



Towards Sustainable Governance: Funding & Capacity

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The United States Institute of Peace's ([USIP](#)) handbook on "[Guiding Principles for Stabilization and Reconstruction](#)" states that effective governance requires domestic capacity. This capacity comprises skills and capabilities as well as adequate financial resources. However, according to *Deutsche Welle*, the Afghan government may face significant challenges in financing its operations and its security services in the coming years if, as the [World Bank](#) predicts, aid to the country [decreases significantly](#). This report examines various ways in which the Afghan government and the international community have responded to the dual challenges of fiscal sustainability and skills building.

Fiscal Sustainability

According to an October 2011 US Department of Defense ([DoD](#)) report, revenues collected by the Afghan government [increased markedly](#) between March 2009 and March 2011. While the World Bank notes that domestic revenue collection is expected to rise significantly, the Afghan government's expenses are also anticipated to grow as the Afghan state takes over functions previously filled by the international community. The projected decline in funding from foreign donors combined with limited (yet growing) domestic revenues will leave Afghanistan with a projected financing gap of around [25% of GDP](#), or approximately USD 7.2 billion per year, says the World Bank.

Foreign aid accounts for [40% of Afghanistan's operating budget](#) and 100% of the development budget, *Outlook Afghanistan* reports. Afghanistan will, according to experts, have to continue to focus on increasing the revenues it collects so it can independently cover its budgeted costs once foreign aid levels decline. The Afghan government has already made progress towards fiscal sustainability. For instance, between 2009 and 2011, the "[fiscal sustainability indicator](#)" improved according to the aforementioned DoD report. This indicator reflects the percentage of the government's operating expenditures which are covered by domestic revenue. In fiscal year (FY) 2008-09, this amounted to 60%; by FY 2010-11 it had increased to 73%, says the US DoD. Much of this



improvement was reportedly achieved as a result of improvements in taxation and customs collection, which are both addressed below.

Tax Revenues

Afghanistan's domestic revenue-to-GDP ratio remains [among the lowest](#) in the world but is also rising, the World Bank reports. In FY 2002-03, Afghanistan's domestic revenues accounted for [3.3% of GDP](#); this figure increased to 9.4% by FY 2009-10. The World Bank states that this growth was [largely attributable to](#) the institution of the Large Taxpayers Offices (LTOs). LTOs provide one-stop shops to help large taxpayers, primarily major businesses, navigate complex procedures related to the payment of relevant taxes.¹ Setting up special offices to control large taxpayer compliance has resulted in increased revenue and more effective tax administration. According to a document from the UK Department for International Development ([DFID](#)), LTOs contributed [30% of all tax revenues](#) raised by the Ministry of Finance ([MoF](#)) in 2008. The United States Agency for International Development ([USAID](#)) has supported both LTOs and Medium Taxpayer Offices (MTOs) in [Herat](#), [Balkh](#) and [Nangarhar](#) provinces; these offices have reportedly brought [significant increases](#) in revenue mobilisation. USAID also reports that it launched a Revenue Reconciliation Database in various provincial offices which [allows automatic settlement](#) of revenues into the Afghan government's treasury account. Between 2008 and 2011, DFID allocated approximately [GBP 11.5 million](#) (USD 18.1 million) of technical support to the Afghanistan Revenue Department ([ARD](#)). The goal of this programme was to support the Afghan government in improving domestic revenue mobilisation rates by acquiring and developing a [computerised taxpayer system](#) known as SIGTAS (*see Box I*).

Box I. The SIGTAS Tax Payment System

According to a [2010 Public Expenditure Review](#), the World Bank and the UK Department for International Development ([DFID](#)), have introduced the Standard Integration of Government Tax Administration System ([SIGTAS](#)) in [Herat](#), [Balkh](#), [Nangarhar](#), [Kunduz](#) and [Kandahar](#) provinces. SIGTAS is an information system that enables the Afghan government to automate the administration of taxes and licences. SIGTAS was designed to meet [the needs of developing countries](#) such as Afghanistan, according to the SIGTAS website. SIGTAS is able to manage various aspects of tax management, including the following: (i) taxpayer registration, (ii) handling of tax declaration forms, (iii) assessments (including payments and withholdings), (iv) case management, (v) penalties and calculation of interest and (vi) audits. SIGTAS can operate in three languages simultaneously.

