SOME ASPECTS OF THE AFGHAN TAX SYSTEM WITH PARTICULAR REFERENCE TO THE INCOME TAX LAW

(Summary)

Shamsuzzakir Kazemi
May, 1970.

The aim of this study is to assess the Taxation System of Afghanistan with particular reference to Income Taxes.

The study begins with a brief outline of the structure of the economy.

In Chapter 2 an overall look is taken at the Monetary and Fiscal Policy and this is followed, in Chapter 3, by a discussion of the various sources of Public Revenues.

This leads to the major part of this study concerned with an analysis of the various aspects of the Income Tax System. In Chapter 4 the analysis is confined to the sale of Income Taxes as; (a) a source of development finance, and (b) a counter-cyclical instrument of Fiscal Policy. The analyses under both time rate of growth series and regression functions examines the incremental tax/income ratio and the elasticity of the income taxes. The conclusions arrived at indicate the ineffectiveness of these two functions of the tax system.

Unlike indirect taxes, taxes on income and profits, in addition to meeting revenue requirements, are capable of achieving another important objective of fiscal policy; namely the achievement of equity in taxation. Chapter 5 is devoted to an examination of this function. Chapter 6 deals with an approximation of the initial impact of income taxes on various functional groups. The results in both these chapters indicate that the tax system fails to serve either the "horizontal" or "vertical" aspects of equity considerations.

The questions of revenue, equity and impact of taxation have a strong bearing on the level of economic activities by changing the level of demand for and supply of the factors of production. The study, in Chapter 7 examines the effects of income taxes on certain specific aspects of economic activities, namely the incentives to work, save and invest. The examination also covers a study of certain features of the Private Investment Encouragement Law. The various amendments and concessions initiated, particularly during the development decade, fall short of affecting a higher rate of saving and investment within the Private Sector.

Where the state of tax administration and its degree of competence, or lack of it, are factors responsible for the success or failure of any tax system with respect to the various budgetary objectives, the enquiry examines, in Chapter 8, some of the important and relevant aspects of the Afghan Income Tax Administration.

In the light of the above analyses, Chapter 9 draws the conclusions and emphasises some of the necessary and feasible changes the writer recommends for futher improvement of the Afghan Tax System in general and of Income Taxes in particular.

" SOME ASPECTS OF THE AFGHAN TAX SYSTEM WITH PARTICULAR REFERENCE TO THE INCOME TAX LAW "

by

Shamsuzzakir Kazemi
B.Sc. (Econ)., M.B.A.

A Thesis Presented for the Degree of
Doctor of Philosophy at the
University of Glasgow

1970

ACKNOWLEDGEMENT

I wish to express my gratitude to Professor Alec Nove who so generously gave of his valuable time supervising the various drafts of this study. To his guidance and invaluable comments throughout the period of this study, I remain indebted. I also wish to express my appreciation for the supervision which I received from Mr. I.A. Ghazalah and for the useful comments made by Miss Diane Dawson.

I am equally indebted to the Ministry of Overseas Development for the grant and assistance which made this study possible.

My appreciation goes to the many officials, in Afghanistan, particularly those in the Ministries of Finance and Planning, for the generous time and co-operation given to me in the preliminary stages of this study.

Finally, I thank my wife for her patience and encouragement; to her this work is dedicated.

Shamsuzzakir Kazemi
Glasgow, U.K.
May, 1970.

SOME ASPECTS OF

THE AFGHAN INCOME TAX SYSTEM

WITH PARTICULAR REFERENCE TO THE

INCOME TAX LAW

TABLE OF CONTENTS

		Page
INTRODUCTION		
CHAPTER ONE	... ...	11
	Structure of the Afghan Economy	
	A. Area and Population	13
	B. Structure of Production	14
	1 - Agriculture	15
	2 - Industry	20
	3 - Power	23
	4 - Transportation	25
	5 - Trade	26
CHAPTER TWO	... ...	35
	Instruments of Economic Policy	
	I Monetary System	37
	A. Banking System	38
	(1) History	38
	(2) Development of the Present System	39
	B. Money Market	40
	C. Capital Market	47
	II Effects of Monetary Policy	47
	III Fiscal Policy	58
	A. Expenditures	
CHAPTER THREE	... ...	69
	Sources of Public Revenue	
	I Non-Tax Revenues	73
	A. Borrowings	73
	(1) Domestic	73
	(2) Foreign Aid (grants and loans)	74
	B. Revenues from the Public Domain	77

II /

II Tax Revenues 81

A. Indirect Taxes 84

(1) Import Duties 85

(2) Export Duties 86

(3) Sales Taxes 89

(4) Excises 89

(5) Stamp Duties 89

B. Direct Taxes 90

(1) Income Taxes 90

a - Income Taxes between 1944-56 91

b - Income Taxes between 1956/57-1966/67 93

c - Individual Income Tax Under the present system 97

d - Company Income Tax under the present system 100

(2) Taxes on property, real and personal 101

(3) Municipal Taxes 112

(4) Pension Funds 113

(5) Miscellaneous Imposts 114

CHAPTER FOUR 116

Income Tax as a Source of Revenue and Instrument of Economic Policy

(1) Individual Income Tax 141

a - The coverage of the Base 141

b - The Rate Structure 142

Schedule (B) 143
Schedule (C) 147
Schedule (D) 147
Schedule (E) 150

(2) Corporate Income Tax 155

Appendices 160

(a) 161

(b) 163

CHAPTER FIVE 169

Equity Consideration: The Concept of Income and the "Horizontal" Aspect of Equity under the Afghan Income Tax Law.

1. Income in-kind 178

2. Capital Gains 183

3. Gross vs Net and Taxable Income 194

(a) Foreign income and the treatment of taxes paid 195

(b) Personal Allowances and Deductions 197

(c) Business Expenses and Deductions 198

Appendix (c) 205

Appendix (d) 209

CHAPTER SIX 211

Equity Consideration (continued)

A First Approximation to the Initial Impact of Taxes under the Afghan Income Tax System.

CHAPTER SEVEN 239

Economic Efficiency of the Afghan Income Tax System

A. Income Tax and the Incentive to Work 242

1. Agricultural Workers 245

2. Industrial Workers 246

3. Professional Workers 247

B. The Effects of the Income Taxes on the Incentive to Save and Invest 252

1. Discretionary Concessions 263

(a) Exemption from Custom Duties on Exports and Imports 263

(b) Income Tax Holiday for "approved" industrial Enterprises 265

(c) Income Tax Relief on Dividends distributed out of Tax-exempt Profits and on Interest Income 269

(d) Repatriation of Foreign Capital and Profits 274

2./

2. Concessions offered under the Income Tax Law. 280

(a) Concessions to Individuals 280

i Exemption of Interest on Government Bonds 280

ii Exemption of Interest Income from Deposit Accounts with Afghan Banks 283

iii Abolition of the Two-tier Tax on the Distribution of Company Source Income 287

(b) Concessions to Companies 294

i Tax Rates 295

ii Depreciation and other Relevant Allowances 300

iii Loss offset provision 307

CHAPTER EIGHT 312

The Administrative Aspects of the Afghan Income Tax System

1. Adequacy and Clarity of the Law 316

2. Lack of Book-keeping and Auditing of Accounts 322

3. Administration of the Tax 325

(a) Organisational Structure 325

(b) Recruitment Practices 328

(c) Employee Remuneration 329

4. Collection and Enforcement 333

CHAPTER NINE Summary Conclusions and Recommendations 339

I N T R O D U C T I O N

The past decade has witnessed marked changes in the socio-economic structure of Afghanistan. As a highly complex phenomenon, this transition has been profoundly influenced by the inter-play of a variety of social, political, cultural, economic and other factors. This enquiry concentrates on one of the economic variables, i.e. Taxation, that facilitates the achievement of certain ultimate objectives.

No attempt has been made, so far, either in the form of an official enquiry as a guideline to policy measures and/or in the form of a sheer academic exercise, to examine the crucial role of taxation in the planned development of Afghanistan. The purpose of this study is to attempt this, aiming at providing a guideline for future policy measures against the background of developmental objectives and to initiate an academic study which would serve as a background to any further attempt made in this area.

One of the problems confronting developmental efforts in Afghanistan has been the mobilisation of adequate resources in the economy. Growth objectives have put considerable pressure, primarily on the Public Sector, to incur certain necessary expenditures for purposes of capital formation. Although the rate at which such outlays, carried out during the First and Second Five Year Development Plans, 1957-58/1966-67, seem quite impressive, domestic contribution has been very small indeed. In 1968/69 this share of the government budget allocated to capital outlays has amounted to only 2.8 percent of GNP in spite of the fact that it has been the highest rate in 12 years. The rate of growth of National Income for the same year has also been very small, estimated in the order of 2.5 percent. To achieve/

achieve at least a 3 percent rate of growth in per capita income, it would demand, under the present circumstances, a GNP growth rate of about 5 percent which would allow for a modest rate of population growth at 2 percent assuming no change in the level of prices. Assuming a gross capital output ratio of 3:1, it would necessitate a gross investment at a rate of 15 percent of GNP to achieve the 3 percent rate of growth. To achieve such a rate of investment, domestic sources, both public and private, have been supplemented by foreign aid in the form of loans and grants and by deficit financing throughout the period of planned development. Since an adequate amount of revenues had to be raised from domestic sources, the Afghan Revenue Structure has been marked by the predominance of indirect taxes, (custom duties), monopoly levies and the growth of revenues from the public domain. A major part of revenues from these sources, allocated to developmental programmes, has gone into the construction of the infra-structural projects resulting in a rise in the level of effective demand unmatched by an increase in real output. Neither monetary nor Fiscal policy instrumen-ts have been successful in regulating the level of effective demand. The result has been a continuous rise in the general level of prices. It was, however, realised that in view of the regressive effects of indirect taxes that further reliance on this source of public finance would only exacerbate the unequal distribution of income. This is especially so as (a) the portion of national income passing through the foreign trade channels and affected by custom duties has been small, and (b) the expenditure/income ratio of recipients falls with a rise in the denominator. In the absence of some kind of a wealth tax and effective income tax system such a development would further impair the basis of the distributive justice of the fiscal system. It may be/

be argued that direct taxes on income (or on consumption with other taxes on wealth), with a certain degree of progression and a broad base, are the only taxes that can be sufficiently income elastic to meet the requirements of the growth of public expenditures as national income increases. With the process of democratisation spreading in every sphere of social structure, such taxes are likely to facilitate a more equitable distribution of income and wealth. Moreover, manipulations with income taxes, as one of the important fiscal instruments, are equally expected to influence the pattern of resource allocation between consumption, savings and investments. Taxes on income and profits have been the only direct taxes to have undergone considerable changes. More than six major amendments embody some necessary and appropriate provisions which influence the pattern of resource allocation. Despite all these amendments and revisions, income taxes still occupy a minor role in framing the budgetary policies of the government. The concept of income still remains very limited in scope. It excludes, owing to structural and/or administrative shortcomings, various groups, among them the agricultural sector where output accounts for almost 75 percent of national income. In 1966, tax revenues from this sector constituted only 0.3 percent of national income. The lack of a supplementary tax on wealth, and the regressive nature of indirect taxes leave equity considerations still unattended to. The inadequacy of the coverage of the tax and the arbitrary treatment of income from certain sources tend to fall equally short of meeting public sector revenue requirements and inducing savings and investment in the private sector.

A detailed consideration of the various aspects of the different taxes in the Afghan Tax Structure, does not only fall beyond the scope of one/

one volume, but is also handicapped by the limitations of sufficient and reliable data. As a consequence, the emphasis in this study is greatly influenced by; a) the availability of data and, b) the significance, both at present and in the future, of the major taxes (i.e. Indirect Taxes, such as custom duties, and Direct Taxes such as those on real and personal property and on income) in the revenue structure of the Afghan government. Owing to the potentially increasing role of Direct Taxes in the Afghan Economy, a major part of this study is concentrated on a detailed examination of some aspects of the Income Tax System and its contribution to the process of economic growth.

In examining the Afghan Tax System in general and Income Taxes in particular, it is appropriate to conduct the analysis on the basis of the following policy objectives; (a) to achieve an increase in revenue, i.e. a transfer of purchasing power from the private to the public sector, in order to facilitate the process of capital formation (b) to maintain a satisfactory degree of stability in the economy, (c) to mitigate the inequalities of income, and (d) to facilitate and encourage growth of investment within the private sector. The study is therefore divided into several chapters, each dealing with one particular aspect of the Tax System.

It is apparent that an understanding of the social and economic structure of a society is a helpful requisite for an analysis and evaluation of any sets of policies and recommendations that may follow. The study will therefore commence with a brief outline of the structure of the Afghan Economy. It will be followed by a general study of the effects of some of the relevant monetary and fiscal measures adopted during the period concerned. This is preceded by a short introductory note on the/

the monetary structure covering the functions of the Banking System in general and of the Central Bank in particular. As the effectiveness and degree of autonomy of the instruments of monetary policy play a significant part in regulating effective demand and influencing the design and success of financial policies, it is the purpose of this chapter to investigate to what extent the Afghan monetary policy has succeeded in this direction.

Having briefly outlined the scope and magnitude of public expenditures, the next chapter deals with the sources of Public Revenues. Since sources of revenue, both tax and non-tax, are numerous, the structure is broken down into its components and the share of each one is examined separately. The increasing active role of the Government in the economic life of the society has altered the structure of Public Revenues. Traditional levies have been supplemented by additional sources of finance. As domestic sources proved inadequate, both foreign and domestic (deficit finance) loans have formed a considerable portion of Non-tax Revenues. Although the government's share in national income is very small, the rate at which revenues from the Public domain has grown over the last ten years, puts it in a significant place in the revenue structure. As for Tax Revenues, the examination here will begin by covering some of the major Indirect Taxes, such as Tariffs, Sales and Excises. Under Direct Taxes, the emphasis here is placed on taxes imposed on Income, Real and Personal Properties, i.e. Land and Livestock Taxes. The study on Income Taxes in this chapter is confined mainly to an historical review of the development of the Income Tax System. For purposes of convenience, amendments brought into the structure of Income Taxes may fall under two distinct periods. The first period covers changes that were introduced between 1944, the year Income Taxes were first initiated, and/

and 1956-57 the year after which Afghanistan embarked on a planned economic development programme. The second period covers the development decade between 1957 and 1967 when the implementation of the development programmes, necessitated the initiation of appropriate changes in the Income Tax System. Since the changes and amendments from the introduction of the Income Taxes up to 1956 have been numerous, the evaluation in this paper will be mainly confined to the post 1956-57 period which also corresponds to the Plan period. The rest of this chapter is almost entirely devoted to an analysis of the taxes imposed on real and personal properties, in the form of Land and Livestock Taxes. The significant place agriculture holds in the economy of Afghanistan and the irresponsiveness of taxes from this sector suggests the revision of Land Taxes, and the study at this point presents certain feasible propositions. This will not only eliminate tax differentials between this and various other sectors, but will emphasise the urge to increase this sector's contribution to the process of economic growth.

This leads to the major part of this study which is concerned with the analysis of the various aspects of the Income Tax System. At this stage the study will be confined to the role of income taxes as a source of development finance. Under this chapter the adequacy of the Tax Base or coverage and the effectiveness of the Rate Schedule(s) as well as the different sets of exemptions and deductions, affecting both the base and rate schedule, will be examined. The examination in this chapter includes an analysis of the incremental tax/income ratio and the elasticity of the income tax system compared with indirect taxes. In the light of our findings an appraisal of the most recent, i.e. 1967, reform of the Income Tax Law is also attempted in this chapter. Furthermore, since income taxes, as a counter-cyclical fiscal/

fiscal instrument, are one of the most effective automatic stabilisers, it is important to examine whether the Afghan Income Tax System fulfils this task.

Unlike Indirect Taxes, taxes on income and profits, in addition to meeting revenue requirements, are by definition capable of achieving one of the important objectives of taxation, namely the achievement of equity in the distribution of tax obligation in accordance with the principle of the "ability to pay". The next two chapters, i.e. (5) and (6), are devoted to an examination of this function of income taxes. The question of equity and tax burden has received adequate attention, both in academic and political circles; however, ideas governing the solution to it still remain subjective and controversial. Moreover, an analysis of this issue in relation to any one or group of taxes would only provide a partial solution. A comprehensive examination would require to see the combined net effects of all taxes and all direct and indirect benefits arising from government budgetary operations. Nevertheless, the enquiry here will investigate the question of equity in taxation among income tax payers and the rest of the community, however partial such an examination may be. Since one of the characteristic features of income taxes is generally some degree of progression in rates, their imposition is expected to take into account the two aspects of equity consideration, namely the "horizontal" and "vertical". While the former aspect necessitates the existence and definition of an adequate index constituting the basis of income taxation, the latter ensures that individuals or entities situated in different economic positions along the vertical line of such an index must be treated differently. For this purpose an examination of the concept of income, as an acceptable index, under the Afghan Income Tax Law is attempted. The study will cover the treatment of different/

different items of income such as in-kind, gross vs. net or taxable, earned and unearned income, capital gains and the like.

since statistical facts and information on personal income by income groups and factor cost are not yet available, the effects of the tax on the process of distribution of income and the shifting and incidence of the tax are not considered in any detail. This chapter (6), will be mainly confined to an estimate of the initial impact of these taxes. As income from different sources has been subject to separate rate schedules, during the period under study, taxpayers are divided on a functional basis and tax obligation of the different groups is examined with respect to income and compared with each other and the rest of the community. It must be noted that as wealth is not taxed, any result arising from the above analysis may appear to provide a partial picture of ultimate tax obligation. Although the Afghan Tax System is based on the principle of the 'ability to pay', in practice taxes are based only on part of the index of economic well-being.

The questions of revenue, equity and impact of taxation seem to have a bearing on the level of economic activities, by changing the level of demand for and supply of the factors of production. They will in turn influence the level of income, its composition and distribution. The study at this point moves into an examination of the impact and bearing of these taxes on certain specific and vital aspects of economic activity, namely the incentive to work, save and invest. Here too, the effects of the coverage of the tax base, the different schedules, exemptions and deductions, as well as the various concessions affecting the level of economic activities will be evaluated. At this stage, an/

an examination of the different features of the Private Investment Encouragement Law, covering discretionary concessions, will also be made.

Last, but not least, where the state of tax administration and its degree of competence, or lack of it, are factors responsible for the success or failure of any tax system in terms of revenue, equity and/or inducements to work, save and invest, the enquiry will examine some of the important and relevant features of the Afghan Income Tax Administration.

In the light of the above analysis, the study will finally, while drawing the conclusions, recommend some of the necessary, feasible and urgent changes, aiming at the further improvement of the Afghan Tax Structure in general and of Income Taxes in particular.

The information and data necessary to help carry out this enquiry come, to a great extent, from the statistics and reports published and issued by the relevant Departments of the Ministry of Finance. Since development efforts have been co-ordinated and supervised by the Ministry of Planning, the economic reports issued by this Ministry normally form the basis of the facts and figures on expenditures, national income aggregates and other aspects of the Afghan economy. Statistics on the money supply, prices, foreign exchanges and other relevant monetary operations come from the publications of the Central Bank, prepared with the co-operation of the Ministries of Finance, Planning, and Commerce. Foreign trade and industrial investment statistics are obtained from the publications of the Ministries of Commerce and Industries respectively. Where statistics and information on specific aspects of the Tax System and the economy were not available in published/

published form, owing to the undeveloped state of Afghan statistics, efforts are made to compile them, from the records and files of the Ministry of Finance which has significantly contributed to and made this study possible. The writer has equally benefited from and drawn on the valuable personal experience acquired during his term of office as an official in charge of the Department of Inland Revenue in the Royal Afghan Ministry of Finance.

Domestic sources of information are supplemented by the publications of the United Nations, its subsidiary agencies, chiefly ECAFE, IMF and IBRD, as well as OECD and other international organisations.

C H A P T E R   O N E

STRUCTURE OF THE AFGHAN ECONOMY

Structure of the Afghan Economy

A. Area and Population

B. Structure of Production

1 - Agriculture

2 - Industry

3 - Power

4 - Transportation

5 - Trade

Prior to the examination of the main subject of this paper, it is necessary to present the reader with a brief study of certain relevant aspects of the Afghan economy. We begin with an examination of the socio-economic structure of the Country in this chapter.

A. Area and Population:

The size of the population, distribution among sectors, and relation to the size of the cultivable area and natural resources, are all important determinants on the appropriateness and effectiveness of a policy measure as well as having a significant impact on the process of economic growth. Afghanistan, forming the north-eastern portion of the Central Asian Plateau, has an area of 647,497 square kilometers and a population of over 15 millions, which gives it a population density of almost 23 persons per square kilometer. A large percentage of population, about 80 to 85 percent at present, has for long depended on a primitive primary economy as the principle means of livelihood. This includes the over two million nomads dwelling in different parts of the country. Due to a comparatively favourable climate, there is a higher concentration of population in some areas of the south, east and north of the country. Of the 15 millions some 2 millions live in towns and cities and the rest dwell in rural areas. Such a distribution may not be of an immediate concern, and the 1.75 per cent population growth per annum indicates that the country has yet ample room to absorb this modest rate without serious economic danger. But due to better medical care and higher life expectancy the rise in population rate of growth is likely to create a possible threat to the maintenance of the present level of employment and material well-being. One of the major aspects of population issue which has received considerable attention in almost all less developed economies is the relationship between the rate/

rate of population growth and the rates at which national and per capita income increase. This is one of the issues which will be of major concern to the Afghan planning experts in the years to come.

B. Structure of Production:

Afghanistan is one of the countries with national development planning which does not maintain national income accounting procedures and statistics except on the crudest basis. The Gross National Product for the year (1337 A.H.)[1] 1958-59 was estimated by officials in the Ministry of Planning at Afghanis 26.6 billions[2]. It was increased to an amount of Afghanis 30.4 billions in 1960-61, the end of the First Five Year Plan.[3] This represents a compound rate of growth for the first two years of approximately 8 percent in current prices. For the longer period of 1961/62 - 1966/67 (1345 A.H.) a growth rate of over 11 percent in current prices was estimated which resulted in a GNP, in 1966/67 of 54.0 billion Afghanis in current prices. Allowing for population increases this leaves a rate of growth in per capita income at approximately nine and one-quarter percent during the period. Allowing for sharp increases in the level of prices during the period[4] GNP rate of growth falls to a negative level.

Of the estimated total 54.0 billion Afghanis more than 75 percent come from/

---

1. Afghanistan follows the Al-Hejri Solar Calendar which begins on the 21st of March and ends on the 20th of the same month.

2. The Afghan currency unit "Afghani" is equivalent to U.S. $00.2, 22 or £0: 0: 2.3 at the official rate. The effective market rate of exchange has increased by more than 66 percent since 1962/63. For further information on the currency and monetary system reference may be made to the following chapter, page 36.

3. Framework of the Third Five Year Plan, Unpublished proposal, Ministry of Planning, 1965/66, and Afghanistan, by J.C. Griffiths. 1967. Pall Mall Press, London.

4. Table 5, page 32.

from agriculture and pastural activities, 8 per cent from industrial activities, forestry, cottage industries and crafts, 15 percent from trade and services, and the remaining 2 percent from miscellaneous activities. The per capita income at the end of the Second Five Year Plan has been estimated at approximately Afs.4000 or 21 Pounds Sterling, 59 U.S. Dollars, exchanged at the free market rate of 191 Afghanis to a Pound and 70 Afghanis to a U.S. Dollar, respectively.

1 - Agriculture:

With almost 85 percent of the population being engaged in agriculture and farming activities, contributing approximately 75 percent of national income, Afghanistan's economy is almost entirely dependent on agriculture. Apart from being the largest sector of the economy and the major source of national output and employment, the agricultural sector is the mainstay of the country's export trade.

Three-fifths of the total area is barren mountains and dry plains, and out of the total 30 million Jereebs (a jereeb is equivalent to half an acre) of cultivable land, about 20 million Jereebs are under cultivation. This gives an area of around 1.7 jereebs per person engaged in agriculture. (Reference on land ownership may be made to page 106). One third of the cultivable land is left fallow due to water shortage and/or to allow soil fertility to return[5]. The sum total of cereal food crops production (wheat, maize, barley and rice) in the year 1965/66 has amounted to 3.9 million long tons or 8736 million pounds weight. To accept a population estimate/

---

5. Land is left fallow in order to regain its fertility which has been lost in usage over a long period of time due to the lack of organic fertilizers.

estimate of 15 millions the per capita production of grain would be approximately 582 pounds, which is hardly sufficient to sustain population, especially where grain and in particular wheat bread forms the back-bone of the Afghan diet. The production of these items during the year 1965 has shown a slight cumulative increase amounting to less than 3 percent over 1961[6].

To supplement this very low level of domestic production, the government has from time to time imported wheat from the United States of America and the Soviet Union, particularly, since 1956/57 corresponding with the implementation of the Development Plan[7]. However, looking at the objectives for agricultural development, the Plan stipulates: "........ although Afghanistan is not faced with an explosive population and pressure on land is relatively less, as a result of the extension of preventive and curative medicine, its population is likely to increase at a rate faster than before. Food production must rise within a relatively short period and keep pace with population. Again, demand for agricultural raw materials - particularly cotton, wool, and sugar-beet - will grow in the coming years with the expansion of domestic industry. Furthermore, exports have to increase pari-passu with the growing imports of machinery and equipment needed for industrialisation .... "[8]. In spite of these broad policy guide-lines it has been estimated by the Second Development Plan that production of/

---

6. Information from officials at the Ministry of Agriculture, Kabul, 1965. See Note 26, page 259 for further explanation.

7. The import of wheat from the United States has taken place under the 1954 Agricultural Trade Development and Assistance Act known by its serial number Public Law 480. The purpose of these imports has been twofold; in the first place, to ensure against food shortages and rise in prices of main staple items, and in the second place to help the government raise enough local currency through the sale of these items for financing developmental projects.

8. Ministry of Planning, Second Five Year Plan, 1962-67, page 17.

of food grains must show a cumulative increase of a little over 7 percent for the entire period of five years. Production fell short to a level of 3 percent amounting to an increase in value of agricultural output of 1.6 percent, Table 1. Such an increase is bound to get completely absorbed by the increase in the population of the agricultural sector.

The development of cotton and its production has been lagging behind the estimated forecast, despite an increase of almost 10 percent over the five year period. Actual output fell short by 62 percent below the target figure of 159,000 tons. Some of the reasons for this failure may be summarised as follows: (1) The rise in the price level of food items has adversely affected the cultivation of cotton in reducing the area for its cultivation. Wheat, rice and other crops compete with cotton for land, water and labour. The price per "seer " (Afghan unit of weight equivalent to 16 pounds) of cotton paid to producers is Afs.39.00 as against Afs.39.00 to 42.00 for wheat in the market. As the supply pattern of both types of output is price elastic, even in the short run i.e. on a yearly basis, resources can easily be drawn from one and employed in the other whenever such price changes appear. This price differential becomes very discriminatory in the export sector due to the peculiarities of the exchange system and the taxes imposed on cotton. Cotton is one of the three export items - the other two being Karakul lamb skin and wool - the foreign exchange proceeds of which is totally surrendered to the government at less than the market rate of exchange[9]. A rate of Afs.45.00 per U.S.$ is offered as against the free market rate of Afs.70-75 from hard currency, i.e. Multilateral, and Afs.55.00/ U.S.$ from/

9. Ministry of Planning, Third Five Year Plan, 1967-71, page 57. See pages 54-57 below for further reference on this point.

Table 1.

Agricultural production achievements in relation to production target during the second plan

1962 - 67

Production	Estimated Production end of first plan	Production Target end of second plan	Estimated actual production 1345	Percent of target met
Food grains:				
Wheat (000 tons)	2279	2449	2158	88
Corn (000 tons)	700	755	720	95
Barley (000 tons)	378	405	375	93
Rice (000 tons)	319	357	337	94
Industrial crop:				
Cotton (000 tons)	54	159	59	37
Sugarbeets (000 tons)	44	66	56	85
Oil seeds (000 tons)	50	57	55	96
Fruits and vegetables:				
fruits (000 tons)	305	N.A.	372	-
Vegetables (000 tons)	500	N.A.	590	-
Livestock products:				
Karakul (000 pelts)	2500	2800	2610	93
Wool (000 tons)	21	24	24	100
Hides and Skins (000 tons)	7000	7500	7230	96

Source: Survey of Progress, 1968. Kabul.

from Bilateral areas. In addition to this an export tax of Afs.13.00 per dollar is collected. This leaves a low effective rate of Afs. 32.00 to a dollar proceed. Obviously this has forced the producer to shift to the production of other items or find ways of reducing costs of production and marketing. The low cost of transportation to bilateral areas, including Soviet Union and some Eastern European countries, coupled with a high sales price for cotton in this area[10] has proved beneficial to the exporter to ship a large percentage of total exports of this item to this area. In 1964 the Central Bank received over U.S. $15 millions in foreign exchange from the sale of cotton. All but U.S. $600,000 of this came from sales to bilateral customers. Recently, in 1967/68 the price of cotton was increased by 40 percent, i.e. 19.36 Afghanis per seer[11], to improve its competitive position vis-a-vis food production and prevent its decline in exports. This act increased the export of cotton in spite of a decline in total cotton production. The effect has been on the existing stocks. Whether or not it will enable the Plan to meet the reduced target of 116,000 tons[12], a 97 percent increase over the Second Plan actual figures, again depends on the difference between the official and free market rate of exchange, the level of food production and the availability of further areas to be allocated to the production of these rival items.
(2) a second factor responsible for the low output of cotton is that total area under cultivation of this crop has not, as expected, increased.
(3) a third factor which has put the actual output of cotton below the target/

---

10. U.S. $750 per ton of cotton in bilateral as against U.S. $550 per ton in the multilateral areas. Ministry of Planning, Next Steps in Foreign Trade and Exchange Management, 1965.

11. Survey of Progress, Ministry of Planning, Kabul, 1968, p.46.

12. A Mid-term look at the 3rd Plan, III Revised Edition, August 1968. The Plan initially estimated a target of 130,000 tons or 120% increase over the Second Plan actuals.

target level is the estimated target itself compared to the pattern of increase in the past. As data reveals cotton production had increased on the average at a rate of 14 percent between 1959 and 1964 which is more than twice the average for the ECAFE region.[13] In addition to these it may be seen that total developmental outlays appropriated for agriculture amounted to only 1.9 percent of national income[14]. The number of acres per person, may have also made it difficult for the small farmer to increase output owing to limited means and capital resources at his disposal. Furthermore, the usage of improved seeds, chemical fertilisers, insecticides, small tools as well as more intensive use of technology all require better training and additional investment which an average farmer will not be able to afford without the necessary help of the appropriate institutions.

2 - Industry:

Afghan industry is still in the early stages of development. In 1965 there were a total of 80 factories operating in the whole of Afghanistan; consisting of both Public and Private enterprises, output of these factories ranges from textile to mining, food processing, woodwork, printing, transport and other activities. With the exception of a few large enterprises the rest is entirely consisted of small concerns. Industrial output increased during the Second Plan period by more than 80 percent.[15] Nevertheless, total industrial output is only very small, Table 2.

Industrial/

---

13. Economic Survey of Asia and the Far East, Bangkok, 1967, page 216.

14. This included certain indirect outlays such as that incurred by the Ministry of Public Works for the building of roads, canals and dams which will, among other things, contribute to the agricultural sector by expanding the size of cultivable land.

15. Ministry of Planning, "Third Five Year Plan", 1967/71, page 187.

Table 2

Industrial Production Over the Second Plan Period

1962 - 1967

	1962/63	1963/64	1964/65	1965/66	1966/67
A - FACTORY PRODUCTION					
* 1 - Electricity Output (000 KWH)	158.2	181.7	203.7	263.2	302.3
* 2 - Fuel, Briquettes (000 tons)	22.0	26.6	27.2	37.0	29.4
* 3 - Coal (Mine Production)	84.4	99.2	112.7	144.0	161.6
4 - Marble (000 CM)	8.8	8.1	6.0	5.4	4.7
* 5 - Cement (000 tons)	59.5	103.3	142.2	172.2	174.0
Food Industry					
* 6 - Wheat Flour (000 tons)(1)	29.8	47.9	43.7	54.4	55.3
* 7 - Bakery (000 tons)(2)	12.6	13.8	15.0	14.3	15.5
8 - Sugar (000 tons)	8.0	7.0	3.9	7.4	7.1
9 - Vegetable Oil (000 tons)	1.6	1.6	1.2	2.1	1.6

Light Industry/

(continued overleaf)

Table 2 (contd.)

	1962/63	1963/64	1964/65	1965/66	1966/67
Light Industry					
10 - Soap (000 cakes)	2.0	1.9	1.8	2.8	1.4
11 - Shoes (000 pairs)	25.2	57.0	52.9	74.8	107.6
12 - Ginned Cotton (000 tons)	21.1	23.6	31.4	30.1	24.0
13 - Cotton Yarns (000 tons)	163.3	208.6	177.8	239.4	245.2
14 - Cotton Textiles (Mil.Met.)	36.8	36.9	47.0	55.2	66.0
15 - Woollen Textiles (000 Met.)	200	200	213	305	463
16 - Rayon (000 Meters)	200	300	700	1000	1304
Miscellaneous					
17 - Ice (000 tons)	2.2	2.0	3.9	1.5	4.2
B - MINE PRODUCTION					
18 - Salt (000 tons)	31.6	31.7	29.5	38.1	38.7
* 19 - Lapiz Lazali (000 Kg.)	2.2	2.0	3.9	1.5	4.2

Source: Ministry of Mines and Industries, Kabul, 1968

* Production of these items is handled either by Government Agencies or State Economic Enterprises.
(1) and (2) consist of flour mills and bread silos, in a few cities.

Industrial employment mainly in the private sector, has, under the prevailing circumstances, numbered to only 26,325 workers in 1967, (see page 248 for further reference). There are many more engaged in local handicraft industries throughout the country. Textile is the largest industry accounting for fifty percent of total industrial labour force. Mining and quarrying, food processing, printing, manufacturing of non-ferrous products and repairing of transport equipment, all employing the other 50 percent. Semi-skilled and skilled labour has been very short in supply, but the engagement, in infrastructural projects, of manpower organized under the "Labour Corps" of the armed forces has contributed to increasing their number, (page 246). In addition, manufacturing and craftsmanship have been the training platform for such labour. It is from these sources that the industrial labour force has developed. On a formal level, efforts have been made to provide technical training through the media of vocational schools established in different parts of the country. There are no trade union movements or workers' syndicates.

3 - Power:

In view of the importance of some natural resources like petroleum, and coal, as sources of energy and a fundamental pre-requisite for industrial expansion, adequate sums of money have been allocated for the discovery of petroleum in various parts of the country. As a result, deposits of natural gas amounting to more than 62,000 billion cubic meters have been located. However, the output is presently greater than the immediate requirements of the country, owing to the lack of industrial and domestic uses. It was estimated that at least 500 million cubic meters would be produced annually after 1967, and that a major part of it would be exported to Russia, the nearest outside market available. This export item will not only enable the country to be less dependent upon borrowings from abroad but will also enable her to offset part of the outstanding foreign loan. It was planned that a major part/

part of this output be used domestically after the establishment of the artificial fertilizer plant producing an amount of 56,000 tons chemical fertilizer in 1967. The project, however, has been dropped, at a later stage, from the priority list of the Plan.

Coal, which is one of the most important fuel and source of energy for industry and household, has been given a considerable emphasis in the development plans. Programmes and operations have been launched and deposits totalling more than 90 million tons have been discovered so far. In 1966/67 production amounted to 161,600 tons as compared with 41,400 tons of 1959[16]. Nevertheless, it falls short of the estimated target by almost 9 percent.[17]

One of the most important factors behind Afghanistan's potentially growing industrialisation programme is the supply of electricity. The high seasonal rainfall characteristic of all Afghanistan makes the production of hydro-electric energy extremely feasible, and therefore, storage dams and reservoirs must be built. Hydro-electric plant projects were launched during First and Second Plans. Although the completion of some of these projects has increased production capacity by more than ten times during the past twelve years, from 27 million KWH in 1955 to 302.3 million KWH in 1967[18], more than 40 percent of the entire production is being used by the industrial sector, leaving a small amount for household consumption. At the moment a few cities, including the capital province have electricity supply. The rest of the/

---

16. Ministry of Planning, "Survey of Progress", Kabul, 1964, p.138, and 1968, p.62.

17. Ministry of Press and Culture, "Afghanistan News", March, 1962, Vol.V, pages 6-18.

18. This amount includes all the electricity production, including the diesel generators supplying more than 7 million KWH of electricity per annum. Ministry of Planning, 1968.

the country obtains its lighting and heating from fuel, i.e. paraffin-oil and wood.

4 - Transport and Communication:

Afghanistan's planned economy after 1956 gave first priority to agriculture and irrigation to be followed by transportation, industry and social overheads. After two years of operations under the Plan it was realised that neither agriculture nor industry could develop efficiently without the necessary infrastructure of which transport and communication are among the most important. Price differentials were very high owing to the inaccessibility of markets and high cost of transportation both of which made it costly to open wholesale or retail businesses in these rural areas. Consequently, the market and people in these areas largely depended on pedlars. Since the volume of business of such pedlars is usually very small, turnover very low and cost of transport high, large percentage price differentials between the cities and small towns and villages have not been unusual. The lack of communication divided areas and provinces into self-contained economic units. One of the vitally important roles played by transportation was to break through the traditional social and cultural patterns. A transport development programme had to take into account the land and the extremely mountainous terrains of the country on the one hand, and its changing economic and social setting on the other. Emphasis was, therefore, directed to the construction of roads and airports. Around 50 percent of the total investment outlays during the First Five Year Plan, and 25 percent during the Second Plan were allocated for this purpose. This considerable amount of expenditure, over a period of ten years, has resulted in the completion of the "Great Circle" route which connects the Capital province with major points in the country. This gives Afghanistan a total/

total of more than 45,000 miles of all-weather roads and highways. Air transportation has also improved, as it serves a need in domestic transportation where distances between cities and production points are great and topography an inescapable obstacle to direct rapid surface movement of goods and passengers.

5 - Domestic and Foreign Trade:

As indicated earlier, trade also occupies a small portion of the total economically active population and yet this sector represents more than 15 percent of national income.

Foreign trade occupies an important place in the economy of the country. Merchandise export earnings contributed 8.1 percent of GNP in 1966, (using the figures from Table 3, page 27a, and GNP figures from page 14 above). The main export item is fruits which accounts for 35 percent of total foreign exchange earnings in 1967/68. Next in importance is Karakul lamb skin, which accounts for 21 percent of earnings, cotton 19 percent, wool, carpet and others make the remaining 25 percent of export earnings[19]. Efforts are being made to widen the scope of exportable commodities. However, the increasing burden of foreign debt service[20], together with rising imports during the past five years have not only erased appreciations in the balance of trade, but has resulted in balance of payments difficulties, Table 4.

Prices/

---

19. Foreign Trade Statistics, Ministry of Planning, 1967.

20. Total debt service in 1967/68 had been estimated at about U.S. $19.00 millions or £7.9 millions, or more than 30 percent of the U.S.$61 million export earnings for that year.

Table 3

AFGHANISTAN'S FOREIGN TRADE STATISTICS

IMPORTS BY COMMODITY 1962/63 - 1967/68

(Million Pounds Sterling)*

Commodity	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68
Sugar	0.85	0.43	2.03	1.08	2.29	2.22
Tea	1.33	1.32	1.49	1.02	2.17	2.01
Other food items	0.19	0.26	0.18	0.30	0.62	0.91
Tobacco and Tobacco Manufactures	0.09	0.12	0.11	0.28	0.13	0.15
Petroleum Products	2.03	2.33	2.67	1.54	1.56	2.25
Medicinal and Pharmaceutical products	0.46	0.75	0.91	0.54	0.81	1.06
Other chemical products	0.20	0.99	0.47	0.56	0.72	0.93
Rubber, tyres and tubes	0.89	1.04	0.40	0.75	1.08	1.59
Cotton Fabrics	1.78	0.95	1.39	1.43	1.37	1.46
Fabrics, excluding cotton	2.17	2.01	2.07	1.54	1.75	2.14
Other non-metallic mineral manufactures	0.45	1.85	1.58	1.23	1.45	2.89
Metals and Metal Manufactures	0.50	0.77	0.78	0.68	0.88	1.96
Machinery, excluding electric	0.19	0.24	0.46	0.29	0.49	0.61
Electric Machinery	0.41	0.48	0.71	0.69	0.88	0.84
Automobiles	0.42	0.75	0.82	0.50	0.41	0.51
Other road motor vehicles	0.32	0.64	0.38	0.94	0.68	0.53
Bicycles	0.04	0.09	0.18	0.08	0.10	0.16
Other transport equipment	0.41	0.43	0.35	0.37	0.41	0.77
Plumbing, Heating and Lighting Equipment	0.23	0.28	1.10	0.39	0.30	0.44
Used Clothing	0.38	0.55	0.73	0.50	0.35	0.91
Footwear	0.50	0.53	0.66	0.58	0.49	0.63
Other miscellaneous manufactured articles	1.16	1.34	1.45	1.41	1.23	0.74
All other commodities	6.12	3.46	2.91	3.66	3.57	2.89
Sub-Total	21.03	21.11	23.83	20.36	23.74	28.58
Non project loan and grant imports	1.77	4.39	5.49	6.47	8.34	4.21
Project loan and grant Imports	18.41	18.39	21.12	20.12	21.68	25.83
Total	41.21	43.89	50.44	46.95	53.76	58.62

Source: Ministry of Planning, Survey of Progress, August, 1968, Calculated from Table (s-15 and 16).

* A conversion rate of U.S.$ 2.80/Pound Sterling is applied to 1966/67, and thereafter the rate has been adjusted to U.S.$2.40/£1.

Table 3
(contd.)

AFGHANISTAN'S FOREIGN TRADE STATISTICS (continued)
EXPORTS BY COMMODITY 1962/63 - 1967/68

(Million of Pounds Sterling)*

Commodity	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68
Casings	0.44	0.61	0.57	0.41	0.52	0.53
Fresh Fruits	0.60	1.03	2.04	2.19	2.58	6.20
Dried Fruits and Nuts	5.32	4.11	4.81	6.38	5.45	4.64
Fresh and Dried vegetables	0.01	0.08	0.07	0.06	0.07	0.70
Oil Seeds	0.77	1.23	1.26	1.60	0.36	0.37
Hides and Skins	0.51	0.77	7.00	0.48	0.78	0.85
Karakul Skin	4.26	6.01	4.44	5.74	4.20	5.94
Other Fur Skins	0.10	0.17	0.11	0.04	0.07	0.05
Wool	2.71	2.64	2.19	0.71	2.33	2.02
Raw Cotton	3.01	4.51	5.33	3.97	5.10	5.27
Medicinal Herbs	0.26	0.35	0.36	0.03	0.35	(1)
Carpets and rugs	2.71	2.46	3.11	3.19	2.91	2.15
All other comodities	0.28	0.80	0.20	0.14	0.08	1.54(2)
Total**	20.98	24.77	31.49	24.94	24.79	28.26

Source: Ministry of Planning, Survey of Progress, August, 1968, Calculated from Table (S-16)

* See page 27 above

** The discrepancy between these figures and the total of Exports of goods and services in the Commercial transaction section of the Balance of Payments, See Table 4, is mainly due to certain adjustments and improvements made in the export statistics. The data comprising the total of exports in the Balance of Payments table are recorded on a change of ownership basis, that is the mere shipment (export) of certain export items, such as Karakul, cotton, wool and carpets and rugs, does not enter the Balance of Payments table until ownership has changed hands. The recording as such reflects actual sales and value at the point of time ownership actually changes. For all other commodities physical export data as reported by the Ministry of Commerce are used. On the other hand, the Table for exports and imports are based on the Physical exports and imports figures reported by the Ministry of Commerce, Ibid., p.38.

(1) Included in all other Commodities, (2) Natural gas export included

AFGHANISTAN'S INTERNATIONAL BALANCE OF PAYMENTS   Table 4.

1964/65 - 1967/68

(IN MILLION POUNDS STERLING)

	1964/65			1965/66		
	Bilateral	Multilateral	Total	Bilateral	Multilateral	Total
GOODS AND SERVICES:						
Export of Goods and Services	+ 9.95	+ 13.66	+ 23.61	+ 7.28	+ 18.27	+ 25.55
Merchandise Export (FOB)	+ 9.56	+ 13.02	+ 22.58	+ 6.88	+ 17.64	+ 24.52
Foreign Embassies' Local Expen.	+ 0.39	+ 0.64	+ 1.03	+ 0.40	+ 0.63	+ 1.03
Import of Comm. Goods & Services	- 8.56	- 15.78	- 24.34	- 8.68	- 11.99	- 20.67
Merchandise Imports (CIF)	- 8.38	- 15.49	- 23.87	- 8.48	- 11.70	- 20.18
Expen. of Afghan. Diplom. Actg. Abroad	- 0.18	- 0.29	- 0.47	- 0.20	- 0.29	- 0.49
Balance of Commercial Trans.	+ 1.39	- 2.12	- 0.73	- 1.40	+ 6.28	+ 4.88
Import of Project Goods & Services	- 16.13	- 4.98	- 21.11	- 13.73	- 6.38	- 20.11
Commodity Assist. Imports.	- 0.91	- 4.58	- 5.49	- 1.57	- 4.90	- 6.47
Foreign Deeds Interest Payments	- 1.08	- 0.64	- 1.72	- 0.08	- 0.62	- 0.70
Balance on Goods and Services	- 16.74	- 12.33	- 29.07	- 16.78	- 5.63	- 22.41
CAPITAL ACCOUNTS:						
Gross Capital Inflow.	+ 17.04	+ 9.57	+ 26.61	+ 15.30	+ 11.29	+ 26.59
Development Loans and Grants	+ 16.14	+ 4.98	+ 21.12	+ 13.74	+ 6.36	+ 20.10
Commodity Assistance	+ 0.91	+ 4.58	+ 5.49	+ 1.57	+ 4.90	+ 6.47
Gross Capital Outflow	- 0.65	- 0.64	- 1.29	- 0.68	- 0.67	- 1.35
Amortisation, Payment of Foreign Loan	- 0.65	- 0.64	- 1.29	- 0.68	- 0.67	- 1.35
Balance on Capital Account	+ 16.39	+ 8.93	+ 25.32	+ 14.63	+ 10.61	+ 25.24
Net Receipts or Payments	- 0.35	- 3.40	- 3.75	- 2.15	+ 4.98	+ 2.83
Errors and Omissions	+ 0.93	+ 2.39	+ 3.32	+ 3.14	- 4.06	- 0.92
Foreign Exchange Asset Changes	- 0.58	- 1.01	- 1.59	+ 0.98	+ 0.92	+ 1.90

Source: Compiled and Prepared from the Foreign Trade Figures, 1964/68

A rate of £1 = $2.80 has been applied up to 1967, and there onwards the rate has been reduced to 2.40.

Figures have been rounded up after two decimal points.

(continued overleaf)

Table 4 (continued)

	1966/67			1967/68		
	Bilateral	Multilateral	Total	Bilateral	Multilateral	Total
GOODS AND SERVICES:						
Export of Goods and Services	+ 9.39	+ 14.33	+ 23.72	+ 10.82	+ 17.38	+ 28.20
Merchandise Export (FOB)	+ 8.85	+ 13.91	+ 22.76	+ 10.33	+ 16.76	+ 27.09
Foreign Embassies' Local Expen.	+ 0.53	+ 0.41	+ 0.94	+ 0.49	+ 0.62	+ 1.11
Import of Comm. Goods and Services	- 10.22	- 14.10	- 24.32	- 8.27	- 19.40	- 27.67
Merchandise Imports	- 10.00	- 13.80	- 23.80	- 8.06	- 19.07	- 27.13
Expen. of Afghan Diplom Actg. Abroad	- 0.19	- 0.29	- 0.48	- 0.21	- 0.33	- 0.54
Balance of Commercial Trans.	- 0.81	- 0.23	- 1.04	+ 2.55	- 2.02	+ 0.53
Import of Project Goods and Services	- 19.54	- 3.24	- 22.78	- 19.87	- 5.97	- 25.84
Commodity Assist. Imports.	- 1.61	- 5.63	- 7.24	- 2.34	- 1.83	- 4.17
Foreign Deeds Interest Payments	- 0.06	- 0.71	- 0.77	- 1.77	- 1.41	- 3.18
Balance on Goods and Services	- 22.03	- 9.35	- 31.38	- 21.43	- 11.27	- 32.70
CAPITAL ACCOUNTS:						
Gross Capital Inflow	+ 21.15	+ 8.87	+ 30.02	+ 22.21	+ 7.83	+ 30.04
Development Loans and Grants	+ 19.54	+ 3.24	+ 22.78	+ 19.87	+ 5.96	+ 25.83
Commodity Assistance	+ 1.61	+ 5.63	+ 7.24	+ 2.34	+ 1.87	+ 4.21
Gross Capital Outflow	- 0.78	- 0.73	- 1.51	- 0.57	- 0.94	- 1.51
Amortisation, Payment of Foreign Loan	- 0.78	- 0.73	- 1.51	- 0.57	- 0.94	- 1.51
Balance on Capital Account	+ 20.37	+ 8.14	+ 28.51	+ 21.65	+ 6.89	+ 28.54
Net receipts or payments	- 1.65	- 1.21	- 2.86	+ 0.21	- 4.38	- 4.17
Errors and Omissions	+ 1.24	- 1.30	- 0.06	- 0.20	+ 5.29	+ 5.09
Foreign Exchange Asset Changes	- 0.41	- 2.52	- 2.93	- 0.99	+ 0.90	- 0.09

(See overleaf)

Note on Table 4:

The relatively high level of a favourable balance on Commercial transactions amounting to £4.91 millions in 1966 is mainly attributed to the curb on unnecessary imports imposed for a short period of time. In addition, the slight increase in export receipts, resulting from a rise in exports of such items as fruits and the auction of Karakul lamb skin, has also contributed towards this improvement

Prices have shown a steady upward trend for the past six years. Table 5 shows a cumulative 164 percent increase in the general level of prices during the 1961/62 - 1967/68 period, indicating an average rate of increase of a little over 27 percent per annum. A moderate rate of inflation such as the upper 5 percent limit suggested by development economists[21] may be necessary in order to promote growth, but such a limit has been vigorously exceeded under the Afghan experience. The Table also reveals that the highest rise of prices has accompanied developmental expenditures, particularly, under the Second Plan. Since the total price index is a weighted average of its components, a brief examination of movements in the price indices of these components and the underlying causes will shed some light on price index in general.

Following 1962/63, cereal prices have been the principal immediate cause for the acceleration of the national price index. This is explained not only by the fact that cereals carry the largest single weight in the index[22], but that their prices collectively, and that of wheat alone, rose at unprecedented rates since 1962. Despite the sale of wheat obtained under the PL480 arrangements the prices of cereal rose at an annual rate of 34 percent during 1965/66 - 1967/68. While such a rise in the price level of these items is mainly attributed to droughts causing a reduction in output of the agricultural sector, the inflationary effects of the budgetary outlays (pp.60 and 62) reflecting themselves in the level of effective demand have highly aggravated the situation. This has obviously shifted the terms of trade in favour of agriculture and a re-distribution of income to land-owners. Moreover, the rise in food prices forced/

---

21. W.A. Lewis, Theory of Economic Growth, pp.224 and 404.

22. In low income countries expenditure on non-protein food items such as grains, fruits and vegetables have a higher income elasticity than the protein foods such as meat and dairy products. If production is unable to keep up consistently year after year, prices rise and consumers are forced to spend an even greater proportion of their income in order to satisfy their physical needs. The result is, obviously, a reduction in the proportion of consumer income remaining to satisfy other wants,. Survey of Progress, Op. Cit. pp. 26-28.

Table 5

RETAIL PRICE INDEX

(1961/62 to 1967/68)

1961/62 = 100

ITEMS	1961/62 (1340)	1962/63 (1341)	1963/64 (1342)	1964/65 (1343)	1965/66 (1344)	1966/67 (1345)	1967/68 (1346)
Cereal	100	95.7	143.5	173.4	186.5	246.7	336.0
Meat	100	97.9	110.4	145.0	174.9	217.0	212.3
Fruit	100	100.5	138.3	147.0	168.0	188.0	177.4
Vegetables	100	103.6	127.9	138.7	144.6	157.4	155.8
Other food articles	100	107.4	106.9	129.9	141.0	151.5	151.7
Non-food articles	100	101.6	98.6	99.1	103.4	111.1	110.9
All items index	100	98.1	132.2	156.1	170.5	214.1	264.2

Source: Survey of Progress 1967/68, Ministry of Planning, Kabul, 1967.

Note: Expenses on non-food items include that on cotton piece goods as clothings, rugs and carpets, soap, electricity, kerosene, wood and petrol.

