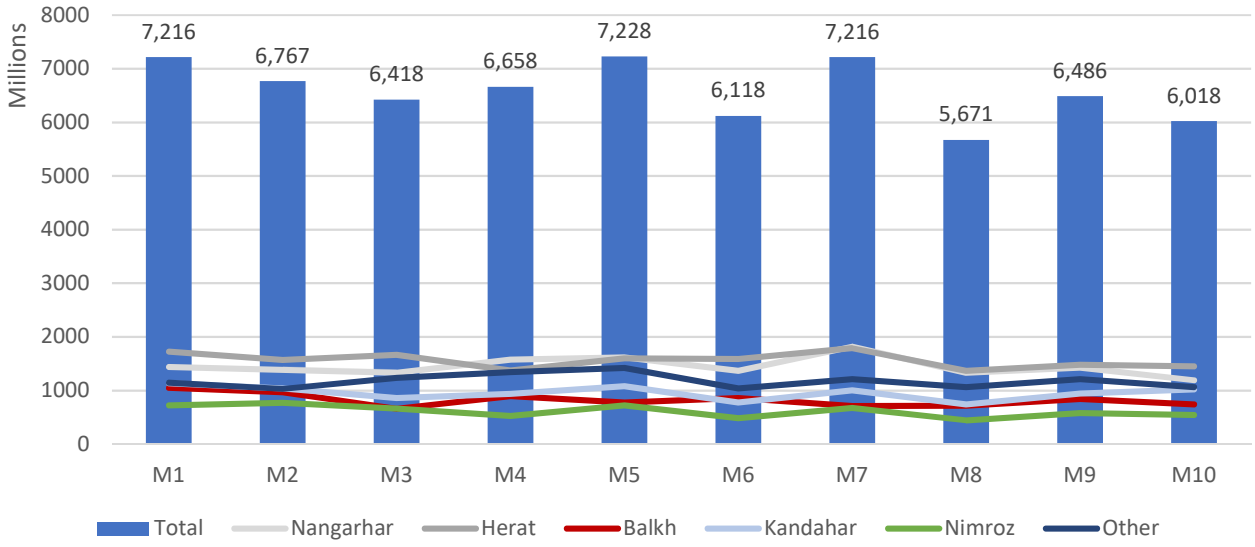
[9] In the last two months of FY1397, an average of AFN 13 billion in core taxes was collected per month. Tax collection typically increases towards the end of the FY.

[10] Cash Management Committee, Meeting Minutes, October 15, 2019. https://mof.gov.af/sites/default/files/2019-10/CMC%20Meeting%20Minutes%20-%20October%2015%2C%202019.pdf

[11] For comparison of trends see https://ard.gov.af/?s=english&c=fy-1398-current-revenue-collection-reports.

Figure 3: ACD Monthly Collections, by Major Customs Port

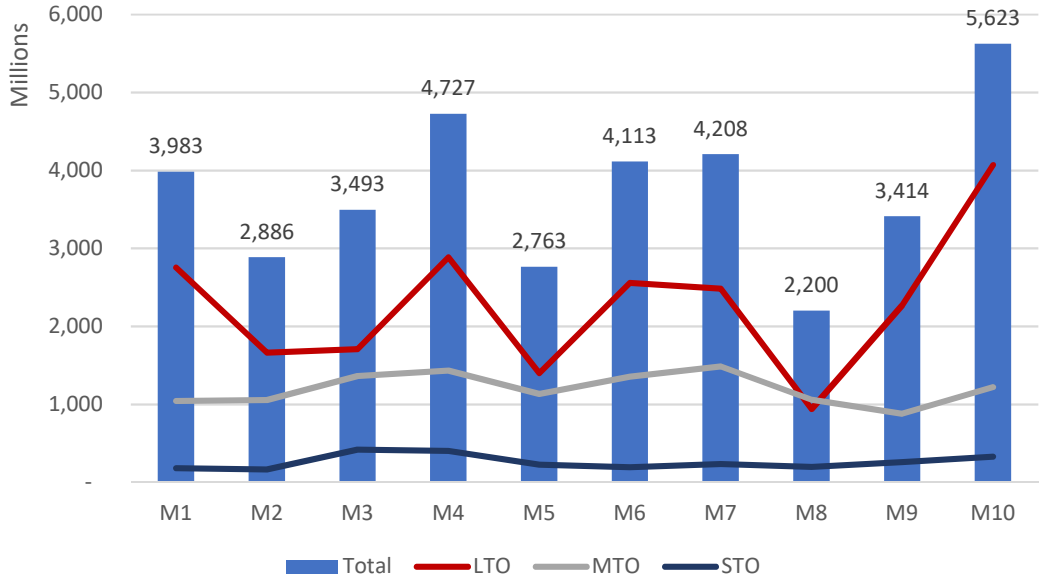
(FY1398)



Source: ASYCUDA, Staff Calculations.