Other reasons for the increase in Afghanistan's revenue-to-GDP ratio include the enactment of an [amended income tax law](#), according to the World Bank. In addition, the introduction of a 2% Business Receipt Tax (BRT) and [revenues gained from](#) the state fuel company also contributed to the increases in domestically mobilised revenues. The Afghan MoF is [planning to introduce a Value-Added Tax](#) (VAT) in 2014 with support from DFID. If successfully implemented, the VAT could increase the government's revenues, though it would also make various goods and services costlier.

Customs Revenues

The United Nations Office for Project Services ([UNOPS](#)) reports that cross-border trade in Afghanistan increased substantially between 2004 and 2010, with customs revenue increasing from USD 50 million to nearly [USD 400 million](#). Since 2003, the United Nations Conference on Trade and Development ([UNCTAD](#)), the United Nations Industrial Development Organization ([UNIDO](#)) and UNOPS have been working with the Afghan Customs Department on a USD 32 million reform project which has been financed by the World Bank. UNOPS reports that

¹ According to the International Monetary Fund ([IMF](#)), countries may [gain significant benefits](#) from setting up special institutions to control the compliance of the largest taxpayers.



[improvements in infrastructure](#), communications and administration systems have been accompanied by the development of customs legislation, regulations and procedures. In addition, UNCTAD created the Automated System for Customs Data ([ASYCUDA](#)), a computerised customs management system that covers most foreign trade procedures, which was first [implemented in the Kabul Customs House in 2006](#). The system has since been expanded to include an additional seven main custom offices, including Kabul Airport which [receives approximately 55%](#) of all the country's customs declarations. The MoF states that the ASYCUDA programme is said to have helped improve customs revenues by [more than 700%](#) between 2003 and 2009. According to the MoF, this was largely [attributable to computerised control](#) over transit shipments, tighter control over the clearance of goods and the enhanced capacity of Afghan Customs Department ([ACD](#)) staff.

Box 2. The Mining Sector and Afghan Government Revenues

In Afghanistan, the World Bank states that domestic revenue increases [will also be driven](#) by anticipated mining revenues. The International Council on Mining and Metals (ICMM) states that [revenues from minerals](#) can come in different forms. Government revenues may be accrued from corporate income tax, profit taxes or royalties based on profit. Production-based taxes, however, may also apply and generally consists of sales and excise taxes, import duties and registration fees. Unfortunately, profits-based taxes often lead to a situation where government receive [very little revenues](#) for a number of years, whereas production-based taxes may be easier to collect, reports the ICMM. Although much attention has been given to mining revenues, Afghanistan's Minister of Economy, Abdul Hadi Arghandiwal, says that the mining sector will [take a long time](#) to develop and begin generating revenues. In addition groups such as Integrity Watch Afghanistan ([IWA](#)) have also [raised concerns](#) that corruption could prevent the Afghan government from receiving the full benefit of its mineral deposits, says *Reuters*.

Enhancing Capacity / Building Skills

According to "An Assessment of Sub-National Governance in Afghanistan" completed by the [Asia Foundation](#) in 2007, the [legitimacy of the Afghan government](#) can be bolstered by the effective and responsive delivery of services. The United States Institute of Peace ([USIP](#)) states that several key factors are hampering the development of a capable civil service, [including illiteracy and corruption](#). The international community has thus invested large sums into building Afghan capacity with the US DoD and other coalition partners placing 587 [advisers and mentors](#) in the Ministry of Defence ([MoD](#)) and Ministry of Interior ([MoI](#)) in 2011 alone, according to the US Government Accountability Office ([GAO](#)).

The aforementioned Asia Foundation assessment found that [service delivery has been hampered](#) by limited government capacity, especially in rural areas. In some provinces the Asia Foundation found [20% of the teaching positions](#) were vacant and 75% of the positions that were filled were occupied by teachers with only an elementary school education. Moreover, international non-governmental organisations (NGOs) focused on health care, such as *Medicins Sans Frontieres* ([MSF](#)) report that Afghanistan lacks [medical professionals](#) since many qualified employees have fled insecure areas. Afghan universities also reportedly suffer from a chronic lack of funding, infrastructure and staff at time when [demand is high](#), according to a 2011 press release from the [British Council](#).