Note on Table 5

The national price index is a weighted average of food and non-food item prices collected across the country. Prices of twenty-four commodities are currently collected by the Central Bank, from twenty-eight main cities. Beginning with 1966/67, the national average price has been calculated for each item through multiplying by the estimated 1966/67 population of each city. For the period 1961/62 - 1965/66 when prices from 16 cities were collected, the estimated 1959 population figures were used. The commodity content has remained constant throughout the period and as such changes in preferences associated with rises in income have been disregarded. Using the year 1961/62 as the base period the city or national average price for each commodity for each year is converted to a price relative. The commodity price relatives are weighted according to their estimated expenditure in GNP in 1958 to arrive at the group and general index.

The index is, therefore, of the Laspeyres, base-weighted type. It has the advantages of establishing the base weights once and using them in future for the rest of the series, which gives greater speed if such series are calculated and produced at shorter intervals, i.e. monthly or even weekly if need be, with some time lag involved. However, the method still retains its inherent weakness by maintaining the base weights for calculation over a long period which very quickly become irrelevant in a dynamic situation. As prices increase they will obviously affect the quantities so purchased which will not be reflected in the base year and calculations will either exaggerate or underestimate the real trend in price changes.

forced up the level of wages , (page 246). Regarding non-food items, they include electricity and petrol, both monopoly items (page 79), the prices of which are deliberately kept down. The price of other items such as cotton, wool, rugs and carpets, being at the same time export items, is highly susceptible to changes in the international market affected by consumer preferences, type and quality of competitive goods, technological changes and the efficiency of market organisations necessary in affecting larger sales. A drop in prices in the international markets evidently depresses domestic prices to a large extent particularly when a larger share of the items concerned is destined for export purposes and where the elasticities of supply take some time to adjust themselves to such movements. The rise in the price of other items has slowed down as cereal prices are continuing their spiral trend.* Whether or not the general trend will bring hopes to peg the inflationary pressure and reduce its effects on foreign exchange rates remains to be seen. A great deal of this depends not only on the output of cereal but also on the level of budgetary deficit and its method of finance.

With this brief outline of the main features of the Afghan Economy in mind we shall now proceed to a study of some of the main economic institutions, the policies and measures of which have been responsible in affecting the pattern of economic growth.

---

* Ministry of Planning, Survey of Progress, Op.Cit., PP 28 and 29.

CHAPTER TWO

INSTRUMENTS OF ECONOMIC POLICY

Instruments of Economic Policy

I -- Monetary System

A. Banking System

(1) History
(2) Development of the Present System

B. Money Market

C. Capital Market

II - Monetary Policy

III - Fiscal Policy

A. Expenditures

A thorough study of the total legal framework of institutions and their relevant policies, facilitating the process of social and economic change, appears to fall beyond the scope of this paper. Nevertheless, attention in the following pages will be focussed on some relevant aspects of Monetary and Fiscal policies best suited to mobilise the requisite volume of savings and resources for economic development, and help ensure an increasing rate of sustained growth.

Before proceeding with the examination of the role of these two major tools of economic policy, a brief note on the structure of the Afghan Monetary System appears necessary.

I. Monetary System:

Until 1935, gold, silver, copper and other metallic coins constituted the currency and were considered the only medium of exchange in the country. Treasury Notes, the first paper money to be introduced in 1935 remained in circulation until the end of March 1948. Bank Notes which supplemented Treasury Notes and eventually replaced them, were introduced in 1941 as the Central Bank of the country was established.

The basic monetary unit is the "Afghani" which is equal to one hundred "Pouls", page 14 above. As a member of the International Monetary Fund Afghanistan established a par value for her currency in terms of U.S.$, in 1963[1]. There is no specific monetary legislation and the sole right to issue currency notes and to regulate the monetary situation is vested in the Bank of Afghanistan, the Central Bank, by virtue of the articles of its Statute.

A. Banking System /

---

1. Page 57 below.

A. Banking System:

The Afghan Banking System operates on a "branch bank" basis with headquarters in Kabul, the Capital City, and branches in many parts of the country. There are no foreign banks or their branches operating in Afghanistan. In addition to foreign banks operating as correspondents to members of the Afghan Banking System, transactions abroad are also handled by the branches of Afghan banks incorporated under the laws and regulations of the countries in which they operate.

There is, as yet, no banking law other than the Afghan Commercial Code, defining the banking profession. The Banking profession is, therefore, considered an ordinary commercial activity subject to the provisions of the Commercial Code, that governs the legal form, capital requirements, Shares of capital, Bye-laws and other aspects of commercial enterprises. For tax purposes banks are treated as joint-stock companies subject to the tax rates applicable to such commercial enterprises.[2]

(1) History:

Afghanistan's awareness of the need for economic development started right after complete independence in 1919. Being a land-locked country, one of the most important schemes was to improve trade. Bilateral trade agreements were concluded with neighbouring as well as European countries. A number of local trading companies were established by the joint efforts of the Private and Public Sectors, to help promote foreign trade activities and accumulate capital for the various development projects. A few of these companies were allowed to deal in gold and silver transactions to accumulate foreign exchange to meet the requirements in both Sectors. This/

2. They differ from other commercial enterprises in that they are allowed to establish reserve from taxable income up to a certain ratio of outstanding loans, which affects tax liability. See page 209 for further reference on this point.

This trend of progress continued until 1928 during which year the country experienced an internal disturbance culminating in a revolutionary regime. The regime was suppressed in 1929 and replaced by a Constitutional Monarchy. Since then, there has been a continuous progress in many aspects of the social and economic life of the country. One of the stabilisation and reconstruction measures taken by the government was the establishment of a company, then known as Afghan Joint-Stock Company, or "Shirkat-e-Sahami Afghan", authorised to deal in foreign exchange operations in order to secure and maintain the value of currency in terms of foreign exchanges. Another purpose behind establishing the company was to provide short, medium and long-term loans to industrial projects. In 1932 the name Afghan Joint Stock Company was altered to the "Afghan National Bank" Bank-e-Milli Afghan. It thus became the first financial institution to perform commercial and certain Central Banking activities throughout the country. The Bank was authorised to engage in other activities such as the purchase of necessary capital and consumer goods for government agencies. The initial authorised capital of the Bank amounted to Afs.35 millions, fully paid up. This initial amount, however, has been increased by new stock issues and calls on the shareholders from time to time until it obtained the present (1968) level of Afs.500 millions and an additional Afs.356 millions as reserves.

(2) Development of the Present System:

In the late thirties, as Bank-e-Milli was overburdened with many other activities the need was realised to relieve it of the irrelevant activities such as the procurement of supplies and capital goods to government agencies. Bank-e-Milli was hence entrusted mainly with some of the Central Banking functions, while at the same time enjoying the monopoly over all commercial banking operations. As the need for an independent Central Bank was growing stronger, the statutes for such a bank/

bank were finally ratified in 1939 and with a capital of Afs.120 millions, fully owned by the Government, the Bank of Afghanistan was established. Among some of the activities, the function of issuing bank notes which was in the hands of the Treasury, was entrusted to this Bank. In 1940 it was declared as the fiscal agent of the Government. The Central Bank also maintains the operation of a separate commercial banking department. Although more than quarter of a century old, the Bank has not yet been able to perform some of the orthodox functions of a Central Bank, such as operating the "reserve ratio", and "discount rate"; dealing in "open market operation" and the like. For various reasons the organised sector of the money market has been cut off from the rest of the monetized sector of the economy. This obviously renders monetary policy ineffective with respect to regulating prices, interest rates, the level of effective demand and the supply of money. Much of this lack of success in this direction may be attributed to the dualistic nature of the economy. However, it does not relieve the Central Bank of its responsibilities regarding the establishment of a framework of a Central Bank and sound management of the monetary affairs in a dynamic situation. An account of the development of the banking system since the forties will substantiate this argument.

Early in the forties some economists in Afghanistan were convinced of the merits of centralising all kinds of banking operations and thereby suggested the possible merger of Bank-e-Milli and the Bank of Afghanistan. Others, aware of the growth of specialisation in every aspect of social and economic life of the community, proposed the establishment of separate specialised credit institutions. The problem of raising funds for such organisations made it difficult for the government to depend on the Private Sector for equity capital and/or the volume of saving to be created. If any need for specialised credit institutions was felt, the Government/

Government had to provide all the capital required. Consequently, the framework of these specialised credit institutions was created by establishing, in 1947, a Construction Credit Fund (later known as the Construction, Mortgage and Real Estate Bank) under the management of the Central Bank. The functions of this bank were to grant credit to civil servants for buying land and constructing houses. These loans were almost entirely unsecured except for the land. The bank was also allowed to grant loans to the inhabitants of Kabul for the same purpose. Such credits were supported by collaterals which were mostly over-valued. It has been mainly due to this and other unsound banking practices that the Construction & Mortgage Bank experienced losses for more than three years from which it has not yet recovered. At present, while trying to collect as much of its outstanding loans as possible, it is extending commercial credit to at least cover operational and administrative expenses. This movement has obviously taken the bank away from its initial objective.

The Agricultural and Cottage Industry Bank was established independent of the Central Bank in 1955. About 51 percent of its capital was subscribed by the Central Bank and the rest by other government agencies and private investors. This bank was established with the purpose of assisting farmers and land-owners throughout the country. It started operation by extending short and intermediate-term loans aimed at raising agricultural output. The loan policies of this bank, too, lacked prudence. In 1957, an analysis of loans in Kabul shows that out of 60 applications, 20 were for household expenses, 18 for marriages and 9 for expenses on death[3]. In general, it appears that most of the loans have/

---

3. "The possibilities of Agricultural Co-operatives in Afghanistan". F.A.O. Report No:690 Rome, 1957.

have been obtained for household expenses, purchase of cattle and other personal expenses. This is just because interest on private loans extended by money-lenders sometimes exceeds more than 50 percent of the loan[4], as against the bank rate of interest at 8 percent. This state of affairs has forced the closure of the chapter of extending any direct credit to the farmers. Losses have been partly due to the lack of sufficient and accurate facts and data and partly due to inefficient management of the loan portfolio.

The initiation of the First Five Year Plan in 1956/57 increased the need for foreign exchange earnings in order to meet an increasing level of imports of both consumer and capital goods. In a move to expand and develop the foreign trade sector, and facilitate the movement of goods to local and export markets, the Government laid down in 1956 the framework of a second commercial bank, known as the "Afghan Commercial Bank" (Da Pashtany Tejaraty Bank). The immediate objective of the bank was to provide credit facilities for the growing number of small merchants who had not previously been adequately accommodated by the banking system and had therefore been compelled to borrow at exorbitant rates in the "Bazar"[5]. Despite the existence of Bank-e-Milli and Pashtany Bank, the Central Bank still conducts commercial banking operations. Credit extended by the Central Bank to individuals and institutions, including members of the Banking System, bear the same interest rate, i.e. at nine percent per annum. This has created an atmosphere of lack of co-operation among/

---

4. Ibid.

5. Private rates of interest, even for commercial loans, are presently at 26-30 percent. Bank credits bear a rate of interest that ranges from 8 percent on agricultural and industrial loans to 15 percent and 16 percent on commercial overdrafts. Time deposits on the other hand bears a rate of interest between 6 and 6½ percent. The difference between the deposits and credits may be narrowed by increasing interest on certain specific deposit accounts.

among members of the banking system especially between the recently established PTB and the Central Bank. The former claims; (1) Central Banks in other countries do not lend directly to the public and, therefore, the Bank of Afghanistan must refrain from such commercial activities, (2) The Central Bank should first lend to commercial banks and they in turn will lend to the general public. The first contention is not entirely in accord with the facts. While Central Banks in many countries do not directly deal with the public there are a number of them, such as the Commonwealth Bank of Australia, Bank de France and the Central Bank of Turkey that maintain both the Central and the Commercial Banking Departments. Since the Central Banks in a number of other countries do in fact make direct loans to the general public the second contention is based on an incorrect premise. Nevertheless, as a result of such an attitude there is very little sign of co-operation between the Central Bank and members of the Banking System. This is of great importance as relations among them are not based on any kind of legislation or indirect control, but rather on direct control and moral suasion of the Central Bank.

Once the Plan was underway, the foundation of an industrialisation programme was laid down. The provision of both medium and long term credits to industry became the major concern of this programme. Prior to 1956, industry was mainly financed by the private investors through Bank-e-Milli. This policy was carried to a very limited extent. The contribution of the Central Bank was equally inadequate. In 1957 an Industrial Credit Fund was established with a capital of 220 million Afghanis, subscribed by the Central Bank and Bank-e-Milli in equal proportions. At the same time the Government bought at least 63 percent of Bank-e-Milli's share of investment in the Northern Cotton Company and 51 percent in the General Electric Company and so established their control over the selling prices of/

of textiles and electricity. Furthermore, dealings in foreign exchanges were entrusted solely to the Central Bank. The Fund had, until 1963/64 granted a total of 369 million Afghanis as credit mostly to major establishe industrial enterprises such as the Kabul Hydro-electric Project, the Gulbahar Textile Mills, the Afghan Textile Company, and the Jangalak Repairing Plant. These loans have been mainly for further expansion of these enterprises. Meanwhile, the government increased their share in industrial investment in new enterprises through advances by or balances at the Central Bank. All this marked a departure from the traditional "guiding"[6] role of the Government to an active "participation" with the private enterprise.

B. Money Market:

The allocation of resources in an economy is considerably influenced and affected by the development of communication and of the means by which capital is transferred from the control of one party to that of another. The network of individual institutions through which the process of transfer and allocation is carried out is known as the "Money Market". This Market consists of a nucleus of specialised institutions including the banks, the market for negotiable securities, the discount houses, the brokers and other specialised credit institutions providing funds for short term uses.

It is apparent that there are markets of this sort in almost every economy. Some of these markets are highly developed while a large majority of them are not. It would be appropriate to list some of the characteristics of a developed money market and evaluate the state of the Afghan Money Market. Four/

---

6. See pages 78 and 309 below for further reference on this point.

Four major characteristics of a developed money market may be listed as follows:[7] (1) The presence of a highly organised banking system that forms the nucleus of the whole money market, (2) the development of a number of sub-markets for specialised dealings in funds for various maturities and against different collaterals, implying the existence of a substantial supply of and demand for funds in all these sub-markets, (3) the existence of an integrated structure in which every sub-market is dependent upon, and is affected by the other parts, and the presence of an easy flow and movement of funds from one part to the other parts of the market, and (4) the attraction of funds from abroad due to the high degree of liquidity of the market. Those who prefer to possess highly liquid assets will send their funds to such a centre even if they happen to live away from it.

The brief description of the Afghan Banking System bears ample witness to the undeveloped state of the Afghan Money Market. Unlike the developed economies the majority of the public does not use the services of the banking system. As a result, banking facilities are available at a few centres only. The low ratio of demand deposits to money supply and the ratio of bank credit[8] (especially to the private sector) to national income both indicate the undeveloped nature of the Banking System and the size of the Money Market.

Liquidity of this narrow market is not assured both because of the absence of banking legislation and because of the lack of proper Central Banking operations. Liquidity requirements, at times, may leave these banks with undesirably high cash holdings on hand. Although there are trade bills/

---

7. S.E. Sen, "Central Banking in undeveloped Money Markets", Bookland, Calcutta, 1952, pp.15-20.

8. See Table 7, page 51 below on this point.

bills in use, the number of people using them evidently is very small. The majority of transactions are made in cash which, among other things, reflects upon the degree of confidence in the character and capacity of traders. There are no dealers or discount houses, primarily because the practice of discounting is non-existent. Short term self-liquidating transactions are financed by means of overdraft facilities. The discount market will tend to develop on modern lines if trade bills were widely used in financing self-liquidating transactions, and, if the Central Bank undertook to provide rediscounting facilities in order to ensure adequate liquidity. This will establish control over the role of interest, which is one of the most important factors in investment decisions, and the act of rediscounting, a fundamental function of the Central Banking in a less developed country. It will prepare the way for the initiation of short and medium term bills.[9].

As far as the acceptance market is concerned, it can be stated that the Bank of Afghanistan, the Pashtany and to some extent the Milli Banks have confined their operations to providing short term credit to finance foreign trade. Nevertheless, in almost 80 percent of such credits an advance deposit of up to 100 percent in foreign exchange or in local currency, at the prevailing exchange rates, is required. The balance, if any, is then extended in the form of short term credit. This practice, initialled at times by the Central Bank, is one of the measures effectively adopted to stabilise foreign exchange rates and to reduce the pressure on imports and balance of payments.

Since the government has always financed budgetary deficits through borrowings from the Central Bank, the so called "market for government securities" is equally unknown, both, to the general public and to the Banking/

---

9. See page 282 for further reference on this point.

Banking System.

As a result, the narrow and unorganised nature of the money market in Afghanistan has given rise to a market for private money-lenders and usurers who are not connected with or affected directly by the activities of the Banking System. Private rates of interest for commercial loans are presently at 26 to 30 percent.[10] They include a high degree of risk premium, perhaps as much as 15 to 20 points.

C. Capital Market:

The securities and shares market, facilitating the finance of medium and long term needs is considered to be a vital factor in the economic growth of any community. One of the factors largely responsible for the undeveloped state of the Afghan Industry and for the low agricultural output is the lack of adequate provision for long term capital. Equity financing is still a new movement. The practice of holding shares of stock or debentures as assets, instead of real estate and the like, has not yet gained popularity among the general public. This leaves a considerable part of long term financing in agriculture and industry to be met by the prospective entrepreneurs themselves.

II. Effects of Monetary Policy:

We could best sum up the effects and the contribution of the entire monetary system under the two development plans by taking a brief look at the issues of money supply and the trend in the level of prices[11].

Only/

---

10. Ministry of Planning, 1964.

11. Table 5, above.

Only three of Afghanistan's banking institutions comprise the commercial banking system. The Bank of Afghanistan, Pashtany Tejaraty and Bank-e-Milli are "deposit banks" in the usual meaning of the term. They have the power to establish deposit accounts at the same time they extend loans, thus acting as agents for the increase or decrease of the money supply. A comparison of the volume of money supply between the years 1959 and 1966/67 reveals that the money supply during the last seven years has jumped from an amount of 2.09 to 5.55 billion Afghanis showing an increase of over 265 percent, see table 6. The table also indicates that currency in circulation overshadows Private Demand Deposits. This expansion in the total money supply, justifiable on the basis of money/income ratio, may be attributed to an increase in all the components of the money supply involved. Money in circulation represents a liability of the Banking System to the public. The counter-part to these liabilities, in the form of bank notes and demand deposits payable by the banking system are the assets acquired by the banking system in the process of creating money. For example, the money supply may be increased by the Banking System giving credit to the private sector or to the public sector, or by acquiring gold, silver and foreign exchange in return for Afghanis which become part of the domestic money supply. It is interesting to see which of these factors has been mainly responsible for the change in the supply of money: (1) Credit to the private sector, including loans to the specialised non-bank financial institutions, namely the Agricultural, Industrial and the Construction Banks, as well as participation by the Central Bank in the Public and Private enterprises increased from a figure of 2113 million Afs. in 1962 to 2349 million Afs. in 1966, a total increase of almost 11 percent over a period of five years, (2) The Banking System's net credit to the Public Sector is approximately measured by the size of the deficit in the Government's budget, including finances from abroad. The Government's position vis-a-vis the Banking System has deteriorated from an/

Table 6

MONEY SUPPLY

(Volume and Rate of Change)

(1958/59 to 1966/67)

ITEMS	Volume in Million Afghanis				Annual Average rate of change	
	1958/59	1962/63	1966/67	1967/68	1962/63-1966/67	1967/68
Bank Notes and Coins in Circulation	1769.5	3134.2	4717.8	4800.9	10.8	1.7
- Private Demand Deposits	330.1	612.8	758.7	753.7	5.5	- 0.7
1. Private Sector	-	586.5)	626.1)	585.5)	1.6	- 6.5
2. Non-Bank Financial Institutions	-	26.3)	132.6)	168.2)	50.0	26.8
TOTAL MONEY SUPPLY	2099.6	3747.0	5476.5	5554.6	11.5%	1.4%

Source: Compiled from the statistics of the Bank of Afghanistan and the Ministry of Planning, Kabul, 1968.

an indebtedness of 1549 million Afs. in 1961/62 to 4302.6 million Afs. in 1966/67, see Tables 7 and 8. The Banking system's assets in the form of gold, silver and foreign exchanges, too, have increased the volume of money supply.

	1961/62	1966
	(In Million Afs.)	
a - Gold and silver reserves	979.3	2260.6
b - Foreign exchange	920.1	2265.6[12]

The primary factors responsible for the rapid expansion of the Money Supply have, therefore, been: (i) the growing demand of the Government on the reserves of the Bank of Afghanistan, (ii) the increase in the Bank of Afghanistan's participation in the Industrial and commercial enterprises, and (iii) the increase in the gold, silver and foreign exchange holdings of the Central Bank as well as the devaluation of the Currency in 1963. There has been a fourth factor responsible for the expansion in the volume of Money Supply, namely the manipulation of the minimum ratio of Currency Cover. Since 1939 the Bank of Afghanistan has been required, by its statutes and the resolutions of its Supreme Council, to maintain, as backing for the currency notes issued, at least 50 per cent in gold, silver and foreign exchanges. This rule authorised the Central Bank, as the exclusive monetary authority in charge, to issue currency as it deemed necessary. Unless the 50 percent reserve requirement was lowered or any of the above three assets increased substantially, the Bank would not have been able to meet any further demand for money and had to refrain from increasing money supply more than it was legally possible. The Second alternative, which was a substantial increase in the assets, was also unlikely in view of the low level of exports and export earnings. Since the government intended to launch development programmes in the coming future, this dilemma spurred it in 1953,

to/

12. Bank of Afghanistan, Bulletin, 1967.

Table 7

Banking Sector Credit Outstanding
between 1341 - 1346, i.e. 1962 - 67

(Million Afs.)

	1962	1963	1964	1965	1966	1967
To the Government	1549.0	3650.0*	3463.0	3572.5	3692.5	4302.6
To the Private Sector	2113.0	2154.0	2402.0	2645.0	2736.0	2349.0
a - from central bank	2113.0	998.0	985.0	1007.0	1028.0	584.0
b - from commercial banks	-	1156.0	1417.0	1638.0	1708.0	1765.0
Total	3662.0	5804.0	5865.0	6217.5	6428.5	6651.6

Source: The Central Bank, 1968, Kabul

* The Central Bank provided a substantial loan to the Government to cover the deficit incurred during the first year of the Second Five Year Plan, 1962/67. The devaluation and increase in the level of Ordinary (current) as well as Development expenditures have also been responsible for such a sharp increase of Bank credit to the Public Sector. The expansion of Bank credit to the Government has been accompanied by a policy of restricted increase of Bank credit to the Private Sector, partly to maintain a certain level of money supply and partly to prevent diversion of funds into speculative investments.

Table 8

PUBLIC SECTOR POSITION WITH
BANKING SYSTEM 1963 - 1968

(In Million Afs.)

Government	1963/64	1964/65	1965/66	1966/67	1967/68
Long Term Loans	3613.8	3795.9	4400.4	4469.4	4872.3
Short Term Loans	984.7	554.1	-	-	539.7
Advances in Afghanis	271.1	252.4	305.1	342.0	303.6
Advances in Foreign Exchange	35.8	35.1	34.0	79.0	55.3
Treasury Coins	121.1	123.3	123.3	123.3	123.3
IMF Accounts	187.5	187.5	187.5	187.5	187.5
Total	4838.9	4573.2	4675.3	4862.2	5706.7
State Enterprises					
Loans	455.8	130.0	107.3	185.8	68.8
Advances in Afghanis	4.3	4.6	0.5	0.5	168.6
Advances in Foreign Exchange	17.7	10.7	9.4	9.4	9.4
Total	477.8	145.3	117.2	195.7	247.0
Total Public Sector Position With Banking System	5316.7	4718.5	4792.5	5021.9	5953.7
Minus Government Deposit With the Banking System (1)	1666.7	1255.5	1220.0	1729.4	1651.1
NET PUBLIC SECTOR POSITION WITH THE BANKING SYSTEM	3650.0	3463.0	3572.5	3292.5	4302.6

(1) Includes counterpart funds, deposits in clearing account currencies and export taxes not yet credited, in addition to time and demand deposits of government and government enterprises in Banks.

Source: Survey of Progress, Ministry of Planning, Kabul, 1968.

to revalue the gold and silver stocks of the Central Bank. The value of gold stock had been previously entered in the books according to the price of gold effective at the time of purchase. Some purchases were made at prices less than the equivalent of U.S.$ 35.00 per ounce, the rate adopted by the IMF and other International financial organisations.

In an act of faith in the soundness of the Afghan economy, the Government announced the revaluation of gold in the last quarter of 1954. This act amounted to an increased book-value of gold and silver stock by over 1800 million Afs., increasing the currency potential by twice this amount. This enabled the government to launch some of the projects of the Plan pending the availability of resources and funds. The need for further expansion of the money supply persisted for some of the reasons listed above. The Central Bank would not have been able to further expand the money supply had it remained under the 50 percent reserve requirements. It was early in 1957 that a lower reserve of thirty percent, as a currency cover, was approved. Moreover, to ~~have~~ improve~~d~~ and supplement~~ed~~ the minimum foreign exchange reserves needed to cushion fluctuations in export earnings, a 5 percent of foreign exchange earnings was to be carried over directly to the foreign exchange reserve account.

With the 30 percent currency cover it is evident, as the pattern of the growth of money supply in table 6 indicates, that currency in circulation can be expanded considerably. The subsequent years have witnessed this development when the level of deficit finance increased substantially[13]. While the Central Bank holds the balance between currency issued and that in circulation, as cash reserves, it however cannot exercise control over this portion. In addition to deficit financing of the Government, with/

---

13. See Table 13 below, on this point.

with the fluctuations in export proceeds, the Bank faces recurrent conversions of foreign exchange into local currency which would reduce its cash balances. Thus, the non-circulating amount hangs over the monetary situation as a potentially disturbing factor. Unless National output is also stepped up further price inflation would be inevitable.

It is conceivable that in the context of an expanding economy, such as Afghanistan's, the demand for the quantity of money is bound to increase, mainly - (a) as a result of the growth of national income, (b) as a result of the increasing monetisation of the economy, and (c) as a result of the growing transaction, precautionary and speculative (liquidity preferences) demand for money. Of equal importance in this process is the nature of development expenditures. They have to result in an increase in the output of goods and services to the extent that the inflationary potential of a major part of such development expenditures may be neutralised. Recalling the review of the economy under the two Plans, the main result of such a monetary expansion has been a rise in the level of prices with very little change in output. Consequently, a depreciation of the value of the Afghan Currency in terms of foreign exchange was inevitable, Table 9.

To have avoided any further adverse effects on the Country's balance of Trade and International Payments, a reform of the foreign exchange system was introduced. Prior to 1932 foreign exchange transactions were handled by private dealers, set up in the market places of Kabul and Kandahar. It was in 1934 that all foreign exchange transactions were handled by the Afghan National Bank, (Bank-e-Milli Afghan). In 1943 Bank-e-Milli relinquished/

Table 9

AFGHANI PAR VALUE IN TERMS
OF U.S. $ AND U.K. £

1956 - 1966

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Official rate/U.S. $	30.00	30.00	30.00	30.00	30.00	30.00	30.00	45.00	45.00	45.00	45.00
/U.K. £	84.00	84.00	84.00	84.00	84.00	84.00	84.00	126.00	126.00	126.00	126.00
Free rate/U.S. $	52.96	53.71	50.06	41.89	42.49	47.15	50.00	50.61	65.75	73.85	78.40
/U.K. £	147.2	150.38	140.1	117.29	118.97	132.00	140.00	141.60	184.10	206.10	219.00

Bank of Afghanistan, Bulletin, 1967

relinquished its control over exchange matters to the Bank of Afghanistan. The Exchange System was codified in 1951 by the Government[14] which formed the basis of a multiple exchange system with variable buying and selling rates. The buying rates, applicable to the surrender of exports proceeds, have usually been a mixture of a budget rate, an industrial rate and sometimes the free market rate. The buying budget rate was Afs. 14.00/U.S.$ in 1948, depreciated to Afs.16.80 in 1949 and again fell to Afs.23.00/U.S.$ in 1951 and to Afs.30.00/U.S.$ in 1956. On the selling side, imports or payments made by the government or the private sector in connection with industrial activities approved by the Government, were effected at the budget rate of Afs.21.00/U.S.$ and Afs.28.00 per U.S.$ corresponding to years 1949 and 1956 respectively. The rest of the transactions were effected at the free market rate, Table 9. While there seems to have existed only three rates, the actual number of exchange rates increased in number over the years as the surrender requirements have become more elaborate for different export items combining one rate with one or two other rates at varying percentages. In 1960 there existed more than ten buying and five selling rates, both ranging from Afs. 20.00 to Afs. 400.00/U.S.$. These rates can be viewed as essentially equivalent, in terms of economic effects, to a system of differential taxes and subsidies on various transactions. The total surrender of exports proceeds at very low rates of exchange penalised the most important export items, namely cotton, karakul and wool. This was bound to have discouraging effects on the export sector and an adverse effect on the economy. Such a system tends to force resources into less efficient lines of production. Furthermore, the continuation of such a multiple exchange system would have rendered Afghanistan ineligible/

---

14. Government Decree No.2632, Bank of Afghanistan, 1951.

ineligible to draw on the resources of the International Monetary Fund for temporary Balance of Payments difficulties. In 1963 this complicated multiple exchange rate system was replaced by a unitary rate with dual rate feature, one fixed official rate which was set at Afs.45.00/US.$, another an uncontrolled "free market rate" used for unofficial transactions. Both rates were established at Afs.45.00 U.S.$; however, the fluctuating one was allowed to follow the course of the free market on a daily basis. The surrender of export proceeds at the official rate was extended to cover, in addition to cotton, wool and karakul 80%, part of the proceeds of items such as carpets 15%, sesame seed 40%, sheep skin 20%, and casings 10%. Although the measure removed the difference between the official and the free market rates and established a more realistic rate, with one or two currency units difference between the official and effective market rates in 1963, the gap has since grown larger and has almost reached a similar situation existing prior to the exchange reform of 1963. The persistence of a large disparity between the official and free market rates is to be taken as an indication that another change in the former is required. It is misleading to accept the argument that the lower the official rate the lower will be the pressure on the budgetary requirements in the form of increases in the expenditures of Government Departments, subsidies and foreign debt service. On the contrary an artificially maintained lower exchange rate implies that the costs of Government purchases of goods and services from abroad and certain private imports, considered "developmental" are heavily subsidised and are not realistic. It provides an ever-present danger of the misallocation of scarce resources, and is most likely to deplete the Country's reserves in defence of an exchange rate which ceases to be the true equilibrium rate.[15] A rate which is realistically high would tend/

---

15. Ministry of Planning, Next steps.... Op.Cit. 1964/65. For the treatment of the surrender ratios and other taxes on exports as a source of government revenues page (88) may be consulted.

tend to encourage exports while discouraging imports. However, prior to a further devaluation, an improvement in the foreign exchange system appears necessary. The surrender requirements and taxes on the export proceeds of the most important items must be reconsidered. Export promotion schemes may be necessary as a first gesture in this direction. Moreover, as the level of domestic deficit finance adversely affects the balance of international payments, the government is well advised to follow a policy of moderation in incurring domestic budgetary deficits, especially where the level of domestic savings is low.[15a] These measures are necessary if any improvement in the exchange system or a devaluation is to make a headway.

It may be inferred that in the light of the present state of the Afghan economic structure and the undeveloped nature of the Monetary System, in particular, a high rate of stable and sustained economic growth is unlikely to be attained solely through instruments of Monetary Policy. While the present state of the Monetary System requires considerable improvements the effective role that Fiscal Policy can play must not be neglected.

III. Fiscal Policy:

Under this caption, measures that affect the Government's budgetary operations, i.e. Revenues - which have been substantially supplemented and affected by the process of monetary expansion outlined above - and Expenditures will be dealt with. We leave the topic of Revenues, and particularly that raised through taxation, to be studied in the subsequent chapters. The remaining pages here will be devoted to Government spending.

The effects of government expenditures do not only depend on the nature of the sources of revenue, i.e. whether it consists mostly of inflationary finance/

15a. Ministry of Planning, Op.cit.,

finance or otherwise, but they equally depend on the proportion of those expenditures devoted to consumption and investment of a productive nature. Tables 10 and 11 present the pattern of public expenditures allocated between these two areas under "Ordinary" and "Development" outlays. Although the percentage of budget aggregates allocated for development expenditures, during 1957/58 and 1967/68, amounts to an average of 35.8 percent per annum, the distribution is nevertheless characterised by wide fluctuations. The ratio, during the entire development decade, rose to its highest level of 49.8 percent in the early sixties and dropped to a low level of 28 percent in 1967/68, which is only a little over the 1957/58 percentage distribution.

Ordinary expenditures had a net increase of almost 361 percent during the period. The major factors responsible for this rise have been (i) a rise in the salary level of government employees which became effective as of 1963/64, (ii) the normal increase in the level of services made available as a result of government development outlays. As projects have been completed and became operative, and as institutions are established in accordance with the planned programmes, increased expenditures have been necessary for their operation and maintenance, (iii) another factor has been the higher Afghani cost to the budget of debt service and other government payments to the outside world, a concomitant of the foreign exchange reform mentioned above. The expiry of the moratorium on debt payments will put a further pressure on the pattern of distribution of budget outlays, alongside their effects on the level of economic growth. Although defence expenditures rate almost 30 percent of the Ordinary budget, their share has declined in the growing government budget. On the other hand, a considerable portion of this outlay may be added to the Development Expenditures as a result of the contribution of the "Labour Corps" in the implementation and completion of a number of infrastructural projects, such as the construction of roads, bridges, dams, canals and the like.

The/

Table 10

DOMESTIC GOVERNMENT EXPENDITURES

ORDINARY

(In Million Afghanis)

1957/58 - 1967/68

Field Applied	1957/58	58/59	59/60	60/61	61/62	62/63	63/64	64/65	65/66	66/67	67/68
Debt Service	140	174	179	183	133	258	612*	501	286.4	474	664
Ministry of Defence	329	415	438	553	253	594	645	777	900	800	N.A.
Ministry of Finance	68	76	97	104	45	127	156	123	324	313	170
Ministry of Education	99	124	159	172	79	240	309	302	382	392	447
Ministry of Interior	91	95	108	112	56	131	150	143	212	239	232
Ministry of Foreign Affairs	20	24	27	48	20	85	106	110	77	74	74
Ministry of Public Health	22	31	37	33	11	48	62	69	84	92	102
Ministry of Public Works	88	112	67	40	77	53	53	97	123	121	106
Ministry of Agriculture	14	21	43	47	24	45	41	52	45	47	37
Ministry of Mines and Indust.	11	17	25	43	52	42	53	51	56	50	72
Tribal Affairs Department	25	37	41	44	13	21	25	25	26	23	31
Ministry of Communication	28	23	38	33	14	33	34	36	48	47	47
Helmand Valley Authority	-	-	-	-	21	37	31	33	29	30	26
Other Ministries & Agencies	72	93	135	146	80	136	185	247	335	697	1634**
	-	-	-	-	-	-	-	-	-	-	-
TOTAL	1007	1251	1394	1558	878	1850	2462	2566	2927	3399	3642

Source: Compiled from the Statistics of the Ministry of Planning "Survey of Progress" 1962/64 and 1967/68.

*

The growth in debt service arises from the termination of the moratorium on some debt obligations as well as the effect of devaluation in the accounting of such services.

**

A number of other Government Agencies have been established, on an independent basis not included in the list of ministries, which accounts for part of the rise in the level of this category. Nevertheless, a considerable amount of this category may be year-marked for defence outlays not reported separately for 1967/68.

Table 11

DOMESTIC GOVERNMENT EXPENDITURES

DEVELOPMENT

(In Million Afghanis)

1957/58 - 1967/68

Field Applied	1 1957/58	2 58/59	3 59/60	4 60/61	5 61/62	6 62/63	7 63/64	8 64/65	9 65/66	10 66/67	11 67/68
Ministry of Public Works	121	178	378	854*	264(1)	791	923	850	370	325	234
Ministry of Mines and Indust.	43	47	113	183	98	367	442	445	645	586	426
Ministry of Education	46	35	48	157	36	37	81	39	76	102	108
Ministry of Agriculture	7	15	20	24	24	32	56	51	75	134	335
Ministry of Public Health	8	2	16	63	20	17	13	13	12	19	11
Helmand Valley Authority	91	70	62	79	20	70	90	54	35	51	58
Civil Air Authority	43	38	38	85	40	44	6	8	10	4	19
Ministry of Communication	13	17	18	10	4	9	9	19	23	33	17
Ministry of Press. & Cult.	-	-	-	69	8	10	85	36	23	10	2
Rural Development Authority	-	-	10	12	6	14	20	19	21	-	-
Ministry of Finance	5	-	3	14	-	5	50	44	66	25	11
Other Ministries & Agencies	5	18	-	-	-	49	54	44	x364	x437	218
TOTAL	374	421	705	1550	520	1445	1829	1622	1720	1726	1439

Source: Compiled from the Statistics of the Ministry of Planning "Survey of Progress" 1962/64 and 1967/68

x Paktia Development Authority accounts for Afs.266 and 250 Million during the period respectively.

*

Expenditures on Transport and Communication and Agricultural extension programmes such as dams and canals and the like carried the heaviest weight in the development programmes of the First Five Year Plan. The rising trend continued throughout the early part of the Second Five Year Plan when in 1963/64 Public Works accounted for almost 50 percent of the domestic development budget outlays for that year. A major part of this increase was incurred on transportation. As most of the highway projects were completed the emphasis in development outlays was later shifted to Agriculture, Mines and Industries.

(1)

Until 1962, the beginning of the Second Five Year Plan, Afghanistan maintained, on an experimental basis, a Fiscal Year ending in August every year thus falling in the middle of the Afghan Calendar Year which ends on the 20th March, (see page 14 above). Since the experience proved unsatisfactory for reasons of accounting and interpretation of other calendars, i.e. Lunar and Western (A.D.), the fiscal year was allowed to coincide with the calendar year. As a result, column 5 represents figures for half a year.

The Development Expenditures of the Government (tables 11 and 12) have been supplemented by deficit financing (table 13) and Foreign Loans and Grants[16]. The latter raised the 27 percent level of domestic public saving to over 59 percent of the budget expenditures in 1957/58 and the 33.6 percent of domestic public savings in 1966/67, to over 60 percent of the total marking the highest level of foreign aid during the period. Table 13 reveals part of the Afghani Counterpart funds for the aid. In this respect the relative share of total Ordinary Expenditures and their components shows a corresponding decline. This obviously raises the total deficit in terms of domestic Revenues, but the inflationary impact on the economy may be asserted to be relatively less than the aggregate budget deficit over the period. A sizeable amount of the deficit has been appropriated to the import of both capital and consumer goods. However, the pattern and composition of the total expenditures including development outlays, have contributed much to the rise in the level of prices,. It can be seen that more than 70 percent of the Development Expenditures has been absorbed by two sectors, namely Transport-Communication and Mines and Industries.

One of the criteria for evaluating the growth of Government expenditures, their distribution between Ordinary and Development outlays and the level of domestic Revenues is to see these aggregates in relation to changes in the level of National Income. Table 14 reveals both Expenditures and Revenues as a share of Domestic National Income. All figures have been taken in current prices, meaning that the real value of government expenditures may not be taken into account. However, as this factor affects, in this case, all other aggregates in the same way, the fall in their value is not of our concern in evaluating their relative/

---

16. See Table 16 below, on this point.

FINANCING ECONOMIC DEVELOPMENT
PLANS

1957/58 - 1966/67

(In Billion Afghanis)

ECONOMIC SECTOR	FIRST PLAN 1957/58-1962	SECOND PLAN 1962-1966/67	Aggregate	Expenditure as percent of Total
Mines and Industries	3.0	8.8	11.8	33.1
Agriculture	1.3	4.4	5.7	16.0
Transport and Communication	5.1	9.6	14.7	41.3
Education and Health, Other Social Services	0.8	1.8	2.6	7.3
Miscellaneous Expenditure	0.4	0.4	0.8	2.3
ALL SECTORS	10.6	25.0	35.6	100.0

Source: Ibid.

Table 13

DEFICIT FINANCING

1957/58 - 1966/67

(In Million Afghanis)

	Year	Amount Surplus + / Deficit -
	1957/58	+ 59
	1958/59	+ 10
	1959/60	- 385
	1960/61	- 804
(Last six months of 1340)	1961/62	- 573
	1962/63	- 1057
	1963/64	- 556
	1964/65	- 709
	1965/66	- 54
	1966/67	- 424 (1)
Net Total		- 4493

Source: Bulletin, Bank of Afghanistan, 1968. Kabul.

(1) Preliminary figures not adjusted.

Table 14

GOVERNMENT EXPENDITURE AND
REVENUES RELATIVE TO GDP

1957/58 - 1966/67

(In Billion Afghanis)

Year	1 GDP	2 Public Expend.	3 Public Revenue	4 (2) as % of (1)	5 (3) as % of (1)
1957/58	23.326	1.381	1.348 (1)	5.8	5.7
1960/61	28.173	3.108	2.099	11.0	7.4
1967	49.457	5.081	4.247	10.3	8.3

Source: Computed from "Survey of Progress", Ministry of Planning, 1967.

(1) This amount does not include Proceeds of commodity assistance nor does it include borrowings from the Bank of Afghanistan.

growth relative to GDP. The above table shows that although public revenues have increased, the increase has been lower than the growth of public expenditures. This shows the very poor tax effort of the government. Obviously, when the ratios are seen in terms of GNP aggregates, the relative position of the Revenue Section drops further to a lower level. An attempt is made in the following chapter to examine some of the important features of the Revenue Structure, and the share and role of the main categories of Revenues in the Afghan economy. The study will cover the historical development of the revenue sources before, during, and after the Development Plans.

C H A P T E R   T H R E E

SOURCES OF PUBLIC REVENUES

Sources of Public Revenues

I - Non-tax Revenues

A. Borrowings

(1) Domestic Debt
(2) Foreign Aid

B. Revenues from the Public Domain

II - Tax Revenues

A. Indirect Taxes

(1) Import Duties
(2) Export Duties
(3) Sales Taxes
(4) Excises
(5) Stamp Duties

B. Direct Taxes

(1) Income Taxes

a - Income Taxes between 1944-1956
b - Income Taxes between 1956/57-1966/67, the Development Decade.
c - Individual Income Tax under the Present System
d - Company Income Tax under the Present System.

(2) Taxes on Property, real and personal.

(3) Municipal Taxes

(4) Pension Fund.

(5) Miscellaneous Imposts.

As examined earlier, the Afghan economy has been growing at an annual average rate of over 9 percent in current prices for the past seven years. It is the purpose of this and the following chapter to see what portion of this aggregate is tapped off through the revenue structure and to examine which sources of revenue promptly respond to variations in the level of national income. For this purpose a study of the components of total public revenues, appears necessary. Total government revenues, including loans and grants from abroad, and excluding borrowings from the Central Bank, amounted to 7789 million Afghanis in 1967, representing about 14.2 percent of GNP. Excluding foreign aid, this ratio drops to 7.6 percent of GNP. This may be considered a rough index of the burden of taxes on the entire economy. About 75 percent of total domestic revenues were raised through taxation. Revenues from utilities, State properties, economic enterprises and participation in private sector investments all contributed about 22.2 percent. The remaining 2.8 per cent represented revenues from other non-tax sources. Table 15 shows changes in these sources with respect to GNP over the Plan period. Total public revenues, from domestic and foreign sources, represented 10.4 percent of GNP in 1957/58, and increased to a figure of 15.6 percent in 1961/62, but, even-though there was a rise in the volume of foreign aid, it dropped slightly below this figure in 1967. Revenues from loans and grants (foreign aid) increased by over 160 percent during the entire period of the two Plans. Their share as a ratio of GNP on the other hand, fell from 9.2 percent in 1961/62 to 6.6 percent in 1967.

Prior to 1957/58 Government revenues from public enterprises, including Monopolies, were a small portion of total revenues. In an effort to increase savings the Government expanded the share of the public sector in the economy. As a result, revenues from State enterprises, mixed ventures and other public earnings increased by more than sixfold over the/

Table 15

PUBLIC REVENUES AS PERCENTAGES OF GNP BETWEEN 1957/58 - 1967

Government Revenues	1957/58 Amount in Billion Afs.	% age of Total	% age of GNP(1)	1960/61 Amount in Billion Afs.	% age of Total	% age of GNP	1967 Amount in Billion Afs.	% age of Total	% age of GNP
1 - Loans and Grants (2) (Foreign Aid)	1.373	52.1	5.5	2.801	58.2	9.2	3.582	45.9	6.6
2 - Revenues from the Public Domain	0.170	6.4	0.6	0.509	10.6	1.6	1.069	13.7	1.9
3 - Other Miscellaneous Revenues (3)	0.016	0.7	0.06	0.077	1.6	0.2	0.077	1.2	0.14
4 - Tax Revenues	1.076	40.8	4.2	1.422	29.6	4.6	3.061	39.2	5.6
TOTAL	2.635	100%	10.36	4.809	100%	15.6	7.789	100%	14.2

Source: Computed from the Statistics of the Ministries of Planning and Finance. Revenue Accounts. "Survey of Progress" 1962 and 1967/68, Kabul.

(1) Page 14 above

(2) Including commodity assistance but excluding domestic borrowings. Reference may be made to Table 16 page 76.

(3) For purposes of accounting and comparison, Non Revenue Receipts for the corresponding three periods amounting to almost Afs.86, 89 and 40 millions respectively are omitted from this figure. This figure consists of contributions and others.

the entire period 1957-67, indicating an average absolute increase of more than 69 percent per annum. Similarly, revenues from other non-tax sources too increased, in absolute terms, by more than fourfold over the period. Nevertheless, since both these sources contribute only a fraction of total Public Revenues, the increase in relative terms is negligible. Total tax revenues increased by 284 percent, in absolute terms. However, as a ratio of GNP, the rise has been considerably small. Tax revenues/GNP ratio increased from 4.2 percent in 1957/58 to only 5.6 percent in 1967.

For a detailed analysis, the major sources of revenue will be studied under two main headings, namely Non-tax Revenues and Tax Revenues. Each, in turn, will be broken down into its components. Under Non-tax Revenues we shall look into the growth of Internal and External loans, Revenues from State owned and mixed enterprises and the rest of the public sector. Revenues from Taxes will be mainly studies under Direct and Indirect Taxes.

I - Non Tax Revenues:

As Table 15 reveals, Non-tax Revenues have increased considerably over the past nine years. This increase has been mainly in loans and grants from abroad as well as revenues from the operations of the public sector.

A. Borrowings:

Both domestic and external loans have served as a major source of revenues for the Afghan Government.

(1) Domestic Debt:

As far as Domestic Borrowing is concerned, based on the brief description of the Money and Capital Markets in Afghanistan (pages 44-47 above), it is apparent that Government borrowings in the market, through the sale of Bonds or Treasury bills is non-existent.[1] As a consequence, budgetary deficits have been met almost entirely by loans from the Central Bank. This/

1. For a detailed analysis of this potential source of public revenues reference may be made to chapter seven, page 282 below.

This, of course, has been in addition to foreign loans and grants or their proceeds in local currency. There is no regulation or practice in the Afghan fiscal framework specifying the extent of borrowings from the Central Bank, and consequently the aggregate supply of money.

In view of the above situation the Afghan Government's position with the Central Bank has changed considerably. Its position deteriorated from a surplus balance of Afs.95 millions in 1957/58 to an accumulated total debt of 4493 million Afghanis in 1967, representing more than 80 percent of total money supply. The effects of such a trend on the level of prices cannot be overlooked, even though the money/national income ratio is as low as 10.2 percent for the latest year. A major part of the purchasing power is directed towards the consumption of agricultural output, the supply of which has been rigid, and only a fraction of it goes to non-food items including industrial output. The amortisation of such loans from the Central Bank with reasonable terms, may appear to be less of a worry as compared with that borrowed from abroad. Even so, the repayment of the total loans implies an additional increase in the resources of the Government over and above their growing expenditure requirements. The fact that the Government can easily negotiate such loans does not necessarily justify an excessive recurrent use of this source. The volume and the appropriate field and purpose for which such funds may be spent must also be carefully evaluated.

(2) Foreign Aid, (Grants and Loans):

In many less developed economies, private and public savings and investments from domestic sources fall short of the aggregate amount required to fulfil the objective laid down in the development programmes; as a consequence, reliance/

reliance on foreign capital to fill-in the gap appears inevitable. Without resort to external resources, the pace of growth has to be slowed down by curtailing certain expenditures and that of the level of employment and consumption, or by resorting to inflationary finance. As indicated above, foreign aid occupied an important role in the finances of the Afghan Government. As Table 15 shows, foreign capital covered well over 50 percent of the total outlays of the First and Second Development Plans. These funds have played a very significant part in the development of the present state of the Afghan socio-economic structure. It seems quite unlikely that Afghanistan would have achieved the present rate of progress had it not been for the availability of these external resources. On the other hand, they have created debt service obligations to be duly met by the Afghan Government in the future, see Table 16. The Soviet Union has been the leading supplier of aid, providing 67 percent of total foreign aid from 1961/62 onwards. The United States provided 19 percent[2], and 9.5 percent was provided by the German Federal Republic. The rest is shared by a number of other countries[3]. Military aid is excluded from the/

2. Total economic aid from the United States to Afghanistan, between 1954 and 1965, has amounted to U.S.$281 million as against U.S.$ 552 million from the Soviet Union during the same period. But total U.S. Aid to Afghanistan since the end of World War II has amounted to 586 million dollars. Next to transportation, a considerable amount of Soviet Aid has been extended mainly for the exploration of natural resources such as gas and petroleum, for the production of electricity and construction of industrial plants. Industrial plants in this respect cover only those in the public sector. Aid from the United States, on the other hand, covers areas such as transportation, education, agriculture, industry, community development, health and public administration.

3. It may be noted that aid from the United States consists mainly in the form of grants, while that from the Soviet Union, Czechoslovakia and China are mainly inloans, the amortisation of which will hang over the balance of payments for some time to come. The proportion of grants in the Soviet Aid has dropped considerably in the last few years. The entire amount of aid from this country in 1967/68 consisted of loans.

Table 16

FOREIGN LOANS AND GRANTS BY MAJOR SOURCES
1957/58 - 1967/68
(In Million £)(1)

SOURCES	1957/58	1958/59	1959/60	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67	1967/68
U.S.S.R.	N.A.	N.A.	N.A.	N.A.	N.A.	18.57	12.50	16.07	19.29	19.66	15.97
Loans						11.43)	6.07	11.78	17.14	19.57	15.97
Grants						7.14)	6.43	4.29	2.15	0.09	-
U.S.A.	N.A.	N.A.	N.A.	N.A.	N.A.	5.36	7.14	5.86	4.57	3.83	2.71
Loans						-)	0.36	0.14	0.04	1.87	1.32
Grants						5.36)	6.78	5.72	4.53	1.96	1.39
GERMANY (FGR)	-	-	-	-	-	0.63	2.38	2.50	2.98	4.80	2.73
Loans						0.60)	2.34	2.46	2.86	4.23	2.12
Grants						0.03)	0.04	0.04	0.12	0.57	0.61
CZECHOSLOVAKIA	-	-	-	-	-	0.32	0.36	0.36	0.11	-	-
Loans						0.32)	0.36	0.36	0.11		
Grants						-)	-	-	-		
CHINA (Mainland)	-	-	-	-	-	-	-	-	-	-	1.06
Loans											1.06
Grants											-
UNITED NATIONS	-	-	-	-	-	0.07	0.11	0.36	0.71	0.58	0.35
Loans						-)	-	-	-	-	-
Grants						0.07)	0.11	0.36	0.71	0.58	0.35
UN/IBRD	-	-	-	-	-	-	-	-	-	0.12	-
Loans										-	
Grants										0.12	
ALL SOURCES	9.88	12.34	16.49	21.40	14.46	24.95	22.48	25.14	27.66	29.00	22.83
Loans	7.34	8.49	8.20	8.79	4.70	12.34	9.13	14.75	20.15	25.67	20.48
Grants	2.54	3.85	8.28	12.61	9.76	12.61	13.35	10.39	7.51	3.33	2.35

Source: Compiled from the Statistics of the Ministry of Planning, "Survey of Progress" 1964, 1967/68 and 1968/69.