Figure 4: ARD Monthly Collections, by Taxpayer Office

(FY1398)



Source: SIGTAS, Staff Calculations.

Table 1: MFPD Revenue Forecast, Oct 15th
(FY1398)

	Actual									Forecast			
Billion AFN	Jad (M1)	Dal (M2)	Hou (M3)	Ham (M4)	Saw (M5)	Jaw (M6)	Sar (M7)	Asa (M8)	Sun (M9)	Miz (M10)	Aqr (M11)	Qaw (M12)	Total
Linear Trend	14.5	13.7	14.3	15.7	22.3	13.5	15.5	11.4	15.3	15.7	15.5	17.1	184.4
Growth Trend	14.5	13.7	14.3	15.7	22.3	13.5	15.5	11.4	15.3	16.8	18.5	20.3	191.7
Pattern	14.5	13.7	14.3	15.7	22.3	13.5	15.5	11.4	15.3	16.3	17	24.4	193.8
Actual FY1397	13.3	11	13.6	14.7	12.4	14.7	15.5	13	17.8	16.6	23.5	23.8	189.9

Source: Cash Management Committee, Meeting Minutes, October 15, 2019.

Risks

This raises the question what risks a revenue shortfall may induce, and how possible negative impact may be mitigated. The government's cash position remains relatively comfortable. On October 31st the government had AFN 18.8 billion in cash available for non-restricted funding (over and above the AFN 10 billion floor established under the IMF program). Operating expenditures for M11 and M12 are forecasted to be AFN 27.4 and AFN 29.5 billion respectively. Revenues from core taxes, excluding one-off revenues are likely to be around AFN 14.5 billion per month. This would meet expenditure for M11, but not for M12. In other words, being able to secure one-off revenue will be critical for meeting projected expenditures.

Further, additional cash resources may become available through the disbursement of budget support under the World Bank Incentive Program during the last months of the year. In the short-term, risk mitigation measures are already being implemented by the government, including: i) rationing/prioritization of some discretionary development budget payments; and ii) additional attention to drivers of revenue underperformance, especially at customs points. Risks may intensify in the next fiscal year, however, with the government agreeing an ambitious revenue target of AFN 209 billion with the IMF and establishing expenditure enveloped in line with these ambitious revenue expectations. Prudent risk management may involve revising expenditure ceilings for 2020 downwards to ensure that – if revenue underperformance continues – cash shortages do not emerge and disrupt service delivery.

Putting Collections into Perspective

As noted above, while FY1398 collections are falling behind target, they are still very close to, or even exceed revenue collection in FY1397. In FY1397, domestic revenues reached a record high of AFN 189.8 billion, or 13.4 percent of GDP.[12] Despite slow growth in FY1397, estimated at 1.8 percent by the World Bank, revenues increased by 12.8 percent from FY1396 levels. Strong revenue growth was supported by improved tax administration, with estimated arrears collection of AFN 10.5 billion, and a surge in non-tax revenues from state-owned enterprises (SOEs). The latter represented more than AFN 20 billion, or 10.5 percent of total revenue

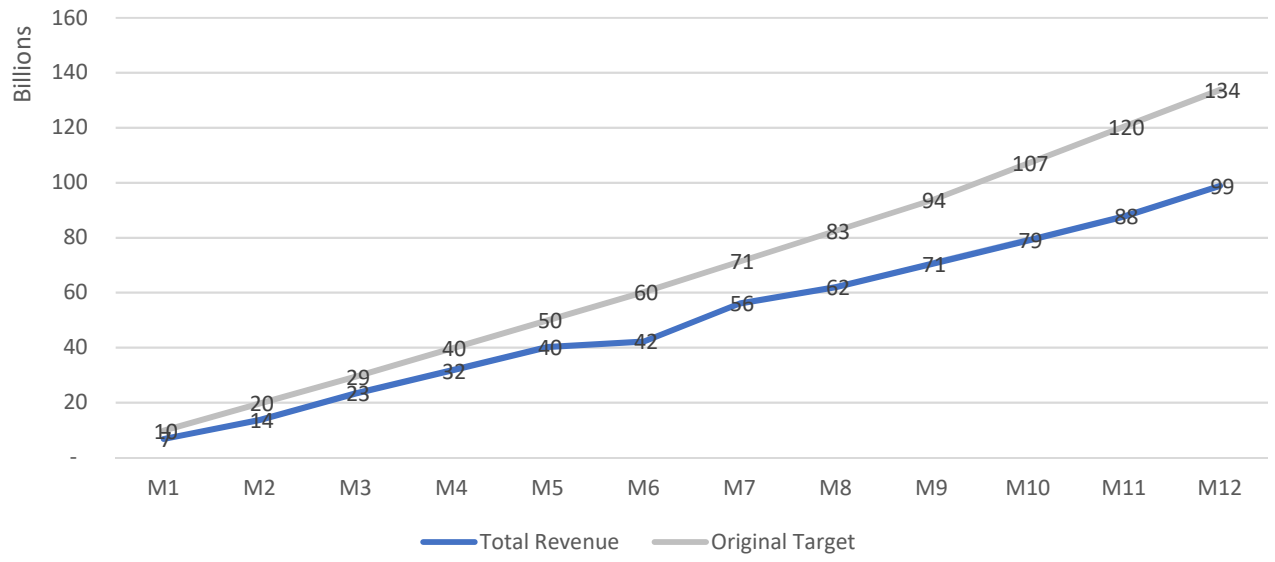
[12] International Monetary Fund (2019). Islamic Republic of Afghanistan. Fifth review under the extended credit facility arrangement and request for modification of performance criteria. IMF Country Report No. 19/157.