Box 3. Select Capacity Building Projects

In addition to the small number of projects addressed in the main text of this document, there are also a wide variety of past and on-going initiatives in Afghanistan which are intended to build government and governance capacity. A selection of such projects is listed below.

- **The Economic Growth and Governance Initiative (EGGI):** Established by USAID, EGGI builds capacity in areas of economic policy, market reforms, budgetary reforms and investment decision-making. It has supported a new [provincial budgeting process](#) by training [800 civil servants](#) across 52 budgetary units and facilitated training for MoF officials in 34 provinces.
- **Capacity Building and Change Management Program (CBCMP):** By building the [capacity of the directorates](#) responsible for accounting, contracts, facilities management and human resources, the US Department of Agriculture ([USDA](#)) and its partners reportedly supported the Afghan Ministry of Agriculture, Irrigation and Livestock ([MAIL](#)) in raising the level of their professional skills.
- **Support to the Afghanistan Revenue Department:** DFID aid provides support for the [simplification of provincial taxes](#). Development of a performance-based management system, [explicit benchmarks](#) for capacity building and technical knowledge transfer to local staff will be established and monitoring throughout the course of the project.
- **Technical Assistance to the CSO:** DFID's [Operational Plan](#) indicates that it offers technical assistance to the Central Statistics Organisation ([CSO](#)). The World Bank says that assistance that seeks to enhance the quality and increase the quantity of official statistics could [aid future monitoring and evaluation](#) efforts.
- **Technical Assistance to Municipal Offices:** USAID has been active in the capacity development of municipal staff, providing [technical assistance and training](#) in areas such as trash collection, street repair and park renovation and rehabilitation.
- **The UNDP National Institution Building Project (NIBP):** Launched in 2010, the NIBP has assisted Ministry of Transport and Civil Aviation ([MoTCA](#)) in developing a mechanism for [identifying 235 suitable officers](#) from MoTCA and MoI to attend aviation security courses and in developing a Human Resource plan.

The World Bank and other development partners have supported a number of measures and [programmes to cultivate capacity](#) in the Afghan civil service through the Independent Administrative Reform and Civil Service Commission ([IARCSC](#)). The IARCSC conducts training through the Afghanistan Civil Service Institute as well as via the IARCSC's regional offices and provincial training facilities.

The USAID-funded Afghanistan Civil Service Support ([ACSS](#)) project also assists the public sector by supporting the implementation of a [system-wide pay and grading reform](#) and by building a Human Resource Management Information System (HRMIS). Furthermore, the ACSS has provided training in various functional areas to [16,000 civil servants](#) across Afghanistan's 34 provinces and has offered technical assistance to the IARCSC. In October 2011, the US DoD reported that the Afghan government continues to improve its [ministerial and institutional capacity](#). Moreover, since 2007, USAID has spent USD 218 million on its Capacity Development Programme ([CDP](#)), which addresses economic issues and democratic governance, according to a report entitled, "[Analysis of USAID'S Capacity Development Program](#)". That report indicates that the number and broad scope of programmes addressing capacity building [has led to duplication](#) and has reduced aid effectiveness. The IARCSC has also expressed concern that foreign technical advisors tend to become [de facto civil servants](#) that supplant the existing bureaucracy without effectively transferring technical knowledge or enhancing local capacity.

Conclusion

A 2011 International Monetary Fund ([IMF](#)) report says Afghanistan faces two main challenges in the upcoming years. First, the Afghan government will have to take over an [increasing share of security spending](#). Second, there



will likely be a gradual decline in overall donor support. Participants in the [Second International Bonn Conference](#) in December 2011 stated (in the Conference Communiqué) that the “Government of Afghanistan will have special, significant and continuing fiscal requirements that [cannot be met by domestic revenues](#) in the years following Transition”. However, many foreign nations participating in the Bonn Conference also pledged to provide economic assistance to the Afghan government until 2024, the year in which the IMF expects Afghanistan to become [financially self-sufficient](#), *The Guardian* reported. Details of funding commitments may not be announced until the May 2012 NATO summit in Chicago or later, according to *Reuters*. What is known, however, is that, according to the Bonn Conference Communiqué, “the role of international actors will evolve further from [direct service delivery to support](#) and capacity-building for Afghan institutions” in the coming years.