(1) An exchange rate of U.S.$2.80 = £1 has been applied for the conversion

the above table. Commodities imported through these aid programmes included wheat, sugar, petrol, vegetable oil, vehicles and spare parts. Commodity assistance from the United States and the U.S.S.R. consist mainly of wheat and vegetable oil, initiated under the U.S. PL480 arrangement and the Soviet Aid Agreement, which also provided part of the counterpart local currency requirement of the development expenditures. Both these arrangements have helped the government to regulate the prices of certain staple items such as wheat and vegetable oil and have reduced the pressure on the limited foreign exchange holdings of the Government. With the present state of economic progress and the long term economic and social objectives, it appears difficult, if not unlikely, for the Government to try to achieve an even greater rate of growth in the coming decade by relying entirely on finances from domestic sources. Foreign capital, such as inter-governmental loans and grants, and/or private investment, will remain part of the resources expected to be employed in the process of capital formation for a number of years to come. Loans and grants, as part of the finances of the Third Five Year Plan, have been estimated at 20 percent and commodity assistance almost 40 percent over the Second Plan actuals. It may be indicated that a continuous reliance on foreign assistance is not likely to induce the Government to take a hard look at the domestic resources. The burden of debt service is already growing heavier in the annual budget of the Government, which suggests that an increasing portion of development finance must be internally raised.

B. Revenues from the Public Domain:

Revenues from this sector, have shown an upward trend lately occupying a third place in the revenue structure, after foreign aid and taxes. Prior to the implementation of the development plans the function of the Government was mainly confined to the maintenance of law and order and the/

the provision of certain social services. Its role in the economic sector has been traditionally based on what is called a "Guided" system with minimum intervention. On the other hand, the existence of obstacles tended to make a rapid achievement of growth objectives, at the private and public sectors, more difficult. In 1956/57 the Government declared that "...... both Government and private enterprises should function for the benefit of the Country and general welfare of the people. In future full economic resources of the Country, private and public, will function in such a manner as to provide maximum benefit to all sections of the population; therefore, for the co-ordination of the Country's economic activities, it is necessary that the Government, which represents all sections of the population, guide and regulate such activities.."[4] By so declaring, the Government expanded their traditional role and followed a more vigorous and direct policy of development. This laid down the grounds for the active intervention and participation of the government in certain fields of economic activity.

Economic activities of the government are usually conducted under various forms of organisation and management, depending upon the objectives the government wishes to follow. They may be carried under a form of organisation operating at a loss, in which case the government actually subsidises the recipients of goods and services such as health, education and others. They may be conducted on a no-profit no-loss basis, whereby the services and goods may be offered at cost, as in transportation, electricity, water and other utilities. A third category falls under organisations working on a profit earning basis whereby the government enters into commercial and industrial activities aimed at furthering the process of capital formation.

The/

---

4. From the speech of the Prime Minister to the Parliament initiating the First Five Year Plan. Kabul, 1956

The entire operations of the public sector in Afghanistan consist of all three categories. In the area of social and economic overheads the total cost is borne by the Public Sector. For example, in the field of education, the government is liable by the Constitution to provide free education up to the end of the University level. The same applies to the provision of medical health services. Tables 11 and 12 above, indicate the magnitude of government obligations in these areas.

In the case of utilities such as electricity, fuel, water and communication one of the most important factors is to determine the feasibility of the project, which will satisfy various conflicting objectives. That is (1) to obtain a rate of return sufficient enough to render the project profitable, whether based on the profitability concept of the private or the public sector, (2) achieve an improvement in the standard of living of the population by offering such goods and services at less than economic prices and (3) promote growth in the industrial, commercial and agricultural activities. As a result, the growth of revenues from this source has been slow.

Revenues from government economic activities increased from Afs.3 million in 1957/58 to Afs.158 million in 1965/66. Revenues from government participation in private enterprises has increased from nil in 1957/58 to a level of Afs.96 million in 1966/67. Income from Government Monopolies rose from 59 million Afs. to 611 million Afs. during the ten year period. Monopoly operations cover the purchase and sale of items like tobacco, sugar, petrol, cars and certain non-monopolised articles. Owing to the retention of profits, revenues from State Enterprises to the Treasury - both as taxes and transfer of profits - have been small. Table 17 depicts the growth of revenues from this source over the past 28 years.

II. Tax Revenues: /

STATE ENTERPRISE TAXES AND TRANSFER OF PROFITS TO THE GOVERNMENT
1940 - 1968
(In 000 Afs.)

Year	Profits	Taxes	Transfer of Profits	Retained Profits
1940 - 1950	147,850	8,556	-	139,294
1951 - 1955	421,839	27,004	155,610	239,225
1956 - 1960	2,250,001	140,807	1,208,105	901,089
1961 - 1965	951,654	2,793	349,407	599,454
1966 - 1968	1,022,328	911	197,298	198,209
TOTAL	4,793,672	180,001	1,910,420	2,077,271

Source: Compiled from the Statistics of the State Enterprises Department, Ministry of Finance, Kabul, 1969.

II. Tax Revenues:

The Afghan Constitution provides for taxes to be imposed by the State[5], through the Central Government and municipalities. There is no local taxation although the collection of national revenues is a provincial responsibility.[6] Following Foreign Aid, Tax Revenues occupy the second important place in the revenue structure of the Afghan Government. Its role as a source of revenue has increased over the past few years. Tax revenue figures indicate a rise of about 284 percent from 1957-67. Although this rise in absolute terms seems quite substantial, its growth in terms of GNP is not all that impressive and significant. The average annual increase as percentage of GNP increase has been less than one percent between 1957/58 - 1959/60 and almost two percent between 1961/62 - 1966/67. Total Tax Revenues, as may be recalled from Table 15, page 72, amounted to only 5.6 percent of GNP. This indicates that tax revenues in Afghanistan do not only fall below the 25-30 percent ratio of tax revenues to GNP prevailing in the more advanced economies, but is also less than the low average of 8 or 10 percent Tax/GNP ratio known for less developed countries[7], Tables 18 and 19[8]. An examination of tax/income ratio or a tax/per capita income ratio puts Afghanistan in the lowest rank among a large/

---

5. "Every Afghan is bound to pay tax and duty to the State. No duty or tax of any kind shall be levied without the provision of the law. The rate of tax and duty as well as the method of payment shall be determined by law with consideration for social justice. The provisions of this Article are applicable to foreign persons as well." Constitution of Afghanistan, Article 38, Kabul, October 1, 1964.

6. Further reference on this point may be made to Chapter 8 on the Administration of Taxes.

7. N. Kaldor, Essays on Economic Policy, Vol.1, page 255, London, 1964.

8. It may be noted that the above tables do not provide any information regarding the ratio of the monetized and non-monetized sectors of the various economies concerned. This limits the usefulness of such a comparison, i.e. the share of direct and indirect taxes, to a considerable extent.

WEIGHT OF DIRECT AND INDIRECT TAXES
IN SELECTED COUNTRIES OF ECAFE

COUNTRY	Year	Total Tax As %age of GNP	Direct Taxes As %age of Total Tax Revenues	Indirect Taxes As %age of total Tax Revenues
BURMA	1960	23	32	68
CAMBODIA	1959	15	12	88
CEYLON	1959/60	21	19	81
INDIA	1959/60	10	31	69
INDONESIA	1959	6	41	59
JAPAN	1959/60	14	50	50
PHILIPPINES	1959/60	11	22	78
PAKISTAN	1959/60	7	33	67
THAILAND	1959	13	8	92
AFGHANISTAN	1958	4	26	74
	1960/61	5	21	79
	1967	5.6	13	87
ECAFE REGION(1)	1966	-	12 - 30	88 - 70

(1) Tax Potential and Economic Growth in the countries of the ECAFE Region, 1966, Pages 29-48, in Economic Bulletin For Asia and the Far East Bangkok, 1966. The figure for Afghanistan is computed from Table 23.

TAX REVENUE, GOVERNMENT EXPENDITURES AS A PERCENTAGE OF GNP AND DIRECT TAXES AS A PERCENT OF TOTAL TAX REVENUE FOR SELECTED COUNTRIES

Countries	Year	Tax Revenue As %age of GNP	Direct Taxes as %age of total Tax Revenue	Government Expenditure As % of GNP
AFGHANISTAN	1965	5.4	21.8	16.0 (1)
BURMA	1965	23.2	56.2	15.8
CEYLON	1965	20.8	28.2	28.0
INDIA	1964	11.06	29.05	26.0
IRAN	1964	17.68	10.59	28.7
PAKISTAN	1964	7.98	29.49	20.7
PHILIPPINES	1964	8.36	26.86	10.9
THAILAND	1964	12.26	11.60	15.4
TURKEY	1965	13.61	31.59	18.2

Source: For Countries other than Afghanistan the figures are computed from the UN Statistical Year Book, New York, 1966.

(1) This is composed of both ordinary and development budgets. The rate of increase is mainly in the development expenditure sector. Although it forms over 11 percent of GNP it has been growing at a rate of 25 percent per annum between 1957/58 and 1965/66, much faster than all the components of aggregate expenditures put together. Discounting for items such as repayment of debts interest and the like, the above ratio among other effects shows the increasing influence of government budget on aggregate demand. Although in an economy where the prime objectives of the Government is to promote growth, the stability factor cannot be overlooked.

large number of less developed countries[9]. A more realistic comparison based on the purchasing power parity still shows Afghanistan to hold the lowest position among 52 countries. In terms of tax efforts, too, Afghanistan ranked lowest among these countries[10]. Such a state of affairs does not only provide an interesting ground for conducting this enquiry, but demands that radical and immediate changes must be brought in if some of the objectives envisaged in the social and economic programmes of the government are to be accomplished.

Prior to proceeding with the main part of the paper, i.e. the appraisal of the various aspects of the Afghan Income Tax System it is appropriate to take a look at the structure and significance of the overall Tax System. For this purpose taxes may be grouped under the main categories of "Direct" and "Indirect" Taxes.

A. Indirect Taxes:

Most characteristic of the tax revenue in Afghanistan, as in many less developed countries, is that it is derived to a great extent from indirect taxes. Reliance on revenues from this source has been primarily for reasons of convenience in collection. Indirect Taxes were one of the early levies imposed by the Afghan government. These included taxes on imports, exports and certain other duties such as excises, sales taxes, stamp duties and the like. Taxes on imports and exports were subject to periodic changes in their rates in order to raise further revenues or to affect economic activities. Since the government has had/

---

9. See Jorgen, R. Latz and Elliot R. Marss, "Measuring Tax Effort in Developing Countries." IMF Staff Papers, Vol.XVI, 1967, pp.478-99, and "Tax Effort" in Developing Countries, Finance and Development No.3, 1969.

10. Ibid, Page 36, and pages 130-1 below.

had the power to change the weights of export and import tax rates without the prior approval of the Legislature, such changes have been brought in from time to time to meet the economic objectives. Indirect Taxes at present are the most important source of public revenues amounting to around 88 percent of Tax Revenues. In 1965/66 it amounted to over 52 percent of the total domestic revenues.

1. Import Duties:

These duties constitute a major part of indirect taxes. As indicated above, import duties have been imposed mainly for two purposes. The first aim was to raise revenues, and later, as some aspects of import duties made themselves felt, rates were raised and new ones, in the form of "Ad valorem" and "Specific" rates were added to serve the multi-purpose of revenue, protection, restriction, economisation of the limited foreign exchange earnings and affecting the pattern of public consumption. It should be mentioned that the past thirty years of amendments have rendered the tariffs system very complicated. In 1966/67, the rates per unit of item ranged from 10 percent on powdered milk to 150 percent on alcoholic beverages. However, as these percentages are based on "specific prices",[11] they cannot portray an accurate picture of the Tariff System. In addition to these ad valorem or specific rates of custom duties, "all individuals in the business of importing goods from foreign countries for sale in Afghanistan are subject to a fixed tax of four percent."[12] The tax is computed on the total cost, including custom duties, on the goods imported. As a turnover tax, this four percent is deductable from income in the same taxable year. Poor organisation and precarious control at custom houses, whether along the border or in the cities, have created smuggling practices which will, if/

11. See page 87 below.

12. Income Tax Law, Article 80, Kabul, 1966/67

if not remedied and prevented, not only make future measures less effective and the achievement of the anticipated objectives less likely, but will also destroy the honesty of those who conduct their activities through legal channels.

Revenues from import duties in 1966/67 have amounted to 1450 Million Afs. almost 54 percent of total indirect taxes. Compared with the value of imports for the same year, which amounted to U.S.$66.7 million or 4669 million Afs.[13] import duties amounted to 30 percent of the value. The fact that indirect taxes in 1967 constituted more than 50 percent of total revenues and more than 87 percent of tax revenues, and that over 50 percent of it came from import duties reveals a major shortcoming of the Afghan tax system. This may be attributed to the pattern of tax structure change during early years of growth, when imports and exports tend to be almost directly related to the changes in the level of national income and the level of money supply. These are as such tied up with a fairly wide income elastic base. However, the orientation of the tax system towards a base, which comes as low as 15 percent of GNP, renders the system virtually incapable of affecting aggregate demand through tapping-off larger share of GNP increments which does not go through the foreign trade channels.

2. Export Duties

Duties on exports yield a relatively small amount of revenue, eventhough proceeds from this source are reported under two separate revenue categories, namely "Custom Duties on Exports" and the "Foreign Exchange Taxes on Export Proceeds". The latter is primarily resorted to in order to reduce domestic demand and secure revenues for the government. Tariffs cover/

---

13. A free rate of exchange of Afs.70.00/U.S.$ is applied for the conversion. It does not include imports for the development projects or commodity assistance.

cover most of the items exported. The rates range from five to one hundred percent. Tariffs are maintained largely on the basis of what is called a "Free Price List", arranged and established on the prices of exports and imports which prevailed a long time ago. There is no relationship between prices on this "List" and the level of market prices at present. It was meant to provide a basis for customs tariffs. However, as the price list has been very seldom adjusted to reflect the current price level, it has lost its significance. With low "List" prices the tariff rates in most cases reach a hundred percent. These apparently high rates give a false impression of the actual rates. Furthermore, the existence of "List" prices makes it difficult to compare the level of revenues with changes in the level of prices, particularly if the actual duty is stated as a percent of price. If the duty has no relevance to the price of the article, then it is advisable to completely abolish the "free price list" altogether and introduce the duty on an ad valorem basis. There is no valid reason for maintaining such a list as it serves no useful purpose unless it is constantly adjusted to reflect prevailing market prices. These specific duties not only reduce revenues but also weaken the stabilising effects on the economy. Revenues from export tariffs amounted to Afs.139 million in 1965/66 as against 57 million Afs. in 1959/60.

The Income Tax Law of 1966/67 also incorporated a 2 percent tax on the export of goods and products from Afghanistan, computed on total cost including custom duties.[14]

In/

14. The Income Tax Law, Op.cit., Article 81.

In addition to the above tariffs, a number of export items, by being subject to the surrender requirements, bear varying amounts of additional taxes. As indicated above, proceeds of a number of export items are surrendered, either in full or in part,[15] to the Central Bank at the official exchange rate. The difference between the recorded value of foreign exchange so acquired and the effective selling rates prevailing in the free market is the share of government profits in the foreign exchange transactions. The rising price level and the wide gap, at times over 65 percent (Table 9 above) between the official and the free market rates have resulted in an increase of revenues from this source. Export proceeds are further subject to an additional tax known as the "foreign exchange tax". This brings the effective foreign exchange rate well below the official rate, as was noted in the case of cotton.[16] The exact amount of revenues from taxes on foreign exchange is not available as it is combined with the profits from the purchase and sale of foreign exchange in the free market. The level of such profits is further affected by the acquisition by the government of foreign exchanges through drawing under special (Standby) arrangements on the resources of the International Monetary Fund. In 1966/67 the entire amount of revenues from foreign exchange transactions, including the profits on sales and taxes, amounted under "Revenues from Commercial Transactions" to almost 830 million Afs.[17] Whether the level of revenues from these export taxes will continue to rise is uncertain owing to fluctuations in the conditions of demand and supply for Afghan exports.[18]

3. Sales Taxes /

15. Page 57 above.

16. Page 17 above.

17. The balance under this category constitutes revenues from Stamp Duties and the related items, pages 89-90 below.

18. See page 235 below.

3. Sales Taxes

There is no general sales tax in Afghanistan on a retail level. Sales taxes have been imposed at wholesale level on imports of all articles (Article 80 Income Tax Law, page 85 above). Revenues from this source amounted to Afs.162 million in 1967/68.

4. Excises:

Excise taxes have been imposed on textiles, cement and certain other items. Revenues from this source amounted to 62 million Afs. in 1967/68. Both this and sales taxes imposed at industry and wholesale levels, respectively, provide ease of collection. However, against this advantage lies the argument that, unlike taxes on a retail basis, taxes at the manufacturing and wholesale levels fail to promote consumer awareness of the amount of tax included in the price of goods and services in demand.

5. Stamp Duties:

Such duties are collected on all deeds, documents, applications of a commercial nature, commercial and legal registers, court resolutions, contracts, income tax forms and the like. Duties collected by the party concerned are duly transferred to the Treasury. These duties are of two main types; the first one is a fixed amount which is determined by the nature of a transaction, and the second type which varies according to the value of a transaction. Stamp duties are imposed in a variety of ways; as stamped paper supplied by the government agencies, or stamped stationeries prior to use, or as affixed stamps or seals. Revenues from this source are not separately accounted for. It appears under Profits from exchange dealings of the Central Bank entitled "Commercial Transaction". This does not represent an accurate classification as part of the duty, that on Income Tax Forms and the like, may be classified as/

as direct taxes. Nevertheless, Revenues from this source amounted to almost Afs.100 million in 1967/68.

B. Direct Taxes:

Total revenues from direct taxes dropped from 26 to almost 13 percent of the total tax revenue, between 1958 and 1967, a corollary of the initial stages of economic growth.[19] This change in tax structure leading to a greater reliance on indirect taxes, during the initial stages of economic growth noticed in the above paragraphs, may be attributed to two main factors. First, since the volume of foreign trade normally increases with a rise in the level of GNP, tax revenues from this source tend to have a corresponding increase under the existing tariff rates. Second, owing to administrative expedience in revenue collection from this source and the growing revenue requirement, by adjusting the existing tariff rates, the government aims at raising revenues and/or achieving other economic objectives. In 1967, revenues from Direct Taxes amounted to 1.1 percent of GNP.

This major source of revenues includes taxes imposed directly upon the annual income of a taxpayer, whether individual or corporate, computed on a progressive scale or a specific rate, and on the personal or real taxable property of an individual or a corporate entity.

1. Income Taxes:

Although income taxes are a fairly recent development in the Afghan tax system, they have, nevertheless, undergone frequent and radical changes since their inception in 1944. In 1966/67 revenues from this source/

---

19. Harley H. Hinrichs, "A General Theory of Tax Structure Change During Economic Development" Harvard Law School, Cambridge, 1966., pp.19-28

source amounted to 85 percent of total direct and 16 percent of total tax revenues.

Since the following Chapter, 4, examines the revenue aspect of income taxes in greater length, the enquiry here is mostly confined to a brief historical account of all the amendments and development of the income tax system. This will provide a background to what the writer attempts to present in the subsequent pages of this paper. For purposes of convenience, the study here falls under two distinct periods. The first period covers the study of the system between 1944 and 1956, while the second period covers the development decade, i.e. between 1957 and 1967.

(a) The Income Tax System between 1944 and 1956:

Taxes on the income of individuals and companies were first instituted in 1944 under a progressive schedule ranging from 5 percent on a taxable income[20] of over Afs.5000 and up to Afs.20,000, and a maximum of 25 per cent on Afs.500,000 and above. "Individuals" subject to this schedule consisted of traders operating under proprietorships or partnerships of different forms. The word "Company" on the other hand applied to limited liability and joint-stock enterprises,. Early in 1945 a flat rate of 20 percent, applicable to both categories of taxpayers, replaced the 1944 progressive tax schedule. Shareholders were also added to the category of individual income tax payers, as dividend was declared taxable. However, the coverage of the tax base remained narrow and limited since income arising from other sources in the form of salaries, wages, rent and interest remained untaxed. Following a series of further amendments in 1946 and subsequent years the tax law initiated, in 1954/55, certain major changes in the system whereby the taxation of individual and company/

20. See Pages 177 and 194 below, on what constitutes taxable income, under the Afghan Tax Law.

company were separated from each other. Accordingly, four different categories of taxpayers were created:

(i) Individual traders and shareholders. Traders whose net income, i.e. after the provision of legal deductions, exceeded the exemption limit of Afs.4,000 were subject to a fixed tax rate of 10 percent and a progressive rate schedule ranging from 3 percent to 43 percent on taxable amounts of Afs.4,001-10,000 and three million Afghanis and above, respectively. Shareholders receiving dividends were, however, not entitled to the Afs.4,000 exemption. The law also required both individuals and companies to maintain adequate and reliable records for purposes of assessing taxable income, i.e. the deduction of allowances and expenses incurred in the process of earning that income. In practice this provision proved inadequate as the tax office found it necessary to question the reliability of these records maintained and presented by individual traders, partnerships and limited liability companies. As a result, an arbitrary 4 percent of total turnover of such businesses was regarded as taxable profit subject to the above tax rates, irrespective of whether the business experienced a higher rate of profit or sustained a real loss. Later in 1954 and again in 1956 this arbitrary percentage profit was raised to 5 and 7 percent, respectively.

(ii) Income from wages and salaries was declared taxable for the first time under a progressive schedule ranging from one percent on a taxable income of Afs.13,001-20,000 and a maximum rate of 10 percent on Afs.70,000 and above. In addition to such a low rate, income from salaries and wages enjoyed a personal allowance of Afs.13,000. Income from other sources, mentioned above, escaped taxation.

(iii) Companies engaged in commercial and trading activities, including banking and other financial enterprises, were subject to a 10 percent tax/

tax on the total taxable income. Dividend distributions were, as indicated, taxable under a progressive tax schedule. This way a two-tier tax feature was introduced into the system, in that, income was first taxed as company profits and later as dividends, if any, in the hands of the shareholders.

(iv) Industrial and Agricultural Companies were subject to a 5 percent tax on their profits and distributions as dividends were again subject to the individual income tax schedule. The five percent tax on the profits of the company was to be credited towards total tax liability of shareholders as an incentive to induce investment in such organization.

(b) Income Taxes between 1956/57-1966/67, the Development Decade:

The First Five Year Development Plan launched in 1956/57, asserted "that although changes had occurred in the level of economic activities, tax rates underwent no radical changes."[21] The situation affected the value of currency and weakened the financial position of the Country. It had offered no effective incentives to enterprise. The history of the revenue structure reveals that for a long time government revenue depended on direct taxes, namely, land and livestock. For example, in 1948/49, revenues from land alone constituted over 19 percent of total government revenues. In 1954/55 this share dropped to almost 7 percent.[22] The role of indirect taxes had increased rapidly since the mid-fifties. Income Taxes had not contributed significantly to the government budget, Table 20. Owing to these facts, necessary adjustments were introduced in the tax system and again income taxes were the only group of levies to experience major changes. As a consequence, a series of fixed and progressive/

---

21. Ministry of Planning, "The Five Year Plan of Afghanistan", pages 208-230, Kabul, 1956/57.

22. Ministry of Planning, "Survey of Progress", Kabul, 1967.

Table 20

GOVERNMENT REVENUES FROM DOMESTIC SOURCES

1951 - 1955/56

(In Million Afs.)

Sources of Revenue	1951	1952	1953	1954	1955
Custom Duties	172	215	244	301	401
Income Taxes	52	68	81	98	98
Land Taxes	67	68	77	76	77
Livestock Taxes	30	31	34	32	40
Small business and artisans (1) tax and stamp duties	13	32	43	69	112
Monopoly dues and related items (2)	106	79	75	98	138

Source: First Five Year Development Plan. 1957, page 209, Ministry of Planning, Kabul.

Note:

(1) The income tax did not cover all income earners. Small businesses, artisans and other independent occupations, with or without a fixed place of business, covering more than 50 different occupations, were and still are subject to a fixed tax in lieu of income taxes, (see pages 97-100)

(2) The Department of government Monopolies, established almost 30 years ago is engaged in the purchase and sale of items, such as sugar, petrol, tobacco and others. Revenues from such operations include duties, profits from the difference between the purchase of foreign exchange at the official rate and its conversion for price calculation at the market rate of exchange, as well as annual profits. These items in later years have been reported under separate headings in the expanded classification of revenue items.

progressive profit and income tax rates, on a schedular basis, was introduced.[23] The change towards a schedular system was largely influenced by the fact that, by recognising a distinction in the "kinds" of income the varying tax rates under a schedular system offer a differential treatment of income from various sources with minimum administrative complications. It expected to simplify and facilitate the taxation of income from any individual source. Since the number of schedules under such a system is largely determined by a careful and elaborate classification of income and policy objectives, it had been kept down to three and limited to income from wages and salaries, dividends and individual businesses. In addition to the varying rates, the schedules were equally accompanied by various amounts of allowances and deductions.

The existence, until 1966/67, of the Schedular System of income tax with rate differentials and varying levels of exemptions tended to render the realisation of the overall objectives of the tax policy more difficult. Although income from different sources was declared taxable, the discriminatory treatment, which was by itself arbitrary in nature, was contrary to the principle of the "ability to pay" recognised by the tax law. The multiple schedules allowed income to be split among different sources and created the likelihood of reducing one's total tax obligation thus working against the revenue objective of the government. It is true that rates were increased considerably; however, the inefficiency in administration and lack of taxpayer consciousness were both inconsistent with the move. The fact is that, like its predecessors, it still left areas, such as the self-employed professions where the recipient of income paid little or virtually no tax, untouched. This obviously worked against the success of the system. The low level of tax education/

---

23. For an evaluation of these schedules reference is made to the following chapters, pages 117-238 below.

education of the tax officer and the lack of adequate regulations in the form of manuals increased the discrepancy in the interpretations causing further confusion among taxpayers. Similarly, the low level of literacy and lack of well-established systems and habits of maintaining records added to the shortcomings of the system. The fixed corporate income tax of 1955 was also supplemented with a progressive surtax of up to 17 per cent, (page156). Such a move imposed both high effective, or average, and marginal rates on the successful rewards of risky enterprises. Coupled with higher rates of progressive taxes on dividends this did not seem conducive to a high rate of investment in the private sector.

It was primarily due to these and other shortcomings, which we will come across in our later chapters, that another attempt was made, in 1967, in order to introduce necessary revisions in the 1944 and 1957 income tax laws. Since these changes coincide with the implementation of the Third Five Year Plan, efforts have been made to orient these revisions towards meeting some of the requirements helping to achieve the objectives of the development programmes. Accordingly, the latest changes in the income tax structure have been to achieve equity in distributing the tax burden on a global basis. The schedular tax with its impersonal characteristics was far from attaining an equitable distribution of the fiscal burden as it ignored the personal aspects of the various taxpayers.

The revenue effects are expected to help reduce budget deficits and act as a strong deterrent to the inflationary pressure that impeded the success of the First and Second Development Plans. It also has introduced a number of concessionary provisions aimed at promoting the incentives to work, save and invest.

Under the present global feature of the Income Tax Law, a tax is imposed on the income of all persons (individuals), corporations (consisting of limited liability and joint stock companies) and other entities in Afghanistan; on the income of Afghan citizens abroad, and on the income of alients and foreign companies from sources within Afghanistan.[24] However, statutory exemptions and preclusions of income from sources such/

---

24. Income Tax Law, Op.Cit. Article One, See also page 175 below.

such as agriculture, liberal professions and others render the scope of the tax very limited indeed[25].

(c) Individual Income Tax Under the Present System:

Personal or individual income tax in Afghanistan is still far from having become a general tax. Although personal income is declared taxable under a consolidated single progressive tax schedule ranging from 4% on an income of Afs.10,000 and 40% on an income of Afs.2.5 million and above, the areas and the number of individuals subject to the tax are still very limited and small. Since the assessment of personal income and the application of the tax vary according to the source of income, the study of the 1967 Income Tax Reform may be better understood through an examination of the already established groups of taxpayers in the following manner:

(i) The first category may be taken to include recipients of salaries, wages, fees, commissions, bonus payments and other emoluments. Taxes computed on the total of an individual's income from the above sources, less legal exemptions,[26] are under the reform withheld at source. Discharging tax liability, therefore, requires that income from these sources must be added to other income and additional taxes, if any, paid.[27]

(ii) A second category includes recipients of what may be called unearned income, i.e. income arising from sources other than work. Included among these are sole proprietors, partners both active and sleeping of either general or special partnerships or any other unincorporated business enterprise. As separate groups of taxpayers they constitute - (1) recipients of dividend/

---

25. See page 99 below.

26. A maximum of Afs.35,000 is allowed each taxpayer in this group, See page 197 below.

27. See page 320 below.

dividend income, from joint-stock company or any public enterprise,[28] whose taxes under the 1967 Reform are withheld at source. Dividends distributed in shares are exempt from personal income taxes.[29] The net after-tax dividend plus the tax withheld constitute part of the total taxable income of any such recipient; (2) recipients of profits from commercial and industrial ventures, interest, rents, royalties, awards from a private organisation, prizes, distributed shares of partnerships and any other return from labour and capital or from economic activities; (3) recipients of gains. Under the 1967 tax Reform a capital gains tax is imposed. The tax considers such gains part of total income of an individual subject to the general provisions of the rate schedule. (More on these points in Chapters 5 and 6.)

(iii) As the assessment of income from certain occupations still appears difficult, the law has maintained the appropriate provision from the previous legislations, enabling tax authority to impute the level of such income, particularly in individual trading activities, and apply the turnover arrangements whenever the amount of profits declared in the annual statements fall short of the seven percent requirement. A second case where income for tax purposes is imputed covers all artisans and small businesses with a capital less than Afs.50,000, who do not submit acceptable balance sheets and profit and loss statements. These businesses constitute over 50 different occupations grouped under separate categories in accordance with the type of goods and services handled. Each category is divided into grades reflecting estimated net income potential. A fixed tax, which is in lieu of income taxes, is imposed on each grade. The net income potential of each establishment is estimated with due consideration to the following factors:

(1)/

---

28. Public enterprises denote those enterprises where ownership of their capital is represented by shares of stock transferable among members of the public.

29. See Page 201 below, for further reference on this point.

(1) The kind of goods and services offered; (2) the estimated volume of business; (3) the size and rental value of the establishment; (4) the economic advantages of its location, and (5) the population of the district or village. Various procedures may be used in estimating net income potential of each category and grade depending of course on the nature of business[30]. After having imputed income an annual income tax is computed on the net income in accordance with the general income tax schedule. In this respect, the tax will be higher for a Beauty Salon than a shoe repair shop, lower in towns than big cities. An individual owner of several such businesses will have to pay the tax on each of his business places separately. If the individual so taxed has income from sources other than the business covered by the fixed tax the income will be reported for income tax separately. There are other activities under the artisans group such as entertaining establishments, flour, sugar cane and oil mills where income tax liability is a fixed percentage of the volume of business conducted. In the case of entertainment activities the tax is 10 percent on the receipts from sale of admissions. Owners of mills equally pay a 10 percent of the gross income per year. Individuals who furnish supplies, materials, or services under a contract or a lease are subject to a separate tax computed under a graduated schedule applicable on the total contract amount. The rates range between one percent on a total contract of up to Afs.20,000 and 5 percent on Afs.One million and over. The Fixed tax of individuals in the business of transportation is a tax on each vehicle used in the business. The tax, which is in lieu of income taxes, varies according to the vehicle; a taxi must pay a tax of Afs.600, a truck or bus pays a tax of Afs.500 per ton of rated capacity. Since the right to carry on any one of these individual activities is based on/

---

30. Methods to estimate the net income potential include projection of daily profits to annual profits, estimating annual profits from purchases and the like.

on the obtaining of licences and permits, the individual concerned will also incur minimal charges on this account, see Table 23 below. Although the number of such fixed taxpayers has increased over the years, Table 27, page 218 , income from certain professions such as the practice of law, medicine, architecture, engineering and the like still remains outside these provisions, and as such, totally escapes taxation.

(d). Company[31] Income Tax under the Present System:

The income tax of a corporation and limited liability company is 20 per cent of its taxable income from all sources including capital gains[32] in the taxable year[33]. There is no significant licence tax on corporations in Afghanistan. Limited liability and corporations are subject to a turnover tax, known as the "Business Receipt Tax" at specified rates in the following manner:

(1) Five percent of receipts (before deduction of expenses) during the taxable year of commissions, fees, interest, dividends, rent, royalty and similar income.

(2) Two percent of all receipts (before deduction of expenses) during the taxable year for materials, equipment, services, transportation and construction provided under terms of contract.

(3) Two percent of receipts (before deduction) during the taxable year from premium income whether that premium is exempt from or subject to income taxes.[34]

(4) /

31. The word company under the recent income tax reform covers only limited liability companies (known as Sherkat mahdoodul masuliat) and joint-stock companies or corporations (known as Sherkat Sahami). A limited liability company is subject to the same provision of the income tax law as corporations. Partners in such companies are considered shareholders, and distribution of earnings as dividends.

32. See pages 192-3 on the special treatment of Capital Gains.

33. Income Tax Law, Op.Cit. Article 3. The taxable year is the Solar or Fiscal year, page 14 above.

34. All premium income for insurance written in contracts that require ultimate payment of specified benefits to the policyholder or his beneficiary is exempt from income tax. Ibid, Article 56.

(4) Two percent of receipts (before deduction) during the taxable year from the sale of admission to public entertainment, including cinemas, shows, plays, concerts, exhibitions and carnivals.

(5) Two percent of receipts (before deduction) during the taxable year from sale of products, goods, assets and services not included in (1), (2), (3), and (4) above.[35]

The Business Receipt Tax is not affected by either profits or loss in the same or preceding years.

Both individuals and corporations are also subject to certain other minor taxes on their income, such as the stamp duty, (page 89), contributions to the Afghan Red Crescent and Municipalities, (pages 112-3) below.

2. <u>Taxes on Property, real and personal:</u>

A second major tax included under the category of Direct Taxes is the tax on the Agricultural Sector. It consists of taxes on land and livestock. These taxes were originally meant to be a tax on the gross product of land. However, as they are not at present assessed on the basis of actual or potential income derived from this source, these taxes have appeared to represent a nominal tax per unit of property owned.

Whether for purposes of revenue or as an instrument of manipulating economic activities, the historical development of the Afghan tax system shows that most taxes have been imposed in accord with the principle of the ability to collect. Shortly, after Independence, such taxes as custom duties and land taxes and stamp duties were some of the first kind of levies to be initiated on a nation-wide basis which raised the bulk of government revenues.

Land/

---

35. <u>Ibid,</u> Article 73.

Land taxes were first initiated as a "tithe", which were based on the Principles of Islamic religion, whereby 1/10th of land produce (gross harvest) was to be collected, in-kind, by the government. In the case of double cropping, the tax was 1/10th of each crop harvested from a given piece of land in the same year. This was not based on the results of a scientific cadastral survey and land register for purposes of tax or transfer of property. It was imposed on the actual yield per unit (jereeb) of land or other property - fruit bearing trees - multiplied by the number of such units owned. It was assessed by tax inspectors at harvest time, for every village, and was then collected on behalf of the government by the chief of the village. The chiefs were also responsible to report changes in the nature and ownership of land, in their respective districts. Towards the end of the nineteenth century, land was divided into various categories and their taxes were accordingly revised. Land irrigated by rivers was taxed at one-third or 33⅓ percent of the value of the yield, i.e. gross produce; land irrigated by natural springs was taxed at one-quarter or 25 percent of gross yield; and land irrigated by "Karaiz" (subterranean wells) was taxed at one-tenth of the yield value.[36] Taxes not duly paid were converted to cash on the basis of the highest price of the year. This was normally the price prevailing during the ninth month of the year, as it is generally the highest.[37] Such an arrangement created administrative and technical difficulties. This problem and the intention of the government to introduce monetisation of the different sectors of the economy, brought some changes in land taxes. While preserving its "tithe", nature land tax was converted in 1918/19 from kind to cash, at the prevailing level of prices for agricultural commodities[38]. While such an attempt may have eliminated some/

36. Ministry of Finance, 1967/68.

37. This price is still used in computing tax liability of flour mills, page 99 above.

38. Ibid.

some of the difficulties associated with a tax in-kind, it has definitely aggravated the highly inequitable feature of the tax today. Among other points, it did not provide for the tax to be adjusted in the event of possible changes in the level of prices over a period of time. Later on, an attempt was made to remove this inequitable feature of the agricultural tax. A nation-wide land classification and registration was ordered in 1920. According to the tradition in every province and district, land was classified on the basis of its fertility and potential yield. This classification created a set of different grades for every province and district. A schedule of tax rates ranging between 0.25 and 20.00 Afghanis per jereeb was initiated to go with the different grades of land. This measure also specified the amount of tax per head of livestock owned. Livestock raised or kept for purposes of personal consumption, i.e. the use of meat, milk and other by-products by the owner, or employed to utilise land was exempt from taxes. To have avoided a substantial potential loss of revenues through this conversion of taxes from kind to cash, the act provided that in cases of emergency the government can demand taxes to be paid in-kind at the rate of one-tenth of output. Other than this, it failed to provide for any adjustment to be made in tax rates due to changes in the value of money. It made no provision for taxes on agricultural income. Land owned by certain institutions, like religious and charitable organisations, were exempt from land tax altogether. On the other hand, a tax equal to one-third of the actual yield was imposed as a rent for the use of government land. The rent was not converted into cash. The district tax inspector, together with the chief of the village, are still responsible for the assessment and collection of the government share at harvest time. Such collections are deposited with the nearest agency of the Food and Public Necessities Procurement Department.

There are no other levies imposed on the Agricultural Sector. Realising the/

the fixed and inequitable feature of land and livestock taxes, and the pressing need for more revenues in the public sector, the government proposed a revision of agricultural taxes to an Agricultural Congress held in 1964/5. This was the first move after a period of almost half a century, when the last changes were made. The Congress, representing the farming population, agreed to a hundred percent increase in land taxes under the present structure. Table 21 shows, by province, the minimum, average and maximum land tax rates before and after the doubling of the tax in 1964/65. Such a move was bound to increase revenues from land tax by twice the amount. It, however, failed to remedy the erosion of the tax base and eliminate or reduce the gap existing between the obligation of this sector and the others. It failed to eliminate the inequalities existing within the same sector. Table 22 shows the pattern of land tenure in the Country. The past fifteen years have undoubtedly altered the situation mainly through land reclaimation programmes in the different parts of the country. Furthermore, the reduction of labour from land and its attraction into rural and urban areas in search for other occupations may also relieve the pressure on the owners of small-holdings. Nevertheless, while more than 80 percent of the population is engaged in agriculture, from which approximately 75 percent of the national income is derived, land tax, in 1966, amounted to about 82 million Afs. This comprises less than 50 percent of the total Afs.170 million revenues from agricultural taxes, which include livestock tax, and only 3 percent of tax revenues or 1.7 percent of total government revenues, as against almost nineteen percent in 1948/49. Seen as a ratio of GNP, land and livestock taxes together represented only 0.3 percent in 1966. In view of the share of agriculture holds in the economy of Afghanistan, this percentage appears to be low by all standards. This, obviously shows a fundamental weakness of the tax in not being able to automatically siphon off an increasing proportion of the growth in national income.

A proposed land tax:/

Table 21

MINIMUM, AVERAGE AND MAXIMUM LAND TAX RATES BY PROVINCES, BEFORE AND AFTER THE DOUBLING OF THE RATES IN 1964/65

		RATES PRIOR TO 1965		
		Minimum Tax	Average Tax	Maximum Tax
Name of Province		Afghanis	Per	Jereeb
1.	Faryab	1.85	6.25	13.19
2.	Kabul	3.00	11.00	21.00
3.	Kandahar	1.00	8.50	17.00
4.	Parwan	2.50	7.50	13.00
5.	Badakhshan	22.00	3.50	5.00
6.	Uruzgan	2.15	-	5.00
7.	Kataghan	4.50	5.40	7.50
8.	Ghazni	4.00	13.00	14.28
9.	Ghor	2.50	5.00	10.00
10.	Herat	2.50	5.80	8.73
11.	Nangarhar	2.85	7.76	10.75
12.	Helmand	6.00	8.50	11.00
13.	Sheberghan	3.42	3.68	4.59
14.	Nimroz	1.50	7.00	15.00
	NATIONAL AVERAGE	2.84	7.15	11.14
	NATIONAL AVERAGE AFTER DOUBLING OF TAX RATES IN 1344 (1965)	5.68	14.30	22.28

Source: Ministry of Finance, 1968

Table 22

THE PATTERN OF LAND TENURESHIP
IN AFGHANISTAN UP TO 1955

(In Jereebs)

Amount of Land	Number of Owners
Less than 2	257,872
3 - 20	265,243
21 - 30	32,844
31 - 50	26,240
51 - 100	22,484
101 - 500	13,832
500 - Over	1,208

Source: Ministry of Planning, 1956/57

A proposed land tax:

In the following pages an attempt is made to study the case of agricultural taxes in view of the tenureship pattern, the potential and actual output and in the light of our findings recommendations aiming at removing the present anomaly are made.

In an underdeveloped economy such as Afghanistan's, agriculture and particularly land is the principle source of production. However, land taxes are not charged in proportion to output and income from this source. As observed, this is primarily due to the fact that taxes have been collected at one-tenth of output converted into cash at a level of prices prevailing approximately half a century ago. Prices of agricultural output have increased more than fiftyfold since then. The level of prices for the past decade, covered earlier, is representative of this phenomenon. Before making any feasible recommendation towards the alteration of the present land tax system, it is desirable to relate the tax to income, which is normally accepted as the index of income tax base. This suggests that, as a first step, the average ability of an owner to pay a tax on a one jereeb of land must be found out. The following figures on the average gross income[39] and expenditure, and net average income per jereeb of water irrigated wheat-producing land may be helpful towards this direction:

39. This is based on actual rather than potential output.

A - Average Expenditure[40]

Nature of Expenditure		Quantity or Number	Expenses per unit	Total Expenses
			Afs.	Afs.
1.	Ploughing			
	(a) Labour	3 persons	30.00	90.00
	(b) Pair of Oxen	3 pairs	50.00	150.00
2.	Cultivate Seeds	5 Seers[41]	50.00	250.00
3.	Land Cultivation	1 person	30.00	30.00
4.	Irrigation	1 person	30.00	30.00
5.	Harvest-labour	2 persons	30.00	60.00
6.	Thrashing-oxen	2 pairs	50.00	100.00
7.	Winnowing	2 persons	30.00	60.00
8.	Cleaning	2 persons	30.00	60.00
9.	Reaping	2 persons	30.00	60.00
10.	Other expenses	-	-	30.00
Total average expense per jereeb				920.00

40. Based on the 1967/68 estimates of the Ministry of Agriculture, calculated largely on the basis of factor cost in the monetised sector of the economy and will be subject to adjustment owing to changes in the level of prices. The level of real wages in the monetised exchange sector is normally higher than the average (as opposed to marginal income) real wage (income) in the subsistence sector in order to affect an immigration of labour from land to the modern sector. This state of affairs is not necessarily the result of trade union pressures as in most cases such movements are still lacking. It is equally not due to a high legal wage rate. It is mainly due to the willingness of the employer, whether local or foreign, to build up a stable and efficient labour force and to avoid a high turnover which impedes productivity. Since the sector under consideration is predominantly non-monetised the difference in these expenses which would normally exist between the monetised and non-monetised sectors, has not been considered in these calculations, owing to lack of statistical information. The difference, however, may have to be borne in mind as it affects both gross and net income per unit of land involved in these calculations.

41. A Seer is equivalent to sixteen pounds weight.

B – Average Income from One Jereeb Of Irrigated Wheat Producing Land

		Quantity of output	Income from One Seer	Total Income
			Afs.	Afs.
1.	Wheat	36 Seers	50.00	1800.00
2.	Straw	54 Seers	5.00	270.00
Total average income from one jereeb of wheatland				2070.00

C – Net Average Income from One Jereeb of Wheat Producing Land

		Afs.
1.	Average income of one jereeb of wheat producing land	2070.00
2.	Average cost of one jereeb of wheat producing land	920.00
Net average income of one jereeb of irrigated wheat producing land		1150.00

This simple calculation can be carried on for all grades of land under the present classification, and for every crop. The result is obviously different for each crop, even though an average grade of land is chosen. This is due to the varying amounts of output and cost involved. The following summary presents the net income per jereeb of land producing the following crops:

	Nature of the Crop	Net Average Income/Jereeb
		Afs.
1.	Irrigated Wheat	1150.00
2.	Dry Land Wheat	290.00
3.	Corn	1113.00
4.	Vegetables	1298.00
5.	Cotton	1229.00
6.	Beetroots	1013.00
7.	Rice	4300.00
8.	Fruits (apple)	4790.00
9.	Vineyards	4995.00

The/

The above findings may be divided into the following groups on the basis of the value of the crop and the four main grades of land accepted under the present land classification:

1 - Average net income/jereeb of the first group Afs. 4674.00
2 - Average net income/jereeb of the second group Afs. 1163.00
3 - Average net income/jereeb of the third group Afs. 583.00
4 - Average net income/jereeb of the fourth group Afs. 290.00

Since some of the cultivable land is not cultivated every year, due to shortages of water, and rainfall, it is advisable to divide land into two main categories; continuous cultivation and fallowing cultivation. The first two groups above belong to the first category, while the second two fall under the second category. Although a tax on the basis of one-tenth of the value will place land tax liability in line with the lowest group of income tax payers[42], the implementation of it might still evoke reaction and encounter political resentments. An alternative solution may be to consider a one-twentieth of the value of output as the basis of land tax.

The latest preliminary land registration estimates the cultivated area to be about twenty million jereebs. Assuming that the total area is taxable, the tax revenue under one-tenth and one-twentieth of the net average income of each group would be as follows:

Group	Approximate Area in Jereebs	1/10th net income per jereeb		1/20th net income per jereeb	
		Tax/Jer.	Total Tax	Tax/Jer.	Total Tax
		Afs.	(000 Afs.)	Afs.	(000 Afs.)
Group One	500,000	467.00	233,500.00	234.00	117,000.00
Group Two	10,000,000	116.00	1160,000.00	58.00	580,000.00
Group Three	2,000,000	58.00	145,000.00	29.00	72,500.00
Group Four	6,000,000	30.00	180,000.00	15.00	90,000.00
TOTAL	20,000,000	-	1718,500.00	-	859,500.00

Although/

42. Chapter six below.

Although the amount under 1/20th of the value will represent a 50 per cent reduction in the total would-be tax liability of land owners, it nevertheless raises the notoriously low level of agricultural taxes. An element of progression in terms of holdings of land may be introduced above a level whereby owners of large holdings, in addition to the 1/20th proportional tax, will bear a further tax liability. This will not only establish equity within the agricultural sector, but will also induce land-owners to make full utilisation of their resources. Considerations regarding the size of the land and the progression of surcharges will depend on administrative feasibility of such a tax, the personal circumstances of the taxpayer, equity and revenue considerations as well as productivity objectives envisaged under the Plan. Owners of small holdings falling between one and fifteen jereebs of land may be exempt from such a progressive surcharge primarily on administrative grounds. Furthermore, to encourage land improvement and greater productivity, exemptions on improvement outlays incurred by owners may also have to be taken into account. In order to encourage and safeguard such investments, measures ensuring the availability of such factors as labour, capital, raw material and technical knowhow must be given serious consideration. In the case of landlords and tenants, a system of rent contract may be devised to avoid a backward shifting of the tax.

It must be pointed out that the government should reserve the right to adjust, at least every three years, these rates in the light of changes in the levels of prices and production. For the sake of simplicity small changes in these magnitudes, of up to 10 percent, may be ignored. Moreover, reservations must be made that if and when a situation arises, in-kind payments can and must be demanded by the government. At the moment the Money/National Income ratio is very low and the process of monetisation cannot/

cannot be extended all over the country in a short period of time. Tax collection in-kind may be accepted as an inevitable feature of the agricultural tax system for the time being. To avoid administrative and technical difficulties, one crop may be chosen at present as a basis of such possible in-kind payments and the 1/20th of the value must be expressed in terms of "seers" weight of that crop, as a measurement. Changes in the type of grade of land, which will affect output and hence tax obligation, will have to be accounted for almost every year through the services of the Cadastral Survey Authority so as to maintain an equitable treatment in the system.

A similar exercise may be attempted to compute the income and taxes of personal property, i.e. livestock. Each single animal may be valued for meat and other by-products such as wool, milk and others in a year.

3. Municipal Taxes:

As noted above taxes are levied and collected by the central government after their ratification by the Parliament in accordance with the authority vested in it by the Constitution. There are certain levies also imposed at the municipal and other secondary levels. Municipalities have independent and separate budgets of operations which are not entirely dependent on the central and local governments for further support. Advances or grants may be made from the government budget to some municipalities; nevertheless, almost all of them have the power to impose and collect their own specific levies, with the approval of the government and the legislature. The magnitude of such levies vary from one municipality to the other. An annual property tax, as "cleansing charges" of almost Afs.3.00 per Afs.1,000.00 value of real estate property is levied upon leassors or occupants of houses and apartments. The rate rises to Afs.7.50 per Afs.1,000.00 if the property is held for commercial purposes./

purposes. These properties are supposed to be periodically assessed to maintain the level of taxes in accordance with the rise in the level of prices. No such evaluation has been carried out for the past two decades or more. Construction fees, licences and permits to the 50 different categories of artisans and a number of other levies form the main source of municipal revenues.

In addition to these there is a tax equal to one month rent, per year, on all rented real estate properties. Kabul Municipality also collects from individual merchants and companies, a levy equal to one percent of their income tax paid to the Central Government, a 10 percent on the profit of bus companies, and one percent on the profits derived from the operation of government transport facilities. The one percent tax on merchants and companies is collected at the tax offices on behalf of the Municipality of Kabul at the time the income tax of such taxpayers is collected. It is then transferred to their account, together with any other government subsidy needed. Due to poor administration, coupled with lack of tax consciousness, the percentage of revenue raised from real estate property or its income is very small. It has been due to the problems of collection of these imposts, that the government, in addition to partly financing the activities and programmes of the municipalities, has offered its relatively effective services in as far as the assessment and collection of municipal revenues are concerned.

Another secondary organisation which has imposed levies is the Afghan Red Crescent.. Personal and company income taxpayers are subject to an additional tax equal to one percent of their income taxes paid. In addition to this, authority has been vested in it by a government decree to carry out a national lottery programme.

4. Pension Contributions:

Another/

Another potentially large source of revenue is the social insurance contributions, including pension fund. At the moment, contributions to the pension fund are made only by civil servants from their salaries after taxes. The fund is maintained independent of the government budget and is normally invested in safe assets such as buildings and other similar properties.

5. Miscellaneous Imposts:

In addition to the above sources of revenue, there are a number of other levies imposed at different levels of activities. Revenues from these sources either appear under their own separate headings, or, for purposes of simplicity, are added together with revenues from other sources. These levies include e.g. Cess taxes, on a certain district for the upkeep and maintenance of certain projects such as dams, bridges, canals, as well as road-tolls and the 10 percent commission for facilitating or collecting bad debts in the event of a recourse to the law court by the creditors. For a full picture of the growth in the revenue sources of the Afghan government Table 23 may be consulted.

With this brief study of the sources of revenue and their importance in the Afghan economy, attention is now moved to the main part of this paper, i.e. the analysis and evaluation of the Income Tax System.

Table 23

DETAILS OF GOVERNMENT REVENUES FROM DOMESTIC SOURCES
BETWEEN 1957/58 - 1967/68 (In Million Afs.)