collection in FR1397. In other words, current performance is still relatively strong, in particular considering it is an election year.

In the previous election year, FY1393, collections ended 33-35% lower than the revenue target, which led to a cash crisis.[13] The difference compared to this election cycle is that in FY1393 collections were underperforming from the start, well ahead of the first round, and the gap kept widening over time (see Figure 5). The election cycle was 6 months ahead in FY1393, compared to FY1398: lead up to the first round of voting in early April; second round of presidential election in mid-June; and inauguration in mid-September. While the trend this year seems slightly different with only fairly recent signs of underperformance, we are seeing a shortfall in revenue collection leading up to the first round of voting.

The experience of FY1393 calls for close monitoring of revenue performance and expenditures in the weeks and months to come. This includes a review of FY1399 revenue projections and expenditure ceilings, to avoid too much fiscal pressure and risk. One-off revenues from previous years have pushed up the year-over-year revenue targets to the point where core tax collections may be under too much pressure and risk introducing fiscal uncertainty. It also points towards the importance of strengthened tax compliance in the remaining political transition period. The large drop in revenue collection in M8 suggests that stronger vigilance and monitoring of core tax collections, notably the LTO and major customs offices, is critical in the coming months, especially if a second round of elections is to be held.

Figure 5: Total Domestic Revenue Collection (FY1393)



Source: Monthly Fiscal Bulletin, Month 12, 1393.

13 https://www.budgetmof.gov.af/images/stories/DGB/Reports_publication/FiscalBulletin/1393/MEB%20Period%2012%20FY%201393%2010-01-2015.pdf
https://www.budgetmof.gov.af/images/stories/DGB/Reports_publication/FiscalBulletin/1393/Annual%20Fiscal%20Report%201393%20Final%20v7.pdf

Annex

Revenue Collection FY1398 YTD

	Jad (M1)	Dal (M2)	Hou (M3)	Ham (M4)	Saw (M5)	Jaw (M6)	Sar (M7)	Asa (M8)	Sun (M9)	Miz (M10)**	Aqr (M11)	Qaw (M12)	Total (budget)
Domestic Revenues	14,503	13,706	14,323	15,713	22,364	13,471	16,214	11,587	15,297	20,056			
Income, profits and capital gains	3,252	4,639	4,227	4,258	3,086	3,908	3,532	2,899	2,797	1,683			
International trade and transactions	3,192	2,049	2,916	2,910	3,916	3,835	3,291	2,346	2,390				
Goods and services	3,924	2,389	2,187	4,055	2,415	2,181	4,043	1,819	2,108	1,554			
Other	259	75	160	94	106	612	302	315	245	35			
Nontax revenues	3,876	4,555	4,832	4,396	12,840*	2,935	5,046	4,209	7,757	16,784			
Target (revised)	14,670	14,670	14,670	15,330	15,330	15,330	16,670	16,670	16,670	20,000	20,000	20,000	200,000
Monthly Shortfall	167	964	347	(383)	(7,034)	1,859	456	5,085	1,373	(56)	20,000	20,000	
Cumulative Shortfall	167	1, 131	1,478	1,095	(5,939)	(4,080)	(3,625)	1,458	2,831	2,775	22,775	42,775	

Source: AFMIS, Staff Calculations. * M5 includes AFN 8.9 billion in DAB dividends. ** For M8, M9 and M10 AFMIS entries are not yet fully allocated: a large portion is still labeled as 'miscellaneous' and 'unclassified' revenue, which falls under nontax revenues. Allocation to appropriate categories occurs with roughly one month delay.