Rev. Code	Sources of Revenue	1957/8	1958/9	1959/60	1960/1	(6 Mths.*) 1961/2	1962/3	1963/4	1964/5	1965/6	1966/7	1967/8
100	DIRECT TAXES											
		286.5	266.7	241.5	293.3	81.3	319.9	375.5	447.8	575.0	602.8	417.0
110	Individual Income Taxes	191.8 }	161.1 }	83.8	105.9	38.5	113.6	157.2	238.4	324.3	390.2	187.0
120	Company Income Taxes	}	}	51.3	74.0	6.3[a]	77.1	78.8	80.6	81.1	122.7	144.0
130	Real Property (Land Taxes	34.9	42.4	39.7	40.2	33.7	64.7	49.8	44.3	81.9[b]	89.3	85.7
140	Personal Property (livestock) taxes	59.8	63.2	66.7	73.2	2.8[a]	83.0	89.7	84.5	87.6	0.6[c]	0.1
150	Others	-	-	-	-	-	-	-	-	-	-	0.2
200	INDIRECT TAXES	789.2	874.1	766.0	1120.7	316.5	1127.1	1712.3	1917.4	2175.5	2645.0	2644.2
210	Import Duties	728.8)	787.3)	604.8	788.7	197.4	883.6	944.4	1095.1	1129.2	1450.7	1355.2
220	Export Duties	)	)	57.2	61.9	34.9	74.7	76.7	80.1	139.3	167.1	159.1
230	Tax on sale of Consumer Goods	12.0	22.7	33.9	130.2	34.8	71.6	90.3	197.6	92.3	80.2	62.7
240	Tax on commercial transactions	44.1	42.3	63.7	131.4	45.4	89.0	592.5	529.5	804.3	934.3	886.5
250	Monopoly Taxes	4.3	21.8	6.4	8.5	4.0	8.2	8.4	15.2	10.4	12.7	14.7
260	Fixed Taxes on Imports	-	-	-	-	-	-	-	-	-	-	162.0[d]
270	Fixed Taxes on Exports	-	-	-	-	-	-	-	-	-	-	6.0
300	INCOME FROM SALE OR PROPERTY & SERVICES /											

(continued overleaf)

Table 23 - Sheet 2

Rev. Code	Sources of Revenue	1957/8	1958/9	1959/60	1960/1	(6 mths)* 1961/2	1962/3	1963/4	1964/5	1965/6	1966/7	1967/8
300	INCOME FROM SALE OF PROPERTY AND SERVICES:	36.2	72.9	77.7	92.7	40.7	115.5	150.9	197.5	244.6	278.9	204.9
310	Sale of Natural Resources	13.4	52.1	21.0	36.7	14.6	34.5	45.1	42.6	60.3	66.4	59.5
320	Sale of Land Buildings	3.2	3.8	33.7	20.5	11.9	44.7	58.9	105.8	101.9	122.2	10.2[e]
330	Sale of rights to exploit natural resources	-	-	-	-	-	-	-	-	-	-	0.1
340	Sale of mineral and agricultural products	-	-	-	-	-	-	-	-	-	-	50.6
350	Sale of printing services and production	1.3	1.0	0.2	4.2	2.4	2.8	3.1	2.9	7.0	1.2	1.6
360	Communication Services	17.3	15.9	22.0	30.3	11.3	31.4	41.3	42.5	48.8	52.4	53.4
370	Health Services	1.0	0.1	0.8	1.0	0.5	1.8	1.9	2.4	4.7	5.0	5.5
380	Others	-	-	-	-	-	-	-	-	-	-	23.0
400	INCOME FROM LICENCES, FEES AND FINES	60.4	115.7	66.7	66.3	35.7	76.7	90.0	110.8	114.1	132.9	127.3
410	Income from sale of vehicle licences	-	-	-	1.3	0.9	1.8	1.8	-	-	-	-
420	Income from sale of Identity Documents	1.1	1.1	0.6	0.6	0.3	0.8	0.8	1.6	5.4	6.8	6.3
430	Income from Notary and Court Charges	34.1	41.6	25.4	23.9	16.6	26.7	27.8	38.3	45.3	52.4	50.9
440	Income from Penalties and Fines	5.6	19.1	0.5	1.6	1.0	2.5	2.5	2.4	3.7	3.0	4.9
450	Custom fines and penalties	4.8	0.5	14.7	8.0	1.9	8.4	23.8	10.5	10.3	13.2	10.3
460	Transport and Traffic	-	-	-	-	-	35.2	32.4	45.8	38.2	45.0	42.4
470	Licences, fees and fines not classified	14.8	53.4	25.5	30.9	15.0	1.2	0.9	12.2	11.2	12.5	12.5
500	INCOME FROM USE OF STATE PROPERTY AND MONEY	10.1	1.0	82.0	103.2	19.3	29.7	79.3	86.1	50.0	122.6	109.4
510	Rental of Real Estate	1.1	1.0	2.2	6.7	4.1	7.1	6.6	17.5	11.6	18.3	18.6
520	Rental of Moveable Property	-	-	2.9	11.7	1.9	13.9	22.7	8.4	9.8	7.6	2.7
530	Interest on Bank Deposits	-	-	0.1	0.1	1.3	1.8	0.1	0.2	0.2	0.3	0.2
540	Interest on Loans	9.0	-	1.6	0.6	0.4	-	1.0	0.3	3.3	-	-
550	Investment in Non-Government Ent'prises	-	-	75.2	84.1	11.6	6.5	48.1	59.4	24.9	96.0	54.7
560	Income from Road Tolls	-	-	-	-	-	-	-	-	-	-	32.9
570	Others	-	-	-	-	-	0.4	0.8	0.3	0.4	0.2	0.3

Table 23 - Sheet 3

Rev. Code	Sources of Revenue	1957/8	1958/9	1959/60	1960/1	(6 Mths)* 1961/2	1962/3	1963/4	1964/5	1965/6	1966/7	1967/8
600	INCOME FROM GOVERNMENT ENTERPRISES	62.1	28.4	316.2	250.3	163.1	388.8	569.9	347.2	767.7	377.7	627.4
610	Monopoly Operations	59.1	0.5	263.7	206.9	154.1	367.3	393.7	156.3	609.3	322.9	611.2
620	Co-operative Operations	-	-	-	-	-	-	-	-	2.0	8.3	2.1
630	Slaughterhouse Operations	-	-	-	-	-	-	-	-	-	-	-
640	State Factories (Textile)	-	-	13.2	-	-	0.3	-	-	-	-	0.1
650	Public Utility Operations	-	-	-	-	-	0.1	50.1	20.6	0.1	-	0.1
660	Prison Manufactures	-	27.5	0.6	0.4	-	0.3	0.3	0.3	0.7	0.5	0.1
690	Other Government Enterprises	3.0	0.4	38.7	39.4	9.0	21.1	126.1	170.3	156.3	46.5	13.8
700	MISCELLANEOUS INCOME	16.1	25.8	32.2	77.3	27.8	93.2	75.2	64.6	67.7	69.7	76.6
710	Collection of Delinquent Taxes	8.8	20.3	13.6	65.7	22.9	39.9	39.6	49.8	44.7	40.2	58.0
720	Domestic Contributions	1.3	1.7	1.1	0.8	1.8	6.9	4.2	5.7	4.8	4.9	4.1
730	Others	6.0	3.8	17.5	10.8	3.1	46.4	31.4	9.1	18.2	24.6	14.5
800	NON REVENUE ITEMS	86.1	147.2	16.3	88.6	30.5	29.9	56.2	58.3	151.0	55.3	40.1
810	Refund of overpayments	-	-	2.8	3.9	3.1	7.3	9.8	6.5	6.1	7.4	4.9
820	Repayment of loans by Government Employees	-	-	1.8	2.5	0.7	3.4	3.6	2.0	41.3	2.7	5.5
830	Cash Repayment of advances	86.1	147.2	11.6	81.8	26.5	19.2	34.7	43.6	90.5	38.8	29.4
840	Transfer from other Agencies	-	-	0.1	0.4	0.2	-	-	-	-	-	-
850	Others	-	-	-	-	-	-	8.1	6.2	13.1	6.4	0.3
	Sub-Total 100 - 800	1346.7	1531.8	1598.6	2092.4	714.9	2180.8	3109.3	3229.7	4145.6	4284.9	4246.9
	Commodity Assistance Proceeds Not Included above	128.3	149.2	113.3	204.8	104.0	51.4	182.9	241.8	564.0	889.1	705.3
	GRAND TOTAL:	1475.0	1681.0	1711.9	2297.2	818.9	2232.2	3292.2	3471.5	4709.6	5174.0	4952.2

Sources: (See overleaf)

continued/

Footnotes, etc. on Table 23.

Sources:

(1) Ministry of Finance Revenue Reports, 1961/62 - 1967/68.

(2) Ministry of Planning, "Survey of Progress", 1962-64, August, 1964, and 1967-68, August, 1968. While consolidating the figures for the period 1957/58 - 1961/62 with the rest of the Table, figures in the thousands have been rounded up and the classification of revenues unified.

* As a result of change in calendar year, revenues in this column represent the total for six months, See page 63 for explanation on the change of fiscal year.

a - Company taxes are payable within six months after the end of the fiscal year. Since this column represents figures for the second half of fiscal year it does not include company taxes. Similarly, since taxes on personal property (livestock) are payable at the beginning of the calendar year, the corresponding amount in this column represents only late collections for the entire year.

b - Land tax rates were doubled by the Agricultural Congress held in 1965.

c - Livestock taxes were temporarily suspended by a government move in an attempt to find, with the co-operation of the Parliament, better ways of collecting the tax.

d - These taxes were instituted under the Income Tax Reform of 1966/67. The amount for year 1966/67 appears in the total of Revenues from Category 100, i.e. Direct Taxes.

e - Although there has been a drastic fall in revenues from this source a major part of this decline may be attributed to improvement in Revenue classification.

CHAPTER FOUR

INCOME TAX AS A SOURCE OF REVENUE AND INSTRUMENT OF ECONOMIC POLICY

Income Tax as a Source of Revenue and instrument of Economic Policy

A. Income Tax as a source of revenue.

(factors affecting revenue (income elasticity) and stabilisation functions of income taxes)

1. Individual Income Tax

(a) The Coverage of the Base

(b) The Rate Structure

Schedule (B)
Schedule (C)
Schedule (D)
Schedule (E)

2. Corporation Income Tax

This Chapter deals mainly with an evaluation of the financial (revenue) aspect of the Income Tax System. The economic effects of the System are dealt with separately in Chapter seven, page 239 below.

The rate at which aggregate savings and investment in an economy accumulates is generally indicative of the pace at which that economy is expected to grow. Therefore, a higher rate of growth in employment and per capita income necessitates a larger share of national income increments to be siphoned-off, as savings, at both the private and public sector levels. However, when the private sector's share in total savings is low and inadequate, pressure mounts up on the public sector to shoulder greater commitments in order to attain a certain desirable rate of savings and capital formation. This renders the functions of instruments of economic policy more significant in manipulating and regulating the flow of resources in the economy. One of the objectives behind the manipulation of the instruments of fiscal and monetary policy, often emphasised, is the extent to which they transfer purchasing power from the private to the public sector. Taxes in general, and certain taxes in particular, are among the most appropriate of these levers in achieving this objective. This is primarily true where the buoyancy of the tax is directly related to and promptly affected by fluctuations in the level of national income. However, where such a prompt or what may be called "automatic" response proves inadequate, alterations, covering changes in the level of statutory rates and in the base of the tax often known as "formulae" and "administrative" flexibility, are initiated to render the tax system, or a particular tax, more buoyant. On the other hand, frequent adjustments of the structure of tax rates and the base corresponding with changes in the level of national income may be impracticable as they may encounter resentments, and create an atmosphere of uncertainty, not conducive to the/

the process of sustained growth of commerce and industry. This is of particular importance where entrepreneurs may have to be urged to step in as pioneers, laying down the foundations of these sectors, where the element of risk is sometimes very high. Furthermore, it is difficult to precisely attribute a specific change in revenue to such amendments, as the existence of a number of other variables, operating simultaneously, makes it difficult to clearly isolate the consequences and benefits of such periodic changes, let alone the lags involved[1]. As a result, and where possible, the reliance is placed on the "automatic" response of the tax system to variations in the level of income. Taxes on income appear in the majority of cases, to be highly responsive to changes in the level of national income. This ability of the tax to increase or decrease tax revenues in terms of variations in the level of income is known as the "Built-in Flexibility" of the system. It is attributed to the structure of the tax, i.e. the coverage of the tax base and the progression of its rates. The effectiveness of the tax, both in terms of revenue yield and stabilisation, depends on the scope of the statutory coverage of the base, the structure of the average and marginal tax rates and the future movements in the pattern of income distribution. In other words, it assumes no change in the rate structure, introduction of new levies or the modification of the tax base by altering the level of exemption and deduction. For that matter, it may be argued that due to their "automatic flexibility", income taxes are more sensitive to fluctuations in the level of national income/

---

1. Lags arising in the course of the recognition of the problem, implementation of the measure and expectation of the effects. See "Taxation and Income Stabilization", J.A. Bristow The Economic Journal, June 1968, Vol.LXXVIII, pp.299-311.

income than any one of the fixed outlay[2] or property taxes. Only where and when such automatic response proves ineffective with respect to achieving various objectives, resort to formulae and/or administrative flexibility becomes inevitable. This is primarily because the formal incidence of the tax structure may not always help achieve some of the objectives of budgetary policy, i.e. sustained growth[3] and stability, particularly during the upturn of the cycle or recovery period. The built-in flexibility effect may not be appreciated if the elasticity of government expenditures, with respect to GNP, appears to be either equal to or less than unity. Both the higher growth rate of GNP during the upturn of the cycle and the built-in flexibility feature of the tax will enable revenues to grow faster than the rise in personal income, GNP, or government expenditures, thus creating budgetary surpluses. This effect of the built-in flexibility feature of the income tax becomes more obvious when revenues from this source constitute a fairly large share of total government revenues[4]. The problem then becomes not one of raising additional revenues, as one of the objectives of fiscal policy necessitates, but one of determining the appropriate ways of disposing of this growing balance. The public sector may be tempted to expand its own sphere of economic activities at the expense of the private sector[5]; as an alternative/

2. This is primarily so for two reasons; first, as income increases with the level of exemption held constant, more people will enter a tax bracket; second, as income rises in the middle and higher brackets of income, part of it is hit by higher marginal rates. The progression here denotes structural progression rather than the progression of incidence seen in the case of a general sales tax. For a discussion of a different view, reference may be made to N. Kaldor, "An Expenditure Tax", the latest contribution in this line of argument.

3. Douglas Dosser, "Tax Incidence and Growth", Economic Journal, 1961, pp.572-591.

4. The percentage of revenues from this source amounts to 60.6 percent in the United States in 1965 and 46 percent in the United Kingdom. The figures are inclusive of taxes on personal income and capital. See Richard E. Caves, Britain's Economic Prospects, Brooking Institutions, Washington, D.C., 1968, pp.45-48.

5. E.J. Mishan and L.A. Dicks, "Progressive Taxation in an Inflationary Economy", American Economic Review, September, 1958, pp.590-606

alternative, in most such cases the situation may call for a possible reduction of taxes or the use of a combination of different instruments of monetary and fiscal policies is then called for, depending of course, on the politico-economic structure of the society. Another reason why the automatic response of an income tax to variations in the level of income may appear undesirable is that the objectives of a tax policy are bound to change with the overall changes in the prevailing situation. In spite of all such shortcomings income taxes have been one of the most effective tools of economic policy. While governments have preferred to retain much of the desirable features of these taxes, they have occasionally resorted to amendments such as tax cuts by increasing the size of exemptions and decreasing rates wherever the situation has warranted[6] in order to minimise the adverse effects on the growth and stability objectives of budgetary policy.

It may be noted that, while such a state of affairs may appear to be the case in some of the more advanced economies, where taxes such as those on income generate the largest portion of public revenues, it is far from being so in the less developed economies such as Afghanistan's where income taxes make up for too small a portion of total revenues and the budget is increasingly characterised by rising levels of deficits. The public sector's contribution towards economic growth has been increasing during the post-war years. Growth objectives have in many cases taken governments away from giving adequate attention to the question of equilibrium or stabilisation policies. Strong political pressures for more and rapid increase in all public services at rural levels is rising with the advance of the process of democratisation. Representatives are equally eager to give support to these demands especially as the finances necessary for them/

---

6. Vito Tanzi, "A proposal for a Dynamic Self-adjusting Personal Income Taxes", Public Finance, No.4 1966, page 507. The "tax cut policy" followed in the Japanese case, since 1950, has been mainly due to the high elasticity of the income taxes. See "Foreign Tax Policies and Economic Growth", N.B.E.R., 1966, p.53.

them are rarely being borne, especially by the majority of rural electorates[7]. The rural sector, as drawn out earlier bears no significant burden of taxes except for a very minor and nominal amount of direct tax known as "land tax"[8], plus the indirect levies that are of a general nature and borne by all sectors, however regressive they may be. The growing demands of a rising urban population for more social and economic services, have also compelled governments to undertake increased investments so as to adequately provide these services. As a result, expenditures on such services in many less developed countries, to which Afghanistan is no exception, have risen at a faster rate than the growth of GNP[9]. Whatever the causes behind the increasing share of government expenditures[10] may be, it is obvious that a dynamic equilibrium must be maintained between the rates of growth of expenditures and revenues. The policy implications of this trend have been obvious in so far as the structure of government revenues is concerned. Although certain sources of revenues such as foreign aid, custom duties and other direct taxes, revenues from the public domain and others have increased accordingly, narrowing the gap between revenues and expenditures; the relative weight of domestic revenues, particularly from income and other direct taxes, still/

---

7. Shibshankar P. Gupta, "Public Expenditures and Economic Growth; a time series analysis", Public Finance, 1967, pp.423-461.

8. Page 101 above.

9. Thorn, Richard S., "The evolution of Public Finance during Economic Development". Manchester School of Economic and Social Studies, Vol.XXXV, No.1., 1967, pp.19-51.

10. Reference on the growth of government expenditure, both on the basis of a time-pattern of growth series and/or in relation to economic development, may be made particularly to A. Peacock and J. Wiseman, "The Growth of Public Expenditure in the United Kingdom", Princeton, 1961., A.M. Martin and W.A. Lewis, "Pattern of Public Revenues and Expenditures" Manchester School of Economic and Social Studies, Sept., 1956, pp.203-244, J.G. Williamson, "Public Expenditure and Revenues, an International Comparison", Manchester School of Economic and Social Studies, Jan.,1961, pp.46-51, and Thorn, Richard S., Op.Cit., pp.34-45.

still remains meagre. Apart from their failure to serve as a source of development finance, Direct Taxes in general and Income Taxes in particular have equally proved ineffective instruments serving the stabilisation objectives of budgetary policy.

The following analysis is concerned with an examination of the Afghan Income Tax System with respect to revenues and contribution towards achieving some of the objectives envisaged in the Country's development programmes.

The period under consideration extends from 1957/58 to 1966/67 during which time the Afghan socio-economic structure has experienced marked changes under the programmes of the Development Plans. However, due to the lack of adequate statistics, part of this analysis may have to be confined to a shorter and more recent period, that of the Second Five Year Plan.

The procedure employed is to first of all study over-time growth and changes in the ratio of income tax revenue to variations in the level of some of the main relevant magnitudes such as Direct tax, Total tax, and Total government Revenues and the level of national income. This is clearly indicated in Tables 24 and 25. As examined earlier, it appears that the ratio of Tax revenue to GNP is around 5 percent. Revenues from Direct Taxes amounted to 13 percent of total tax revenues and only one percent of GNP.

The most immediate derivation from these Tables and comparisons is that income tax revenues have increased substantially over the past few years, particularly since 1962. This may partly be attributed to an increase in the levels of income and prices and, partly to the number of income tax payers which reflects a relatively wider income tax base rather than a/

Table 24

THE TREND OF INCOME TAX REVENUES IN RELATION TO DIRECT TAXES, TOTAL TAX YIELD, AGGREGATE PUBLIC REVENUES AND GROSS NATIONAL PRODUCT AT CURRENT PRICES

1957/58 - 1966/67

(In 000 Afs.)

Years	1 Taxes On Income (In 000 Afs.)	2 Direct Taxes (in 000)	3 Total Tax Revenue	4 Total Public Revenues**	5 GNP At Market Prices	6 Taxes On Income / Direct Taxes in %	7 Taxes On Income / Total Tax Revenue in %	8 Taxes On Income / Total Public Revenue in %	9 Taxes On Income / GNP in %
1957/58	191,860	286,662	1,075,973	1,476,424	-	68.9	17.8	12.8	-
1958/59	161,187	266,813	1,141,036	1,681,978	-	60.4	14.12	9.53	-
1959/60	135,166	241,651	1,007,771	1,714,287	-	55.9	13.4	7.88	-
1960/61	179,785	293,490	1,422,460	2,303,501	-	62.3	13.2	8.2	-
1961/62*	(44,813)	(81,428)	(398,103)	(824,570)	31890000	55.0	11.5	5.5	0.14
1962/63	190,700	320,000	1,447,000	2,235,025	35430000	59.6	13.17	8.5	0.52
1963/64	236,000	375,100	2,087,400	3,320,114	39360000	62.8	11.29	7.1	0.59
1964/65	319,000	447,800	2,365,300	3,471,403	43740000	71.2	13.48	9.1	0.71
1965/66	405,400	574,901	2,750,500	4,709,556	48600000	70.5	14.73	8.6	0.81
1966/67	512,000[a]	602,000[a]	3,247,800	5,174,000	54000000	85.00	16.23	9.9	0.94

Source: Computed from the Statistics of the Revenue Department, Ministry of Finance, Kabul, 1967/68

a - This amount includes Afs.187 million collected from exporters and importers, See Chap.3, p.115

* Attached Sheet

** This includes commodity assistance from Abroad, but excludes other grants and loans from such sources.

Note on Table 24

*

This low level of tax revenue for this period represents an amount for half the fiscal year, after Afghanistan's fiscal and calendar years coincided with each other, see page63. The adjustments of accounting practices, plus the fact that the period corresponded to the first half of the pre-1962 fiscal year both have resulted in the considerably low figure for half a year.

Table 25

MAJOR COMPONENTS OF INCOME TAX AS
A RATIO OF PUBLIC REVENUES AND NATIONAL INCOME

1957/58 - 1966/67

Year	Individual Income Tax (In 000)	Corporate Income Tax (In 000)	Public Revenues (In 000)	National Income (In 000,000)	Individual Income Tax / Public Revenues	Individual Income Tax / National Income	Corporate Income Tax / Public Revenues	Corporate Income Tax / National Income
1957/58	54,539	47,321	1,476,424	-	3.6	-	3.2	-
1958/59	97,078	64,078	1,681,978	-	5.7	-	3.8	-
1959/60	83,832	51,334	1,714,287	-	4.8	-	2.9	-
1960/61	105,971	74,014	2,303,501	-	4.6	-	3.2	-
1961/62[1]	(38,497)	(6,316)	(824,570)	31,890	4.6	0.1	0.7	0.02
1962/63	113,600	77,100	2,235,025	35,430	5.0	0.3	3.4	0.2
1963/64	157,100	78,700	3,320,114	39,360	4.7	0.4	2.3	0.19
1964/65	238,400	80,619	3,471,403	43,740	6.8	0.5	2.3	0.18
1965/66	324,336	81,107	4,709,556	48,600	6.8	0.6	1.7	0.16
1966/67	390,200[2]	122,700	5,174,000	54,000	7.5	0.7	2.3	0.22

Source: Revenue Department, and calculations therefrom.

1 - Page 124 above.

2 - This amount includes Afs.187 million as fixed taxes on exporters and importers. Excluding these will bring the share of income tax to the aggregates considerably low

a higher marginal tax rate[11]. It should be indicated that part of this rise during later years, i.e. 1965 and 1967, represents the addition of certain indirect taxes, namely the turnover taxes collected from importers and wholesale businesses, pages 84-87 above. This recording mistake in tax revenue classification has affected the level of income tax revenues for these years. This is depicted in later parts when the income elasticity and formal incidence of the tax are being examined. Column 6 in Table 24 shows that revenues from income taxes, as major portion of direct taxes, have risen to a considerable extent. The major reason for this may not be entirely a corresponding and prompt response of income taxes to changes in the general level of national income, but rather a reflection of the extreme inelasticity of most of the fixed property taxes, i.e. land and livestock taxes which have virtually remained stagnant. Column 7, i.e. income tax/total tax revenue ratio, in Table 24 shows a declining trend during the first half of the period. With the other components of direct taxes remaining almost constant the fall here signifies a heavier reliance on indirect taxes. It is only after the second half of the period that revenues from income taxes have shown an increasing trend. Although the share of direct tax in total tax revenues has dropped during the period, page 82, the rise in the share of income tax revenues may again be attributed to and explained by a relative fall in the share of other components of direct taxes. In other words, even though income tax revenues have increased the relative fall in the level of revenues from other direct taxes has wiped out the increase.

The low share of income tax to total public revenues and to the level of national/

11. If export taxes are added to direct taxes, it will obviously reduce this ratio. This is due to export taxes, page 86 being at times regarded as taxes on the income of the producers of export commodities in which case their addition to direct taxes will affect the relationship of income taxes to other imposts under the category. But for purposes of convenience and the fact that the degree at which such export taxes may be borne by the producers of export commodities is not clear and difficult to establish, export taxes have been kept separate and appear under Indirect Taxes.

national income while reflecting the inadequacy of income tax efforts, signifies the government's inclination to raise the bulk of their revenues from sources other than direct taxes, namely, custom duties, increasing the share of revenues from public enterprises, state monopolies and income from the public sector's participation in the private enterprises.

Revenues from corporate income tax alone have equally increased in absolute terms, but their share in relation to both total tax revenues and GNP has decreased, except for the year 1966/67 when a higher tax collection from public enterprises has changed the declining trend. The fall is difficult to explain since it is generally asserted that the corporate type of organisation would grow rapidly as the process of development makes progress. There has been a definite increase in the number of organisations, page 155 but the rather slow response of corporate income tax revenue may partly be attributed to the tax holiday period or to losses. Moreover, attempts to reduce the payment of higher corporate taxes through diversification of funds cannot be disregarded. This is due to corporate income being subject to a progressive income tax schedule.

The rate of change in income and profit tax revenues, although high, is declining in relation to that of GNP, table 26. The explanation may partly be given that the GNP rate of growth reveals an estimated constant percentage change over a period, while in reality it may not have been so regular. The trend might not have been regular; however, it has been rising. The same is not true of income taxes. Taking the ratio of time rate of growth of income tax revenues to that of national income, the elasticity of income taxes appears to be more than one[12]. The findings of the time/

12. Page 129 below. Income elasticity of a tax is the measure of the degree of response in tax revenues to changes in the level of national income. See Appendix (a) on this point.

Table 26

FLEXIBILITY AND ELASTICITY OF THE AFGHAN INCOME TAX AND THE TAX SYSTEM AS A WHOLE - 1957/8 to 1966/7

					RATE OF CHANGE						
	1	2	3	4	5	6	7	8	9	10	11
Years	Income Tax Revenues (in 000)	Total Tax Revenues (000)	National Income (In 000,000)	Ratio of Income Tax to National Income	National Income (in %)	Total Tax Rev. (in %)	Income Tax (in %)	Relative Change of Tax to Relative Change in National Income	Time Rate of Growth of Total Tax to National Income	Relative Change of Income Tax To Relative Change of National Income	Time Rate of Growth of Income Tax to National Income
								(1) $\frac{\Delta T}{\Delta Y}$ (B.F)	(2) $\frac{\Delta T}{T} \cdot \frac{Y}{\Delta Y}$	$\frac{\Delta t}{\Delta Y}$ (B.F.)	$\frac{\Delta t}{t} \cdot \frac{Y}{\Delta Y}$
1957/8	191,860	1075,973	-	-	-	-	-	-	-	-	-
1958/9	161,187	1141,036	-	-	-	6	58	-	-	-	-
1959/60	135,166	1007,771	-	-	-	- 12	-17	-	-	-	-
1960/1	179,985	1422,460	30,400	0.5	-	41	39	-	-	-	-
1961/2[a] (6 mths.)	44,813	398,103	31,890	0.14	7						
1962/63	190,700	1447,000	35,430	0.5	11	1.7[b]	14	0.004	0.09	0.008	0.08
1963/64	236,000	2037,400	39,360	0.6	11	44	23.6	0.162	3.9	0.011	2.1
1964/5	319,000	2365,300	43,740	0.7	11	13	35	0.063	1.1	0.09	3.1
1965/6	405,400	2750,500	48,600	0.8	11	15	26	0.074	1.3	0.02	2.4
1966/7	325,000	3247,800	54,000	0.6	11	17	-24	0.094	1.6	-0.014	-1.7

Source: Ministry of Finance and Computations Therefrom

a - Page 63 footnote (1) and page 125 above, Note *

b - As 1961/62 covers a six month period, figures for 1962/63 have been compared with that of 1960/61

(1) - Relative change in tax to Relative change in Income Using $\frac{\Delta T}{\Delta Y}$ where ΔT denotes changes in Tax Revenues and ΔY is the change in National Income

(2) - We have also found the elasticity of the tax system and of income tax by using $\frac{\Delta T}{T} \cdot \frac{Y}{\Delta Y}$

the time rate of growth series of both income tax and national income is supplemented with the outcome of a double log function which is considered worth attempting, in spite of the fact that the period covers a limited number of years, i.e. 1961–1966. Although the results of the linear regression function of the first degree attempted in the following paragraph is clearly indicative of the degree of responsiveness of the income tax system, the double log function of the same degree[13] provides not only a better "fit", but the constant "b" signifies the elasticity of income taxes to changes in the level of national income and that part of income declared for income tax purposes[14]. The elasticity of income tax to changes in the level of national income appears from this analysis to be 1.607 which largely agrees with our findings under the time rate of growth series. This elasticity coefficient may be interpreted as such; on the average a one percent change in national income during the period has been associated with a 1.607 percent change in total income tax revenues. The elasticity of Indirect Taxes to variations in the level of national income, on the other hand, has been as low as 1.50. The overall narrow coverage of the tax, whether Direct or Indirect, and the low tax revenue/national income ratio render the elasticity of the tax system as a whole and of Income Taxes in particular, however much greater than unity, less effective with respect to variations in the level of national income. The/

---

13. Using $\log X = \log a + b \log Y$, where X denotes the level of income taxes and Y the level of national income, "a" the level of taxes when national income is equal to zero, and "b" signifies the coefficient of elasticity of income taxes. Further reference is made to appendix (b) to this chapter on the definition and the suitability of statistical method employed.

14. Ibid, page 163 below.

The fact that income taxes have succeeded to transfer[15] only 1.4 per cent [16] of the increments in national income indicates the inadequacy of the elasticity features. Consequently, Income Taxes have, first as a source of development finance, proved inadequate in mitigating the level of effective demand by transferring an increasing ratio of purchasing power to the Public Sector. Secondly, owing to the narrow coverage and low elasticity, the impact of the income tax as an automatic stabiliser on cyclical fluctuations or the process of multiplier[17], does not appear to be significant, even though the high coefficient of determination, ($r^2 = 0.94$) and the low standard error of correlation coefficient (0.024) indicate a good "fit".

A/

15. Although statutory tax rates have been held constant during the period under study, the effects of formulae and/or administrative flexibility as part of an increased tax effort affecting the buoyancy of tax revenues has not been isolated and as such must not be overlooked. The introduction of the withholding scheme and the assessment of taxes on the basis of actual rather than imputed earnings of employees, page 218 are examples of such efforts.

16. The regression method employed here has been of a linear function of the first degree using the equation $X = a + bY$, where the variables and constants have the same denotation as in the log function, page 130 above.

17. The multiplier in this case equals to $\frac{1}{1-bc}$ or $\frac{1}{1-c(1-t)}$ where "b" has been the fraction of the changes in the level of income which is largely reflected in disposable income, "c" is the marginal propensity to consume, and "t" is the amount of tax. Both "b" and (1-t) are likely to reduce the effect of the multiplier process by their weight. Given the necessary data, the fraction of changes in disposable income, important from the viewpoints of immediate and successive changes in national income, may be obtained by $b = \frac{c(\Delta T/\Delta Y)}{1-c(1-(\Delta T/\Delta Y)}$ where "c" is the MPC and T and Y denote computed changes in the level of tax and income, respectively. "b" as the resultant is the fraction of the change in income which may be governed by the degree of effectiveness of built-in flexibility of income taxes. The final outcome is further to be adjusted by the income effect of other taxes and the net changes resulting from the expenditure side of public sector budget over the period concerned.

Further reference on this point may be made to Richard A. Musgrave "The Theory of Public Finance", Kogakusha Co. Limited, Tokyo, 1961, pp.505-512.

A more meaningful approach of evaluating the effectiveness of both the tax base and rates would be to examine the elasticity of the tax with respect to variations in the level of that portion of income, gross or taxable, declared for income tax purposes. Our findings reveal still lower elasticities of (0.72) and (0.77)[18] for gross and taxable income, respectively. This suggests that an increase of one percent in income was associated with an increase of 0.72 percent or 0.77 percent in tax revenues. On the other hand, both gross and taxable income declared for income tax purposes have increased at a considerably faster rate than the rise in the level of national income. Such a result may partly be explained by the fact that total income taxes have been inclusive of other revenue items - not directly related to the level of income assessed for income tax purposes. Nevertheless, this signifies mainly the responsiveness of the base and the effectiveness of the marginal rates of income taxes to changes in the level of income. Apart from the narrow coverage of the tax, the low elasticity in effect suggests that the majority of income tax payers fall within the lower income tax brackets of lower average rates, representing a weaker built-in flexibility,. Consequently, it may be inferred that neither the coverage nor the responsiveness of the base, or the progression of marginal rates has been effective enough to syphon off a larger portion of the increments in either GNP, gross or taxable income. A higher income elasticity of the income tax is necessary if the income tax is to be called upon as a major source of development finance and a stabilisation measure.

A note of caution must be added regarding the effectiveness of the elasticity and stabilisation functions of the income taxes. It may, under the present circumstances, be argued that even when a higher income elasticity is achieved by raising the effective tax rates, the effect on stabilisation/

18. Appendix (b), page 165.

stabilisation is not likely to be significant. On the contrary, where and when the tax impinges on private savings which are not matched by savings and real productive investments of equal amount in the public sector, may fail to serve the allocation (i.e. investment) and stabilisation objectives of budgetary policy. Exploring this aspect of the tax furthermore and establishing its significance in the overall economy, necessitates an examination of the behaviour of those subject to the income tax system, and those falling outside the scope of this tax, bearing, however, the immediate and/or ultimate impact of other taxes and policy instruments as well as the influence of the institutional set-up in the type of economy under consideration.

The Afghan economy, like almost all less developed economies, is distinctly characterised by a dual structure consisting of a "modern" and "traditional" sector. The former is identified with the exchange or money economy or the sector consisting mostly of large scale economic units employing capital-intensive methods of production[19]. The latter, i.e. the traditional or subsistence sector, accounting for the large portion of population and output, is characterised by small-scale economic units with labour-intensive methods of production. This dualistic nature of the economy renders the "modern" sector, although expanding to occupy still a small portion of population and contribute a small share of national income. It leaves the "traditional" sector to carry a considerable weight in the economy, for some time to come, before a larger degree of integration between the two sectors is achieved. Under a dynamic relationship, factors such as production of a surplus with a view to sale, growth of specialisation in output and benefits from technological advance determine the pace at which integration between the two sectors is established. In the context of planned developmental programmes, the government intends to facilitate/

---

19. H. Myint, "Dualism and the internal integration of the Under-developed economies". Paper submitted to a Seminar, University of Glasgow, September, 1969.

facilitate and add impetus to this dynamism by mitigating the "structural" rigidities. Expecting this to have been the objective of the Afghan developmental programmes, it is interesting to see to what extent the tax system as an instrument of policy can and has contributed to the realisation of this objective.

The immediate effect of a rise in the level of effective demand, from a low base whether affected in the "modern" or "traditional" sectors, is an expected increase in the level of consumption among the majority of the recipients. This rise in demand accompanied by population increase and a high income elasticity of demand for food[20], should lead to an increase in the availability of goods and services produced both in the modern and subsistence sectors of the economy. Where production in the modern sector depends for raw material on the subsistence sector, either for purposes of transformation and/or creating substitutes, it increases the demand on the subsistence sector not only for labour, but also for raw materials. With inelasticities in the supply of output the result is an inevitable rise in the level of prices. This result is even accentuated, if we allow for deficit financing which does not affect the level of output. In order to maintain stability in the economy, particularly when a major portion of this rise in demand is generated through income as a result of inflationary finance in areas having an indirect effect on output with fruits to be expected in the long run, the function of the tax as one of the policy instruments is to regulate this level of induced demand at least in the short run. Under the assumption of a smooth functioning of all other policy instruments, the success of the tax (on salaries, wages/

20. Total Demand (D) in this respect becomes a function of $D = P + \eta g$, where "P" and "g" are the rate of growth of population and per capita income and "η" is the income elasticity of demand for agricultural products. See G.F. Paparnek, "Development Problems relevant to Agriculture Tax Policy", appearing in G. Meier <u>Leading Issues in Development Economics</u>, pp.289-97

wages, interest, profits and the like in the money economy) with an efficient administration in this respect depends not only on the coverage of the tax base, but also on other important factors such as the consumption behaviour of the income recipients and the response in supply function of the goods and services demanded.

The coverage of the tax in the monetised sector is very limited indeed, owing to a general low level of income, provisions for various types of exemption and allowance and the degree of efficiency in administration and enforcement, all dealt with in Chapter 5 below. The tax in this respect becomes effective only in the upper income brackets where consumption behaviour is different and identified with a higher MPS, compared to what is found among the lower income groups in the economy. This leaves demand and consumption almost unaffected in this sector. On the other hand, even where, as a result of a tax on lower income groups, demand for and consumption of essentials is not likely to be adversely affected. The pattern of consumption among the majority of the would-be taxpayers is such that only those marginal expenditures incurred on non-essentials are likely to be adversely affected. With the high income elasticity of demand for essentials, mainly food items, expenditure on food consumption is not so much affected by the tax, unless its rates are so high that it would affect not only money but also real income. However, if total income of these recipients is spent on consumption and the marginal propensity to save is nil, the tax suggested will result in a reduction of consumption. If consumption is affected in real terms by the tax, the net result would depend on its relation to that obtained in the subsistence sector reflected in terms of substitution and income effects. Where the difference in real consumption (in favour of income in the modern sector) is not satisfactory, particularly where permanent as opposed to seasonal employment is looked for, the result is a shift of labour back to the subsistence sector.

Under/

Under such an assumption, employment, total output and real consumption both in the modern and subsistence sectors, will all fall. However, given the elasticity of supply in the subsistence sector, output and employment in both sectors tend to increase, which would result in a further expansion of the modern sector. Failure of a rise in output, however, raises prices and shifts the terms of trade against the appropriate sections in the modern sector, resulting in a reduction in investment, employment output and consumption in both money and subsistence sectors. Salaries and wages increase will amount to a net addition in money income, after tax; however, it will further accentuate the effects on prices and add to the problems encountered. Therefore, a solution to the question of stability under both cases, i.e. with or without taxes, requires not only a prompt increase in the output of the subsistence sector, but it also necessitates that an increasing portion of this rise must be made available as marketable surpluses to the modern sector.

The subsistence sector, as it may be recalled from previous chapter, is not directly affected by the income tax system as income from agricultural pursuits is excluded under income taxation. Instead the recipients of income in this sector are subject to a nominal tax bearing no relevance to the level of income received. As a result neither income nor agricultural taxes, excluding the heavy impact of the discriminatory export taxes, (page 86) has had virtually any effect on output in this sector. Owing to a low level of output, and real income and modest tastes, production in this sector, under the present circumstances, is largely for subsistence. Only when a marketable surplus is available, whether for purposes of domestic consumption or exports, the modern sector is likely to benefit which will, in turn, help towards achieving a greater degree of integration between the two sectors. The result of this addition to the value of output is a rise in the purchasing power of the subsistence/

subsistence sector providing a further incentive, particularly for industry in the modern sector, to expand. Total opportunity for industrial expansion in this sector provided by agricultural market in the traditional sector is made up of the industrial sales for farm inputs and the industrial sales for consumer goods. The change in the traditional sector's purchasing power may be illustrated by the following equation $Y = O + R - C$, where Y represents total income, O is consumption in the traditional sector, of its own production, which is supposedly very high at the moment, R is the monetary receipts from the surplus goods and services sold, and C is the cost of production, including the total cost of purchasing all inputs. The net monetary income or purchasing power of the subsistence sector is therefore the difference between R and C. The larger the share of income increments that goes to both cost of production (C) and money receipts (R), the stronger is the stimulus of rural demand for both farm inputs and consumer goods of an industrial nature. On the other hand, factors such as the agricultural extension programmes, subsidies on farm inputs and above all the shift in the terms of trade in favour of the agricultural sector are all likely to raise the aggregate level of (Y), reduce the C/Y ratio and lead to an increase in the level of O + R. Whether for purposes of a greater degree of monetisation in the economy, and/or growth of the industrial sector, it is necessary that a larger share of this increment in income accrues as (R), representing effective demand.

One would expect that with the rise of income in the modern sector, and the general consumption pattern of its recipients supplemented particularly by the degree of "openness", i.e. availability of external markets for cash earning activities covering such items as cotton, wool, karakul and the like, would provide adequate stimulus for an increase of total output in the traditional sector. Although production of most major crops and livestock increased, Table 1, page 18 the increase did not keep pace with the growth of non-agricultural income and population increase. Population increase by itself has been estimated to run over 1.75 percent per annum. Total output in this major sector of the economy during the past five years increased by only 1.6 percent. Both domestic and export markets suffered as a result. Output for domestic market was supplemente by food imports which deprived industry from their vital foreign exchange require ments. In spite of this, it has not been possible to maintain a stable price/

price level in food and other agricultural products. This has adversely affected existing industry in the modern sector, mainly manufacturing and processing based on farm and pastural raw material such as sugar beets, cotton, fruits, leather and the like. It has affected even more the creation of new plants which would depend on agriculture for labour and raw material. In the future although extractive industry will also develop, nevertheless, a potentially growing number of manufacturing and processing industries is still expected to have an important place in Afghanistan's predominantly agricultural economy.

In exploring the causes of such a low response of output in this sector, as may be recalled, are, first, that agriculture, while responsible for increasing capacity growth of the economy, has received a lower priority in the allocation of investment resources aimed at mitigating the "structural" rigidities which would otherwise impede the growth rate. Whatever, expenditures incurred in this area, pages 60-62, have not directly contributed to corresponding and sufficient increase of output in the traditional sector. Output, neither in the short run, with which stabilisation objectives are concerned, nor in the long run which has interested growth objectives, has shown any sizeable increase. Although the infra-structural projects aimed at bringing markets and production centres close to each other, the pattern of land ownership and the availability of appropriate credit and other institutions required to help peasants benefit from the merits of market operations, render the benefits, if any, from these projects to be enjoyed mostly by larger units who can command access to a greater share of such public services.[21] Although this shifts the terms of trade, under the present circumstances, in favour of owners with large holdings and available (or potentially available) marketable surplus, their marginal tax rate with respect to holdings and/or output is zero. These increased surpluses are seldom reinvested/

---

21. For a detailed coverage of this issue with respect to both modern and subsistence sectors, reference may be made to H. Myint, Op.cit.

reinvested in land with the aim of raising productivity. On the contrary, increased opportunities promising high speculative profits and the rate of inflationary pressure are apt to make these recipients lose confidence in money and indulge largely, in Conspicuous Consumption.[22] Taxing these surpluses is likely to reduce such consumptions and not productivity. The taxation of these surpluses can be carried out on the basis of the proposal made in an earlier Chapter (3), as well as instituting prohibiting rates on import items of a luxury nature, with high income elasticity of demand.

Pricing policy in the export sector too has had an adverse effect on the output of such primary items as cotton, wool, Karakul, covered above and in page 159. They tend to check the extension of the modern sector "because they reduce the area over which production for sale is possible.[23]

Another factor responsible for the slow response of output in the subsistence sector, particularly during the last three years has been an unfavourable climatic condition, accompanied by continuous natural hazards. A reduction in fallowing, accompanied by lack of an agricultural extension programme which would provide for credit facilities, use of improved seeds, tools and other agricultural implements, wheat threshers, biological inputs (fertilizers and insecticide) as well as storage places, will adversely affect the level of output, income, employment, and stability in the economy.

The above pages indicate the extent to which income taxes are capable of fulfilling their revenue and stabilisation functions in a dual economy such as Afghanistan. Its success is largely dependent on and affected by/

---

22. W.A. Lewis, Theory of Economic Growth, p.227.

23. P.T. Bower, "Economic Analysis and Policy in Underdeveloped Countries", Cambridge University Press, London, 1957, p.117.

by the inter-play of various other factors, including taxes on other areas. Nevertheless, it may be asserted that there still remains, particularly under a dynamic situation, ample room for the improvement of all the factors affecting the incremental tax/income ratio; leading towards a greater success of these and other budgetary policies.

For one thing, to be truly income elastic, the base of any tax must have a wide coverage. Taking income taxes alone, with the income of potential taxpayers rising, the wide coverage will raise the elasticity of the tax through an increase in the incremental tax revenue/income ratio.. As the tax is income elastic it will have an immediate effect on those whose income[24]/expenditure rises either in real or in money terms. Where the effect of the rate structure appears inadequate, through its built-in flexibility feature their alteration must not be ruled out. Lastly, an effective and competent administration is necessary if these measures are expected to bear any satisfactory results.

Although the income tax reform of 1966/67, as can be seen in the following sections of this paper, has improved certain relevant features of the system, an examination of some of the factors which have been responsible for the above state of affairs in the past and which will, to some extent, affect the performance of the recent changes appears necessary. While some of these factors may be of a legislative and administrative character a great many of them are typical of the kind of society under study. Since the examination in this part of the chapter deals mainly with the income elasticity of the income tax system, i.e. assuming no changes in the tax base and the rate structure, the remaining few pages will be confined to the examination of factors influencing the operation of these two major determinants, under both individual and corporate income taxes.

---

24. Reference is made to Page 175 below on the concept of income, acceptable for purposes of income taxation.

1. Individual Income Tax - (a) The Coverage of the Base:

Apart from the fact that only the monetised sector of the economy, representing a money/national income ratio of ten percent, is subject to the provisions of income tax, within the sector itself the percentage of income effectively covered for income tax purposes is still very small, page 218 below. Examining the individual income tax base, it appears that only three percent of the working population, a total of 163,000 in 1964 from both the private and public sectors, filed income tax returns. The total number of individuals assessed for income tax purposes averaged about 14.1 thousand per annum over the period 1961-1966[25]. It shows an annual average rise of about sixty percent almost wholly attributable to the initiation of the withholding scheme[26]. However, this total indicates that income tax has been effective over less than one percent of the population. Legislative loopholes and poor administration may be held largely responsible. The fact that income from the agricultural sector and from the growing number of self-employed professions is not covered under income taxes, leaves the number of assessees basically very small and retains a virtual contraction of the base. In addition, the increase in the level of personal allowances, and the tax unit, was confined to every income earning member of the family[27] which encourages income splitting, further affect the tax base. The adverse effect of this rise in the exemption limit on the level of revenue/

---

25. Page 223 below. This excludes the artisans group as their tax liability under the provisions of the income tax law is a lump sum amount in lieu of income taxes.

26. The withholding scheme differs from the PAYE scheme in that the amount of tax deductions from wages and salaries under the latter is kept in step with the recipient's income. As such, total tax borne at any time is related to the total earnings to date, which enables the scheme to have a better built-in stabilising effect. See K.S. Carmichael "Income Tax and Profits Tax", pp.102-104, 1968.

27. Reference on Tax Unit may be made to page 175, Note 8, below.

revenue was defended on the ground that the tax force will have more extra time to cope with bigger assessees whose tax payment will more than compensate for loss of revenue. The results of such an optimistic view still remain to be seen. A third factor responsible for the narrow tax base is the tax exemption extended to cover income from interest on individuals' accounts with Afghan banks, and on government and municipal bonds[28]. It must be pointed out that the base of tax is more crucial where the elasticity feature is concerned. Even a flat rate will render a wide and growing base promptly respond to changes in the level of national income. A fourth factor limiting the tax base is the existence of the schedular tax system itself, (b) below. Under such a system the base appears to be less responsive to variations in the level of taxable income due to a steep progression between income brackets particularly at higher levels of income.

(b) The Rate Structure:

One of the factors affecting the effectiveness of the second major determinant of the elasticity of income tax is the existence, up to 1966/67, of the schedular tax system. Under this system, covering the period between 1957/58 - 1966/67, income from different sources was subject to separate rate schedules varying from each other both in minimum and maximum tax rates. (For an historical development of the system pages 90-101 may be consulted). Although the procedure for assessing income was of a general nature applicable to all schedules, the final assessment of income under each schedule was affected by provisions specifying further adjustments[29]. Consequently, the total income/

28. An elaboration of these points is made under the concept of income and equity considerations in the following chapter.

29. As such, it is different from the schedular arrangement under the United Kingdom income tax system. Here each one of the four Schedules, while dealing with a different source of income, sets out the rules for measuring and assessing income from that source as part of total income liable to one levy. K.C. Carmichael, Op.Cit. Further reference on the various features of a schedular tax, such as the one in Afghanistan, is made to R.M. Sommerfield, "Tax Reform and The Alliance for Progress" University of Texas Press, 1966

income of an individual, coming from various sources, is allowed to be split among different schedules resulting in a virtual reduction in one's ultimate tax liability. There were three income tax schedules in use prior to 1966/67. Schedule (B) applied to unincorporated businesses and covered such items as profits, interest, rent, gains and other business income, except dividends. Schedule (C) covered dividend income in the hands of individual shareholders including unincorporated businesses. Schedule (D) applied to income or emoluments from salaries, wages, fees and other such compensations for labour. A comparison of these Schedules will shed some light on the issue and the fiscal policy objectives envisaged during the period under which such changes were initiated.

Schedule (B):

In 1957/58, both fixed and progressive rates were increased with the expectation to collect more revenues. The ten percent fixed tax rate (page 91) was increased to 12 percent for all three schedules. Schedule (B) reveals an increase in the progressive rates from a minimum of 3 percent under Schedule (A), applicable up to 1956/57 on income from all sources, to a five percent, and from 43 percent to 60 percent, respectively, pages 144 and 146. It was maintained that the majority of income taxpayers in Afghanistan seem to fall within the low income groups[30], and tax rates were, therefore, increased for the first few income brackets. Since taxpayers in these lower income brackets spend most of their disposable income on consumer goods, this increase in the tax rates was expected to reduce their purchasing power and therefore serve as a control measure to prevent the rise in the general level of prices[31]. However valid such an argument may be, the inadequacy of the system/

---

30. Ministry of Planning, "First Five Year Plan, Page 208, Kabul, 1957

31. Ibid. page 113.

INCOME TAX SCHEDULE (A) ON TOTAL INDIVIDUAL
TAXABLE INCOME. EFFECTIVE BETWEEN 1954/55 - 1957

Taxable	Income		Tax Rate	Total Amount in Tax	Percentage Increase In Taxable Income	Percentage Increase In Amount of Tax
1	2	3	4	5	Column 3:1 6	7
Afs. 4,000	Exempt from	Taxation		-	-	-
From Afs. 4,001	to 10,000	Increment of Afs. 6,000	3%	Afs. 180	-	-
10,001	to 20,000	" 10,000	5	680	100%	277%
20,001	to 30,000	" 10,000	7	1,380	50	103
30,001	to 50,000	" 20,000	9	3,180	66	130
50,001	to 75,000	" 25,000	13	6,430	50	102
75,001	to 100,000	" 25,000	16	10,430	33	62
100,001	to 150,000	" 50,000	18	19,430	50	86
150,001	to 200,000	" 50,000	20	29,430	33	51
200,001	to 300,000	" 100,000	22	51,430	50	74
300,001	to 400,000	" 100,000	25	76,430	33	48
400,001	to 500,000	" 100,000	28	104,430	25	36
500,001	to 1,000,000	" 500,000	33	269,430	100	158
1,000,000	to 3,000,000	" 2,000,000	38	1,029,430	200	282
3,000,001	and over		43			

Source: Computed from Income Tax Law, 1954, Kabul.

Note on Schedule (A):

Column 4 represents marginal rates applicable to the increments of taxable income, i.e. column 3. Column 5 is the effective amount of tax consisting of taxes on the previous level of income and on increment. For example, Afs.680.00 which is the effective (average) tax amount consists of Afs. 180.00 and an excess of Afs.500.00 at the marginal rate of 5 percent on the increment of Afs.10,000.00. Similarly, the amount of Afs.51,430,00 is the effective tax on the total taxable amount of Afs.300,000.00. It consists of Afs. 29,430.00 on a total of up to Afs.200,000.00 and Afs.22,000.00 on the increment of Afs.100,000.00 at a marginal rate of 22 percent. Column 6 is the product of column 3, as a ratio of column one, indicating the increment, i.e. the difference between column one and two. Column 7 is column 4 multiplied by column 3 and the product taken as a ratio of the immediate preceding figure in column 5,

e.g. (a) 5 x 10,000.00 / 100 = 500.00,
(b) 500.00 x 100% /180 = 277.

The same procedure is applied in computing other schedules in the pages that follow.

INCOME TAX SCHEDULE (B) ON INDIVIDUAL'S
INCOME FROM BUSINESS ACTIVITIES
EFFECTIVE AS OF 1957/58

Taxable Income			Tax Rate	Total Amount In Tax	Percentage Increase In Taxable Income	Percentage Increase In Amount of Tax
1	2	3	4	5	6 Column 3:1	7
Afs. 4,000	Exempt from	Taxation		-	-	-
From Afs. 4,001	to 10,000	Increment of Afs. 6,000	5%	Afs. 300	-	-
10,001	to 20,000	" 10,000	6	900	100%	200%
20,001	to 40,000	" 20,000	9	2,700	100	200
40,001	to 80,000	" 40,000	14	8,300	100	207
80,001	to 160,000	" 80,000	22	25,900	100	212
160,000	to 320,000	" 160,000	30	73,900	100	185
320,001	to 640,000	" 320,000	38	195,500	100	164
640,001	to 1,280,000	" 640,000	45	483,500	100	147
1,280,001	to 2,560,000	" 1,280,000	50	1,123,500	100	132
2,560,001	to 5,120,000	" 2,560,000	54	2,505,900	100	123
5,120,001	and over		60			

Source: Computed from Income Tax Law, 1957/58
"First Five Year Plan".

system in contributing towards the achievement of such an objective is due to the fact that the schedules were limited in scope and covered only a small portion of the national income. The rise in the rate of tax increments on marginal income falls gradually after the fourth income bracket in this schedule. This may, presumably, have been based on the assumption that the rising income of merchants and other non-corporate enterprises available for investments ought not to have been adversely affected. The rise in the volume of trade and investment is the product of a number of factors and not of lower tax rates alone.

Schedule (C):

It was further believed by the planners that to encourage greater participation in economic enterprises, profits accruing to owners of shares of stocks, in joint-stock companies should be accorded a different treatment from the rest of an individual's income[32]. Schedule (C) presents the rates of such a special tax on dividends. Although the highest marginal rate remained the same as under Schedule (B) the initial rates were reduced and the degree of progression stretched allowing for more tax brackets and reducing steepness of the rate structure.

Schedule (D):

The taxation of income from wages and salaries was maintained under a separate Schedule (D), with an increase in both the rates and the level of personal exemption.

As noted above, the purpose behind all these changes in 1957/58 was mainly twofold. On the one hand, they were meant to increase government revenues and help mitigate the inequalities in the distribution of income. The splitting of taxpayer's total income, as a result of these changes, was not only/

---

32. Ibid, paragraph 4, page 113.

INCOME TAX SCHEDULE (C) ON INDIVIDUAL'S
INCOME FROM DIVIDENDS

EFFECTIVE AS OF 1957/58

Taxable	Income		Tax Rate	Total Amount of Tax	Percentage Increase In Taxable Income	Percentage Increase In Amount of Tax
1	2	3	4	5	Column 3:1 6	7
Up to Afghanis	1,000		1%	Afs. 10	-	-
From Afs. 1,001	to 2,000	Increment of Afs. 1,000	2	30	100%	200%
2,001	to 4,000	" 2,000	3	90	100	200
4,001	to 8,000	" 4,000	4	250	100	177
8,001	to 14,000	" 6,000	6	610	75	144
14,001	to 20,000	" 6,000	8	1,090	43	79
20,001	to 30,000	" 10,000	10	2,090	50	99
30,001	to 50,000	" 20,000	13	4,690	66	124
50,001	to 100,000	" 50,000	16	12,690	100	170
100,001	to 200,000	" 100,000	19	31,690	100	150
200,001	to 400,000	" 200,000	22	75,690	100	139
400,001	to 700,000	" 300,000	27	156,690	75	108
700,001	to 1,200,000	" 500,000	32	316,690	71	102
1,200,001	to 3,000,000	" 1,800,000	40	1,036,690	150	227
3,000,001	to 5,000,000	" 2,000,000	48	1,996,690	66	92
5,000,001	and over		60			

Source: Computed from Income Tax Law, 1957/58

INCOME TAX SCHEDULE (D) ON INCOME FROM WAGES, SALARIES, FEES AND COMMISSIONS, EFFECTIVE AS OF 1957/1958

Taxable Income			Tax Rate
Afs. 1	up to	10,000	2 percent
10,001		20,000	3 "
20,001		30,000	5 "
30,001		50,000	7 "
50,001		75,000	9 "
75,001		100,000	11 "
100,001		150,000	14 "
150,001		200,000	17 "
200,001		300,000	20 "
300,001		500,000	25 "
500,001		and over	30 "

Source: Income Tax Law, 1957/58

only likely to adversely affect total revenues, but it also introduced an element of inequality in tax treatment, confusion and administrative difficulties. It was, on the other hand, believed that with the application of different progressive rate schedules inflationary and deflationary movements in the economy could also be brought under control. In other words, it was expected that the stabilising effects of the income tax schedules would prevent undesirable fluctuations in the level of economic activities. It is obvious that the inability of the system to have achieved these objectives lies in some of the weaknesses and limitations of the system indicated so far.

Some of these undesirable features of the system were later considerably improved under the income tax law of 1966/67. The major weakness of the system, the schedular feature accompanied by fixed taxes and various levels of exemptions and deductions, was eliminated. Income was declared taxable on a global basis[33] under a single Schedule (E). It also provides that taxes on salaries, and wages, is withheld on a graduated scale. This would enable the system to achieve a quick impact on the disposable income, particularly at those low levels of income associated with higher propensities to consume. However, they do not constitute the largest sector of the economy in order to adequately increase the effectiveness of the stabilisation function of income taxes. The withholding of tax on dividends also adds to the effectiveness of the tax as it reduces the possible time lag involved in and following the distribution of dividends.

It may be noted that, under Schedule (C) a taxpayer would have paid only 10 percent of an income which increased almost twenty times the lowest taxable income. It might have been a reason for encouraging small and medium sized savings and investments in industrial and commercial shares of stock. Under the new income tax law, the initial rates are progressing at/

33. Similar to its predecessor, this law too retains the basic weakness of not being a comprehensive tax. See Chapter 5 on this point.

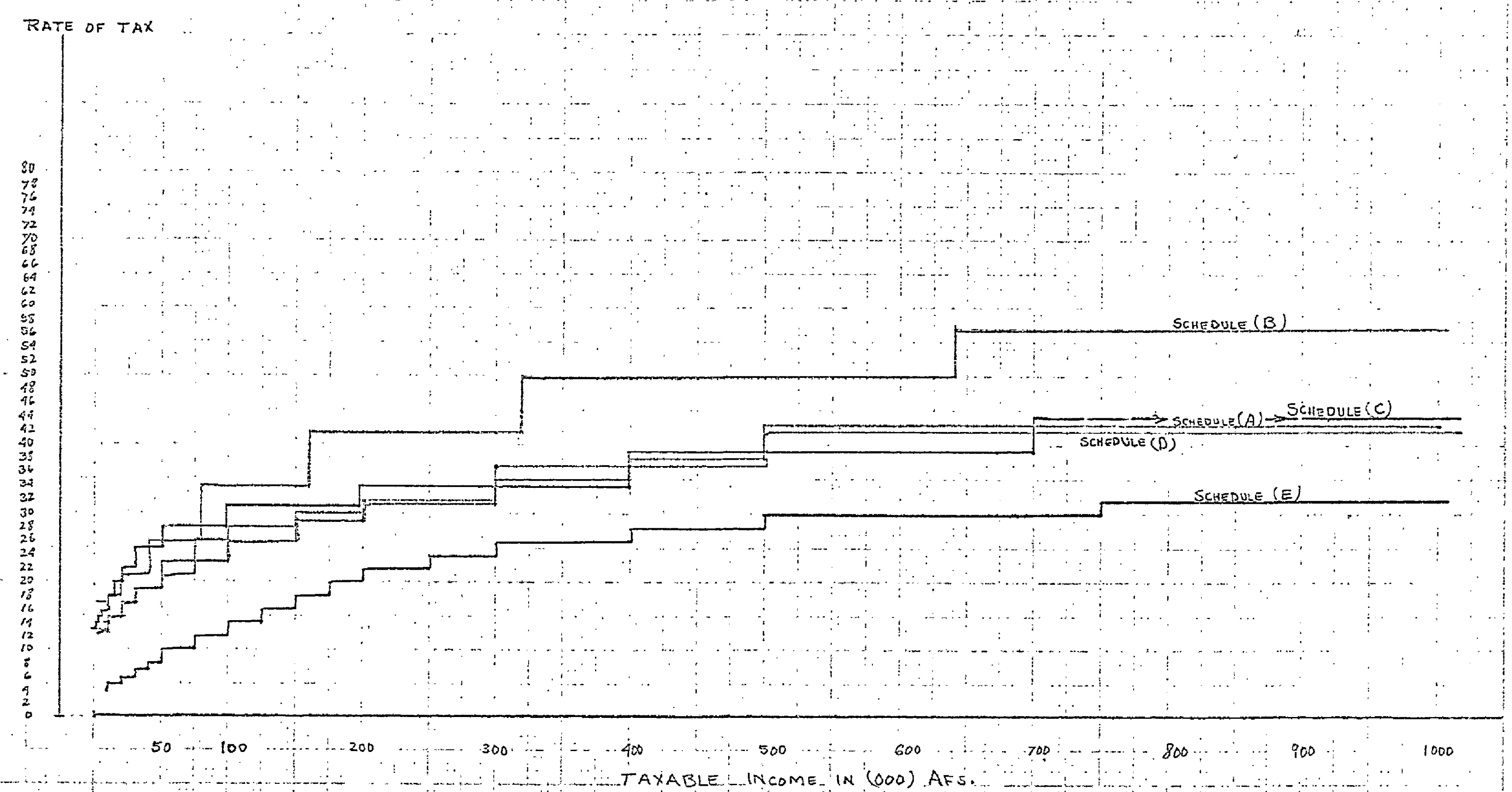
INCOME TAX TAX SCHEDULE (E) ON GLOBAL BASIS, i.e. INCOME FROM ALL SOURCES EFFECTIVE AS OF 1966/67

Taxable	Income			Marginal Tax Rates	Amount of Tax	Percentage Increment In Taxable Income 6	Percentage Increment In Tax
1	2		3	4	5	Column 3:1	7
Up to Afghanis	10,000			4	400	-	-
From Afs. 10,000 to	20,000	increment of	10,000	5	900	100%	125%
20,001 to	30,000	"	10,000	6	1,500	50	66
30,001	40,000		10,000	7	2,200	33	46
40,001	50,000		10,000	8	3,000	25	36
50,001	75,000		25,000	10	5,500	50	83
75,001	100,000		25,000	12	8,500	33	54
100,001	125,000		25,000	14	12,000	20	41
125,001	150,000		25,000	16	16,000	20	33
150,001	175,000		25,000	18	20,500	17	28
175,001	200,000		25,000	20	25,500	14	24
200,001	250,000		50,000	22	36,500	25	43
250,001	300,000		50,000	24	48,500	20	32
300,001	400,000		100,000	26	74,500	33	53
400,001	500,000		100,000	28	102,500	25	37
500,001	750,000		250,000	30	177,500	50	73
750,001	1,000,000		250,000	32	257,500	33	45
1,000,000	1,500,000		500,000	34	427,500	50	66
1,500,001	2,000,000		500,000	36	607,500	33	42
2,000,001	2,500,000		500,000	38	797,500	25	31
2;500,001	and over			40	797,500 + 40% over 2,500,000		

Source: Computed from Income Tax Law, 1966/67. Kabul

Diagram (A)

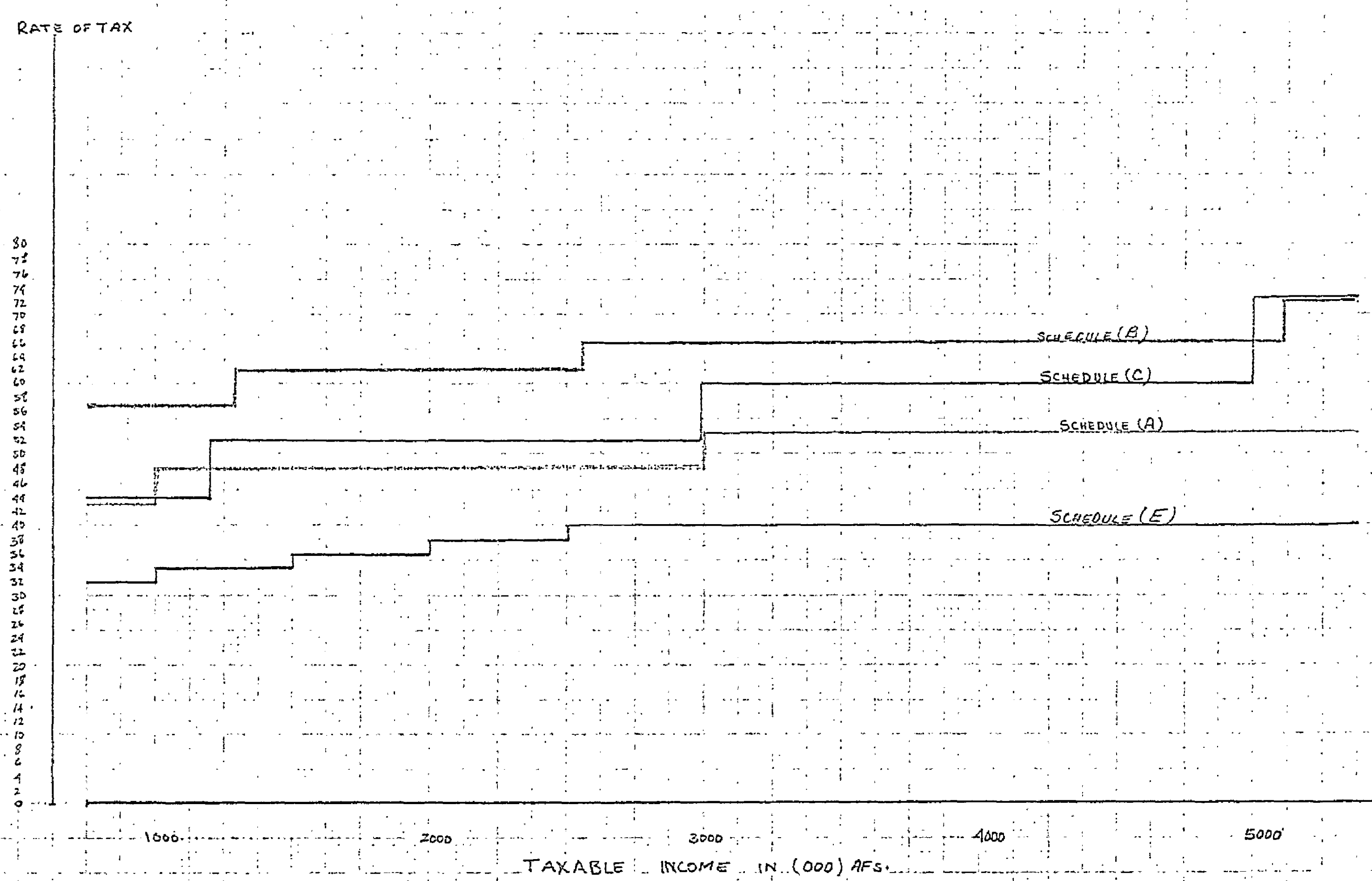
MARGINAL RATES OF TAX
INCOME RANGE —
AFS. 0 — 1000,000.



MARGINAL RATES OF TAX

INCOME RANGE —

AFS. 1000,000 — 5000,000 AND OVER.



at a lower scale as income from all sources is aggregated. A taxable income of up to Afs.10,000.00 would be liable to a 4 percent while, on the average, under the previous schedules it was subject to over 15 per cent of both fixed and progressive rates. The maximum marginal tax rate was also lowered and the difference between the brackets of income narrowed, on the grounds that one cannot rely to a great extent on the highest rates of income taxes for purposes of increasing revenues or influencing and adjusting the level of economic activities. In a society such as Afghanistan's they are relatively unproductive and inefficient in their revenue effect, as the number of those falling in the higher brackets of income is likely to be small. This is clearly demonstrated from our analysis of the income tax burden at the point of impact, Chapter 6. As a result, rate graduation which was emphasised under the schedular system has been ineffective. Although Diagram (A) page 151a, will help in indicating tax obligation under the various schedules at different levels of income, illustration of a few cases will further explain the difference between the various schedules of the schedular system and the global schedule of 1967:

Example:

A taxpayer is married and has five dependent children, and has an income of Afs.500,000.00 Tax liability under Schedule (E) is Afs.92,700.00 after allowing a deduction of personal exemption. The tax will be the same irrespective of the source of income, except agriculture and salaries and wages.

Tax liability under the pre-1966/67 Act may be determined as follows: /

Case 1 - Income of Afs.500,000.00 is from wages,
Tax is Afs.87,775.00.

Case 2 - Income of Afs. 500,000.00 is from Dividends,
Tax is Afs. 101,610.00.

Case 3 - Income of Afs.500,000.00 is from Rent of Buildings,
Tax is Afs.142,300.00

Case 4 - Income of Afs.500,000.00 is from Profits from individual commercial and industrial enterprises.
Tax is Afs.142,300.00

Case 5 - Income of Afs.500,000.00 is from Rent of farm land,
Tax is nil.

Case 6 - Income of Afs. 500,000.00 is from several sources, as follows:

Wages	200,000)	
Dividends	100,000)	Total Afs. 500,000.00
House Rent	100,000)	Tax is Afs.51,790.00

Case 7 - Income of Afs.500,000.00 is from several sources, as follows:

Wages	30,000)	
Dividends	10,000)	
Business profit	100,000)	Total Afs. 500,000.00
House rent	240,000)	Tax is Afs. 63,160.00
Orchard Income	120,000)	

Case 8 - Income of Afs. 500,000.00 is from sources as follows:

Dividends	250,000)	Total Afs. 500,000.00
House Rent	250,000)	Tax is Afs. 94,710

The above hypothetical cases show how widely taxes could vary according to the type of income and how tax liability was reduced when an individual obtained income from several sources under the pre-1966/67 Law. Such a result would obviously hinder the effectiveness of the built-in flexibility feature of the tax system. The global feature and the extended rate schedule with lower marginal rates of the 1967 income tax law are expected to improve these anomalies of the schedular system at the same time they will increase the number of taxpayers at all levels. On the other hand, the higher level of exemption and low initial rates, i.e. starting at 4 percent as against 13 percent under Schedule (C) with the lowest rates, may /

may not only function as a revenue reducing factor and limit the possibility of further downward adjustment when necessary, but also reduce the stabilisation and distribution effects. In view of the acute shortage of revenues experienced under the First and Second five Year Plans and that forced a revision of the third plan, it is difficult to defend these alterations in the tax law. It is essential that the base must be expanded and that the initial rates of the Schedule (E) be raised. Instead of an initial rate of four percent it must start somewhere between 8 and 10 percent accompanied by a further extension in the graduation of income slabs at lower and middle income brackets. This increase will also result in a rise in maximum marginal rates. In view of the possibilities of income splitting it is necessary to stretch income brackets as much as possible so as to make the base of the tax more responsive to changes in the level of income. Both these factors will greatly serve what is called equity objectives of the tax. The upper income limit need not increase in order to allow for the extension of income brackets. As can be seen from Schedules (B) and (E), the limit was lowered by half under the 1967 reform. It can still be reduced at the same time allowing for rates to rise to a maximum of 45 to 50 percent. The disincentive effects, if any, may be remedied by providing concessions for investments in priority areas meeting plan objectives. [34]

It may be maintained that under the present circumstances, a higher degree of income elasticity and stabilisation effects of the income tax system is very unlikely for the following reasons: (1) The tax is not a mass tax having a wider coverage, (2) the definition of the concept of income for income tax purposes is very narrow and limited, (see pages 175-204 for further explanation on this point), (3) although per capita income at least/

---

34. Chapter 7, page 239.

least in money terms, rises, the exemptions and allowances will reduce the relation between gross and taxable income, (4) lastly, it requires a competent and efficient system of administration, not only to prevent evasion but to be able to handle the growing volume of assessments.

On the basis of these points it is inadequate to completely depend on the statutory rates of income taxes, their automatic response and their narrow base, as a reliable source of revenues and an effective instrument of maintaining economic stability. Discretionary measures bringing structural changes in the rates and base, introduction of new taxes and improvement of administration must all be looked for.

2. Corporate Income Tax:

As far as corporate income tax is concerned, the small rise in yield from this source, Afs.51 million in 1959/60 to Afs.81 million in 1965/66, has been mainly due to an increase in the total number of Limited Liability and Joint-Stock Companies. They increased from 56 to 230 over the period covering both commerce and industry. This excludes the 31 State Economic Enterprises. In Afghanistan, as in many less developed nations, the ratio of reproduceable capital to other assets, like land, is small[35]. As such corporate profits, particularly from the industrial sector, constitute a low percentage of national income. Corporate income tax also appears to be less effective as an automatic stabiliser for two main reasons: (1) like individual income tax, the base coverage of this tax is very limited, even narrower than the individual income tax. In spite of the variable marginal rates, the exemption level plus the low initial rates add to the ineffectiveness of the base and rates of Schedule (F). Secondly, a substantial time lag is normally involved in the payment of these taxes. The progressive tax rates with the exemption limit were meant to give small undertakings with small profits a favourable treatment. The justification for this progressive feature, was to provide social justice/

35. Table 33, page 278 below.

CORPORATE INCOME TAX RATE SCHEDULE, (F)
EFFECTIVE AS OF 1957/58

Taxable Income after Fixed Corporation and Municipal Taxes[1]				Tax Rate Structure
Afs.	1	-	50,000	Exempt
	50,001	-	500,000	1 percent
	500,001	-	1,000,000	2
	1,000,000	-	2,000,000	3
	2,000,001	-	3,000,000	5
	3,000,001	-	5,000,000	7
	5,000,001	-	8,000,000	10
	8,000,001	-	15,000,000	13
	15,000,000	-	and over	17

1. All industrial- limited liability and joint stock-companies have been subject to a fixed tax of five percent on taxable income and the rest, if more than Afs.50,000, were subject to the above progressive rates preceded by a one percent municipal tax. Commercial enterprises were subject to a ten percent fixed tax while the rest of the taxable income was subject to the above procedure.

justice. Under the pre-1958 law, small companies with little income were believed to pay the same tax rate as big companies with large incomes[36]. It is true that such an arrangement will help small businesses in their early years, but as they grow the weight of the tax is likely to become heavier. The law was bound to narrow the tax base and create discouraging effects, particuarly on more efficient and prospering establishments. Furthermore, it increased the administrative inconveniences and the possibilities of tax evasion and avoidance by the concealment of profits and the break-up of different integrated businesses of which the Revenue Department has experienced a number of cases.

Since the effect of corporate income tax on consumption is an indirect result of its influence on dividends, the relation between corporate and individual income taxes[37] plays an important role. Initiative, both in theory as well as in practice has been taken for a move towards the integration of these two taxes. This may appear helpful for our purposes here. By avoiding a two tier taxation on corporate source income, i.e. first, at the corporate level, and second, in the hands of shareholders, not only a true degree of progression of income tax may be revealed, but will also promote savings at the corporate level [38]. The Afghan Income Tax Law has, to some extent, gone along with this line of argument. Both dividends/

---

36. Ministry of Planning, Ibid, page 117.

37. Ralph Turvey, "A Tax System without Company Taxation", Canadian Tax Journal, 1963, pages 409-19.

38. This is asserted in spite of the fact that a shareholder is a bearer of a piece of paper rather than a partner in large Corporation. See Report of the Royal Commission on Canadian Taxation, Vol.4, Taxation of Income, Chapter 19, page 34, Ottowa, 1966. For an argument on the separate taxation of corporate and individual income, reference is made to R. Goode, "Corporation Income Tax", Whiley & Son, N.Y. 1955 and to R.M. Sommerfield, Op.Cit, p. 78.

dividends and undistributed profits are taxed at a fixed rate of 20 per cent[39]. Dividends are allowed as deductions from corporate taxable income and the withheld 20 percent tax is credited to the shareholders whose tax liability on total income would exceed the 20 percent. This appears to be inequitable between small and big shareholders. More on this in Chapter 5, page 202. The measure is also likely to reduce both the total revenue from this source and the stabilising effect of the tax, which have to be compensated for by an increase in taxes on other sectors, for however short a period it may be. Furthermore, it penalises profit retention, the encouragement of it one would think to be the objective of the reform. Whether a complete integration of the corporate and individual income taxes would provide an answer to these problems again depends on the importance of the objectives envisaged under a tax policy.

The provision to offset losses from future profits, the existence of investment allowances of up to 15 percent of new capital outlays in mining and manufacturing, deductable from taxes, and other concessions are all likely to reduce corporate income taxes and their stabilising effect[40]. One way by which the corporate base may be broadened, to compensate for the above factors, is to encourage and facilitate the formation of more incorporated enterprises. This will also promote internal financing[41].

Another/

---

39. This has made the Afghan Corporate Income Tax similar in principle and form to that existing in Britain prior to 1965, and to the present West German Corporate Income Tax, where, under the latter dividend distributions are taxed at a "qualifying" rate of 15% and retained earnings are taxed at 51%. On other distributions a withholding tax at a rate of 25% is applied which is later credited. There is no tax credit of this kind either in the United Kingdom after 1965, or in the United States after 1964. In Canada the resident shareholder is entitled to deduct a 20% credit which means that taxes assessed on dividends will be less by 20 percent. For further study of these points, reference is made to the "Report of The Royal Commission on the Canadian Taxation", Op.Cit. pp.47, 641-59.

40. Chapter 7, page 239

41. Further reference on this point may be made to Kerr Gibson, Tax Implications of incorporating small Businesses, Canadian Tax Journal, 1959, pp.100-107

Another way of making corporate income tax more income elastic is to tax public enterprises as individual establishments instead of either as corporations or agency. Such a treatment is essential not because there is a single shareholder, i.e. the government, but according to the criteria accepted, in treating corporations differently, the management and control of these enterprises are not separated. Moreover, the higher level of individual income tax rates will provide for the channelling of the public funds in other areas where the need for them is greatly felt. With no provisions regulating the utilisation of the after tax profits, funds may, due to the administrative and poltical pressure, be either uneconomically accumulated at government agency level or tied up in undesirable investments, both within and outside the particular enterprise. This may not reflect the true objective and aim governing their establishment. The Government Monopolies, for instance, has transferred revenues (both taxes and profits) to government accounts erratically and with no apparent correlation with monopoly profits and the general economic conditions. In addition, the Monopolies Department has apparently made real estate investments and lent amounts of money to ministries and to projects. In doing this, of course, the entire budgetary process is side-stepped and government control of revenues and expenditures is forestalled. This set of circumstances badly needs to be radically altered in favour of closer government supervision of such profits. If there should arise any need for such investments and/or transfer, which actually fall beyond the scope of operations of these existing government enterprises, it is not for that enterprise to assume the function of an investment bank. The financing of new ventures may be better served if independently carried out through the operations of the banking system and the government, if need be, by increasing the level of public accounts with the appropriate bank. The problem of regulating the credit creating capacity of the

Banking/

System may either be handled through the statutory reserve ratio or such financing be made through specific non-bank financial institutions. It will have no power over the over-all volume of money supply and the levelling of credit in the economy.

It may be pointed out that in addition to the structural and administrative shortcomings of the tax system, benefit payments such as pensions, relief and other payments, government expenditures, both current and developmental, pricing, employment and other policies, the coverage of which fall beyond the scope of this paper, all are equally effective and important in as far as the achievement of the revenue, stability, distribution and other objectives of public policy are concerned.

A P P E N D I C E S

Appendix (a)

The elasticity of tax yield, which is the ratio of the percentage change in tax yield to percentage change in income, equals $\frac{\Delta Ta}{To} \cdot \frac{Yo}{\Delta Y}$, where "To" and "Yo" are the initial levels of income tax yield and national income, respectively; Δ denotes changes in the respective items over the period concerned; and "a" is the automaticity of the change. The elasticity of the income tax yield "ET" is affected by and varies with both the elasticities of average statutory rates "Etsr", and tax base "Eb", with regard to changes in the tax base and the level of total income, respectively. It will be more precise to employ, the following formulae:

$$Etsr = \frac{\Delta t(sr) \,/\, to(sr)}{\Delta B \,/\, Bo}, \quad \text{and} \quad Eb = \frac{\Delta B \,/\, Bo}{\Delta Y \,/\, Yo}$$

Where "Bo" and "to" and "Yo" are each the initial levels of the tax base, average effective tax rate and income, respectively. Where national income increases at current prices, the yield of income taxes is expected to rise for two reasons; first, because of the increase in the taxable income which is the base of income taxes, the coverage of which depends on a variety of factors, the definition of the concept of income, the degree of monetisation, efficiency of administration and the like. The response is more obvious and effective if this base is of a general nature covering a wider area in the economy where the marginal share of the tax base to changes in national income is considerably greater than the average; second, because of the progression of the statutory rates, additional shares of taxable income are pushed up to higher income brackets, liable to higher marginal rates of tax. Income elasticity of a tax must not be confused with the built-in flexibility of the tax. A tax may have higher elasticity of yield with regard to changes in income, but may not have greater flexibility. This may be due to a wide base/

base but lower average rates. Built-in flexibility therefore, reflects both the response in the tax base and the marginal tax rates to changes in income which is measured by the aggregate ratio of $\frac{\Delta T}{\Delta Y}$. Moreover, this is separate from measuring the effectiveness of built-in flexibility regulating changes in the level of demand due to fluctuations in income which may best be explained and obtained through the process of multiplier.

For a detailed review of this point, reference may be made to :

R.A. Musgrave, "The Theory of Public Finance", pp.505-512 ;

Richard Goode, "The Individual Income Tax", pp.287-308; and to

R.A. Musgrave and M.H. Miller, "Built-in Flexibility", in Readings in Fiscal Policy, page 379-388.

Appendix (b)

For purposes of convenience and clarity it is deemed necessary that a brief note is provided on the definition of some of the relevant magnitudes and the statistical methods and procedures adopted in our analysis under this appendix.

Income Tax proper, represented by $X_{(pit)}$, where X signifies the tax and (pit) denotes personal income tax, may be defined for purposes of this analysis as follows: They constitute taxes on the income of persons, both real and juridical declared taxable after the deduction of legal or statutory exemptions and expenses incurred for the purpose of earning such income. The categories subject to this tax are clearly examined in the text under "Sources of Revenue..." Chapter 3 and the "...Concept of income..." Chapter 5. The analysis in this respect is based on the "gross" and "taxable" income of such taxpayers declared for income tax purposes, rather than GNP aggregates. The reason is not only because the income tax system in effect fails to be of a general nature, but that an analysis based on the relevant variables, either "Gross Income" (y_{gpi}) or "Taxable Income" (y_{tip}) is expected to reflect a better test of the effectiveness of the base and the rates of the income tax schedule(s).

It may be noted, however, that since revenues under income taxes are inclusive of sums collected in lieu of income taxes but assessed on the imputed income of certain categories, such as artisans, such amounts are separated for purposes of this analysis. This is necessary if the responsiveness of the tax system to variations in the level of the relevant aggregates is to be carefully examined. However, they are not separated when variations in the level of total income tax revenue, denoted by (X) are/

are examined with respect to changes in Gross National Product. National income (GNP) estimates, denoted by (Y), at current or market prices are used.

The statistical observation covers a period of six years from 1961 to 1967, inclusive.* Upon examination of the scatter diagram, the statistical method employed is regression analysis using the equation: $X = AY^b$,** where X (in this case signifying income tax revenues) and Y (signifying income or its components) are the dependent and independent variables, respectively; (A), the constant indicating yield when (b) is zero; and (b) is the elasticity of the income tax system. The application of the method appears to be appropriate as there has been a significant degree of correlation between the level of income tax revenues and variations in all independent variables, i.e. GNP, Gross and Taxable income declared for income tax purposes. It may be recalled that the application of simple regression function of the form, $X = a + bY$ showing the incremental tax/income ratio, (marginal propensity to tax), signifies the overall income tax efforts of the government. It covers the effectiveness of the base and rates, both average and marginal, of the tax system as well as any formulae and administrative adjustments that might have been introduced. Our concern here is mainly focussed on the testing of the effectiveness of the base and rates of the income tax system. The elasticity coefficient in this respect serves as an appropriate indicator.

Tables 1, 2, 3 and 4 below show our observations of the variables during the period concerned. The results arrived at from our analysis may be summarised as follows:

1. /

---

* See Table 1, page 167.

** This exponential function is reduced to a linear equation in the form: $\text{Log } X = \text{Log } a + b \text{ Log } Y$.

1. Total Income tax to GNP :

$$X = -5.0532 + \underset{(0.1344)}{1.607Y}$$

$$R = 0.881$$
$$R^2 = 0.776$$

2. Indirect tax to GNP :

$$X = -1.3832 + \underset{(0.505)}{1.5\ Y}$$

$$R = 0.93$$
$$R^2 = 0.86$$

3. Income Tax to Gross personal income declared :

$$X_{(pit)} = 0.6528 + \underset{(0.1023)}{0.7286}\ y_{(gpi)}$$

$$R = 0.99$$
$$R^2 = 0.98$$

4. Income tax to taxable income declared :

$$X_{(pit)} = 0.5856 + \underset{(0.1920)}{0.7750}\ y_{(gpi)}$$

$$R = 0.97$$
$$R^2 = 0.94$$

Although the short period of our observations may have affected the findings, (t) test of significance, indicates that the results are significant by 95 or 99 percent of confidence. Moreover, in all four cases, the correlation coefficient (R) and the coefficient of determination (R^2) are significantly high, supporting the point made above with regard to the existence of a high degree of correlation between the two series. It may be interpreted that a large percentage of variation in tax revenues is associated with changes in the level of income and that only a small percentage of it may be accounted for by other factors. The results under equations 3 and 4 indicate a low elasticity of tax, i.e. with a one unit increase in the level of income the corresponding increase in the level of tax revenues has been less than one. Although the rise in the level of personal income, both gross and taxable, has been higher than the rate of increase in national income, the elasticity of the income tax system appeared to be very low. It suggests the ineffectiveness of the marginal tax rates at the upper income brackets.

TABLE 1

Year*	GNP At Current Prices (In Million Afs.)	Total Income Tax (In Million Afs.)
1960 - 61	29,658	188
1962 - 63	35,430	191
1963 - 64	39,360	236
1964 - 65	43,740	319
1965 - 66	48,600	406
1966 - 67	54,000	480

Source:

* The six months period of 1961/62 which resulted from a change and the adoption of a new fiscal year has been omitted from our statistical observations. See page 63 of the text for further explanation on this point.

TABLE 2

Year	GNP at Current Prices (In Million Afs.)	Total Indirect Taxes (In Million Afs.)
1960 - 61	29,658	1,121
1962 - 63	35,430	1,127
1963 - 64	39,360	1,712
1964 - 65	43,740	1,917
1965 - 66	48,600	2,175
1966 - 67	54,000	2,645

TABLE 3

Year	Gross Income Declared For Tax Purposes* (In Million Afs.)	Income Tax Revenue (In million Afs.)
1960 - 61	662	173
1962 - 63	755	172
1963 - 64	888	209
1964 - 65	1,133	246
1965 - 66	1,432	281
1966 - 67	1,616	328

* Gross income here refers to income before the statutory exemptions and/or deductions for tax purposes, as "net income".

TABLE 4

Year	Taxable Income Declared (In Million Afs.)	Income Tax Revenues (In million Afs.)
1960 - 61	607	173
1962 - 63	681	172
1963 - 64	695	209
1964 - 65	1,010	246
1965 - 66	1,220	281
1966 - 67	1,301	328

CHAPTER FIVE

EQUITY CONSIDERATION: THE CONCEPT OF INCOME AND THE HORIZONTAL ASPECT OF EQUITY UNDER THE AFGHAN INCOME TAX LAW

Equity consideration: The Concept of Income and horizontal aspect of equity under the Afghan Income Tax Law

1. Income In-kind

2. Capital Gains

3. Gross vs Net and Taxable Income

   (a) - Foreign income and the treatment of taxes paid

   (b) - Personal Allowance and Deductions

   (c) - Business Expenses and Deductions

Income taxes are, generally, regarded as one of the appropriate fiscal devices helping to achieve some of the diverse objectives of budgetary policy, namely - to transfer an adequate amount of resources to the public sector, to mitigate the inequalities in the distribution of resources (income) among members of the society, and to influence the process of resource allocation aimed at promoting economic activities, particularly at the private sector level. It is the second function that we are concerned with in this and the following next chapter.

Equity in taxation is usually referred to meaning fairness in the distribution of the tax burden, where the level of such a burden is constitutionally agreed upon and democratically legislated. On the other hand, terms such as "fairness" and "tax burden" are both vague in meaning and as such do not provide acceptable criteria for evaluating a specific aspect of tax. The meaning of "Fairness" is quite elusive when used by itself. It is important that the interpretation of the term "fairness" be specifically and clearly established either on eithical or economic grounds in order to enable us appreciate its purpose. Similarly, the "burden" of taxes cannot be easily established either. The imposition of a tax indicates a certain amount of tax payment. However, the amount of real burden is not necessarily always the total burden borne by an immediate taxpayer.

For a full understanding of the above terms we have to be more specific. Whether the fiscal burden is based on the "social welfare"[1] concept of taxation/

---

1. This is quite distinct from the "purely financial" concept of taxation aimed at satisfying the growing revenue requirements of the State, irrespective of the pattern of distribution. A.Wagner, Three extracts on Public Finance, "Classics in the Theory of Public Finance", Edit. R. Musgrave and A. Peacock, pp. 1-15.
The "Allocation Branch" under the recent classification of budgetary policy while inclusive of these concepts also suggests under a democratic system to improve the imperfections of the market mechanism and affect the level of economic activities at the private sector. R. Musgrave, Op.Cit. Pages 6-27.

taxation, or as more recent writers have put it, on the objectives of the "distribution branch" of fiscal policy, it requires that the inequalities existing and/or arising in the distribution of economic resources among members of a society be mitigated. Taxes appear as one of the important policy instruments employed on the basis of "ability to pay"[2] in order to transfer larger shares of national income increments for the process of capital formation, and at the same time mitigate such a pattern of inequalities in the distribution of income and wealth. To achieve this objective the "burden" of such a tax (sacrifice), or taxes ought to be based on and related to some meaningful index, i.e. income and/or wealth[3], of the ability to pay. It is the definition and interpretation of the meaning and scope of such an index that will have a significant bearing on ability to pay and the tax burden. Therefore, it is necessary and important to take a wider definition of income and/or wealth into consideration. Taxation on the basis of the ability to pay requires first, that those who are in ———— equal economic circumstances, and have equal ability as a principle must bear equal tax obligation[4].

---

2. The choice of the "ability to pay" approach is strengthened by the fact that it has been accepted as the basis of imposing income taxes in Afghanistan during the period under study. "First Five Year Plan..." Op.Cit., page 209. It is however, important to note that the approach fails to account for the psychic magnitude of a tax sacrifice, which varies among taxpayers in the same economic position. Nevertheless, it is preferable tothe "benefit" approach where tax liability is determined according to the benefits received from the goods and services offered by the government, such as the tax on use of highways and the like.

3. N. Kaldor, (a) "Indian Tax Reform", Government of India, Delhi, 1955-56; (b) "An Expenditure Tax", may be consulted for a more recent contribution on the choice of an index other than income for tax purposes.

4. R. Musgrave, Op.Cit., p.160, and Otto Eckstein, "Public Finance", page 55, 1964.

This is governed by what is called the "horizontal" aspect of equity in taxation,. However, in practice, circumstances under which individuals operate are quite different and as such it is unlikely to expect a full adherence to this aspect of equity in taxation. For instance, where the treatment of retained profits is concerned, individuals and companies (private and public) situated in equal circumstances, are treated differently for political, economic and other reasons. The existence of these factors prevents a full realisation and maintenance of horizontal equity among taxpayers. The stronger the struggle among these rival factors the more difficult is the task of fiscal authorities in reconciling the different interests and objectives towards establishing a greater degree of horizontal equity among taxpayers. Second, it requires equity in the "vertical" sense, maintaining that individuals situated vertically in inequal levels of income and wealth are treated differently, independent of their source of income and wealth. It assumes a degree of graduation in the level of income, and, as such, introduces progression in tax rates. This means that those who fall at a higher level of income and wealth will be liable to contribute a larger share in taxes[5]. There may be little, if any, disagreement regarding progression in tax rates based mainly on the philosophy of mitigating inequalities in the distribution of income in the society[6]. However, the scale of progression has been a controversial issue both among writers and politicians. The structure of marginal and average rates appears to be an important criterion of progression, but when taken by itself the degree/

5. H.C. Simon "Personal Income Taxation, University of Chicago Press, 1938, pages 18-19.

6. Walter J. Blum and Henry Kalvin Jr., "The Uneasy Case for Progressive Taxation". University of Chicago Press, 1953, page 71.

degree of statutory progression is of a very limited significance. A tax may have very high progression with steep rates but this may not be representative of the effective or actual scale of progression. The structure apart from indicating the objective of the government with respect to revenues and distribution of income, will only reveal that the percentages taken from each successive level of income is rising. The scale will indicate whether the progression is of a regressive, uniform or progressive nature. The actual scale of progression, on the other hand, is not what the statutory structure portrays. It is affected by many other factors. In addition to the definition and treatment of income and wealth, the level of exemption, supply of and demand for factors affected by the tax, legislative loopholes, administrative feasibility, the change in marginal rates in percentage points with respect to income, and the level of other taxes are all factors affecting the effective progression of tax rates.

It may be inferred that while the first aspect of equity emphasises the equality of tax obligation among those in similar economic situations, the second aspect goes further and maintains, as a policy objective, to affect the allocation of resources and mitigate the disparities of income and wealth among taxpaying groups irrespective of the degree of utility. It is therefore with respect to these aspects of equity that "fairness" in allocating tax burden is taken in-to consideration; the term 'equity', used throughout this paper is for that reason meant to reflect either one or both of the aspects outlined above in the interpretation of the ability to pay as the basis for income taxes.

The interpretation and treatment of income under the Afghan Income Tax Law will form the criterion for examining the former aspect of equity, i.e. horizontal/

"horizontal", among taxpayers. The Afghan Income Tax Law does not contain a clear definition of income. Nevertheless, receipts in cash or otherwise, of all real and juridical, national or alien[7] entities, subject to income tax include, but are not limited, to the following: salaries, wages, fees and commissions, receipts derived from business and industry, receipts from sale of property (i.e. gains) interest, dividends, rent, royalties, awards, prizes, winnings, gratuities, bonus payments, distributed shares of partnership, income of persons claimed as dependents[8], and any other return from labour and capital or from economic activities, except otherwise provided in the law.[9] Although in theory this itemisation may indicate a comprehensive definition, the reservations made in other parts/

---

7. The word "alien", includes foreign individuals residing in Afghanistan and foreign juridical entities established under the laws of Afghanistan. The individuals enjoy no minimum resident period to become liable to tax. While the income of an alien from sources outside Afghanistan is not part of his taxable income, but income received for services rendered in Afghanistan, regardless of where it is paid, is part of the alien's taxable income. The taxable year of an alient begins upon arrival in the country. A one-twelfth of personal exemption in the taxable year is allowed for each month the alien resides in the Country, Article 5, Income Tax Law, Op.Cit. All non-resident aliens are subject to the tax on annual income from all sources in Afghanistan, without allowing for the deduction of expenses, except those by an authorised local agent, either resident or domiciled. The status of representatives of foreign governments and international organisations is determined by treaties and contracts and mutual practices. Ibid. Article 10. All limited and joint-stock companies organised under the laws of Afghanistan, including subsidiaries of foreign companies and government enterprises, are subject to the income tax on income from all sources within and outside Afghanistan. Ibid. Articles 6 and 7. See page 195 for the treatment of foreign taxes.

8. The tax unit is the individual and not the family. Where both spouses or several members of a family hold a joint title to a property, the income accrued to them is assessed in the name of the husband or head of the family, until the property is legally divided among them.

9. Ibid. Article 14.

parts of the law and /or in practice render the scope narrow. In addition to statutory exemptions and deductions, page 198 the preclusion of income from a number of sources; whether as a result of legislative loopholes or administrative inefficiencies, such as agriculture, inheritance, gains from land and buildings[10] or liberal professions all render the scope of the above definition very limited indeed. As a result what actually constitutes income from all sources for income tax purposes renders the concept of income very narrow in scope and far from the economist's concept, according to which the interpretation includes not only realised gains and losses from current operations, but all the changes in net worth due to all other factors.[11] It also falls short of the accepted interpretation of income in public finance which is based on accretion and defined to equal consumption plus increases in net worth during a specified period of time.[12] Neither consumption nor net worth would/

---

10. (A) Receipts that are not subject to income tax and which are not to be included in the returns of persons, limited liability and joint-stock companies and other entities are limited to the following items - (a) Grants, gifts, and awards of the State of Afghanistan, (b) Grants, gifts and awards of foreign governments international organisations, or the non-profit organisations for the contribution to science, art, literature, social progress and understanding among people, (c) all scholarships, fellowships and grants for professional and technical training, (d) Health, accident and unemployment insurance benefits, (e) Life insurance paid on death, (f) Compensation or damage for personal injuries and sickness, (g) Proceeds of borrowing, (h) Interest on deposits of individuals in Afghan banks, (i) Interest on bonds issued by the State and Municipalities of Afghanistan. Ibid. Article 15.
(B) Income represented by the value of food, fuel, and goods consumed or used by the producers of the same or by members of his household is excluded from income tax. Ibid. Article 16.
(C) Rent received in money or otherwise from leasing immovable property used for residential, commercial, or industrial purposes is subject to income tax. Taxation of the yield (income) from agriculture gardens and animal husbandry is subject to a separate law. Ibid. Article 17.
(D) The income of Charitable, Religious and Educational Organisations established under the Laws of Afghanistan are tax exempt. Article 11.

11. Joel Dean, Managerial Economics, chapter One, PP. 3-43., and R. Musgrave Ibid. page 166.

12. Particular reference may be made to J.R. Hicks, "Value & Capital" Oxford, 1939, p.176; Wm. Vickery, "Agenda for progressive taxation" N. Kaldor "An Expenditure Tax" Op.Cit.pp.54-78; R.Musgrave Op.Cit p.165

would help determine taxable income under the Afghan Income Tax Law unless the concept of accretion is translated into income, which would invite valuation in cases where neither sale nor realisation take place. Moreover, net worth here is inclusive of gifts, inheritance, capital gains and the like, most of which are excluded from income for tax purposes. The corporate practices with respect to the distribution of profits also act against the principle of accretion for tax purposes. Even though the law recognises both "accrual" as well as "cash" methods of record keeping[13], the interpretation of income tax for tax purposes is however equally far from falling close to the conventional accountant's view which assesses income on the bases of historical records recognising gains and losses particularly when they are realised. This view is rejected primarily on the grounds that taxable income[14] of certain groups is only arbitrarily imputed and taxes are assessed accordingly, pages 98-100 above. Actual income realised and based on historical records is not always acceptable for tax purposes, e.g. in the case of traders and artisans. The Income Tax Law of 1967 has widened the scope of income by assuming realised capital gains as normal income and subject to taxation; however, in spite of this the concept of income both in statute and in practice remains far from the accountant's approach in that personal expenses are not deductible. Moreover, in arriving at taxable income a loss of capital under income tax law cannot be normally written off as a rule, while in accounting it is permissible. Similarly, losses under the tax law are not fully recoverable even if they are realised. The partial loss offset provision under the Afghan Tax Law, allows losses not covered during the taxable year to be carried forward for not more than 3 years, (more on this in page 200).

It/

---

13. Articles 42 and 43, of the Income Tax Law.

14. Taxable income is net income less exemptions as personal allowances, Net income on the other hand is adjusted gross income less deductions of a certain fixed amount such as the Af's.4000 for traders, and adjusted gross income is gross income from all sources, less allowable statutory trade and business deductions, see page 194 below.

It is obvious that such an interpretation of the concept of income accepted under the Afghan income tax law conflicts with the 'ability to pay' approach in taxation and undermines equity considerations. An examination of some of the major types of income, allowances and deductions will shed more light on this issue.

(1) Income in-kind:[15]

The fact that income in-kind receives our immediate attention is an indication of the significance of the magnitude of this type of income in the economy. Partially subsidised in-kind compensations to employees have been increasing lately, either in an attempt to maintain the level of real income or that employees and employers find it mutually beneficial to do so[16]. The provision of free meals and lodging for factory workers and employees, medical services, recreational facilities and a host of other fringe benefits are all examples of such compensations enjoyed by the recipients of wages and salaries. In a less developed economy as in Afghanistan, where the economy is less monetised and the percentage of literacy is very low, income in-kind still covers a wider area. Income derived from the ownership of property, such as agriculture, which constitutes a large percentage of national income and which accrues almost entirely in kind, both to the landlord and the tenants, further complicates the problem of interpreting income and determining its scope. The determination of the tax base and the consideration for horizontal aspect of equity, under these circumstances, confront the enquirer with the fundamental question as to whether or not in-kind compensations such as those mentioned above, can and ought to be/

---

15. See William Vickery, Op.Cit., pp.35-44 for a detailed coverage of this issue.

16. Although a total in-kind compensation as wages or other similar payments for services is not allowed by the law, "Labour Legislation in Afghanistan", Chapter II, International Labour Review Vol.57, 1948, pages 83-85) their provision is offered for low prices which implies a partial subsidy by the employer.

be included in an individual's income for tax purposes.

There are divergent views regarding the inclusion or exclusion of such benefits as income in the tax base. Arguments against their exclusion are defended on the grounds that such benefits are offered free of charge or at nominal prices. Not to include them in the income, even if some of them are based on merit wants, as against social wants, in the allocation branch of the budget, would discriminate against those who are deprived of such a subsidy, and have to bid for the commodities concerned in the market at prices governed by the forces of supply and demand. To avoid this shortcoming and to reduce the administrative burden involved in accounting for these benefits, their value can be taken as a percentage of salaries or wages paid, as the money or real value of such benefits is difficult to establish. In practice however, this is still bound to result in administrative complications, both at the public and private sector levels where salary scales are different and the degree of subsidy varies from one organisation to the other. The administrative cost involved may outweigh the gains in tax revenues arising from the inclusion of these benefits. On the other hand, it may equally be argued that revenues will supercede the administrative cost incurred particuarly if these benefits are growing and the problem of administration can be facilitated through the withholding scheme.

It is further argued that in-kind compensations are at times considered necessary to suite a particular type and condition of work. Their elimination or inclusion in the recipient's income will necessitate higher monetary compensations. Even if it is agreed that in-kind compensations ought to be included in the tax base, the main difficulty arises from the method employed to evaluate these benefits. The handling/

handling of home produced goods and services, the consumption by a wholesaler or a retailer from stock-in-trade, barter transactions and the application of an appropriate price level all render the question of evaluation even more difficult. The application of a certain index of prices, either wholesale, retail or at factor cost, might serve the purpose, but it will take the tax system away from one of the important canons of taxation, namely, convenience and simplicity considerations. Whether it is justified to subordinate the importance of convenience and simplicity in taxation to that of revenue and equity considerations is a matter of value judgment largely influenced by policy objectives. This is not meant to belittle the importance of either simplicity or convenience, but revenue and equity are equally important.

It has been on the basis of these controversial views that income in-kind has been treated differently at different times ever since the introduction of the Afghan income tax system. To wage and salary earners, income in-kind, especially food items such as flour, sugar, edible oil and lunches, and housing facilities, the prices of which are subsidised have not been subject to income tax. Although the allowance for lunch may be obtained in cash, the subsidy and convenience involved in obtaining lunches at the premises of the employer render cash receipts less attractive.[17] Such a benefit in this respect becomes inconvertible. It becomes very difficult indeed to assign to all these in-kind benefits a real monetary value which would be the same for every recipient.

The revised income tax law of 1966/67 is still silent on the exclusion or inclusion of these in-kind compensations in the tax base. Article 14 of the law states that "Receipts in cash or otherwise, subject to income tax/

17. Since lunch allowance has lagged behind the price level, the employer has to subsidise the amount and incur further expenses if lunches are to be provided in-kind at their premises.

tax include, but are not limited to the following items - salaries, wages, fees and commissions, ... and other return from labour and capital or from economic activity, are taxable except as is otherwise provided in this law."[18] According to this article, all types of compensations, as " .... a return for labour ..." may be considered taxable income and as such should be included in the tax base,. Whether the phrase ".... return for labour and capital .... " also refers to nominal subsidy or full value of benefits received is not clear. Neither the taxation nor the exemption of such benefits is covered in other parts of the law. To accept the text of this article we may have to include every type of income received in-kind, e.g. including even the use of an official vehicle at certain unofficial times for personal use. These benefits need to be evaluated and assessed to the employee's cash receipt and taxed. A situation such as this is, (a) not practicable, and (b) involves administrative complications which will be beyond the capabilities of the payroll or accounting offices and personnel of the organisation to deal with. On the other hand, to exempt such benefits altogether would create greater possibilities of tax evasion by way of an increase in the volume and value of such benefits. It is necessary that the law should clearly state the limits of exclusion and/or inclusion of income in-kind in the tax base. An acceptable and workable solution may be to require employers to submit a return of any such benefits extended to employees above a certain limit which would exclude the value of some of the essential items provided by the employer. Some of the most direct benefits offered by the government can establish the ceiling. Any benefits above this level must be taxable. The tax on such excess amounts may be borne either by the employers particularly if they wish to offer in-kind benefits to their employees, and by the employees if such a benefit is received in cash. In both cases the tax will have to/

18. See page 175 above on the full extent of the Article.

to be assessed on the total amount of benefits according to the personal income tax rate schedule; however, the tax paid by the employer will be deductible expense in arriving at the taxable income of his enterprises.

As noticed earlier, agricultural income escapes taxation altogether. Although it constitutes the largest sector the majority of those engaged on the land appear to be small farmers and peasants with small lots of land (Table 22, page 106), and low income. The exemption from income taxes of this low level of income may be justified on the ground that in many cases such income will fall below the legal exemption level. It may also be defended for humanitarian reasons. On the other hand, those who own large units of land either enjoy or have the means to enjoy a higher level of income several times greater than their fellow farmers or counterparts in other sectors, such as commerce and industry. It is recommended that the income tax under certain arrangements, such as the one proposed in our earlier chapter, be extended to include income from agriculture. The services of the Cadastral Survey, established several years back, to serve a number of purposes, will help in this direction. But it is an extremely slow process. It is estimated to take at least a decade to 15 years to complete the survey of the entire country. Neither the government with its growing revenue requirements, nor agricultural development programmes can possibly afford to wait so long for the results.

In addition to in-kind compensation, the enjoyment of tax free pension or retirement payments, and the income from such professions as medicine, architecture, law, etc., narrows the scope of income for tax purposes. Moreover, the concessions granted under both the income tax law and the law for the encouragement of private investment, page 252, further limit the scope of income and weaken the foundation upon which the horizontal aspect of equity rests. An expansion of the tax base through a more comprehensive/

comprehensive definition of the concept of income accompanied by the proposed increase in the rate structure will not only render the tax an adequate source of revenue, but will also meet the 'ability to pay' requirements.

(2) Capital Gains:

One of the important issues that affect total tax liability and the question of equity in taxation is the treatment of gains or losses resulting from changes in the value of capital assets, belonging to natural or juridical entities. Opinions in favour of the inclusion of capital gains as a taxable income have increased as the concept of income has broadened in view of the rising trend of such gains. While these gains may be traced both in security and real property markets in more developed economies, in the less developed countries they are largely associated with the latter type of properties[19]. This is because the share of industrial and commercial activities is still very small in relation to real property, namely land and buildings. Furthermore, the undeveloped nature of money and capital markets fails to facilitate the transfer of these small industrial and commercial assets. The sharp increase in the level of prices has made investment in immovable property a safe and speculative type of venture. All this has rendered investment in industry less attractive. Income tax laws of less developed economies have followed the experience of their more advanced counterparts in an attempt/

---

19. For example, real estate investment by the household sector in the United States has been estimated around 28% against 29% in corporate securities. The investment pattern of the top wealth holders in the U.S. shows that their investment in corporate shares is almost double that in real estate, i.e. 40% and 22% respectively. On the other hand, in Ceylon investment in real estate was 60% of the total and only 0.1% in corporate stocks. In East Pakistan too this ratio has been of the same pattern, i.e. 39.4% of total investment was in real estate and only 0.04% in corporate shares. Juanita D. Amatong, "Taxation of Capital Gains in Developing Countries" IMF Staff Papers, 1967, page 344.

attempt to include capital gains as a component of total income subject to taxation either under the general income tax rate schedule or at preferential rates. The taxation of such gains is mainly based on the argument that they accrue, in the main, to a relatively small wealthy group of population. Supplemented by the already low level of taxation and the problem of income and wealth distribution, it will further increase the inequalities (both in a horizontal and vertical sense) of income and wealth. To allow a further tax free increment on those who are already in the higher echelons of income and wealth, enjoying a higher level of income is questionable[20]. A situation like this will only favour the well-to-do group, especially property dealers as against some of the taxpayers whose meagre earnings cannot escape income taxes e.g. a wage earner or a salaried man. The tax, therefore, serves as a strong measure of control over the distribution and allocation in the society.

Enough arguments have been put forward for and against the imposition of a capital gains tax[21]. Although a complete coverage of all these arguments will not be attempted here, nevertheless, in the context of a rapidly developing economy, where the socio-economic changes quickly break through the traditional bonds, establish new sets of values and alter the traditional pattern of distribution of economic resources in favour of some and against others, a brief survey of the major points for and against the inclusion of such/

---

20. "The Nature and Tax Treatment of Capital Gains", N.B.E.R., N.Y., 1951. page 122.

21. Government of the United Kingdom, "Royal Commission on the Taxation of Profits and Income", Majority Report, Page 94 and the final report, page 365, Cmd.9474, London 1955, See also A.R. Ilersic, "The Taxation of Capital Gains", pages 22 - 25, 1962.

such gains as taxable income is necessary and helpful.

Capital gains and losses occur from the sale, exchange or changes in the value of a capital asset. But in the event of a gain it is often argued that such gains are either irregular in nature or not real. It may be due to a fall in the rate of return and, so, any gain in such a case is an accretion to capital and capital need not be taxed under income taxes. In the event of a net worth tax capital may be fully evaluated for such a tax. However, the definition of the concept of income, outlined above, is comprehensive enough to cover realised net gains as an item of taxable income. Irrespective of whether such gain is added to the recipient's capital account or to his cash holdings in an irregular or unexpected manner, he is better off as a result of a greater wealth. Even if the gain has been irregular or unexpected, once realised will obviously enable the recipient to enjoy a higher standard of material well-being compared with another taxpayer who lacks such an accretion.

Another argument is that in the light of rising prices such a gain is not a real increase in the level of income or wealth and as such does not justify the imposition of any tax. The application of an index to adjust price differentials will restore the erosion of the purchasing power of money and eliminate the illusory gains. This argument also lacks substance, for the simple reason that inflationary pressures affect almost all types of income. If any concession is made to the recipients of capital gains, horizontal aspect of equity would demand a similar treatment to other incomes. It is often noticed, especially in a rapidly growing economy, that wages and salaries have always lagged behind the price level. Even if there is any monetary adjustment in the level of income to compensate/

compensate for the rise in the level of prices, this means for the majority a relatively higher tax rate, as income is pushed up the scale to a higher income bracket. This does not follow only if the rise is in the form of allowances or benefits which are not affected by tax rates. In a situation characterised by a persistence of a rising level of prices, even a monetary adjustment will hardly improve the position of such a recipient. A realised net capital gains, which may only be a reflection of a higher level of prices, is just as effective a form of purchasing power as any other source of money income.[22] If any adjustment is required, to reduce the adverse effects of prices, it would have to be directed towards those whose constant income deteriorates in value as price differential arises over a period of time.

The argument in favour of taxing capital gains may be defended on many grounds. The question, therefore, is not whether or not to tax such gains, but rather what to tax and how to tax, so as to achieve best the objectives mentioned above. It is important to see that by improving one aspect of the income tax structure damage is not to be done to other aspects. That is, by eliminating inequalities in tax treatment, certain necessary and desirable activities are not discouraged. Moreover, it is important to know whether or not these gains should be considered as ordinary income and made subject to the usual income tax rates, or whether the law should provide special concessions so as to maintain equity among taxpayers and in the meantime avoid eliminating economic incentives. Therefore, if a realised gain has been the result of several years' accumulation, what are the best possible ways to treat it? What provisions can we allow for possible capital losses? For an examination of these and other relevant technical points we move to the/

---

22. L.H. Kimmel, "Taxes and Economic Incentives", Washington, 1950

the Afghan Income Tax System.

In Afghanistan, capital gain from immovable property has been taxable in an implicit manner, under the 1957/58 tax revision. The Law stated that "Income of individuals who are not engaged in trade, buy and sell immovable property provided they consumate more than three transactions within a year, should be subject to taxation. Also the income of individuals engaged in the buying and selling of shops, garages, public baths, Sarais (bus terminals), and similar properties shall be subject to taxation".[23] Such income was taxable on the basis of the increase in value as shown in bills of sale and other legal documents. However, it was stipulated that expenditure on construction and repair may be deducted and any rise in the price level may be taken into consideration.[24] This was not only inequitable in nature but obviously apt to create formidable administrative problems. Income from movable property such as commercial vehicles was subject to a tax on the sale value of 5% on animal drawn carts and 10% on cars, trucks and other motorised vehicles. The tax did not specify income arising from the purchase and sale of certain other movable property, such as industrial assets in the form of shares of stock and the like. It excluded income arising from <u>inter vivos</u> gift transfers, bequest and inheritance.

The limitation to three transactions per year was meant to provide for such transaction made for personal use and not for profit purposes. In other words, three transactions made in one year were not considered business operation and were not taxable on the gain. It is entirely difficult to differentiate between those whose intentions are for business and those whose personal need necessitates the/

---

23. Government of Afghanistan, <u>First Five Year Plan</u>, Article 4, page 209.

24. Ibid. Article 5, page 209.

the act. Such a treatment was not equitable and bound to invite ways and means of evading the tax. On the other hand, in order to lower tax liability an understatement of the value of real estate property has not been uncommon. The indiscriminate treatment of long term gains at higher rates of income tax is alleged to have forced properties escape official registration by way of a gradual sale where the title stays with the owner until the last instalment is made. Accordingly, owners postpone, reduce, or even escape taxes altogether. Registration of deeds of sale "Qabala" is not compulsory. In cases of succession "Taraka", the taking out of deeds of inheritance is not enforced by law and is much less common than for deeds of sale[25]. The prevailance of such a state of affairs has not only affected revenues but has created numerous judicial problems involving the ownership of the property.

The Income Tax Reform of 1966/67 declared net capital gains from certain sources taxable on the realisation basis. It provides that net gains in any one year from the sale or exchange of any asset of a corporation and limited liability company are taxable income of that year, and subject to the provisions of corporate income taxes. Gains from the sale, exchange and transfer of an asset belonging to an individual, in the form of a gift or the like, except by inheritance, are taxable income and are specified as follows:[26]

---

25. For example, out of 18 landowners in Kabul selling their land in 1957, only 15 deeds of sale were registered. Out of a number of sixty-one landowners, only one deed of inheritance was registered. F.A.O.Op.Cit.

26. Inheritance under this reform is entirely tax exempt. Article 30, Income Tax Law. There is only a nominal stamp duty as court fees required for the registration of a property in possession of an heir(s). Neither bequests nor inheritances are taxable under the Afghan Tax System. This is important as each member of the family and not the group as a whole constitute the Tax Unit.

(a) A trade or business, including good-will.

(b) A factory, including equipment, machinery, building and land, or any part of such assets.

(c) Equipment used in the business of transporting persons and property.

(d) Shares of stock in corporations or limited liability companies.

Gains from such transactions are computed by deducting from the proceeds the cost to the taxpayer of the asset sold, transferred or exchanged, less the total amount allowable for its depreciation, if any left, as such depreciation is expected to be acquired during part of its life before transfer. Transactions, documented fees and other selling and transferring expenses involved and supported by appropriate bills are also deductible. Where no sale is involved the market value of asset at the time of the transaction or transfer is deemed the proceeds. Losses from the sale or exchange of fixed assets used in trade or business are deductible from the taxable income in the taxable year in which the sale or exchange took place, provided that the gains from such a transaction would have been taxable. There is no provision restricting the deduction of short term transaction losses from long term transaction gains. That is, losses from short term transactions, which is normally considered one year, may be offset from long term transaction gains to future years under the procedure of the carry over of losses, which will help establish and facilitate the operation of a securities market. Losses from sale or exchange of shares of stock are not deductible, except from gains through sale or exchange of shares of stock in the same year. Any such gains in excess of such loss is taxable, but any such loss in excess of such gains in the same year is not deductible. This distinction in the treatment of ordinary business losses and loss from capital under income taxes is not a real cost of earning income. This is to prevent concealment of income from other sources and undue speculations in extremely risky ventures./

ventures, especially where the assurance exists that possible losses from such dealings will be offset from profits obtained elsewhere in the business. This may appear unfair; however, it can be defended on the grounds that if losses from such investments were fully deductible from income of other sources, a large investor would be in a position to deliberately arrange his activities in such a manner and proportion that the offset of, even, a small amount of loss from such investments will reduce his ultimate total tax liability by more than the amount. This is especially so where all income of an individual is aggregated and taxed at the normal standard individual income tax rates. On the other hand, the lack of a provision for a full loss offset in the same business is bound to have strong substitution effect unfavourable to risk taking. In view of the treatment of gains from securities the economic efficiency of this measure as a control device during the turns of the cycle is likely to be impeded, which is more important than revenue or equity considerations. As already seen, revenues from this source have not been significant and even if improvements were brought in, this tax would be largely effective as control device more than anything else. What is more important is the economic effects of such a tax during inflationary and deflationary situations.

One of the major weaknesses of this measure is that gains from the sale or transfer of lands or buildings, made by individuals, except through inheritance and those mentioned in paragraph "(b)" above, page 189 are not subject to the capital gains tax. Instead, the sale or transfer of such properties - excluding those acquired through inheritance - are subject to a transfer tax. The tax due and payable at the time of such transfer is one percent of the price received. If the transfer is not a sale, it is one percent of the market value of the land or building concerned, at the time of transfer. The separation of gains arising from the /

the transfer of land and buildings from main streams of income ignores revenue considerations, and encourages large investment in non-productive areas, such as land and buildings. It is contrary to the "realisation" principle on the basis of which capital gains are taxed. In the absence of an inheritance tax or estate duty such accumulated gains are left untouched. The stamp duty of Afs.2.00 on the registration of property distribution[27] imposed during the First Five Year Plan, was abolished in order to facilitate inter vivos transfer of properties. But the total exclusion of inheritance from capital gains and/or income taxes and owing to the "lock-in" effect of the gift tax, holders of properties are encouraged to do just the contrary and thus personally hold possession of the property until death. As noted, bequests are not taxable. It is essential that such inter vivos transfers by the head of a family must be encouraged as the tax Unit is not the whole family but every member of it vis-a-vis his or her income and wealth. Consequently, under the present system, the accumulated gains which might have been realised during the life of an owner will disappear in reality and pass on to his heir untaxed. The effects of this practice on the supply and demand problem of real estate, such as residential houses, cannot be overlooked. The unwillingness to sell property on demand may raise prices more than is normally justified by market conditions to a point where one percent of transfer tax becomes still a smaller portion of the potential gains to be realised. This tends to strengthen the old traditional ways of investing savings and accumulating wealth in land and real estates, held for purposes of prestige, security and/or profits.

Both the 'ability to pay' approach and the global concept of income, accepted under the Afghan Income Tax Law, require that at least once in a/

---

27. "First Plan .... ' Ibid. page 123.

a lifetime, realisation of property (as income and/or wealth to a taxpayer) exceeding in value over a certain minimum must be recognised. Therefore, a relatively heavy death duty or inheritance tax, taking into consideration the social and economic structure of families and the society should be instituted. The latter is preferable as the tax liability of the recipient will be determined in accordance with the ability to pay. To encourage inter vivos transfers, allowing for an exemption limit to the immediate beneficiaries, the rates on inheritance may have to be higher than the present income tax schedule and/or a possible death duty. Whether an estate duty or an inheritance tax is introduced, the present arrangement under which the head of the family, the spouse of the deceased in this respect, or a trustee is responsible for the management of the bequest until the beneficiaries come of age, will have to be maintained. Benefits, as income, arising from the management of the bequest would be taxed to the spouse of the deceased on a family unit basis. Although capital gains are treated as ordinary income with no exemptions and subject to the standard schedule of income taxes, gains accumulated over a long period of time, but realised in one year, enjoy a special treatment under the Income Tax Law. This is to equalise the taxation of accrued and realised gains and to encourage productive investment decisions. The income tax of any person, including capital gains tax, in any taxable year during which fixed assets and investments owned by the persons for at least eighteen months[28], sold or exchanged afterwards, is the product of his taxable income from all sources multiplied by the "special rate" determined as follows:

1. /

---

28. Capital gains from assets held for less than this period is considered ordinary short term gains taxable together with income from other sources during the taxable year, at the normal income tax rate. A lowering of this period seems desirable from the view point of incentives.

1. The gain from the transfer of any asset mentioned above, page 189 is to be divided by the number of years it was owned.
2. The average annual gain or gains so determined are added to all other taxable income, if any.
3. A provisional tax is computed on this total by applying the individual income tax rate schedule.
4. The provisional tax so obtained divided by the amount on which it was computed is the "special rate" referred to above. If this rate appears to be less than four percent, the lowest rate in the individual income tax rate will be applied[29]. The law fails to provide for the treatment of successive gift transfers to or by the same person during one year. As income from gains is subject to a progressive schedule the opportunity to avoid higher tax obligations is thus provided by the law[30].

As seen, the capital gains tax has eliminated some of the undesirable features of the income tax system. The aggregation of capital gains and ordinary income and the progression of the tax rates will no doubt increase the revenue productivity of the tax and add to the automatic stabilisation feature of the system. Owing to the averaging scheme, the taxation of short and long term gains at the same rate will not discriminate against the long term gains. But like certain other provisions of the new income tax law, it creates problems which will have undesirable administrative, economic and social consequences. The all inclusive nature of gifts and their valuation for income tax purposes, are beyond the capabilities of the administrative machinery to cope with. No exemption, however small is provided. By providing tax free interest on government/

---

29. Income Tax ... Op.Cit. Chapter III.

30. A provision should be made to prevent such an eventuality. The procedure may be outlined as follows: (a) Add all gifts made to or by one person during the same taxable year, (b) assess the tax on this total gains including the final transfer, (c) multiply this tax with the total gifts, excluding the latest transfer, (d) The amount so obtained from "(c)" divided by "(a)" will give the tax allowed for previous gifts, (e) Subtract "(d)" from "(b)" and the result is the tax to be collected.

government securities a possible result may, in the event of stable prices, be the discouragement in equity capital investment as against government bonds, however low the interest rate may be. It is likely that gains from these bonds, either issued at a discounted price and redeemed at full par value or sold by the holder at a premium, will also be tax exempt. The taxation of these gains would offset the ultimate benefits of their tax free interest and partly compensate for rising prices. If interest or gains from this source is to be declared taxable, the percentage of interest has to be equally pushed up. This may not be desirable from a general interest rate point of view. Any such shift in the pattern of investment is, of course, a further concession to the high income groups.

3. Gross vs. Net and Taxable Income:

When income and wealth are recognised as the basis of income taxes, the deduction of certain necessary expenses incurred in order to obtain the aggregate income is to be provided for. Accordingly a series of deductions and exemptions may be allowed in order to arrive at the net and taxable income during the period such income is liable to tax. Tax Authorities have often been confronted with problems regarding the nature and extent of these deductions. The practice of several different accounting methods, especially pertaining to accruals depreciation allowances, inventory valuation and the like have had different effects upon the level of net taxable income. Similarly, where the keeping of records of consumption and expenditure items is not widely practised the duty of income tax authorities in determining ultimate taxable income has been made more difficult. Consequently, some income tax legislations have clearly defined and specified the amounts and limits of certain necessary deductions.

The/

The Income Tax reform in Afghanistan has taken a step towards this direction specifying the types and limits of such exemptions and deductions. It has also recommended the use of appropriate methods of accounting, on a cash or accrual basis, affecting the effective level of such deductions at any one time for both individuals and juridical business entities.

To arrive at taxable income all ordinary and necessary expenses of production, collection and preservation of such income is allowed to persons, limited liability companies, corporations and other entities, pages 206-207.

(a) Foreign Tax Credit:

The global feature of the Afghan Income Tax Structure covers income from (a) Business, (b) property[31], and employment on the basis of both "Source" and "Destination". Income of resident and non-resident nationals or aliens originating from the above sources is taxable. The income of an Afghan national (including juridical entities) raised from any one of the above sources is grossed up for income tax purposes. This indicates that the implications of the concept of income is not confined to the "origin" of income alone but takes "residency" also into account. No definition of these terms and their qualifications under different circumstances are given in the law. Similarly, the law does not specify the scope of such foreign income or carry any provision for the period during which time such income may have been generated. This is important as the concept of income and taxable year varies from one country to another. There are no tax treaties between Afghanistan and other countries to take precedence in case of a conflict on these issues between Afghan law and that applied within foreign jurisdictions. These factors render the/

---

31. See pages 176 and 190 for items excluded.

the tax law administratively more difficult and complicated. However, in order to avoid a double taxation of income repatriated to Afghanistan as a country of "Destination", Afghanistan allows a credit for the foreign tax(es) paid on the income raised abroad. The credit does not exceed the amount of taxes assessed, according to the Afghan income tax law on that part of income generated outside Afghanistan. In other words, no carry forward or backwards of foreign taxes, should they exceed taxes computed under Afghan law, is allowed. It states that "Any income tax paid to the government of a foreign country by a citizen[32] of Afghanistan may be taken as credit only against that part of his annual income tax attributable to foreign income. If the income of an Afghan citizen is derived from more than one foreign country, the income tax credit shall be in proportion to the income from each country."[33] In this respect the law restricts the choice between claiming tax credit on a country basis rather than on total foreign income from several countries[34]. A more equitable treatment accorded to such foreign income and taxes, however, would be to:

(a) Allow the necessary deduction of expenses to be made.

(b) Assess the total tax on income (taxable) from all sources under the Afghan Income Tax rates.

(c) The tax so obtained multiplied by income from foreign source -(or sources in case a separate calculation is to be made for each foreign source), divided by total income from all sources will give the amount to be credited against foreign taxes paid.

Whether/

---

32. The word "citizen" in this respect also covers juridical entities established under the laws of Afghanistan, Article 6, Income Tax ....

33. Article 4, Income Tax Law. Further evaluation of this point appears in Chapter seven on the Economic Efficiency of the Afghan Income Tax System.

34. Reference on the alternative ways of foreign tax credit may be made to "Taxation of Foreign Income under the U.S. Internal Revenue Code", Report of the Royal Comm. on Canadian Taxation, Op.Cit. pp.743-771. For the treatment of individuals foreign income and taxes paid, under the U.K. Tax System, reference is made to K.S. Carmichael, Op.Cit., pp.415-435 and 529-572.

(c) contd.

Whether this or the existing method is used, the low tax rates may not leave much tax to be collected especially when such income is taxed under high rates abroad. The application of either one under present circumstances would result in administrative expenses.

(b) Personal Allowances and Deductions:

Exemption and deduction allowed to individuals are based according to an implicit division of "earned" and "unearned" income. The former covering income only from wages and salaries, enjoys a "personal exemption" of up to Afs.35 thousand. No provision is made when income is received both as earned and unearned. The practice further contradicts the terminology of the law. The law states that "A deduction called personal exemption is allowed to persons who are citizens of Afghanistan or aliens residing in Afghanistan...."[35] without specifying the type of income. Either the law or the practice needs to be adjusted accordingly. The present level of personal exemption is around four times the per capita national income for a single person and almost nine times for a married taxpayer with eight dependents, i.e. one spouse, five children and parents. This does of course seem inequitable in the sense that it discriminates against taxpayers with larger families of two or more wives (up to four at one time) and more than five children. Under the progression of the tax/

35. Personal exemption is as follows: (a) Afs.15,000 for the person who is the taxpayer, (b) Afs.10,000 for the spouse of the taxpayer, who is limited to one such exemption, (c) Afs.2000 for each dependent child of the taxpayer under 19 years of age, (d) Afs. 2000 for each dependent child over 19 years of age who attended school not less than six months in the taxable year, and (e) Afs.1000 for each dependent parent so certified by the Ministry of Justice. A personal exemption may not be claimed for a spouse or for any dependent child unless two conditions were met: First, the support of the spouse or the dependent child must have been furnished by the taxpayer during the taxable year; Second, all of the income of the spouse or dependent child must be included with the income of the taxpayer claiming the exemption. The total amount allowed for personal exemption of any taxpayer shall not exceed Afs.35,000 Article 18 of the Income Tax Law.

tax rates this inequal treatment becomes more obvious despite the possibilities of splitting income among members of the family as independent tax units. On the other hand, such a measure may be intended to serve other objectives, i.e. such as discouraging some socially and economically undesirable practices and keeping population growth to its minimum. This might have been achieved, had the tax had a wider base and had it been of a general nature, covering such sectors as agriculture, where tax units are normally characterised by large families. Even then, individuals' decisions concerning the number of wives or children, particularly among the rural population where the level of education is the lowest, are unfortunately less influenced by such economic factors.

Apart from the above level of allowance, there are no other personal exemption or deduction allowed. Personal expenses such as insurance contributions, commuting to and from the place of work, medical, education and other expenses are not deductible for income tax purposes*

(c) Business Expenses and Deductions:

Taxable profit of a business concern is determined according to the accounting method ("cash" or "accrual")[36] employed in the business concerned. Taxable profits of such businesses whether of an individual character, such as proprietorships, partnerships[37], limited liability companies and the like or of a juridical nature such as joint-stock companies/

---

* See Appendix (c) to this Chapter, for further reference, pages 207-208.

36. The income tax law allows accounts to be kept on the basis of either "Cash" or "Accrual" method of accounting. Although the choice between the two is optional, once adopted it is not allowed to be altered. Limited Liability and Joint-Stock (Corporations) Companies are required to maintain their accounts on the basis of the accrual method.

37. The income of a partnership by itself is not subject to the income tax law. Partners are liable for the income tax only in their own separate and individual capacities where each of whom is required to include his share of profit as part of his total income. Article 38.

Companies is determined by way of adjusting gross income[38] that is deducting business expenses incurred in the process of earning that income. The limited scope and lack of a clear definition of deductible expenses together with the poor standard of accounting knowledge, both among the general public and the tax officers, have created controversies and confusions.[39] A greater degree of 'discretion' on the part of the tax collectors, as a result, has added to the problems of administration and the tax office-taxpayers relations. Avoiding further worsening of the situation, the 1966/67 income tax reform specifies what expenditure items are allowed to be deducted as business expenses.[40] Other specific features of the law in this respect include methods regarding the calculation of depreciation charges[41], inventory evaluation, and the limits of advertising and/

---

38. Page 177 above may be consulted on what constitutes gross income.

39. The controversy over the balance sheet items of certain companies which has been going on between these companies and tax auditors may be cited as an example.

40. In addition to the general business deductions specified under Article 19 of the Law (See Appendix (c), page 206 below), rental income from real estate, both residential and commercial, is entitled to a 20% deduction as depreciation and repairs charges. With a 2% statutory annual depreciation allowance this is bound to create administrative difficulties as they contradict each other. The "Business Receipt Tax", page 100 above, and the fixed tax of the individual importers and exporters, pages 85-87 paid or payable at the time the income tax of the business is settled, is deductable expense in computing taxable income for the same taxable year.

41. Depreciation charges allowed for tax purposes, vary from 2% to 50% for "Concrete structures" and "Printing letters", respectively. Mining and metallurgical machines and equipments are depreciated at 15% and 10% respectively. Other industrial machines are depreciated at a rate of 6% per annum. All these charges are calculated on the basis of "straight line" method at cost. The Law however, fails to specify the word "cost" as to whether it is on the basis of "historical" or "replacement" cost.

and entertainment expenses[42]. It however, fails to cover and specify the extent of employers' contributions to the pension plan, expenses for medical services, insurance policies and the like, especially when the beneficiaries of such payments or compensations are totally tax exempt on these receipts. Where the recognised business deductions result in net operating loss, such loss may be carried forward and offset against taxable income of three succeeding years, deducting each year one-third of the loss.[43]

Where business expenses are not supported by reliable documents, and where taxable income has been less than the specified limit of seven percent, (page ninety-two), as it has been the case with the majority of individual companies, taxable income has been computed in an arbitrary manner by imputing a seven percent as a net income on the total turnover of the business. No deduction of expenses, except the fixed taxes on imports and exports (pages 85 - 87), are allowed. To arrive at the turnover of a business the tax offices use the Chamber of Commerce Commodity Price Quotations, and the Central Bank's free market foreign exchange/

---

42. (a) In view of the high fluctuations of the price level the inventory valuation on the basis of either FIFO or LIFO has not been recommended for the time being. The 1966/67 income tax law has therefore stipulated that all taxpayers engaged in manufacturing, trade, or others are required to evaluate and take inventories at original cost or market value whichever is lower at the time such an evaluation is made, i.e. preparing Balance Sheet and Profit and Loss statements. This is a conservative Rule which calls for write-downs during deflation (when market price falls below cost of inventory), but no write-ups during inflation.

    (b) To have further avoided disagreements regarding the deductability of advertising and entertainment expenses, an arbitrary maximum amount equal to 2% of annual profits is allowed, (See Appendix (c) to this Chapter.) Such claims must be supported by the documents and evidence. This is, of course, a crude way of going about it, as such expenses cannot be considered a function of profits. At times and with certain types of businesses such a percentage may be more and at others less than what is actually necessary in the process of earning that profit. Moreover, certain advertisements may represent capital rather than current expenditure. To allow a total deduction in one year of such capital expenditures may appear in conflict with the depreciation allowances. These aspects of the provision need further considerations.

43. Articles 19 and 47, Appendix (c), pages 206 and 208.

exchange rates during the period concerned,. Although the text of the 1966/67 Reform provides that to arrive at taxable profits all ordinary and necessary expenses incurred in earning the profit are deductible, under the present circumstances, where revenue requirements are high and particularly the institutional framework necessary for a successful income tax is lacking, it may still be the only feasible way of taxing these groups, despite the fact that it lacks insight into the problems of the level of potential revenues from this source, equity and economic efficiency.

In the case of companies, in addition to statutory expenses, inter-company dividend distributions were deducted, under the pre-1967 Reform, in computing the taxable income of the recipient company. Such dividends were taxable in the hands of shareholders of the recipient company. This was to encourage the retention of such dividends by the recipient company. Dividends paid in shares of stock, accruing either to individuals or juridical entities, were an addition to capital and as such not taxable. In this particular situation the law recognised a difference between income and capital. However, when these additions to capital were realised or redeemed in cash by the individual shareholders the proceed was taxable as ordinary income under the individual income tax rates.

Under the 1967 Reform, dividends paid out in money are made deductible from the taxable income of companies, both limited liabilities and joint-stock.[44] Under this provision, dividends are distributions of money or assets made out of the earnings of such companies to their shareholders and partners.[45] Dividends received by company (A) from company (B), the/

44. Section (k), Article 19, Income Tax Law

45. Article 50., Ibid.

the latter having withheld the 20 percent dividend tax, are to be included in the taxable income of company (A) and as such will be subject to company income tax. This applies to financial enterprises such as banks and investment companies, and non-financial enterprises alike. It involves double and even multiple taxation and may discourage external investment. It may be intended to ensure that affiliated companies do not confer a tax benefit to their big shareholders through company tax privilege, as against high rates of personal income tax. However, it fails to cover losses arising from such inter-company investments. It also discriminates in favour of investments abroad, by an Afghan Company, where taxes paid to or withheld on behalf of foreign governments are credited against Afghan taxes.

Dividends declared and received in shares of stock are not deductible from the company's income and do not constitute the taxable income of its recipients at the time such certificates are received[46]. Income tax on company income is computed on the total retained profits, including the dividends as shares of stock, at the fixed rate of 20 percent. The new shares of stock received as dividends simply confer a title to the holder of a proportion of the surplus or reserves or the entire increased capital account. If and when distribution of this capital account is made, in cash, the net proceeds, i.e. the difference between actual cost and realised amount, remains taxable income under the provisions of the capital gains tax.

In arriving at taxable income, both banks and insurance companies are allowed to deduct, from net income, additions to various reserves, e.g. Reserve for Bad Debts, Insurance Claims and Losses[47]. While lowering tax/

---

46. Article 50, Section "b".

47. See Appendix (d), page 210, for a detailed examination of these deductions.

tax liability, this adds to total investment capacity of the institutions concerned.

There is no distinction between a domestic company and a foreign company with respect to income taxes. However, the earnings from doing business in Afghanistan, of a resident or non-resident[48] alien and a foreign juridical entity engaged particularly in the business of transportation, may be tax exempt provided the government of the foreign subject accords reciprocal treatment to citizens and companies of Afghanistan. Where no such treatment exists the income of a foreign company such as airlines and other transport companies, carrying on business in Afghanistan is determined either on fixed percentage basis, i.e. 10 percent of gross receipts or by allowing the percentage of world wide expenses in the same proportion as Afghan revenues bear to world wide profits. This also applies to foreign companies established under the laws of Afghanistan and whose records and accounts do not reveal the exact level of profits. This is to ensure that profits are not transferred to the parent company, branches and/or subsidiaries through abnormally high prices. The procedure is conducted as follows:

(a) The gross income of the company from its world wide activities, as shown by its latest report is determined.

(b) After the deduction of expenses under article 19 its net income before taxes from world wide activities is computed.

(c) The amount of taxable income (computed under "(b)" is divided by the gross income (determined under "(a)"). The quotient so determined is the percentage of profits from its world wide activities.

(d) The total gross income from its activities in Afghanistan is multiplied by the percentage of profit, (determined under "(c)"). The product so obtained is the total income before taxes from its activities in Afghanistan.

---

48. See page 175 on residency requirements.

$$\frac{\text{World wide net income}}{\text{World wide gross income}} = \text{\% of profit X Gross income from operations in Afghanistan.}$$

$= $ Taxable income in Afghanistan.

The administrative complications involved in such a sophisticated practice cannot be overlooked.

In sum, it may be maintained that although some of the anomalies of the previous law have been remedied under the 1967 reform, the preferential treatment of certain groups and sectors and the inadequacies regarding exemptions and deductions supplement those observed under the concept of income. The narrow concept of income and the arbitrary fixation, in many cases, of the tax base plus the provision for exemptions and deductions in an ad hoc manner are all responsible for the inadequacy of the system to serve as an effective measure of control and/or mitigation of the inequalities of income and wealth in the society,. Similar to revenue and stability functions of the tax, equity considerations, too, have not received sufficient attention under the Tax System in general and the Income Tax in particular.

Appendix (c)

Article 19 of the Income Tax Law states that "Deduction of all ordinary and necessary expenses of the production, collection, and preservation of income is allowed to persons, corporations, limited liability companies and other entities. To be deductible, these expenses must have been incurred during the taxable year, or one of three previous years, in accordance with the provisions of this Law. Personal expenses, cost of transportation to and from place of work, and expenses not specified in the following paragraphs of this Article are not deductable:

(a) Cost, including freight and insurance, of goods sold in a trade or business is deductible.

(b) The cost of supplies, materials, fuel, electricity, water and necessary services used in production of income, or in a trade or business, is deductible.

(c) Wages, salaries, commissions, and fees paid for services rendered by employees in the trade or business are deductible.

(d) Interest on business debts is deductible.

(e) Rental paid on property necessary to and used in trade or business is deductible.

(f) Cost of repairs and maintenance of property necessary to and used for purposes of the business or trade is deductible.

(g) Depreciation of property (except agricultural land) used in a trade or business or held for the production of income is deductible according to the income tax manual. The total of deductions for depreciation of any item of property over a period of years shall not exceed its cost to the taxpayer.

(h) Any tax or charge that is a necessary expense of doing business, holding property for income, and of producing income if paid or accrued during the taxable year is deductible. Taxes imposed by this Law and taxes not qualifying as necessary business expenses are not deductible, except as otherwise provided by this Law.

(i) /

(i) Losses of property, with recorded value and cost, caused by fire, earthquake, and by casualty or disaster of any kind are deductible over a three year period, to the extent such recorded loss was not covered by insurance.

(j) Losses in business or trade from bad debts are deductible according to the Income Tax Manual established by the Ministry of Finance.

(k) Dividends paid in money by a corporation or limited liability company organised under the laws of Afghanistan are deductible from the taxable income of that corporation or limited liability company. Such dividends are to be included in the taxable income of persons, corporations, limited liability companies or other entity receiving the same.

(l) Other expenses of doing business, of holding property for production or income, and of producing income, established by the Ministry of Finance to be legitimate and necessary expenses to the production of income, and as such set forth in rules and regulations, are deductible.

(m) Advertising and entertainment expenses evidenced by documents and up to two percent of net income is deductible."

<u>Article 20:</u>

"Personal expenses including but not limited to the following items are not deductible:

(a) Wages or other compensation paid to any person for services rendered to the taxpayer or his family or his family's benefit and enjoyment.

(b) Expenses and cost of maintenance, repair, construction, improvement, furnishing, and other expenses of the taxpayer's or his family's house or residence or any property devoted to his own personal or family's use.

(c) /

(c) Interests on personal indebtedness.

(d) Costs of travel to and from work and cost of travel for personal purposes.

(e) Cost of life, accident, health, and liability insurance for the protection of the taxpayer and his family.

(f) Cost of insurance of any kind for the protection of property used for personal purposes. "

Article 47:

Carry-over of losses: A net operating loss is defined as the amount by which deductions allowed under the law exceeds receipts. A limited liability or joint-stock company incurring a net operating loss in a taxable year should deduct this loss from its taxable income of three succeeding years, deducting each year one-third of the loss.

A p p e n d i x (d)

Banks, Loan and Investment Companies are entitled to deduct, from taxable income, additions to Reserves against losses on loans provided such Reserves do not exceed 25 percent of loans outstanding at the end of the taxable year. Any transfers or payments from such Reserves, except in accordance with the purpose of the Reserve, are taxable income in the year the transfer or payment was made (Article 62, Income Tax Law, 1967)

Insurance Companies are allowed to deduct additions to, first, Reserves for claims, provided such Reserves do not exceed 100 percent of premiums for Marine Insurance and 50 percent of premiums for any other risk insurance received during the taxable year. Second, additions to Reserves for Losses in operations in the field of insurance for which premium income is taxable[49] provided such reserves do not exceed twice the amount of paid-in capital for such field of insurance. Any transfer or payments from these reserves, except for actual claims and losses or for dividend payments in money, are taxable in the taxable year during which the transfer or payment was made. (Article 58, sections "d" and "e").

---

49. All premiums for insurance against fire, theft, accident, sickness casualty, or risk, the insurance of which is for a specified term and no claim may be made by the policyholder except for losses from the eventuality insured against, are taxable to the insurance company. However, premium income for insurance written in contracts that require ultimate payment of specified benefits to the policy holder or his beneficiary is exempt from income taxes. Articles 55, "c" and 56, Income Tax Law.

C H A P T E R   S I X

EQUITY CONSIDERATION (Continued)

A FIRST APPROXIMATION TO THE INITIAL IMPACT OF TAXES UNDER THE AFGHAN INCOME TAX SYSTEM

Equity Considerations (Continued)

A first approximation to the initial impact of taxes under the Afghan Income Tax System

It was conceived from our previous analysis that the narrow and limited concept of income, accepted under the Afghan Income Tax Law, renders the Law an inadequate source of development finance and fails to accord an equal treatment to equals. The declining share of Direct Taxes and the regressive nature of Indirect Taxes further increases the inadequacies of the system in reducing the inequalities of income and wealth among members of the society. The arbitrariness of the law, regarding the treatment of income and deductions, is bound to further damage the equity aspect, not to mention some of the undesirable effects it will have upon economic activities,. Although the Income Tax Law accepted the 'ability to pay' approach, it has so far failed to meet the requirements of horizontal equity in taxation.

The initiation of the First Five Year Plan in 1957 carried with it the revision of the Income Tax Law of the Country. The revision was meant to contribute towards the fulfilment of the objectives of the Plan by (1) Generating an adequate volume of finance, (2) Acting as a stabilising device in the economy, and (3) Mitigating the inequalities in the distribution of income and wealth. The latter was particularly important if it is to avoid adding to an already inequitable pattern of distribution of resources among the various sectors of the economy. As it may be recalled, page142 , the 1957/58 amendment of the income tax law introduced a further element of progression into the rate structure under a schedular income tax system. The statutory level of exemptions and deductions was in most cases kept to the minimum; first, due to the narrow definition of the concept of income and, second, because opinions regarding the establishment of a satisfactory level of exemptions and deductions disagreed and varied from case to case. Furthermore, reliable information pertaining to an acceptable level of deduction is hardly available in the underdeveloped/

underdeveloped nature of the Afghan economy. These factors seemed to favour the introduction of a schedular income tax system. While this feature appeared to introduce ease of administration, (pages 312-338 on the validity of this point) it made it difficult to compare the extent and degree at which income from different sources has been taxed, unless it is individually analysed. The measure was primarily intended to bring about a differential tax incidence on different types of income so as to achieve the objectives outlined above, page 213.

A brief look reveals that the mild progression of Schedule (C), page 148 on dividends was meant to favour shareholders, as against recipients of income from individual commercial and industrial ventures,. Such a differential incidence was expected to raise the level of savings and investment in joint-stock type of business enterprise, and hence accelerate the process of capital formation. Similarly, in addition to a relatively high level of personal exemption, Schedule (D) with a lower maximum marginal rate was meant to favour wage and salary earners, whose real income was assumed to show no corresponding rise with respect to increases in the level of prices. However, the rise in the level of price has erroded any resulting benefits from the exemption and structure of low tax rates.

As this chapter deals with the question of tax burden, the study confines itself to the determination of the burden of income taxes at the point of impact, generally referred to as "Formal Incidence"[1]. As data on the distribution of personal income, which normally constitutes the basis of a comparison between income brackets, is lacking in Afghanistan, the income taxpayers/

---

1. Ursula K. Hicks, "The terminology of tax analysis", Economic Journal, Vol. (LVI) 1946, pp.38-50.

taxpayers are grouped on a "functional" basis, for purposes of this study. While this analysis provides a comparison of the relative tax position of the different "functional" groups, it reveals the responsiveness of the progression of income tax rates to changes in the level of income reported for income tax purposes. It will partially satisfy our queries on "vertical" aspect of equity among income tax payers. First, the analysis will examine the extent to which objectives of the Schedular System were realised in aiming at the different treatment of these functional groups; and second, it will compare tax liability of these groups with that of other taxpayers over the period under study.

Dividing the economy into its major economic sectors, namely, agriculture, industry and commerce, the growth of taxable income and the historical trend of direct taxes, among these sectors, reveal that tax liability has shifted from the first towards the second sector, i.e. industry and commerce.

It is appropriate to indicate that not all direct taxes represent taxes on income declared. More than 29 percent of all direct taxes were collected almost entirely from property owners situated in the agricultural sector, page 104. This left income taxes to constitute the remaining 71 percent of total direct taxes; however, total income taxes as such represented only 0.8 percent of GNP. This means that on the whole less than one-half of one percent of national income, at market prices, was syphoned through the income tax system. It may be recalled from an earlier observation, pages 98-100 , that individual income taxes, in addition to taxes assessed on income from wages, salaries, rental income and dividends, also include such lump sum taxes paid in lieu of income taxes by the 50 different categories of artisans, the individual traders and the like whose taxable income has often been too difficult to determine. The exclusion/

exclusion of these arbitrary and lump sum taxes will further reduce the already meagre ratio of income tax proper to GNP.

Examining the different components separately, revenues from taxes on salaries and wages in 1966 amounted to just over 8 percent of all individual income taxes. This comprised of taxes on salaries and wages of local employees and workers, as well as remuneration to foreigners for their services rendered in Afghanistan. It excludes members of foreign legations as the taxation of their salaries falls beyond the jurisdiction of the Afghan Income Tax Law, page 175 Note 7. Since the remuneration to a foreign employee is normally high by any Afghan standard, it has been analysed separately. Its inclusion with the income of the local taxpayers would have rendered the results misleading. Revenues collected from taxes on salaries and wages of local employees and workers have been negligible until 1960. This is due to poor administration and the lack of compliance on the part of both the employer and the employee, in spite of the fact that the Law of 1946 and later amendment in 1957/58 clearly laid down the basis for such a tax. Employers were required to prepare a list of their employees, together with salary payments, and send it to the district tax office concerned. Every employee earning above the personal allowance had in turn to file a tax return and discharge his tax liability at the tax office concerned. (More on this in Chapter 8). It was not until after 1961 that the collection of taxes on salaries and wages gained some momentum, Table 27. Taxes due, prior to this date, are still outstanding. The change in occupation, lack of proper records and the possibility of death all seem to render the collection of arrears from this group very difficult. This is not only true of taxes on wages and salaries, but of all other taxes, see Table 37, page 336 in Chapter eight. It has resulted in carrying-over of arrears from one year to the next, covering almost the past quarter of/

of the century. Where taxpayers can be located, the collection of taxes, not only involves administrative difficulties, but their present ability may make it difficult for them to settle their outstanding tax obligations. The prospects of recovering much of these taxes through further administrative campaign seem equally grim. In 1961, the number of income tax returns voluntarily filed by local salary and wage earners amounted to almost 1.2 percent of the total employed. This low percentage does not imply that the rest of the salary and wage earners fall below the exemption level. As indicated, poor administration and lack of voluntary tax compliance have been a major cause of such a low percentage. Remunerations of army personnel, are excluded from the total since a considerable amount of their compensations is in kind involving high subsidies. Furthermore, the inclusion of their number would have distorted the result of our analysis.

The increase in wages and salaries, mainly due to the effects of the 1963 Devaluation and the annual 19 percent rise in wages and salaries at the public sector,[2] raised the number of these taxpayers. Nevertheless, the amount of tax revenue from this source did not show a sizeable increase up to 1965/66.

As far as foreign employees are concerned, due to a high level of personal income and better compliance, the tax system has tapped-off the increases in income accrued to them as a result of the devaluation and the rise in the level of prices. This is particularly so as almost 70 percent of the remuneration to the foreign employees at the government offices and agencies is paid in foreign exchange, transferable abroad or paid to them in local currency converted at the free market rates of exchange. The other 30 percent, paid in local currency converted at the official rate is also added to the taxable amount due to devaluation. Foreign exchange payment, which fell outside this official 70 and 30 percent arrangement, /

---

2. Ministry of Planning, "Survey of Progress", 1964, p.5, and 1967/68, p.28.

TABLE 27

INCOME TAXES BY FUNCTIONAL GROUPS BETWEEN 1961/62 - 1966/67

(Amounts In 000 Afs.)

	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67
1. SALARIES AND WAGES:						
A - LOCAL						
Number	1,370	2,140	3,062	3,564	7,946	8,342
Gross Income	33,686	51,300	67,191	81,480	184,195	254,420
Taxable Income	6,974	8,500	9,013	10,200	33,221	20,844
Tax	1,030	1,190	1,352	1,530	4,651	3,336
B - ALIENS.						
Number	557	604	682	774	876	928
Gross Income	70,277	83,972	106,362	111,446	120,268	127,295
Taxable Income	60,808	73,704	95,108	98,288	107,128	103,695
Tax	14,594	17,689	23,777	25,555	22,497	23,850
2. INDIVIDUAL BUSINESS ENTERPRISES (Including Limited Companies with a net profit of less than 7% of turnover)						
A - LOCAL						
Number	2,564	2,876	3,289	4,092	4,482	5,625
Gross Income	180,608	195,624	234,524	331,976	417,877	473,375
Taxable Income*	170,352	184,220	221,368	315,608	399,944	450,875
Tax	29,362	31,820	47,020	61,152	74,251	80,072
B - FOREIGNERS.						
Number	103	156	176	212	224	268
Gross Income	58,656	67,692	108,704	138,854	169,526	190,783
Taxable Income	58,240	67,068	108,000	138,006	168,630	189,711
Tax	20.276	22,689	39,766	50,067	61,396	67,149

3. / (continued overleaf)

	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67
3. COMPANY AND SHAREHOLDERS						
A - COMPANY						
Number	164	172	180	197	206	261
Net Income**	319,520	356,628	371,967	435,211	463,326	490,143
Taxable Income	311,320	348,028	362,067	425,361	453,026	477,093
Tax	74,000	77,000	79,000	81,000	81,000	120,000
SHAREHOLDERS:						
Number	3,615	3,986	4,209	4,763	5,134	5,652
Gross Income	112,019	144,869	145,861	172,679	222,454	254,278
Taxable Income	97,619	138,925	119,025	153,627	201,918	231,370
Tax	26,002	21,523	18,895	22,721	29,735	33,409
4. REAL ESTATE OWNERS						
(Residential Buildings)						
Number	N.A.	N.A.	N.A.	1,162	1,847	2,194
Gross Income	-	-	-	34,171	77,099	80,224
Taxable Income	-	-	-	22,829	58,394	59,516
Tax	-	-	-	3,881	7,927	10,713
5. SELF EMPLOYED (Artisans)						
Number	50,974	58,936	65,726	72,508	80,341	86,752
Gross Income	118,522	142,869	165,178	217,357	236,947	254,323
Tax able Income	118,522	142,869	165,178	217,357	236,947	254,323
Tax	15,408	18,573	23,125	30,430	40,381	43,235

Source: Revenue Department, Ministry of Finance, Kabul, 1967/68

* Deduction here is restricted to an exemption of Afs.4,000. See Schedule (B), page 146 above

** This is gross income less all legal deductions. It is, however, inclusive of the amount of Afs.50,000 and Afs.4,000. company exemption and shareholders exemption, respectively.

arrangement, have been totally subject to the free market rates, quoted by the Bank of Afghanistan. This conversion into local currency, at depreciated official and free market rates, puts the taxpayers in higher income tax brackets.

It was not until 1965 that taxes on wages and salaries of local employees were withheld at source under the "withholding scheme".[3] In spite of the lack of familiarity with the withholding scheme, the number of tax payers more than doubled. On the other hand, as revenues from taxes on wages and salaries started to show signs of improvement, the introduction of a higher level of personal exemption manifested itself in a slight reduction of total revenue and the ratio of assessed tax/income,. The scheme is expected to save tax officers' time and result in an increase in tax revenues from other sources by improving administration and enforcement.

The decline in revenues from taxes on foreign employees[4], has been due to the elimination of certain arbitrary measures and practices of determining income and assessing taxes. Until 1965/66, taxable income had been determined and taxes assessed on the basis of a whole year's expected income, even though the period during which income was actually earned fell short of twelve months. In other words, the taxable year was considered to be a twelve month period, irrespective of whether a person worked for 4, 9 or 12 months. The sum of monthly pay multiplied by 12, less personal allowance constituted taxable income. The tax assessed/

---

3. Should an employer undertake to pay an employee a net tax free salary, the tax is added to the net earnings and a tax on the total amount is assessed. As far as foreign employees are concerned, the Inland Revenue Department still remains in charge of assessing their tax liability. This is mainly because of the foreign exchange component in their salaries, the calculation of which is reserved as a duty of the tax office. As such their taxes are normally collected at the end of the taxable year, and not on a monthly basis. This is unnecessary in the first place and, in the second place, inequitable and discriminating against local employees whose taxes are withheld on a monthly basis.

4. See Table 27, pages 218-219.

assessed on this total was then divided by the period (number of months and days) the employee was actually employed in order to appropriate his tax obligation. This practice, undoubtedly, raised the level of taxable income which was not actually attained during one's taxable year, and increased tax liability by placing the taxpayer in a higher income tax bracket. Moreover, as foreign employees received part or all of their remuneration in foreign exchange, the highest exchange rate prevailing during the taxable year, was applied to the total foreign exchange income, hence imposing an extra and unrealistic burden which could not be justified. The improvement of these two features, coupled with the level of personal exemption, have resulted in a reduction of tax revenues from this source. Such a tax imposed solely on an imaginary level of income, largely due to the shortcomings of the law and established practices was unjustified and its continuity as part of the law was contrary to the "vertical" aspect of equity.

Although on the average, tax liability for local salary and wage earners, during 1961-1966, amounted to almost 14 percent, and for foreign employees about 24 percent of their income[5], it will be inappropriate and misleading to pass any judgment regarding either formal tax incidence or equity consideration without analysing the tax liability of other functional groups.

For an evaluation of this question under the schedular income tax system, Table 28 presents the distribution of declared and imputed income by functional tax paying groups, their number and the amount of taxes paid, either on their income or on a lump sum basis between 1961-1967. As agricultural income is exempt from income taxes the table only includes such functional groups as wages and salary earners, earnings of individual businesses/

---

5. This includes only those who filed income tax returns. If the income of those who escaped or evaded taxes are also taken into account, this percentage drops to a lower figure. Taken as a percentage of total government payroll, which includes military payroll, this ratio falls to a minimum of 0.11 percent.

businesses, divided into domestic and foreign traders which in turn include non-company enterprises such as proprietorships and partnerships, companies including limited liability and joint-stock, and income from immovable properties, i.e. buildings. A last functional group known as "artisans" are separated as their income is entirely imputed and the lump sum payments are in lieu of income taxes.

According to Table 28, revenues from income taxes on salaries and wages have been less than proportionate to the income of this group. That is while the income of this group amounts to more than 16 percent of the total, tax revenue from this source is only 8 percent of total income taxes. The exclusion of foreign employees' taxable or gross income will further reduce this proportion. In addition to the deduction of personal allowances, this explains the general low level of income and the effectiveness of tax progression. The same applies to property owners and artisans. The only two groups whose income tax during the whole period has been more than proportionate to their income in the total, are the individual traders and shareholders. Here too, as in the case of foreign employees, looking into the composition of these taxes, a greater percentage of the total is paid by private foreign businesses[6], leaving the tax liability of their Afghan counterparts relatively low. This has been aggravated recently by the influx of new local businesses at the expense of sharing and splitting of capital among a larger number.

The results would have been more meaningful if the gross income was inclusive of various types of compensations and the application of an accepted general level of exemption would have better determined tax liability. This is unlikely, as in the case of wages and salaries, the real/

---

6. See Page 231 for further explanation on this point.

Table 28

AVERAGE GROSS INCOME AND TAXES
OF FUNCTIONAL GROUPS 1961 - 1966

Groups of Taxpayers	Number of Taxpayers[1]	Gross Income (In 000 Afs.)	Taxes (In 000 Afs.)	As Percentage of Total Income	As Percentage of Total Taxes
1. Salaries and Wages	5,137	215,305	23,509	16.5	8.8
Local	(4,404)	(112,045)	(2,182)	(8.6)	
Foreign	(733)	(103,260)	(21,327)	(7.9)	
2. Individual Businesses	4,010	428,033	97,504	32.9	36.5
Local	(3,821)	(305664)	(53,946)	(23.5)	(20.1)
Foreign	(189)	(122,369)	(43,557)	(9.4)	(16.4)
3. Shareholders	4,559	180,027*	(25,381)		
4. Companies (Joint-Stock & Limited)	197	405,999	(85,300)		
(3 + 4)	(4,559)	(405,999)	110,681	31.2	41.3
5. Property Owners[2]	1,734	63,831[3]	7,507	4.9	2.8
6. Artisans	69,206	189,199[4]	28,525	14.5	10.6
TOTAL	84,646	1,302,367	267,726	100%	100%

Source: Computed from Table 26 above.

1. This includes only those who filed income tax returns, with the exclusion of artisans, e.g. from a total of 138,000 employees, excluding armed forces, at the public sector in 1964, only 3564 filed returns and paid taxes. Even with the withholding feature introduced, this number raised 8,342 out of a total of 165,100

2. Under this item the amounts include an average of three years only.

3. Includes the depreciation allowance and property tax to the Municipality

4. Estimates based on an average rate of imputed earnings. The Income Tax Law does not cover all income earners.

* This is gross dividend distributions after company income tax. The whole or part of corporate income has been subject to a tax at two tiers, first at the company level and, second, as dividends to shareholders. Therefore it has been omitted from the total to avoid double counting. This is under the assumption that corporate income taxes are appropriated to shareholders.

real value of income received in-kind is not assessed. Prior to the imposition of the capital gains tax, some remunerations of executives in the form of "option stock" was taxable. Under the 1967 reform such forms of remunerations are not prohibited, but are taxable under the "averaging scheme" provided for under the taxation of capital gains. This is a type of savings which is tax exempt until realised. It provides an element of incentive for those senior employees or managers who may be allowed to build up savings in companies even if there is a watering down of capital stock. The adverse effect on the aspect of control and ownership may be remedied by giving the owners of these shares almost no right to vote, until the shares are converted into common shares of stock. (The aggregation of income for tax purposes leaves this practice an interesting feature of the income tax law). In the case of foreign traders, too, income is imputed in many instances, as any taxable profit below 7 percent of total turnover is not acceptable, page 92 . Both these features of the law make the job of comparing and assessing the total tax burden more difficult.

Although Table 28 indicates the relative tax liability of each functional group on the basis of gross income, it does not serve our purpose here, as total income is not always and in every case an acceptable measure of taxable capacity. The law provides for specific and necessary exemptions and deductions in accordance with the type of income. As pointed out earlier there are no general exemption - such as the widely accepted level of personal allowance - allowed for all taxpayers. Taxpayers within different groups fall under separate tax schedules and furthermore, enjoy different degrees of exemptions and deductions. Since the schedules and exemptions are different for each functional group, it is advisable to allow final comments, regarding tax liability, to after the different taxes are studied in relation to the taxable income.

Table /

Table 29 shows taxable income of the four groups and the income taxes paid during the period 1961-66. The deduction of personal allowances from salaries and wages has left tax revenues from this group still less than proportionate to their share of total income. Property owners' relative tax position, in relation to the proportion of their share of total taxable income has slightly increased due to a decrease in their share of total income. The decrease is not entirely due to the 20 percent page 199 , Note (40), deduction for maintenance and depreciation, but also to a further reduction of a sum paid as municipal taxes, page 112 , deductible from gross income for income tax purposes. The reason for the slight increase in the shares of the total taxable income for traders and other individual businesses as well as shareholders, viewed independent of company tax liability is mainly the low level of deductions allowed to these groups, pages 146,148 . In the case of artisans, no exemption or deduction is recognised as their income is only an estimate of net taxable income.

It is obvious that the structure of the different income tax schedules makes a distinction between income from various sources, and as such various degrees of taxes are imposed. This is evident between rates of Schedule (D) on salaries and wages and those for Schedules (B) and (C) on income from individuals businesses and dividends, pages 146 and 148 respectively. However, it may be inferred from Table 30 that the recipients of wages and salaries, who earned about 16.5 percent of total taxable income paid almost 22 percent of it in income taxes, while shareholders whose income constituted almost 14 percent of total taxable income paid 16 percent of it in taxes. On the other hand, considering the effects of the two tier tax on company source income, shareholders' ultimate tax liability rises to almost 36 percent of income, Table 30. This/

Table 29

AVERAGE TAXABLE INCOME AND TAXES
OF VARIOUS FUNCTIONAL GROUPS
1961 - 1966

Groups of Taxpayers	Taxable Income Amount (In 000 Afs.)		Taxable Income %age of Total		Taxes as %age of Total
1. Salaries and Wages		104,414		9.3	8.8
Local	(14,792)		(1.3)		
Foreigners	(89,622)		(8.0)		
2. Individual Businesses		395,337		35.2	36.5
Local	(273,728)		(24.3)		
Foreign	(121,609)		(10.9)		
3. Companies		396,149**		35.3	41.3
4. Shareholders	(159,081)***				
5. Property Owners (Buildings)		36,913		3.3	2.8
6. Artisans*		189,199		16.9	10.6
Total		1,122,012		100%	100%

Source: Computed from Table 26 above

* As income from this source is an estimate of net taxable income, no deduction or exemption is involved.

** This amount is inclusive of the amount of 180,027 gross dividends.

*** As this amount is included under item 3 above it is omitted from the total.

Table 30

INCOME TAXES AS A PERCENTAGE OF TAXABLE INCOME

1961 – 1966

Taxpayer Groups	Taxable Income (1)		Income Taxes (2)		2 as a percent of 1	
1. Salaries and Wages		104,414		23,509		22.5
2. Individual Businesses		395,337		97,504		24.6
(Local)	(273,728)		(53,946)		(19.7)	
(Foreign)	(121,609)		(43,557)		(35.8)	
3. Company and Shareholders		396,149		110,681*		27.9
- Company	(396,149)		(85,300)		(21)	
- Share: holders	(159,081) (159,081)		(25,381)		(16)	
4. Property Owners (Bldgs.etc.)		36,913		7,507		14.7
Total (xx)		932,813		239,201		25.9

Source: Computed from Table 26 above

* When the relative percentage of corporate income tax, i.e. Afs.38.3 million, attributable to the distributed profit, i.e. 45.4 percent of total and the percentage (12.0 of the amount Afs.38.3 millions) for the Afs.4000 exemption level, shareholders' total tax liability amounts to around Afs. 57 million. This puts shareholders' income tax liability as percentage of total taxable income to almost 36 percent as against 16 percent under the dividend tax alone.

(xx) Artisans who are not subject to income tax proper are omitted from this table. Nevertheless, their tax liability amounted to almost 15 percent of their imputed income. Similarly, assuming that land tax represents a levy on imputed net income from land, excluding animal husbandry, the tax amounts to less than 0.5% of such income, see pages107-112 , the lowest among all functional groups. This is objectionable on grounds of creating intersectoral inequity. The effective tax rate on business (trading) and industrial profit is higher than an income from buildings.

This is obvious on the premises of zero shifting of company income taxes implying a differential taxrate upon persons with the same total income. Even if we assume a fifty percent shifting, covering both short and long term expectations, the differential treatment still reduces the merits of the concessionary rates of Schedule (C) on dividends. Although the elimination of this two tier tax on company source income and the provision of tax credit on dividends for the tax withheld, under the 1966/67 Tax Reform are both expected to reduce ultimate tax liability, shareholders, whose total tax liability appears to be lower than the flat 20 percent tax withheld on dividends, will be discriminated against. This is particularly true as taxes in excess of final tax liability are credited only if taxes assessed on total income exceed the 20 percent, and the balance collected. The proportionality of the withholding tax rate, poor enforcement machinery and the discriminatory credit feature all favour large holdings. Furthermore, the 20 percent tax is borne by both small and large shareholders alike while undistributed profits are not realised or personified, which render the effect of the tax proportional in one respect and regressive in another. The small shareholder has no voice in the volume of undistributed profits especially in the corporate type of business organisation where its legal set up has tried to separate control and ownership from each other. The continuity of such a practice tends to undermine the vertical aspect of equity, and in the long run, lower tax morale and tax consciousness. The provision of a credit, if not a refund, will contribute a great deal to improving the situation.

Income from individual businesses, including partnerships and limited liability companies, both local and foreign, pay the second highest percentage of taxes among the different groups. A greater portion of this percentage comes from foreign businessmen. Their joint tax liability as a percentage of taxable income has been an average of 25 percent

jointly/

jointly, and individually 19.7 and 35.8 percent, respectively. This seems to be more than twice that of real estate owners and higher than almost all other tax paying groups. This is primarily due to the fact that the taxable income for the majority of this group is assessed as a percentage of gross receipts, or the turnover of their business in a taxable year. The greater the turnover, the higher the taxable income and therefore, more taxes. This arbitrary practice, is neither in line with nor justified by either the vertical or horizontal aspects of equity. A more appropriate system of income tax will have to take into consideration the level of actual profits from such activities. The accounting procedures followed by some sections of this group, namely commerce and industry, are varied, poor, and unreliable. The imposition of a high rate of tax on an imputed income is not at all the solution. Accounting systems and records-keeping have to be unified, improved and practised over a wider area. Another reason for such a relatively high ratio of tax among this sub-group is that foreign investment, unlike domestic capital has not had the opportunity to be split and divided among several individuals once it reaches a sizeable account. Licencing procedures and other administrative requirements on commercial operations, particularly in the foreign trade sector, have been relatively different for foreign traders than for locals[7]. A high and greater capital requirement put them under a higher tax liability.

One may cite a number of reasons for such a state of affairs, but the high degree of secrecy, associated with lack of confidence, are especially responsible for the lack of proper record keeping and initiative in this direction. This is particularly true of foreign trade operations characterised by short term turnovers aimed at high rates of profit. Local businesses in general are content to handle relatively smaller amounts of/

---

7. See Note (54) on page 276 for further reference on this point.

of capital for shorter periods of time mainly due to the minimum requirements of capital for record keeping, page 98 . The market limitation, is not a reason for the increase in the number of these individual businesses. The increase in the Country's volume of imports are reflections of the expansion in the size of the market.

The law penalizes the holder of licences who do not engage in any commercial operations allowed under the annual permit. Such holders of trading licences, required in the foreign trade sector, at times make use of this right to engage as commission agents for other traders who already maintain a higher volume of business. This enables traders to avoid higher taxes at the expense of some commission.

Furthermore, brokers and small traders engaged in internal trade between provinces who are not liable to maintain records, are exempt from this kind of income tax altogether. Their tax liability is determined in accordance with the different categories of artisans and craftsmen. This allows members of these groups to clear goods from custom houses, destined for other provinces, and conduct commercial activities on the domestic front on a commission basis. Consequently, this amounts to a reduction of total volume of business and lowers the tax liability for tax purposes of these traders. It will result in the entire loss of taxes on such commissions, received, as these payments are almost never revealed. Apart from the higher transport charges, this is one of the reasons for the general high level of prices, particularly the price differential between various provinces. It is desirable on these grounds that the permit or licence arrangements be withdrawn from the Afghan Commercial Code and operations in these fields should be based on a minimum capital requirement.

All these factors tend to show a reduction in the tax liability on the volume/

volume of business reported for tax purposes. It leaves foreign capital, however small, to bear a relatively higher rate of tax liability. As stated earlier some degree of progression is inevitable, and may be justified on economic and social grounds. But, too high a progression applied in any sector is likely to inhibit initiative. The arbitrary method of assessing a certain percentage of taxable income from the total turnover of a business, subject to the graduated personal income tax rates has worked out to collect in taxes between 3 and 5 percent of the turnover[8], on a value added basis, i.e. inclusive of the cost of goods sold plus all overhead charges incurred during the entire process of either production, accumulation or distribution. Where such overhead charges constitute a large share of total business operations the effective rate of tax liability is likely to rise. As the legal status of some representations of foreign commercial enterprises is not fully clarified, they, too, are treated as individuals under the same procedures. This method favours the business whose margin of net or taxable profit should exceed the seven percent requirement, and who discloses only a 7 percent net profit for tax purposes. It penalises the less profitable ones or those whose ratio of the volume of business to profits is high. This does not only seem to violate equity considerations among taxpayers, but it will undoubtedly, inhibit a larger inflow of foreign private capital, even if it is of a short term commercial nature.

It may be conceivable that the effective tax rate in this sector is still lower than the high marginal rates maintained and applied, not only in some of the economically advanced capital exporting countries[9], but even in/

---

8. Harley H. Hinrichs, "Certainty as Criterion: Taxation of Foreign Investment in Afghanistan.", 15 National Tax Journal, June, 1962, pp.139-154.

9. Even this argument is not tenable in practice for various reasons. Further reference may be made to C.V. Brown, and D.A. Dawson, "Personal Taxation, Incentives and Tax Reform", P.E.P. Broadsheet, 1969, Page 23.

in some developing capital importing economies as well[10]. The fact that domestic capital can and has, either implicitly or explicitly, been allowed to be split and divided among real and juridical entities, and/or transferred to other more profitable and safer investments such as real estate - land and buildings - enjoying tax evasion practices, discredits the validity of any argument regarding the general low level of taxation on foreign and domestic capital. Further, our purpose at this point is not so much the evaluation of the degree of progression of tax rates and their comparison on an international basis, but rather its evaluation among different taxpaying groups within the same country.

Although the above practices have, to some extent, resulted in a lower level of taxes among local traders, it is substantially higher than that on the income from land, both rural and urban, and buildings. It is not that the construction industry is less profitable than, for example, trading activities,. On the contrary, the growing demand for housing in towns and cities, its short supply, high level of prices especially for urban land and above all the inflationary spiral are adequate indications of a reliable and a relatively higher margin of profits in this industry. The lack of an adequate public housing project puts the construction industry in general, and the residential buildings in particular, in a privileged tax position. Unauthenticated contracts, with loose and variable terms, and the lack of information regarding the actual rent and earnings from this sector have made it easy, even for those real estate owners who voluntarily file returns, to conceal their full income from this source - not to mention the large number of owners whose rented properties are never registered and whose income never reported. For an individual merchant, whose activities are governed by licences and permits, the chances of a total escape from the annual tax liability are very small, despite evasion. The continuity of operation, whether in the

foreign/

10. See "Report of the Taxation Enquiry Committee", Government of India 1955, Vol.II, page 133 and Finance Bill, 1967, New Delhi, Ministry of Finance, 1967, pp.41-42.

foreign or domestic trade sector, is subject to the renewal of such permits. A licence or permit is renewable only when the holder attaches his receipt for the immediate year, or of an advance payment equal to at least, his tax liability settled for the previous year. There is no such arrangement to check the business activities of either the owners or dealers of buildings and real estate properties. The revenue authorities have had great difficulties with the assessment of the rent, and the assessment of a sum known among businesses as the "site or business value payment". This sum is traditionally made to the proprietor or the occupier of the property as a bid for renting or sub-letting such a property. Such a payment is usually associated with the renting or mortgaging of commercial real estate and buildings such as shops, "sarais" and markets. The payment of such an amount gives the tenant or any subsequent occupier who sub-leases, a right to stay in the place and carry his business for an unspecified period of time. The entire practice is conducted verbally and is based on mutual confidence. As a result, the amount of such payments are never disclosed. There is no legal provision pertaining to such payments. As the supply of property has proved, so far, short of demand especially in certain city districts and commercial centres, and as prices have risen, the owner and tenant both refrain from increasing the rent as demand and cost rise. Should such an increase be necessary it is again settled by a further Site Value Payment. As the tax liability of many small businesses is influenced by and based upon the rent of the place of their business, page 99 , the owner, by declaring smaller income, pays lower income taxes. The rent is nominal in many cases, and, as such, remains constant. Instead, the parties concerned negotiate on the level of this Site Value Payment. As a greater part of gross rent, inclusive of site value payment escapes taxes, the effective burden of the tax is largely borne by the occupier rather than the owner. This is the case under the seven percent taxable income, or the lump sum arrangements, where/

where no deduction of real expenses such as the rent and others are taken into account.

Attempts were made to register all rented properties in the City of Kabul, and then to determine a realistic range of rates, reflecting demand and supply, which will eventually eliminate the site value payments. But, due to the poor co-ordination of efforts between the municipality and the Treasury, poor tax enforcement and collection procedures and lack of tax moral and compliance on the part of the taxpayers, the results of these efforts have not yet been satisfactory. Only 2194 persons out of a total of 12,756 rented residential properties in 1966/67 in Kabul, paid income taxes on rental income. This shows the inefficiency of the administration in enforcing and collecting income and municipal taxes.

Column 3, Table 30, reveals that, on the average, the majority of income taxpayers, within almost all functional groups, falls below the maximum 30 percent rate set up for income from wages and salaries and for dividends. Here again, the exceptional case is that of the individual traders particularly foreign subjects, whose average individual tax liability equals to almost 36 percent of taxable income. Foreign traders and businessmen appear to be the only sub-functional group whose income tax liability exceeds that of any income tax paying group in the Country. Factors outlined above are mainly held responsible for such a development.

A considerable portion of taxes on commercial and industrial activities will, eventually and inevitably, be passed over (shifted) to consumers and/or to producers both at home and abroad. The majority of individuals and firms operating in the commercial sector is engaged in foreign trade, i.e. Export-import operations. The export sector has, for a long time, depended on items such as Karakul fur skin, cotton, wool, and carpets, the/

the production and distribution of which are primarily export oriented. The import sector on the other hand, covers a large variety of articles ranging from consumer, food and non-food items, to industrial raw material and capital goods. As such, prices of both exports and imports seem to be largely affected by forces in the world market. Under growing international competition, the Afghan exporter has gradually lost his bargaining position, held for some years owing to the so called monopoly power over certain items. This untested hypothesis of monopoly power has, as analysed above, page 17, influenced measures of monetary and fiscal policy of Afghanistan since 1947 when the government initiated heavy export taxes on the foreign exchange earnings of Karakul, followed by cotton and wool.[11] Karakul prices, since 1939, have fallen down, both in relative and absolute terms. The prices of foreign goods, on the other hand, where Karakul and other export items are marketed have gone up by an average of 300 percent in terms of Afghan currency.[12] This means that the true value of the skin is only one-fourth of what it was. The price per piece of Karakul, for example, has declined from an average of U.S.$17.00 in early post-war years to almost U.S.$8.00 in the early sixties.[13] As a result, much of the burden of any tax imposed on the item, even directly in the form of export taxes, must be borne by some group on the Afghan side, in spite of the fact that Karakul is a luxury item with a more income elastic type of demand, than a staple item characterised by less elasticity of demand. In 1951-52 Afghanistan had a large share of Karakul markets in New York, and London, supplying/

---

11. In addition to shifting part of the tax on to the foreign consumer, owing to the so called monopolistic power, the measure would also (a) serve as a reliable source of public revenue, (b) improve the worsening situation of the balance of payments, and (c) achieve a change in the distribution of income through taxing exporters and subsidising imports and beneficiaries of public projects. It is obvious that these objectives may have been partially fulfilled, however, it has been at the expense of the most successful groups and in favour of the big landlords with greater potentialities of output who benefit from favourable terms of trade while contributing almost nothing to public revenues and escape the burden of social cost.

12. American Universities Field Staff Report Service, South Asia Series, New York, 1965.

13. In 1968 this amount dropped to an average of U.S.6.00/skin. Proceedings of IMF Annual Meeting 1968, Washington, 1969.

supplying around 80 percent of the skins, against 15 percent from South Africa and 5 percent from the Soviet Union. In 1965, South Africa supplied 54 percent, Afghanistan 34 percent, and the Soviet Union 12 percent.[14] The bargaining power, if any, of the Afghan exporter has become weaker. The popularity of mutated mink seems to have further hurt Karakul sales. The lack of adequate care in the raising and breeding of the livestock, the quality of the final output and above all the adoption of export taxes, and multiple exchange rates are to be largely blamed for Afghanistan's loss of foreign exchange earnings from this source.

It may be noted that the price payable to the producers of these items is quoted by the government which is normally lower than the effective price in the market. On the other hand, since quite a number of these producers such as farmers and livestock owners are often tied through loans and advances received from the local moneylenders, middlemen, and local exporters or that they lack adequate means of communication to reach suitable markets and obtain better prices for their output, price quotations as an indicator of minimum payment lose their significance. It becomes inevitable that in addition to the export tax imposed on the item, part of the total tax obligation of the exporter-importer may also be shifted to these producers in the form of lower prices,. It remains doubtful whether a "Marketing Board", as experienced elsewhere, will help the situation. It might only guarantee a fixed minimum payment to producers. The inelasticity of supply, mainly subject to natural hazards, and the fluctuation in the level of prices have manifested themselves in a gradual reduction of exports. As a result, possibilities of export diversification have been sought. Producers have found themselves forced into the production of other items, with relatively better prices subject to less or no export and/or foreign exchange taxes, page 17. The Afghan foreign trade figures for the past few years clearly depicts the growth of this situation, page 27. It was not so/

---

14. American Universities Field Staff Reports, Service, Ibid.

so much diversification of exports, or concern over balance of payments difficulties or the distribution of income that the fiscal and monetary measures were directly aiming at. It was primarily the need for more revenues that motivated the monetary and fiscal actions. The continuity of these taxes and the foreign exchange surrender requirements after 1962/63 were in an attempt to capture part of the benefits arising from the devaluation in that year. However, this has continued without having taken into account the effects of successive overall inflationary pressure. The effect on the allocation of resources has been inevitable. It is, therefore, understandable that, as a consequence, these measures have brought about a degree of diversification of exports, reduced fluctuations in earning and helped the economy not to rely entirely on a couple of items. It need not have been at the expense of this main source of foreign exchange. Whether the diversification of exports, which is expected to enhance development, will compensate for the reduction of foreign exchange earnings, resulting from the decline of the Karakul industry, is difficult to determine. However, balance of payments figures show a development contrary to such expectation, page28 . The overall foreign exchange increase in the export sector is not yet substantial enough to help solve the growing balance of payments difficulties.

On the domestic front, owing to market imperfections and lack of price competition, among sellers, the shifting of part of the tax, either import duties or income taxes, in the form of higher prices to consumers cannot be ruled out.

Although the foregoing analyses in this and the preceding chapter reflect only the effects of the Schedular Income Tax System, deliberately designed to favour one type of income as against another, the inadequate interpretation of the concept of income, arbitrary methods of determining income/

income, preferential exemptions, and above all administrative inefficiency, all have weakened equity considerations under the tax system.

The 1967 Income Tax Reform, intended to remove some of these anomalies by expanding the concept of income and taxing it on a global basis under a single rate structure. This is expected to introduce an element of equity in tax treatment by eliminating the differential incidence of the schedular system. However, both legislative and administrative shortcomings of the Reform are likely to introduce new inequities. The concept of income still remains very limited. The law exempts income from the largest sector of the economy and its administration leaves income from professional occupations untouched. The inequities in this respect may outweight some of the benefits such as the withholding of taxes on wages and salaries. No major steps have been taken to improve the taxation of individual commercial and trading enterprises.

CHAPTER SEVEN

ECONOMIC EFFICIENCY OF THE AFGHAN INCOME TAX SYSTEM

Economic Efficiency of the Afghan Income Tax System.

A. Income Tax and the Incentive to work

1. Agricultural Workers
2. Industrial Labourers
3. Professional Workers

B. The Effects of Income Taxes on the Incentive to Save and Invest.

1. Discretionary Concessions.
   - (a) Exemption from Custom Duties on Exports and Imports.
   - (b) Income Tax Holiday for "Approved" Industrial Enterprises
   - (c) Income Tax Relief on Dividends Distributed out of Tax Exempt Profits and on Interest Income.
   - (d) Repatriation of Foreign Capital and Profits.

2. Concessions offered under the Income Tax Law.
   - (a) - Concessions to Individuals
     - i - Exemption of Interest on Government Bonds.
     - ii - Exemption of Interest Income from Deposit Accounts with Afghan Banks.
     - iii - Abolition of the Two Tier Tax on the Distribution of Company Source Income.
   - (b) - Concessions to Companies.
     - i - Tax Rates
     - ii - Depreciation and other relevant Allowances.
     - iii - Loss Offset Provision.

The role of taxation in promoting economic efficiency and achieving growth objectives may be best examined under the functions of the Allocation Branch of budgetary policy. Under situations where the imperfections of market mechanism prevent an optimal allocation of resources, adjustments are often made through budgetary parameters in order to secure such a result[1]. In the context of planned economic growth, any such adjustments required will have to aim at achieving the specific objectives envisaged. Taxation appears as one of the effective policy instruments employed in this respect. This implies a departure from the 'neutrality' aspect[2] which would otherwise govern the operation of a tax system. The tax system in this respect while serving the stabilisation and distribution objectives of budgetary policy, is primarily concerned with the mobilisation of adequate resources for capital formation in the public and private sectors. The adequacy of taxes in mobilising resources for the public sector was covered in the earlier chapters of this paper. The enquiry here will be mostly confined to the role of income taxes in the mobilisation of resources for growth in the private sector.

It must be noted, however, that the fulfilment of such a task, in our particular case, is liable to run the risk of encountering difficulties not only due to the relative importance of this single policy instrument in the Afghan economy, but also where and when the accomplishment of such a task appears to conflict with, rather than complement other objectives of budgetary policy. Furthermore, in a dynamic situation where a variety of factors are operating simultaneously, the net effect of a single policy instrument, however strong, may be somewhat difficult to assess. Nevertheless, the numerous features characterising income taxes tend to render such taxes, together with other relevant measures, one of the most important and/

---

1. R. Musgrave, Op.Cit., pp.6-17

2. J.F. Due, "Government Finance", revised edition, Homewood III, 1959, p.118.

and appropriate instruments of budgetary policy. This Chapter, therefore, attempts to evaluate the impact of income taxes, and certain other relevant measures, on the various aspects of economic activities, namely, the incentives to work, save and invest. The income tax will cover both the 1958 tax law and the succeeding Reform of 1967.

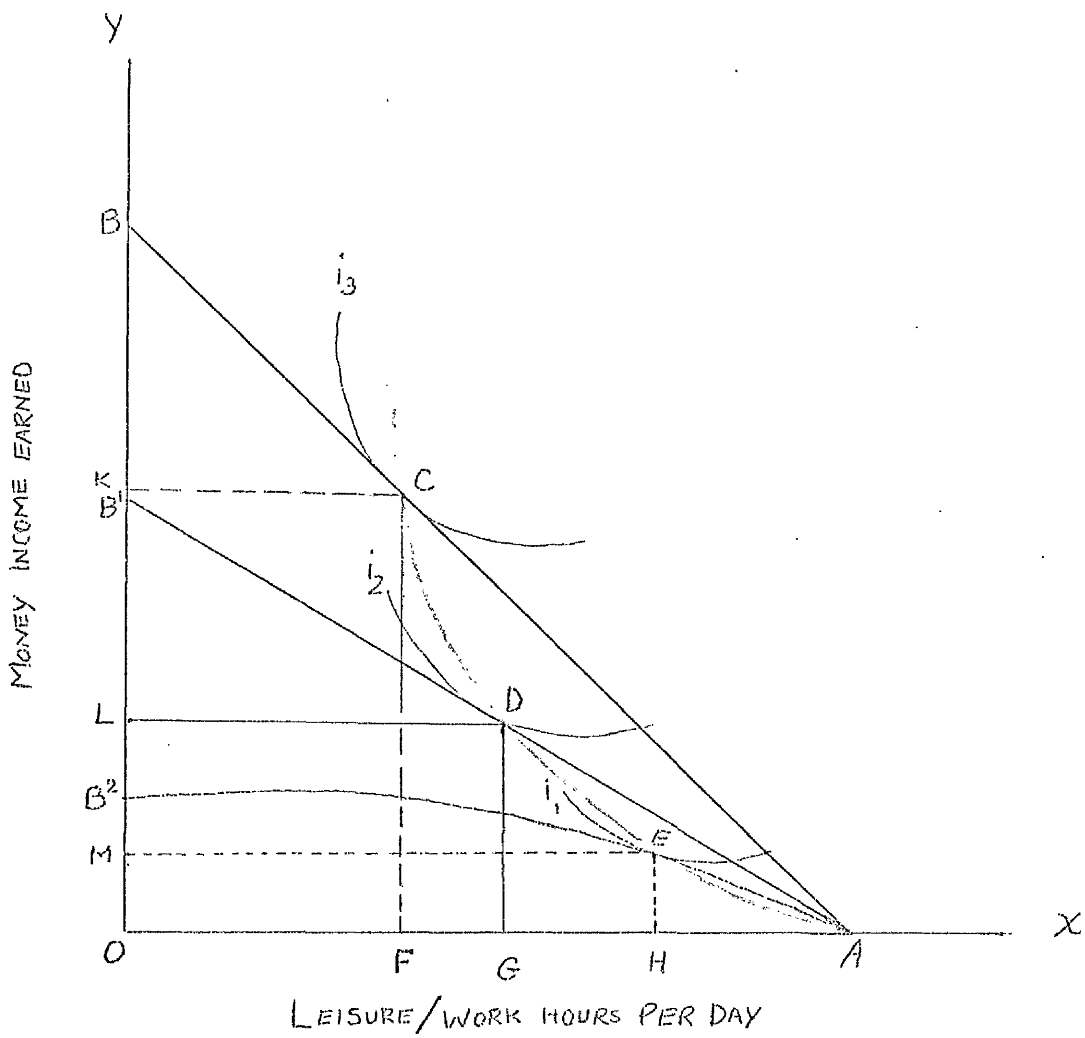
A. Income Tax and the Incentive to Work:

Income taxes, like other instruments of budgetary policy tend to alter the allocation of resources available in the economy by affecting their supply and demand schedules. Examining the effect on work effort, it is generally asserted that income taxes are likely to alter the total supply of labour, as well as the supply of specific employments. It is believed that as income taxes reduce income they will induce people to reduce work effort and spend more time enjoying leisure as it is not taxed. Therefore, the higher the tax rate the lower the reward for work efforts (labour). This results in more time being taken in leisure as leisure becomes "cheap" in relation to work, diagram (a), page 243 . This is generally referred to as the "substitution effect" of the tax. The heavier the tax, i.e. more progressive in the case of an income tax, the stronger the disincentive effects will be on work. However, where maintaining or raising the "customary" level of income, either in real or in money terms is significant to the recipient, efforts will be made to either avoid much of the excess burden of the tax by affecting the supply schedule, to increase efforts by working harder and/or more hours[3], or to shift to a more tax favoured occupation. This behaviour reflects what is called the "income effect" of taxation. The taxpayer tries to achieve the highest level of satisfaction, between these "effects" through the various indifference curves thus revealing the "trade curve" through different points of income (work) leisure combination. The net effect of a tax change, therefore, depends on the following factors:

(a) /

3. This is meant to imply labour inputs as both a function of the length of time on the job - provided one is free to alter the volume of total work hours concerned - and under piecemeal job the intensity of efforts per unit of time, both of which are apt to raise the workers' gross, as well as, net earnings.

diagram(a)



AB is the wage line without any tax being imposed. The imposition of a tax swings the net wage line to AB^1 ot AB^2 down towards OA, the leisure/work endowment axis,. It will establish the equilibrium at the points D and E. Since progressive income tax has a higher marginal rate than a proportional tax and as such leaves a lower net wage rate, the wage line becomes more flat in this case as it may be observed with AB^2. As the diagram assumes a declining marginal utilities of income and leisure the locus of points at which the indifference curves, i_1, i_2, and i_3 are tangent to the price lines forms the supply curve of labour on the trading curve representing different combinations of income, work effort and leisure. With the wage line AB, OK income and OF leisure is secured and BK income is traded with OF. With price line AB^1, OL income and CG leisure is obtained. With OM net income, leisure reaches OH and work effort is reduced to AH. The more flat, in this situation, the wage line the less work effort is attempted and almost the entire period or time is taken in leisure.

(a) The definition of the concept of income, the coverage of the tax base and the magnitude of variations in tax rates. A tax system based on a wider concept of income having a wider coverage, and characterised by high marginal and low average or effective rates, tends to have a stronger substitution effect, adverse to work efforts.

(b) The shiftability of the tax and the supply schedules of various types (skilled and unskilled) of labour. Total labour supply, in turn is further affected by certain socio-economic factors, such as the birth rate, standard of education, changes among different sectors, and the composition of various factors of production within each sector and industry.

(c) The possibility of increasing or decreasing working hours and the contractual obligations between employers and employees and their representatives, if any.

(d) A fourth factor affecting work efforts is the mobility of labour between jobs and occupations and between different sectors of the economy. This, in turn, depends on the state of the economy and the availability of the various types of labour in demand.

(e) The net effect of the various branches, i.e. distribution, stabilisation and allocation, of public policy. The effect of certain direct and indirect benefits, eminent from budgetary operations, may be of considerable importance in this respect.

(f) Non-monetary or psychic benefits and satisfaction arising from prestige, social status, power, challenge of work as against boredom from unemployment etc., are all strong factors motivating work efforts.

Empirical studies regarding these effects of income taxes on the work effort of different taxpaying groups have been attempted by several writers. The conclusion derived from the majority of these cases is that, on the whole, income taxes have had very little effects, if any, on work efforts of/

of the different groups of taxpayers.[4] Although economic theory may be unable to provide an answer to the ultimate and definite effect of income taxes on work efforts, it may be possible to examine the effects of certain factors, such as the supply schedule of labour, the consumption pattern and the like, on the behaviour of an individual's work efforts. The attempt is made to examine the effects of some of these factors under the Afghan Income Tax System.

As the income tax is not of a general nature, i.e. covering all sectors, the effects and repercussions of the above factors, in terms of work effort, will therefore be different on the various working groups in the economy. It is appropriate to put the working population under three main groupings, in order of importance: agricultural workers, industrial workers and Professionals, including civil servants, specialists and other self-employed professionsls in different occupations.

1. Agricultural Workers:

They constitute almost three-quarters of the four million manpower[5] in total, and include tenants and seasonal farm workers who may be engaged in farming activities throughout the year. The 75 percent of GNP coming from/

4. For a review of these surveys, reference may be made particularly to: A. Chatterjee and J. Robinson, "Effects of Personal Income Tax on Work Effort: A Sample Survey", Canadian Tax Journal, 1969, pp.211-220; G.F. Break, "Income Tax Rates and Incentives to Work and Invest", in Public Finance and Fiscal Policy, edited by J. Scherer and J.A. Papke, Boston, 1966; J.F. Due "Government Finance; Economics of the Public Sector", Fourth Edition, 1968; L. Buck and S. Shimmia, "Is Taxation a Deterrent?" Westminister Bank Review, 1959, p.18, and Government of the United Kingdom, Royal Report on Taxation ... Cmd.9105, London, 1954, Appendix, Para.7. A brief survey of some of these and other studies on this issue appears in C.V. Brown and D.A. Dawson "Personal Taxation, Incentives and Tax Reform" P.E.P. Broadsheet 506 January, 1969, pp.52-68.

5. The 2.5 million nomadic population is not included in this sum. The total of male and female, of working age, in 1966/67 was estimated at 3.6 million. The balance between this and the total manpower of 4.0 million constitutes the elderly and children of 10-14 years of age not included in the manpower estimation. Ministry of Planning, Third Five Year Plan, 1967/68

from agriculture gives an average per capita income of much below the Afs.35,000 personal allowance, accepted under the income tax law, assuming no income is accruing due to value added to those in the intermediate levels of output. The land tenure system leaves the distribution of income and wealth uneven. On the other hand, income from agricultural pursuits, accruing either to landlords, full-time tenants, or seasonal workers such as nomads and the like, is exempt from income taxes irrespective of its increase alongside national income over the past half a century. Therefore, under the present circumstances, neither the income effect nor the substitution effect of income tax has any direct relevance or impact on this sector. Even when seasonal employment outside the agricultural sector is sought, in order to supplement the income from land, the income tax law and its rate structure, as noticed earlier, will virtually have no effect on the supply of such efforts. First, owing to a relatively high level of personal exemption, income at low levels is not taxable. Second, most agricultural workers seek employment as manual labourers or engage in occupations without a fixed place of business; income does not become taxable even though it may exceed the personal exemption level. Occupations such as these vary from daily manual work to semi-skilled labour, such as masonry, brick-laying, and the like. Should they seek employment under the 50 categories of artisans, except for the relatively low tax liability the marginal rate of tax is zero.

2. Industrial Labour:

Workers in the industrial sector generally fall under the two categories of semi-skilled and unskilled labour. Their number reached a total of 73,923[6] /

---

6. Survey of Progress, 1968, pp.42-43. Of this total, more than 50 percent were employed in the construction of development projects where the pattern of remuneration does not exactly follow that pertaining to the industrial workers. A great majority of workers on these projects have come from the "Labour Corps" of the National Defence Forces.

73,923 in 1967, employed in industrial and construction projects both in the public and private sectors. This includes those employed in public utilities, transportation and public development projects. No attempt has been made to group their earnings according to the particular type of skill. On the other hand, the difference in earnings between skills, however large it may be, does not exceed the Afs.35,000 personal allowance limit. Most of them will be entitled to this total allowance, due to having large families[7]. The average rate, although rising, has amounted to only Afs.13,335 per worker per annum, Table 32. This excludes the industrial workers from the income tax base and, as such, neither the "income" nor the "substitution" effect of the tax will have any relevance.

3. Professional Workers:

The only group of workers whose work effort may be affected by changes in the tax level are those professional groups, such as civil servants and salaried individuals in the public and private sectors, who are already in the income tax base or near to it. Owing to the high level of personal allowance and to very low initial rates, income tax, as such, applies to a small number in the higher income brackets, where work motivation is not the function of one factor, i.e. taxes, alone. Nevertheless, it is believed that the rate structure of an income tax on wages and salaries and income from capital considerably affects an individual's behaviour and work effort. Therefore, an income tax with sharp and high marginal rates is/

7. A recent study on population growth indicates the high rate of population increase for most of the rural areas to be in the order of 2.3 percent as against the national average of 1.75 percent, "Population and Manpower Resources in Afghanistan", Ministry of Planning, 1967.

Table 31.

INDUSTRIAL EMPLOYMENT

1962 - 1967

Industry	1962	1963	1964	1965	1966	1967
Coal mining	1,358	1,067	1,133	1,324	1,433	1,582
Mining of Non-metallic Mineral	254	349	291	296	326	469
Food Production Processing	1,459	1,488	2,115	2,337	2,421	5,230
Taxtile and Cotton Cleaning	9,483	11,201	11,095	11,909	12,511	12,271
Mobile Manufacturing and Carpentry	785	803	675	572	611	616
Printing and Publications	1,130	1,193	1,007	958	1,012	1,092
Briquetting	88	99	90	107	97	89
Buildings and Construction Materials	1,662	1,781	1,954	1,941	1,973	1,761
Car Repair, Transport Equipment and Metal Work	1,328	1,399	1,399	1,430	1,581	1,592
Generation of Electricity	442	461	477	480	695	1,044
Other Industries	170	252	262	270	311	579

Source: Compiled from the Production Tables, Ministry of Mines and Industry, 1968, Kabul.

Employment in Industry is expected to increase by 66 percent over the coming five years. However, the rate of increase in the past has not been satisfactory. Only in 1967 the rate was relatively high. Even then, it was only a ten percent rise over the previous year. Accepting a modest rate of 2 percent growth in population this will give a rise of more than 300,000 per year. It will obviously increase the pressure of absorbing part of this rise outside agriculture at a more rapid pace than what has been in the past or estimated for the future.

Table 32

AVERAGE ANNUAL WAGE OF THE INDUSTRIAL WORKER
1962 - 67 (In Afghanis)

	1962	1963	1964	1965	1966	1967
Coal mining	—	7,500	8,356	10,109	11,720	10,693
Mining of non-metallic minerals	8,800	8,140	7,324	7,530	9,160	7,787
Food production processing	10,500	8,700	8,460	8,159	7,351	N.A.
Taxtile and cotton cleaning	8,870	9,530	8,729	12,045	13,385	13,188
Mobile Manufacturing and Carpentry	10,800	11,100	11,323	16,994	13,103	17,609
Printing and Publication	9,900	11,450	13,278	13,894	16,180	15,842
Briquetting	6,830	6,120	6,890	7,243	7,474	9,584
Building Construction Materials	9,390	10,150	11,498	14,281	13,901	14,584
Car Repair, transport equipment and metal work	10,680	12,050	12,756	17,620	15,598	16,094
Generation of electricity	11,470	12,500	14,277	15,562	13,185	13,529
Other industries	N.A.	8,250	13,413	20,698	19,000	10,756
Industry wise average annual wage	9,035	9,800	9,669	12,348	12,973	13,335

Source: Compiled from the Tables on Industrial Cost, Ministry of Mines and Industry, 1968. Kabul.

Note:

One of the reasons for the decline in the average annual wage in certain occupations indicates that the number of workers has increased but the rise in wages has not been proportional and as a result, the average rate is reduced, Table 31.

is bound to have a stronger substitution effect, adverse to work effort, particularly at higher levels of income.[8] On the other hand, the discontinuities, conceivable in the context of an underdeveloped economy, such as Afghanistan's will render the possibility of a substitution effect adverse to work effort more difficult. Nevertheless, it is agreed that the disincentive effect on work effort tends to be less when the average rate is either reduced or left unchanged.[9] This involves the stretching of the tax schedule into more and smaller income brackets, and a possible minimum rise of the rates between these brackets, both acting to keep the progression from becoming too steep.

The introduction, under the 1967 Income Tax Reform, of lower marginal rates and relatively higher average rates at higher levels of income, where the range of choice between work and leisure is presumably higher than what it is expected to be at lower or middle income groups[10] has been taken into account. Since income from all sources is aggregated, the rise in the average rates has been prevented from being too steep by providing an extended rate schedule, with a greater number of income brackets. The rise in the income tax rates between the different brackets is no more than two percent above the preceding one. This shows a considerable improvement compared to the pre-1967 complicated schedular system. An awareness and knowledge of this feature of tax rates might further help decision taking and motivate work/

---

8. The results of empirical studies on this question show contrary to such a notion; however, it was suggested, to partly hamper inter-business movements of top executives. T.H. Sanders, "The Effects of Taxation on Executives", Harvard University, Bureau of Business Research, Boston, 1951,.

9. R.A. Musgrave, Op.Cit., pp.242-243

10. R.A. Musgrave, Op.Cit., p.243.

work efforts[11] particularly when taxes on certain sections of this group are withheld at source.

As for self-employed taxpayers, they are made up, as noticed above, of more than 50 different groups of artisans who pay taxes according to the rental value of the place of occupation or business, or a lump sum amount based on a number of factors. They have a zero marginal tax rate. The increase in the tax revenue from this source may be attributed to the establishment of servicing occupations, and more and larger individual businesses. Pharmacies, increased by almost 65 percent, from 164 to a figure of 251 between 1962 and 1968 and beauty salons rose from virtually none to more than 35 during 1966-1968.[12] It must be noticed that since most of these fifty different categories deal in the supply of the basic necessities, it is not unlikely that a considerable amount of this rise in tax revenue would be passed on, backward to the supplier of primary produce, and forward to the consumers. On the other hand, self-employed professionals such as physicians, architects, engineers and the like, page 100, owing to administrative inability and lack of taxpayer co-operation are not yet brought under the coverage of the income tax base. As a result, it is difficult to pass judgment on the effects of income tax on the work effort of this group. However, owing to the growing demand for these specialised services[13], the bearing by the government of the total cost of education involved/

---

11. A recent study conducted by the University of Glasgow on the effects of the tax rate on incentives to work shows that only 3 percent of the 179 workers and 45 percent of the 53 managers interviewed knew their standard tax rates, while none of the workers and only 6 percent of the managers gave their true marginal tax rates, and 23 percent of the managers gave roughly correct rates. Both these results suggest that the introduction of a percentage scale accompanied by frequent publicity may help the situation. See C.V. Brown "Misconceptions about Income Tax and Incentives", Scottish Journal of Political Economy, Vol.XV., February, 1968, pp.1-21. Also see Foreign Tax Policies, Op.cit. pp. 397-473.

12. Ministry of Planning, Survey of Progress, 1968, p.S.25

13. e.g. the number of physicians reached an all time level of about 500 in 1967 for a population of over 15 million. Survey of Progress, Ibid. p.S.25.

involved in most of these services[14], and a variety of other factors mentioned above, it is unlikely that the imposition of an income tax on these specialised groups however progressive in rates, will have a substitution effect adverse to work efforts.

B. The Effects of Income Taxes on the Incentive to Save and Invest:

In order to achieve a certain rate of growth a society ought to save and invest a certain portion of the national income enjoyed by both the public and private sectors. The greater this share appropriated for this purpose, the higher the effects on output and growth of national income. Both public and private sectors, will have to divert larger amounts of resources from consumption to savings and investment in order to achieve this objective. On the other hand, the level of savings is affected by and is a function of the level of real income. The higher the level of relative income the greater the proportion of that income expected to be saved, both voluntarily - as the marginal propensity to save usually rises with increases in the level of income and wealth, and through taxation - as the ability to pay of individuals equally increases with the rise in income. Since the propensity to consume in most of the less developed countries is understandably high, [15] taxes are expected to create forced savings by transferring resources from consumption to savings and investment, with the assumption that a greater propensity to save and invest exists at the public sector level.

All taxes in general, and progressive income taxes in particular, reduce the level of residual income and its allocation between savings and consumption, both for the present and the future. The wider the coverage and the sharper the degree of progression, the stronger is the substitution effect/

---

14. "It is the duty of the Government to provide education free of charge by the State and citizens of Afghanistan ...." Constitution of Afghanistan, Article 34, Kabul, 1964. See also Section (d), Art.18 Income Tax Law, page 197 above.

15. J.S. Duesenberry, "Income, Savings and the Theory of Consumer behaviour," Harvard University Press, 1949. page 25-46

effect, adverse to save[16] and invest. Income taxes in this respect are alleged to (a) leave income in the lower level, with high marginal propensities to consume, virtually untouched and (b) reduce savings as the higher tax rates impinge on higher incomes where the marginal propensity to save is expectedly high. The insurmountable difficulties concerning the application of an income tax as a "mass tax", particularly in the context of a less developed economy, are widely appreciated. It is highly impracticable to advocate the existence of such a tax in the early stages of economic growth, except in those individual and specific areas where its introduction proves effective. The effect on savings, on the other hand, must be evaluated first in terms of aggregate savings in the economy and second, in terms of real and nominal. Where the proceeds from such a tax is utilised in the process of capital formation, the level of aggregate savings is not altered under the assumption that the amount taken in tax would have been totally invested in the same manner. Only a resource transfer which carries with it a change in the process of decision making by a separate institution (in this respect the government or other authorised body) has taken place. This is of crucial importance, particularly where the concept of private and social profitability, coming into the picture, will influence the choice of investment opportunities. Furthermore, a distinction must also be made between real and nominal savings. Savings and investments that command the factors of production aiming at increased productivity and higher rate of growth must be differentiated from the accumulation of currency or property which fail to achieve the above objectives. Although the major role of determining the pace of economic growth, in many less developed countries is assigned at an increasing rate since the early post-war years to the government, appropriate measures have been designed for the private sector, which constitutes/

---

16. R. Musgrave, Op.Cit., pp.257-268.

constitutes a larger sector of the economy, to effectively raise the aggregate level of real savings and increase total volume of capital formation. While an increasing share of resources is being transferred to the public sector through various fiscal and monetary measures, emphasis has also been placed on raising that portion of the individual's income which is voluntarily saved. By affecting the proportion of income allocated between savings and consumption at the private level, these measures would induce individuals to postpone present consumption for accumulation and future consumption at a larger future income. Such economic motives have compelled tax policy, as an effective instrument, to deviate where necessary from the "neutrality" concept and concentrate on narrowing the saving and investment gap between the private and the public sectors aiming at achieving a higher rate of growth. Tax reforms[17] have been advocated to accord a favourable treatment to saving and investment, while penalizing consumption. In the area of income taxation the private sector is encouraged to undertake a larger share of the investment programme. There are a host of factors, including taxes, which affect and influence individuals' pattern of behaviour between savings, investment and consumption. Although the present and future levels of taxation may be one of these factors, equally important are the level of prices, the extent of tax incidence, interest rates, the level of government expenditures as well as the highly controversial issue of the slope of the utility indifference curve regarding consumption and savings. For example, a temporary tax imposed on present consumption may have, in the event of an interest rate and assuming other factors remain constant, a substitution effect favourable to future consumption and accumulation.[18]

The/

---

17. N. Kaldor, "Indian Tax Reform: Report of a Survey", New Delhi, 1956.

18. This is so because the tax rate raises the effective rate of interest from (i) to $(i + t)/(1 - t)$, or, $(1 + i)Y/(1 - t)Y$, where (t) and (Y) are the tax rate and income respectively. Reference may be made to R.A. Musgrave, Op.Cit. pp.263-268

The higher the level of interest rate and the more progressive the rate of tax, the greater is the substitution effect of the tax in favour of savings and accumulation, assuming no tax on future interest income and no change in the slope of the utility indifference curve. However, for a target saver, his level of savings may be inversely, rather than directly, related to variations in the level of interest rates. On the other hand, a high tax on interest or saving - such as a capital or a wealth tax - may discriminate in favour of present and against future consumption and accumulation. It reduces the net after tax rate of return. The substitution effect appears to be adverse to saving, assuming no change in the level of interest rates. This is one of the reasons why an inflationary trend acts as a tax on the value of future earnings and principal, thus reducing the incentive to save in areas where the rate of return is adversely affected by such a trend. The point in view may be made clear when savings and investments are seen in real terms such as in productive ventures and in nominal terms, as in real property. A tax system, such as Afghanistan's, which by taxing income and/or Profits creates differentials in net earnings against the former and in favour of the latter type of savings is apt to affect the direction of savings and capital into the tax favoured areas, i.e. real properties, where the net financial rate of return is higher. The inflationary pressure (change in prices affecting the choice of holding savings in cash or real assets) by conferring further untaxed financial benefits to the tax favoured area, encourages savings for future consumption[19], rather than accumulation. Where income in the form of rent and capital gains from such savings for future consumption remains not only untaxed but difficult to assess, the change in the flow of savings towards this safe and tax favoured/

19. The holding of savings in real property generally termed as "conspicuous consumption" is assumed to be for purposes of future consumption and not investment and accumulation. See R.A. Musgrave, Op.Cit. P.266

favoured area becomes more imminent. The problem is accentuated particularly when the degree of risk involved and the amount of loss[20] as against yield from investments and accumulations are not fully considered by the tax system. Theoretically, one would argue that the "income effect" of such a tax on risk investments will, under the assumption of a rising marginal utility of income as income falls,[21] induces more investment and risk taking as such investments are expected to have higher yield. However, where higher income tax rates are apt to still hit this income (not/under a proportional tax) and affect the net after tax rate of return, the differential tax treatment still remains unfavourable to high risk taking. In addition, where investment behaviour is further influenced by the existence of various other factors such as market prospects, degree of uncertainty, supply of investment funds and efforts the "substitution effect" in this respect, is likely to shift savings in the direction of safer and more profitable areas. This remains valid irrespective of the fact that one might assume the discontinuities existing under such a situation might not make the "substitution effect" in favour of future consumption and adverse to investment and accumulation possible. Therefore, tax concessions likely to increase the net rate of return on risk investments, either through an indirect effect on the level of interest rates or the level of effective return, are given adequate consideration. This is specially needed (a) where the bulk of saving generally goes into the traditional areas such as urban and rural land, residential and commercial buildings and other properties, trading activities, characterised by a relatively high and secure rate of return and a quick turnover of capital involved. Since the use of capital and labour in industry as/

20. See E. D. Domar, and R.A. Musgrave, "Proportional Income Taxation and Risk Taking", Quarterly Journal of Economics, Vol.LVIII, May, 1944.

21. Paul Streeter, "The Effect of Taxation on risk-taking", Oxford Economic Papers, Vol.5., pp.271-287, October, 1953.

industry as against the traditional areas, i.e. speculative ventures and conspicuous consumption, is more productive, by offering these concessions it is intended to switch investment into industry, (b) the undeveloped nature of the capital market is incapable of providing adequate funds for risk undertakings, (c) Even where such a market develops the forces of price mechanism under certain conditions prevent securing an optimal allocation of resources aimed at achieving predetermined growth objectives, (d) Under market mechanism, the costs and benefits to the society as a whole, do not enter the calculation of the rate of return whether gross or net. As such, private risk premium, although different for various undertakings tends to be very high. This in a way overstates the risk for the society as a whole. It is necessary to mitigate these inadequacies of the market mechanism whenever they arise. On the other hand, to render these concessionary measures more effective, they are incorporated in tax laws and other relevant provisions on a selective basis. They include exemption from income taxes and custom duties on raw material and capital goods for the initial years of new enterprises in industry, agriculture and tourism; investment allowances and credit, various forms of accelerated depreciation methods, loss offsets, changes in the structure of taxes and others. Whether or not such concessions will induce greater savings and investment is difficult to say, owing again to the interplay of a variety of tax and non-tax factors[22]. It might only reduce, in certain cases the wide disparity in tax treatment existing between the different groups and sectors in the economy. This may in turn facilitate the intra-sectoral transfer of resources.

Tax/

---

22. J. Heller and M. Kaufman, "Tax Incentives for Industry in Less Developed Countries", Harvard Law School, International Program in Taxation, Cambridge, 1963, pp.58-78.

Tax incentives for inducement of private capital into investments, both directly productive and those serving the secondary objectives of economic development[23], fall under two main categories. The first category covers what is called "Discretionary Concessions" granted under the provisions of the "Private Investment Encouragement Law". This Law was promulgated in 1967/68. It confers to both domestic and foreign capital alike, such specific concessions as (1) Exemptions from duties on the import of raw material and capital goods, (2) Exemption from export duties, (3) Income tax holiday to "approved" enterprises for a specified period of time, (4) Exemption from income taxes (both corporate and individual) of dividends and interest income, (5) Ease of repatriation of foreign private capital, profits and interest.[24] These benefits are relevant to "approved"[25] investments according to the priority schedule of the development programme. Such investments may be recognised in (a) Industry, including mining exploitation and the processing of agricultural and /

---

23. The secondary objectives may consist of facilitating industrial finance, promoting manufactured exports, facilitating the transfer of technology, capacity production and the like.

24. Government of Afghanistan, "Private Investment Encouragement Law", Article 5, 1967/68,. For a detailed evaluation of these concessions reference may be made to page 263 below.

25. No definition of this term is given by the law. One may assume this to apply to investments that are in line with the priority schedule and have met the requirements of the provisions laid down in the law. "The benefits may be enjoyed by any real or juridical non-governmental entity whether Afghan or foreign .... " Ibid. Article 2.

and pastural output, (b) in Agricultural activities, including animal husbandry[26], and (c) in the development of the tourist industry and the construction and management of hotels, expected to increase the invisible earnings and improve the balance of payments situation, and at the same time help secure stability in the foreign exchange market which is of great importance if investment of a medium and long term nature is to come forward and prove successful.

The Second category of concessions are the statutory provisions of the Income Tax Law before and after the 1967 reform. They are "automatically" extended and are of a general nature, enjoyed by the income taxpayers without any administrative discretion. Although benefits automatically conferred have administrative convenience requiring no/

---

26. This was deemed necessary as agricultural output during the Second Plan period, 1962-1967, amounted to only 1.6 percent. As noticed earlier, page17 , this was too low to even maintain a constant level of per capita agricultural output with the 1.75% increase in population growth, even though it is considerably low rate compared with the average population growth rate in the neighbouring countries such as Iran and Pakistan, where population growth rate during 1950-62 has been an average of 2% per annum, "Population and Manpower ..." Op.Cit., p.6. As a result, this sector has appeared to take the first place in the priority schedule at Afs.10.4 billion out of a total of 33 billion Afs. development outlay under the Third Plan, 1967-71, as against 4.4 billion Afs. or 17% of the total between 1962-67. Almost 85% of this amount was allocated to irrigation and land reclaimation projects. Although industry gets a share of Afs. 11 billion, followed by social services and communication, the share of private sector is expected to rise both within and outside planned investments. In addition to the 5 billion Afs. an increase of about four times from 1.6% to 6% within the Plan private investment outside the Planned programme will rise by more than 16 billion Afs. This is 43% of total investment during the period and represents an increase of 69% over the Second Plan period. The bulk of this 21 billion Afs. is expected to go into the expansion of industry and agriculture. Source: "Third Five Year Plan", 1967/71.

no special arrangements such as those under the Private Investment Encouragement Law, [27] they have the weakness of not being able to separate individual cases according to their own merit and contribution to the process of capital formation and the growth of output. Details concerning a prospective venture seeking the benefits granted under the Private Investment Encouragement Law, are required to be filed to the Investment Committee[28] in accordance with the provisions of the law. It is only after an approval of the proposal by the Committee that concessions may be granted. On the other hand, further investments of the already established enterprises were entitled to benefit from the privileges offered under the Income Tax Law.[29] Since such an arrangement was/

---

27. Article 23 of the Investment Law, states that "the following relevant information by type of investment should be supplied: (a) Estimation of capacity and a proformal profit operation, (b) Amount and source of necessary raw material, (c) Imports of goods necessary to establish the enterprise and estimated additional import during the first five years of operation, (d) anticipated domestic sales and exports, (e) estimated number of employee and personnel, (f) Amount, type and country of origin of capital, (g) Degree of Afghan participation." The complete and precise fulfilment of this appears to be a problem mainly to local prospective investors. The number of criteria considered necessary for qualifying a prospective project as an "approved" investment is too many. This makes the appraisal not only time consuming, but the apparent incompleteness may render the required particulars of a project inadequate to qualify for concessions. The prospective investor will find it difficult to correctly prepare information for the entire list without the necessary help of an appropriate organisation. The feasibility study of the project needs to be in part conducted by the agencies concerned, otherwise the inability of the prospective investor to analyse and carefully evaluate the profitability of the project may hold against increased investment. Such technical services must be adequately provided by the agencies concerned. See page 262 on this point.

28. The Committee is composed of the following ministers or their authorised representative: Minister of Commerce as the permanent Chairman, Ministers of Planning, Mines and Industries, Finance and Agriculture, Op.Cit., Article 20.

29. First Five Year Plan, page 220.

was considered implicit discrimination against prospective small ventures and favouring the already established large enterprises, any further investments made by the latter, from retained earnings were subject to the approval of the Ministries concerned. Nevertheless, not many applications for such further investments by established enterprises, have been submitted for approval. In 1965, only two such applications were made. In addition to the administrative requirements, such a treatment would, undoubtedly, hamper the establishment of new enterprises.

Although the Private Investment Encouragement Law of 1967/68 and the Income Tax Reform of 1967 have remedied this shortcoming[30] the administrative machinery for putting particularly the former into effect appears weak and inadequate for the following reasons:

(1) The Law has not made necessary provisions for a permanent staff to evaluate applications for the promotional fiscal and monetary privileges. There is no specific office or person responsible to provide technical information to and assist a prospective investor either to appraise a project or to prepare a financial plan when needed.

(2) There are no simplified procedures set up for small enterprises, and confusion dominates the administration of the various concessions provided.

(3) The problem is rendered more difficult as the provisions of the Investment Law fall under the jurisdiction of different governmental Agencies, even though the Investment Committee is expected to function as a co-ordinating body. The co-ordination of these functions is not likely to prove highly successful unless the functions of the agencies concerned are clearly defined, particularly among/

30. See Page 304, below.

among the Ministries of Commerce, Mines and Industries, Planning and Finance, as the creation of the first three was the ultimate result of the splitting up of the Ministry of National Economy into specialised government agencies in 1955.* The more the overlapping of these functions the more confusion and uncertainty in private investment decisions and the more it adds to the social cost and the slow pace of capital formation. The clarification of the functions of these agencies is urgently necessary if any concession offered under the law is to be effective and if confusion of prospective investors, both local and foreign[31], is to be avoided. On the other hand, there is no reason why the administration of the law should be handled in such a manner where the separation of functions diffuses responsibility and creates inefficiency and fails to give any investment proposal a thorough investigation. These shortcomings may be largely eliminated if the promotional programme was to be administered by an autonomous body to be established as the "Board of Investment". It should include representatives of the appropriate government agencies as well as the private sector. The latter may be represented by an organisation such as the Industrial Development Bank, which represents the various interests of this sector. The decisions of the Board should be by a majority vote and binding. In cases of disagreement the mediation or arbitration of the Ministry of Planning must be sought. The Board should be responsible to follow up the progress of any investment project that has received approval and benefits from the privileges of any promotional programme. An "industrial development centre" must be established and attached to the Investment Board. The latter will be assisted by the consultative services provided to it by the centre.

1. /

---

31. H.H. Hinrichs, "Certainty as Criterion:" Op.Cit.,

* Ministry of Planning: Accelerating Growth in the Private Sector, 1967

1. Discretionary Concessions:

An examination of some of the fiscal stimulants offered under the Private Investment Encouragement Law will provide an insight into their effectiveness in inducing domestic and foreign private investment.

(a) Exemption from Custom Duties on Imports and Exports:

Custom duties, by definition, are of a cost increasing nature and as such affect the prices of the inputs and of final product. The benefit and value of any other concession is therefore directly affected by the magnitude of such duties. If other taxes or duties are kept considerably low while cost increasing charges, such as import or export duties, are increased, the increase will obviously reduce the value of the benefits accrued to the beneficiaries[32]. The result is a barrier, especially to the creation of successful small businesses, as they will be the ones to be pushed out or prevented from entering into the market due to competitive prices. This encourages mergers and integrations between existing establishments. The consequences are not desirable for an underdeveloped country such as Afghanistan, where business activities both in trading and industry, are predominantly characterised by small establishments. Most important of all, it will retard and prevent the establishment of many small, prospective but necessary auxiliary or what may be called "complementary" manufacturing enterprises, upon which the efficiency and productivity of industry in general depend. As such exemption from custom duties, particularly of the imports of capital goods and industrial raw material, has been a common practice among less developed countries[33]. Afghanistan adopted such measures together with the/

32. If, for example, an investor's income tax liability is reduced from 40/100 to 20/100 and at the same time a custom duty of X amount approximately equals to the 20% income tax saving is introduced, the benefits expected from the reduction in income tax is likely to be erased or at least minimized. This is particularly so when full shifting of the tax, either backward or forward, is likely, or if prices of certain items concerned remain or become subject to government regulations.

33. U.N. Industrial Development Organisation, "Tax Incentives for Industrial Dev.", ID/CONF1/B.2, 1967, page 15.

the implementation of the First Five Year Plan, in 1957/58. As noted above, the purpose of these measures was to maintain the value of other fiscal measures such as the tax holiday, and/or a monetary concession such as the provision of foreign exchange at subsidised industrial rates, operative until 1961-62, page 56, in order to encourage investment in the aforementioned areas. Capital goods and raw material not available from domestic sources had been tax exempt for a period of three years. In 1967/68, it was raised to five years for "approved" investments, which coincided with the tax holiday period, page 265. This was further supplemented by a rise in duties on raw material imports which could be obtained in adequate quantities from domestic sources, and on items competing with domestic industrial production.[34] In spite of this, the value of capital goods and raw material imports in 1967, which is to a large extent representative of previous years, amounted to more than 20 percent of the total U.S.$74 million import bill.[35] Almost 75% of this import of industrial input has been for primary and secondary material. Assuming an average rate of almost 20 percent in custom duties, the relative weight of tax savings from this concession cannot be overlooked. With greater economic and social overheads, and a larger degree of external economies this ratio is likely to grow during the initial stages of industrial growth.

As for export duties, the law states that products of "approved" investments are exempt from <u>all</u> export taxes for a period of ten years, from the date of approval of the investment. Whether the word <u>all</u> includes the foreign exchange taxes imposed on export earnings, which at the/

---

34. Afghanistan's Tariff System is not bound under any international trade agreement and therefore it is not committed by treaty or convention to grant most favoured-nation treatment. Tariffs and exchange, as well as administrative controls, are used to restrict demand for less essential imports and redress large trade imbalance.

35. Foreign Trade Statistics, 1967/68, Ministry of Commerce. (Preliminary Estimates)

the moment is the heaviest tax on exports, Chapter 3, is not clear. Export Duties proper are only nominal and their effects on exports will not be as grave. The law requires further clarification on this point. Moreover, to render these tax incentives more effective, the exemption of export earnings from foreign exchange taxes or others may be geared to the value of exports rather than a flat ten year exemption period. This arrangement will serve as a further stimulus to boost exports. In addition, to the "traditional" export items, new lines of export must be encouraged to meet the growing foreign exchange requirements. Investment in such new areas must be allowed a more rapid depreciation allowance, page 300, in order to cope with the rapid pace of technology and obsolecence which largely affect costs. This would differ from industries producing for the domestic market, where second hand equipment may at times be used profitably, provided that adequate repair service and parts are readily available. Exemption from import duty on imported raw materials may be related to exports. Where such an output is consumed domestically the deferred duty may partially or wholly be collected[36]. Where domestic raw materials are used in the export industry concessions on domestic taxes such as sales or excise taxes, may be recognised. This encourages the utilisation of domestic resources and an expansion of the export sector. All such measures, taken to promote either export or domestic markets, will also contribute towards reaching capacity production.

(b) Income Tax Holiday for "Approved" Industrial Enterprises:

It is obvious that an attempt to reduce cost increasing levies, such as import duties, has the effect of raising gross and taxable income. Where corporate/

---

36. Bank-Merkazi, Tehran, "Tax and Custom Regulation and Concessions to Industries, Page 46 in Tax Incentives for Industrial Development, UNIDO, 1967, page 31.

corporate income is taxed on a progressive schedule, as it was the case in Afghanistan prior to the 1967 Reform, in spite of allowing a tax holiday, the benefits of a fiscal concession i.e. custom duty, through the manipulation of prices are reduced. This is especially true if the increase in the taxable income puts the investor at a higher marginal rate, which may absorb more of the taxable income than a tax savings on the imports of raw material and capital goods is expected to accrue. It is important to note that, under any concession, whether exemption from custom duty, a subsidised rate of foreign exchange or others, the benefits will be apparent only when we are dealing with enterprises above the marginal point, i.e. the availability of either a gross or net rate of return, irrespective of the provision for loss-offset. In other words, the enterprise is operating at, or above the "break-even point", during the initial years of operation. It is during these early years of a pioneering enterprise that the effective burden of income tax and its rates, among other factors, is of particular interest to risk taking. This is why the conferring of such specific benefits automatically ceases after a specified period of time. The assumption here is that the continuation of such incentives is not necessary as the viable position of enterprises should enable them to face competition with their rivals both in domestic and foreign markets. Moreover, to extend tax holiday concession to the new investments of already established enterprises is to invite more problems by encouraging a further abuse of an already poorly administered income tax law. It is quite difficult, if not impossible, to isolate the exact amount of profits expected from a specific investment, particularly where vertical or horizontal patterns of production prevail. Even if departments are separately taxed - as it has been the case in the past - the possibility of allocating expenses to various departments or branches will increase the temptations to conceal profits, minimize the overall

tax/

tax liability and reduce public revenues[37]. This will not only be against equity considerations, in as far as the ratio of total tax to profits is concerned, but will render the effectiveness of the measure, as an incentive device very weak. Therefore, in order to promote internal finance, encourage risk taking, and reduce the pay back period, a full income tax holiday was provided to new enterprises for the first three years,[38] and, later in 1967, under the Investment Encouragement Law it was extended to five years effective as of the year in which the first sale of goods or services of the approved investment occurs.[39] As such it does not relate the tax exemption period to the earning of profit,[40] as investment in a less developed country is expected to serve a number of different objectives including the maximisation of profits. The uniformity of the exemption period does not discriminate between investments on the basis of either type or territorial location.[41] The exemption is expected to provide for a quicker recoupment of the original capital outlay and induce risk taking as a result of changes in the net of/

37. Under the 1967 Reform, the Ministry of Finance reserves the right to allocate and distribute expenses receipts and profits among different activities of the enterprise so as to reflect accurately the income and prevent evasion of taxes. Article 46, Income Tax Law.

38. Under the 1958 Foreign Investment Encouragement Law, a three year partial tax holiday on profits of only up to 15 percent of foreign registered capital was allowed.

39. Private Investment .... Op.Cit., Article 3

40. This is similar to that practised in Ghana and Peru, as against that of Israel and South Vietnam, where the period of tax holiday commences with the profitability of the enterprise. See J. Heller and M. Kaufman, Op.Cit., page 26.

41. This aspect of investment in industry has influenced fiscal incentives to be of a differential nature, varying with the location and/or type of investment concerned. For example, Pakistan offers such exemptions on a territorial basis for periods of 2, 4 and 6 years according to priority areas. UNIDO, Op.Cit., page 29 . Mexico and Peru offer for 3, 5, 10 or 15 years and 5, 7 or 10 years, respectively. J. Heller and M. Kaufman, Op.Cit., page 202, Note (23)

of tax rate of return[42]. This is especially important where the risk element is high in the critical early years of operations of most industrial undertakings. It is more so than in other activities, where the recovery of capital or the turnover of the business falls within a relatively short period of time. Furthermore, it will help solve replacement difficulties when affected by the inflationary spiral, and by a depreciation period longer than the normal period, i.e. 10 years, based on the original cost. Although the net revenue loss from this area may be relatively low, as profits are not normally very large during the first few years, the concessions will nevertheless provide a net tax savings, to a newly established enterprise. Compared with certain other concessions such as "accelerated depreciations",[43] the effects on revenue is greatest. An accelerated depreciation scheme allowing full write-off upon acquisition of an asset will still leave future earnings eminating from this source to be taxable, unless the interest/

---

42. Assuming a rate of interest of 10 percent, the present value of a hypothetical perpetual income stream of £3,300 per year, on an initial investment of £10,000 with five year useful life, will be increased with the five year exemption from the 20 percent corporate tax. The present value of the income stream, with the tax, will be £10,007, but tax exemption for five years will raise this value to £12,508, or by 24.9%. This will affect the internal rate and net present value of investments, of the tax, its rate and timing as well as the earnings that follow after the recoupment of the original cost of capital outlay, may be calculated on the basis of the "Discounted Cash Flow" or the "Net Present Value", depending on the rate of interest involved,. Reference to various methods of calculating the profitability of the recoupment of capital and fiscal incentives may be made to A.J. Merritt and Allen Sykes, "Capital Budgeting and Company Finance", Longman Green, London, 1966.

43. Further reference on this subject is made in page 300 below.

interest free loan is further tied in the form of new investments. The same is not true of a complete exemption from tax which involves a net loss of revenues. The significance of this exemption arrangement to a foreign investor will be minimised unless the country of destination allows a tax relief for taxes spared by the source country under tax holiday arrangements.

(c) Income Tax Relief on Dividends Distributed out of Tax Exempt Profits, and on Interest Income:

To allow benefits of the above measures to pass on to the ultimate dividend conscious investor, and to encourage further portfolio investment (including shares of stock and debentures), tax exemption is extended to cover dividends and interest payments on foreign loans. The 1968 Investment Law provides that "... Investors shall be exempt from personal income tax and corporate tax on all dividends for a period of five consecutive years beginning with the year in which a dividend is first distributed. The exemption shall, in no event, extend beyond the eighth year after the date of approval of the investment."[44] With the additional three years, the policy is alleged to result in larger distributions rather than the building up of reserves or promotion of internal finance, particularly after the expiry of the income tax holiday period. Nevertheless, excessive distributions can be avoided by a tax applicable to such distributions, beyond a certain percentage of annual profits, or paid up capital.[45]

Interest on foreign loan, constituting part of the approved investment, is totally/

---

44. Investment Law ... Op.Cit., Article 3, Section (d). This practice differs from one country to another. The Indian Law stipulates that the period for such tax exempt distributions must coincide with the income tax holiday period, while Israel offers up to 10 years after the expiry of the income tax holiday period. See UNIDO, Op.Cit., for such practices in other less developed countries.

45. Article 15 of the Income Tax Act of Pakistan provides that dividends paid out of exempt profits are not tax exempt. It also requires that 60% of tax exempt profits be reinvested. J. Heller and M. Kaufman, Op.Cit., pp.27, 203, and 217.

totally exempt from personal and corporate income taxes.[46] Since both dividends and interest payments are deductible from corporate profits, preference of one to the other, except for reasons of fluctuations in the level of interest rates, is eliminated. Moreover, it makes it possible for an enterprise to obtain funds with low interest rates, particularly if the question of ownership is a handicap in resorting to equity finance. Nevertheless, to avoid unnecessary loss of revenues, this exemption may be first restricted to interest from certain government securities and, second, the benefits should accrue to the prospective investor than to the foreign treasuries.

Since most of these measures are also intended to appeal to foreign private investments, their effectiveness to motivate such interests beyond the jurisdiction of national boundaries is very important indeed. The success of these measures will not only depend on how far they do improve market conditions, with respect ot the allocation of resources, on an international level, but also whether or not they mitigate some of the obstacles arising from tax treatment under various systems. It is understandable that most of these concessionary measures are intended to raise the after tax rate of return in the country of source. Whether or not the increase in the after tax rate of return can be maintained in the country of destination depends on a variety of factors. Our concern here is confined to the effects of tax treatment, as one of these factors.

Owing to the lack of tax agreements, between Afghanistan and capital exporting countries, affecting the extent and direction of foreign private capital among nations, the net effect of the concessions offered under the Afghan Tax System must be studied in the context of tax treatment of the individual country concerned. In addition to the lack of tax agreements, certain features of the 1958 Income Tax Law and the Foreign Private/

---

46. Op.Cit., Article 3, Section (e).

private Investment Law were not conducive to foreign investment. In addition to the taxation of the corporate source income, dividends declared or profits retained have been subject to high marginal rates under the individual income tax schedule. This was due to the difficulty involved in obtaining the composition of capital, the number of shares, their distribution, and the identification of the shareholders. This raised the effective tax rate and treated foreign enterprises as individual tax-payers. It may be recalled from a previous chapter, page 201 that under the 1967 Reform dividend distributions in cash are deductable from corporate taxable profits and subject to only one tax at corporate level, i.e. the 20 percent withholding at source. In the case of anonymous shareholders, this withholding is at a rate of 30 percent. The credit arrangement, as noticed, is only available to local shareholders, whose total income can be assessed on a global basis in accordance with the provisions of the Afghan Income Tax Law, and whose total ultimate tax liability is over the 20 percent withheld. Such a treatment may still appear inequitable and discriminatory, especially where the interests of investors as controllers and/or shareholders are considered. A non-resident foreign investor may have no other income from other sources in Afghanistan. The 30 percent may be more than if the rate schedule were to be directly applied. However, such a treatment may be justified on the grounds that not much is known about the net gains from such assets held by the anonymous and non-resident shareholders, unless the information necessary is supplied through mutual co-operations of the governments concerned. Moreover, to avoid a double taxation of income and profits at the country of destination, unilateral tax reliefs, are common features of/

of a number of foreign tax legislations,[47] similar to the Afghan example cited above. Under these conditions a tax exemption will shift tax liability from the country of source to that of destination. The benefits of the partial integration of personal and corporate income taxes, the tax holiday on corporate profits, exemption of dividend and interest income through tax "sparing"[48] provided under the Afghan Tax Law, go to the treasuries of the countries of destination. Under such arrangements, income from investments abroad will only pay the highest tax wherever it/

47.a) The Income Tax Law of the United Kingdom provides that "Where there is no agreement for mutual relief, the United Kingdom gives unilateral relief for the tax payable in respect of income arising in the other territory, limited to the effective United Kingdom rate of tax, (s.26-1953). For particular arrangements under such a treatment, reference may be made to K.S. Carmichael, Op.Cit., pages 529-575, and A.R. Prest, "Public Finance in Theory and Practice", Third edition, 1966, pp.358-370, b) Similarly, the Internal Revenue Code of the United States provides for a credit or deduction from income of foreign taxes paid on the foreign source income taxable under the U.S. Tax Law as a country of destination. See "Taxation of Foreign Income under the United States Internal Revenue Code", in Report of Royal Commission on Canadian Taxation, pp.743-771. The same may be consulted on the treatment of foreign taxes under the Canadian Tax Law, pp.500-560, c) Income taxes paid to the Afghan Government on the income of German (Federal Republic) subjects - both individuals and juridical entities - from their operations in Afghanistan are credited against their German income taxes. The provision was adopted unilaterally by the Federal German Government on May 21, 1965. "Tax News Service", International Bureau of Fiscal Documentation, Part I, Europe 34, 1965, Amsterdam, Netherlands.

48. "Some capital exporting countries, such as France, Italy, Japan, the United Kingdom, and West Germany have gone into treaties and credit their subjects on remittances of profits from investments abroad, for taxes "spared" by certain developing countries...." UNIDO, Op.Cit., page 20,. Up to 1965, United Kingdom had concluded tax sparing agreements with such countries as Pakistan, Malta, Israel and Jamaica. A.R. Prest, Op.Cit., p.369. For a further note on the pros and cons of "Tax Sparing", reference may be made to Heller and Kaufman, Op,Cit., pp.74-78.

it may be. The higher the exemption and the lower the differential tax paid abroad, as is the case under the Afghan Income Tax system, the larger the benefits accruing to the government of the capital exporting country, unless, a deferment provision exists, which exempts or postpones taxes on the retained amount of profits, or income enjoying the exemptions.[49] Measures to minimise these weaknesses need to be devised by the Afghan Government through such instruments as "double taxation" treaties. In order to render these and other monetary and fiscal incentives more effective in attracting foreign private investments, emphasis, in such bilateral tax agreements, may be placed as much as possible, on the "Source of Income" criterion as the basis of tax liability, and tax credit should be the lowest tax charged on the same income. Here again, it requires that the concept of income be given its most possible, comprehensive definition to, first, avoid any tax loss, and second, emphasise the importance of any concession offered to foreign investors. Taxable status must be based upon "residency" rather than "citizenship".[50] The administration of the tax on the basis of the latter presents formidable difficulties. In order to avoid any tax relief unnecessarily result in loss of revenue to Afghanistan as a country of source and destination, terms such as "Residency","Domiciliary" and others, covering both real and juridical entities, need to be clearly explained in the tax law. It is/

---

49. To encourage the investment of profits in less developed countries the United States Revenue Act, in 1962 excluded from taxable income deferred income of Americans from these less developed countries. Report of the Royal Commission,.... Op.Cit., pp.473-771.

50. To avoid such unnecessary complications, the tax legislations of many countries, such as the U.K., U.S., Canada and others, accept "Residency" as the basis of taxable status, e.g. in the United Kingdom, a person who is physically present in the Country for a period or periods aggregating six months, in any tax year, is a resident for purposes of income taxes. Heller & Kaufman, Op.Cit., and K.S. Carmichael, Op.Cit., and on the U.S. and Canada, the Report of the Royal Commission .... Op.Cit., may be consulted.

is expected that such a criterion will encourage real, private investment, as against loans, especially negotiated through foreign governments. This criterion may render the determination of total taxable income, for certain operations more difficult. The operations of certain enterprises, such as airlines, may not be covered by a reciprocal, or mutual tax exemption treaty. Nevertheless, to remedy this situation, a formaula - such as the one outlined earlier, page 203 on the basis of which the proportion of a foreign enterprise's world wide taxable profits, to expenses, may be applied, in order to arrive at the company's taxable income in Afghanistan. Alternatively, a certain fixed percent of taxable profits may be accepted, which will be the basis of taxation. This latter may be a tentative solution, but it is administratively more convenient and realistic.

On the other hand, the source of income criterion may result in a revenue loss to the Treasuries of the contracting capital exporting countries, particularly where the countries conceived are not at the same level of development, and at a stage where the volume of business is unproportionate.[51] But it is expected that such agreements will eventually increase the volume of business, and trade, between Afghanistan and the countries concerned, whereby the ultimate benefits will offset the revenue loss. Furthermore, such an arrangement will hardly have any significant effect on the revenues of the Afghan Government from the Income Tax on the income of the Afghan Nationals raised abroad. The present low tax rates and the unilateral credit arrangement, already enforced, with respect to foreign income taxes, are likely to affect revenues, all the same.

(d) Repatriation of Foreign Capital and Profits: Another provision under the/

---

51. U.N. Department of Economic Affairs, "The effects of taxation on Foreign Trade and investment", Chapter I, 1, Publication No.1950, XVI, 1. page 3.

the Private Investment Encouragement Law deals with the repatriation of foreign capital. Capital invested may be repatriated at a specified rate of 25 percent, per year of the registered capital, commencing after the approval of the investment.[52] The relative rapidity of the rate at which capital may be repatriated is likely to reduce any possible risk that the investor may anticipate from this area. The foreign exchange market, during the past few years, has achieved a certain degree of stability despite the fact that the gap between the official and free market rates is still very wide. Changes in future government policies regarding the public sector's share of expenditures, its pattern of finance and import - export policies must constantly bear in mind the continuity of such a stability. In order to further safeguard foreign, private capital, in addition to having joined the Convention on the Settlement of Disputes,[53] Government Investment Guarantee Insurances have to be negotiated between Afghanistan and other countries. This scheme will ensure investors of the safety of their invested capital, other than that resulting through business failures.

One of the factors which might have created a barrier to further private foreign investment, has been the requirements on the ownership of capital. Equity ownership of foreign private capital was limited to 49 percent of total equity capital. This may have been advantageous to the Afghan investor in as far as control, formulation of policies and management of the enterprise are concerned. The unwillingness of either side, regarding such an arrangement, may function as an obstacle, mainly against the flow of/

---

52. The repatriation of foreign capital under the 1958 Private Investment Encouragement Law was restricted to 10 percent of the capital, per year, over a period of ten years.

53. Afghanistan became a party to this convention when she signed, in 1967, the protocol governing investment disputes between States and Nationals of other States.

of foreign capital. This specific percentage requirement has been removed under the 1967/68 Investment Encouragement Law, [54] which now allows foreign direct investment of up to 100 percent ownership of capital. Furthermore, the encouragement of "Joint-venture" enterprises is emphasised under the law, but whether or not it implies a termination of the venture after a specified period of time or the fulfilment of certain objectives, is not certain. One obvious result of such a movement is the pooling of modest sums, both local and foreign, which would have individually and separately found themselves incapable of operating on a large scale. The lack of managerial skills and technical know-how, foreign exchange requirements and the like are further handicaps that accompany local capital. However, local potential investors will have to find themselves on equal footing with foreign investors, for a number of reasons, before a great degree of success is achieved from such a movement. The elimination of the limits on the ratio of capital ownership was urgent and desirable. It was a shortcoming of the law, which failed to realise the fact that industries, and their management, differ from each other both, in their optimum size, and their composition.

An examination of the effects of each one of these concessions is difficult/

---

54. In the case of trading, i.e. import-export, activities, a minimum capital requirement is deliberately maintained to be U.S.$10,000 and U.S.$30,000 for holders of licence type "A" and type "B", respectively. Past experience has made it necessary that a level such as this is to be kept. Under licence type "A" a foreign individual will trade in his own name, while under type "B" individuals will operate in exchange for commissions, brokerage fees or other such payments from the foreign suppliers. "<u>Licencing Regulation for Private Foreign Traders and Commercial Firms in Afghanistan</u>", Kabul 1965/1966. No corporate identity or privilege is enjoyed under either one of the two licences. Where the need for trading activities export-import arises for an industrial establishment, corporate privileges may cover such activities under the same industrial licence. This is to encourage the establishment of industries for export purposes and to improve balance of payment situation.

difficult owing to the undeveloped state of Afghan statistics. However, since the main objective behind initiating such concessions has been to induce private investments in industry, an assessment of their overall effects, to this end, may be made from Table 33. The total volume of private, both domestic and foreign investment in industry during the development decade, i.e. 1957/58-1961/62 and 1962/63-1966/67, has declined by almost 50 percent over the 1951/52-1956/57 period, from Afs.1,124,639 Mil. to Afs. 551,800 Million. Even when the few large investment projects are excluded from the pre-plan period of 1951/52-1956/57, the balance between this and the Plan period remains insignificant, both in terms of number of establishments and volume of industrial investments. This supports the argument that the deviation of the tax system from the neutrality concept and the provision of tax incentives do not operate effectively in isolation. Non-tax aspects of investment are important obstacles to investment decisions.[55] It was not until 1966/67 and thereafter that the pace of industrial investment gained momentum. In addition to the Income Tax Reform and the enactment of the new Private Investment Encouragement Law, most of the infrastructural projects, which facilitate establishment of industrial enterprises, were, by this time, built and completed. By the end of 1967/68 some 36 applications for new enterprises were approved; all of which accounted for more than a billion Afghanis of initial investment, within the priority schedule of programmed investments. This rise may have partly resulted from the retention of earnings, and partly from new capital,. Of the total 36 ventures, seven have been of foreign origin from four countries, with a total of £0.83 million worth of initial capital.[56] This rise is more than sixfold, compared to the previous level of foreign investment in industry.

2. Concessions Offered under the Income Tax Law: /

---

55. J. Heller and M. Kaufman, Op.Cit., pp.58-78

56. Ministery of Planning, "Survey of Progress", 1968/69, p.63

Table 33

PRIVATE INVESTMENT IN INDUSTRY BEFORE DEVELOPMENT PROGRAMME

(1951/52 - 1956/57)

(Amount in 000 Afs.)

Type of Enterprise	(1330) 1951/52	No. of Enter-prises	1952/53	No. of Enter-Prises	1953/54	No. of Enter-prises	1954/55	No. of Enter-prises	1955/56	No. of Enter-prises	1956/57	No. of Enter-prises
1. Local	613,355[1]	4	244,104[2]	2	30,000[3]	1	800	3	204,680*	6	30,000	10
2. Foreign	-	-	-	-	-	-	-	-	1,800	1	-	-
TOTAL	613,355	4	244,104	2	30,000	1	800	3	206,480	7	30,000	10

Source: Compiled from the Statistics of the Ministry of Mines and Industries, 1969

* Out of this total Afs.200,000 comprises the capital of "Sprinzer Company".

1 a - "Afghan Textile Company" 462 million Afs. (Privately financed, mainly through Bank-i-Millie)
b - "Ahu Shoe Factory", 150 million Afs. (Privately financed)

2 "Sarobi Electricity Company, 240 Million Afs. (mixed enterprise)

3 "Jabil Assaraj Cement Plant" (mised enterprise)

Table 33a

PRIVATE INVESTMENT IN NEW ENTERPRISES IN INDUSTRY DURING THE DEVELOPMENT DECADE

(1957/58 - 1966/67)

(Amount in 000 Afs.)

Type of Investment	1957/58	No. of Enter-prises	1958/59	No. of Enter-Prises	1959/60	No. of Enter-Prises	1960/61	No. of Enter-Prises	1961/62	No. of Enter-Prises
1. Local	38,800	16	95,000	5	N.A.	N.A.	19,000	7	18,000	5
2. Foreign	-	-	32,000[1]	1	N.A.	N.A.	-	-	-	-
TOTAL	38,800	16	127,000	6	N.A.	N.A.	19,000	7	18,000	5
Type of Investment	1962/63	"	1963/64	"	1964/65	"	1965/66	"	1966/67	"
1. Local	27,000	8	13,000	6	-	-	15,000	9	131,000	33
2. Foreign	-	-	163,000[1]	2	-	-	-	-	-	-
TOTAL	27,000	8	176,000	8	-	-	15,000	9	131,000	33

Source: Compiled from: (a) The statistics of the Ministry of Mines and Industries, 1969, and
(b) Thomas H. Miner & Associates, Kabul, 1969.

1. "Afghanistan Woollen Industries", 150 Million Afs.

2. Concessions Offered under the Income Tax Law:

The second category of incentives falls within the scope of the income tax law, which, as mentioned earlier, automatically accrue on a non-discretionary basis, to recipients satisfying certain minimum requirements. The recipients may be either pioneers, newly established or existing enterprises,. However, for purposes of income tax and granting of incentives, the beneficiaries, whether real or juridical, fall under two separte categories. They are "Individuals", including proprietorships, partnerships - general and special or limited, and other entities of an individual character, and "Companies" which include limited liability and joint-stock companies. The concessions conferred upon one, or both classes under the 1967 income tax law, include the exemption from taxes of interest payments on government and municipal bonds, page 283 interest on bank deposits, pages 287 the abolition of the two tier taxation on distributed corporate income; Depreciation allowances, loss offset; investment credit and others.

(a) Concessions to individuals:

Whether it is a rise in the level of personal allowance, or a total exemption from taxes of income from certain sources, the important economic implication is that: with the rise in the level of disposable income, the level of household savings and investment is equally expected to increase. One such measure taken in this direction, by the 1966/67 Income Tax Law, has been the exemption of interest received on government and municipal bonds. It may be maintained that the objective of such a move is more likely the creation of the capital market rather than an increase in total savings. Total savings might fall as a result of these concessions. The creation of such a market may strengthen the government's borrowing position solve the revenue problem owing to the inelasticity of the tax system, and add to the effectiveness of the instruments of monetary policy, page 44 .

The/

The very undeveloped nature of the Afghan capital and money markets, and the small ratio of the monetised sector, will obviously render the success of any such programme unlikely for a number of years to come. Whether it is for bridging the gap between government revenues and expenditures, and/or stabilising the monetary situation, through the open market operations of the Central Bank, domestic debt policy, under the circumstances, is a very poor policy instrument indeed. It does not compensate for the inelasticity of the tax system. However, should the instrument appeal to the present monetized sector or should a larger money and capital markets eventually develop, the question of possible tax evasion and debt service are to be carefully considered while determining the rate of interest on these bonds and their treatment for tax purposes. Equity considerations affected through tax avoidance will not be repeated here as it has been already covered in an earlier chapter, page 194. Debt service obligation to the Central Bank and foreign creditors under the Third Five Year Plan is estimated to run at more than 5 billion Afghanis, or 18 percent of the development budget for the entire plan period. Furthermore, if a domestic loan programme is to have a successful start, the rate of interest on it has to be, unlike the objectives and expectations of a debt policy, substantially higher at this stage than what is offered by the banks on deposit accounts to attract more savings. On the other hand, since interest payments on bank deposits are also tax exempt, the bonds may be issued at a discount. Any such effective rise in the rate of interest is not only costly to the government, but it also tends to affect the general level of interest rates. The effects of this on the prices of other such assets, e.g. commercial debentures, the interest on which is taxable will particularly be undesirable. This runs against the interest policy of the government, which is very important for small enterprises finding it difficult to raise funds either through equity capital, retained earnings or bank credit. Should the rate of interest be deliberately held at a

lower/

lower level some attractive feature, such as acceptance for the payment of taxes, loan and other obligations to the government may be added to it. Even then, the question of confidence and redemption is still very important. Since a bond programme has not been operative on a voluntary basis[57], private individuals' confidence is crucial if these features are to induce participation in the Scheme.

An alternative attempt would be to embark on the sale of unregistered "savings bonds", with the attractive feature of coupons appended to them, which will be redeemed by the holder, once every three or six months, for the interest due. The interest may be held, if so desired, which would draw interest compounded every 3 or 6 months. This coupon feature will greatly help the soundness of the scheme, particularly to those who may want to be sure of its return. The bond will be issued for a period of five years, redeemable, or renewable, upon maturity. To make the bond more flexible, in as far as the principal is concerned, the bond can be made negotiable after three or five years, and the Bank of Afghanistan must be authorised to handle the purchase and sale, as well as the redemption of such bonds. In order to encourage people to hold to these bonds, a lottery feature, drawn every month, may be attached to them. The bond can be of a longer period of maturity and first initiated at the level of agencies and institutions, public and private, with payrolls. Part of the annual government payroll of Afs.1.7 billion[58] will certainly find its way into the purchase of such bonds. Even a one or two percent will be considered a satisfactory start to the programme. The provision to exempt interest on/

---

57. The government made its first and last unsuccessful attempt about 15 years ago which required many institutions and individuals to buy the bonds. The delinquency of the government to meet the payment of interest and redemption of the principal when due, put an end to the scheme. The main conclusion to be drawn from the previous attempt is that no coercion in the sale of bonds be attempted should the government once again resort to the scheme, for purposes outlined above.

58. Ministry of Planning, Survey of Progress, (Persian) 1969, statistical tables, 6 and 7.

on government bonds from income tax, which is only superficially attractive, must be discontinued, even though tax administration is not so efficient at the moment, and tax revenue from this source may be small. As indicated above, such an exemption is inequitable. It means little to those whose total income is small, but a great deal to those whose income places them in the higher income tax brackets. This is particularly true as there will be no limits regarding the amount of such bonds held. One way to raise the effective rate of return is to allow such savings, of the salary and wage earners in the low income groups to be deducted from taxable income. Interest obtained may have the withholding feature as far as taxes are concerned.

Parallel to this, a short term treasury bill, for a period of three months may be issued. This will be attractive to traders and others who may have large amounts of idle funds due to seasonal fluctuations in their businesses. The interest rate may be held only slightly above what is prevailing at the banking system.

(ii) Exemption of interest on bank deposits:

In an effort to further increase savings, interest income on individuals' accounts with Afghan Banks has also been declared tax exempt under the income tax law. Although the growth of private demand deposit, both household and institutional, appears impressive over the Second Five Year Plan period, the ratio of deposits to total money supply and particularly bank-notes in circulation is yet very small.[59] On the other hand, the first year of the Third Plan exhibits a deterioration in the level of private sector deposits with the banking system. Total private demand deposits, during this period, fell by 0.7 percent. Taking the private sector alone, the fall in the level of demand deposits has been 6.5 percent which indicates a serious deterioration of confidence in the banking system.

page49./

59. Table 6, page 49, Chapter 2.

page 49. On the other hand, the growth of the deposits of non-bank financial institutions[60] with the banking system, has increased,. This sector of the system now accounts for 22 percent of the total private demand deposits, while, in 1962, its proportion was a mere 4.2 percent. This suggests a substantially improved flow of credit to and from these institutions and a health build-up of their capital.[61]

The private sector's time deposits with the banking system have followed a similar pattern, Table 34. On the average, between 1962 and 1966, the private sector time deposits have increased at an annual rate of approximately 30 percent. In 1966/67, they amounted to almost 11 percent of the total money supply, and 1.9 and 2.1 percent of GNP and private expenditures,[62] respectively. The absolute rise is, therefore, insignificant in relative terms. The decline, during 1966/67 and 1967/68, has been over 18 and 28 percent, respectively, as compared to the 1965/66 level. However, the growth in holdings and deposits of non-bank financial institutions compensate for a major part of the decline. It may be noted that variations in the level of deposits are not a function of one factor, such as the tax system, but of a multiple of variables, including:

(a) The choice of the public to hold less cash and more bank deposits.

(b) The level of prices and business activities.

(c) An increase in the earning assets of banks, either by a purchase of securities, or by advances to customers, and

(d) Purchase of securities and other assets, from, or making advances to the general public by the Central Bank.[63]

How/

---

60. They include all the specialised financial institutions, the effects of whose activities are generally not considered in analysing the money supply. They are, as such non deposit banks. See Chapter 2.

61. Survey of Progress, 1968, p.21.

62. Expenditure figures are taken from production table, Third Five Year Plan, pp.187-188.

63. R.S. Sayers, "Modern Banking", 1958, pp.215 and 230.

Table 34

TIME DEPOSITS AT THE BANKING SECTOR

1962 - 1967

(Million Afs.)

	1962	1963	1964/5	1965/6	1966/7	1967/8
Private Sector	166.0	165.6	396.0	746.7	611.8	527.1
Government Sector	92.9	122.8	68.9	116.4	304.1	330.8
Government enterprises	96.8	144.9	117.4	55.8	50.0	90.8
Other Commercial Banks	2.4	1.1	1.0	1.1	0.8	0.7
Non bank financial institutions	-	10.1	27.3	24.8	92.5	112.5
TOTAL	359.0	444.5	610.6	944.8	1052.2	1061.9

Source: The Central Bank, Kabul, 1968

How much of the fluctuation in the level of deposits has been due to any one single factor is difficult to determine. A change in the habits of people to hold less cash and more bank deposits (a) depends primarily, on the degree of monetisation, and the proliferation of banking services throughout the country. All this is admittedly a very slow process. It would be difficult to attribute to it the pattern of fluctuation, which has characterised the level of deposits during the period concerned. A closer look at the issue reveals that, the growth of total deposits has been closely related to variations in the level of money supply. This indicates that bank advances (c) and (d) to customers in the private and public sectors, have had a direct effect on the level of deposits. The decline in the level of private sector's total deposits may be attributed to the relative reduction in the volume of bank advances to this sector, pages 51 and 52 . Moreover, since interest income of institutions (companies), arising from bank deposits, is not only taxable income under the income tax law, but also subject to an additional five percent "Business Receipt Tax",[64] an adversed effect on the level of deposits can not be rulled out. The rise in the level of business activities, (b), accompanied by a virtual decline in the volume of bank advances to the private sector, may be a further factor responsible for the fall in the level of the private sector's deposits with the banks. Moreover, as indicated earlier, the high rate of inflation accompanied by a stagnant money rate of interest have discouraged the accumulation of deposits at the banking system. Deposits are largely encouraged when a positive rate of return either through a stable price level or through manipulations of the money rate of interest is maintained. It is not so much the tax that is largely responsible for the level of deposits. Any attempt to narrow the gap between the effective rate of return and the money rate of interest/

---

64. Chapter 3, page 100.

interest must be reflected directly in the rate of return rather than in the form of ineffective hidden subsidy.

It may be concluded that exemption of interest on bank deposits cannot be justified, whether from the view point of incentive, equity or revenue. The comprehensive definition of the concept of income must, also cover such income on individuals deposit above a certain limit. For purposes of taxpayer convenience and administrative efficiency, the limit will have to exclude small savers with an annual income from this source of below 1,000 Afghanis. Banks will be required to withhold taxes at a flat rate of 8 to 10 percent, the lowest initial rate proposed for the income tax schedule and report the depositor's name and amount of interest to the tax office.

(iii) Abolition of the Two Tier Tax on Distributions of Company Source Income:

A third measure, as noticed earlier, was the abolition of the two tier tax on dividend income,[65] and the provision of a tax credit towards the shareholder's total tax liability arising from other income, with respect to the tax withheld on dividends at the company level, and transferred to the Treasury.

It is expected that excess dividend distribution will be discouraged where individual tax liability falls beyond the fixed withholding rate of 20 or 30 percent. The larger the level of retained earnings the more funds available for financing further expansion, or increasing external investments. Either one is likely to raise the net rate of return to the ultimate shareholder. This is, often more than what the shareholder himself will be able to obtain, due to the existence of tax at several stages. Furthermore/

---

65. It may be pointed out that there is no complete abolition of double taxation on corporate source income. Retained earnings are taxed as corporate income and any subsequent distributions from it are again liable to the dividend withholding tax and individual income tax when received individually.

Furthermore, internal investments and rate of return are likely to affect the value of existing shares,. As a result, capital gains are expected. In the past, realised capital gains on certain assets, e.g. buildings and land have been subject to taxation, without due consideration for the time during which the gain accumulated. The taxation of gains realised from shares of stock, bonds and other such securities had not been specified in the 1957/58 Act.

As analysed above, the 1967 Tax Reform, declared capital gains from a number of movable and immovable properties, subject to taxation, at the normal progressive rates of income taxes with the averaging feature, page 192-193. Although the Reform has altered the situation, the implications drawn from such a policy measure are of vital importance, in as far as the process of investment and capital formation is concerned. A first shortcoming of the tax, as seen, is that its differential treatment discriminates against productive investment and favours conspicuous consumption. Even where discontinuities may be held to prevent such a "substitution effect" from operating, it is very unlikely to see a favourable effect on the total volume of savings in the economy. It is important to note that at these levels of income, where MPS is understandably high, capital gains are not so much drawn upon in order to meet consumption expenditures. What the tax in this respect may accomplish is an institutional change in the process of decision making, i.e. from the private to that of the public sector. Therefore, it is suggested that the tax, apart from its differential effect also reduces the supply of savings in the private sector "by something not far from the amount of revenues produced".[66] Whether the expected rise in the level of savings in the public sector will compensate, depends on the level of savings/revenue ratio, the pattern and composition of public expenditure. Even when all the proceeds are used in the productive/

---

66. H.C. Wallich, "Taxation of Capital gains in the light of Recent Economic Development", National Tax Journal, Vol.XVIII, 1965, page 144.

productive areas, it is necessary to evaluate the effects on incentives to invest by these groups in the private sector.[67] Consequently, where the comprehensive concept of income covers such gains, the disincentive effects have compelled governments to provide concessionary tax rates, irrespective of the fact that income from other sources may escape higher rates of personal income tax as capital gains[68]. A more favourable treatment of gains, especially on equity capital, i.e. shares of stock, as against other types of assets is expected to induce people to buy shares of stock, rather than channelling their savings into the more traditional but popular types of investments, such as land, luxury buildings and others. In Afghanistan, as witnessed so far, the share of business profits, particularly that of the corporate sector, in the national income is very small indeed, as compared to land and real estate, gains realised from such a small sector are not likely to be large. As this sector makes progress and shows signs of a rise in earnings in the early stages of economic growth, it is not advisable to clamp down upon these earnings as soon as they make themselves obvious. The contributions of these earnings, emanating from such sources as retained earnings, which directly affect national income, is much more important than those earnings resulting from fluctuations in the level of prices and speculative investments. In view of growth objectives, the counter productive effects of such a treatment may be considered stronger than those of other measures for the raising of revenues, or inducement of savings and investments. It may be argued that the/

---

68. Such gains (long term, property held for 18 months and over) under the U.S. Tax Law, are subject to a flat rate of 25% as against a maximum marginal rate of 70 percent on personal income from other sources. In the U.K. such long term gains, accruing to individuals, are taxed at a rate of 30% as against over 90% of the individual income tax schedule, where no averaging exists. See A.R. Prest, Op.Cit., pages 228 and 297. For concessionary rates in less developed countries reference may be made to J.D. Amatong, "Taxation of Capital Gains in Developing Countries", <u>IMF Staff Papers</u>, 1967, pp.344-384

67. W.A. Lewis, Op.Cit., p.243

the exemption or preferential treatment of such gains, may enable the wealthy to improve their overall economic situation, and increase consumption from untaxed income. But, as indicated above, a capital gains tax has a direct bearing on savings. Any increase in such gains will affect the level of savings more than that of consumption[69]. Even if a higher level of the propensity to consume is assumed to prevail among such income and wealth groups, consumption at this level may be checked, quite easily, by more effective taxes, such as excises or selective sales taxes on items having a higher income elasticity of demand. This is particularly effective as the various income groups of the society in general differ in their consumption behaviour by consuming different goods in different proportions[70] as their income varies. Furthermore, a death duty or inheritance tax, which takes the realisation and averaging of capital gains into consideration, may be introduced to prevent the gains and benefits from passing on to the heir, without tax payment. In order to break up large properties, it would be advisable to tax inheritance rather than bequests. To encourage retention of income and promote further investment a supplementary measure may be introduced: gains arising from holding venture capital, i.e. shares of stock and debentures, may be entitled to tax reduction at a specified rate every year, starting from say, the fifth year of the possession of such an asset. Gains from such venture capital may be declared tax exempt after ten years of possession. This will have no effect on either estate duty or inheritance tax. It provides for greater degree of retention of earnings, and, also, helps promote the establishment of the capital market. At the present, joint-stock companies are authorised to issue anonymous shares of stock. These shares are transferable without formal registration in the books of the company.

Capital/

---

69. H.C. Wallich, Op.Cit., page 143.

70. W.A. Lewis, Op.Cit., P.403.

Capital gains realised can, therefore, escape taxation. Although the additional 10 percent withholding, in excess of the standard 20 percent dividend tax, may reduce their attraction, further penalties may be introduced to limit the escape of gains without paying taxes. A more effective measure to cover registered and unregistered anonymous shares, and to take care of the "lock-in" factor, would be to exempt gains obtained prior to the end of the fifth year, under the condition that the proceeds are reinvested in similar assets of productive ventures. The length of the time period may be decided upon, which will take economic and other factors into account.

A second shortcoming of the tax is that gains are taxed at ordinary income tax rates, in view of the averaging provision, while on the other hand, losses from such investments cannot be offset from such gains for more than three years. That is losses not offset from gains in the same year can be carried forward and offset against future gains from these sources for not more than three years. This partial loss offset is likely to affect investment decisions and reduce risk taking, since the government only shares in the gains, while losses are largely borne by the investor.

The abolition of the two tier tax on distributed company source income and the reduction in personal tax rates have aimed at ensuring a higher effective rate of return than what may be obtained from other taxable sources. Even though dividend distribution may remain unaltered, this will help increase internal finance. But, the fact that capital gains from equity capital, or certain other industrial assets, receive unfavourable treatment compared to land and real estate, it may discourage and prevent the retention of a larger part of the benefits expected to accrue from these amendments to the corporate sector. This is more likely where further capital acquisition is related to and affected by the level of/

of dividend distribution, rather than a rise in the value of equity capital, under a rising price level. The wide disparity of the effective rates of interest among the different sectors of the economy further adds to the significance of a dividend policy.

A third and perhaps most important shortcoming of the present capital gains tax is its economic inefficiency. In a less developed economy, one of the most important economic functions of the capital gains tax is to curtail speculative activities, particularly, in real estate, land and other unproductive, immovable properties, the value of which has and is rising more rapidly with the pace of rising prices. The fact that gains from land and buildings are not equally taxed is, by itself, a discouragement to savings and investments into these risky but economically productive areas. Under the Afghan Income Tax Law, gains arising from the transfer of land and buildings are not taxable, as such, and instead, the entire value of the property is subject to a nominal flat tax rate of one percent, page 190. This is against the policy of discouraging such speculative financial transactions that are economically unproductive. It seems contrary to the fundamental aims of the capital gains tax that of serving as a control device which would assist the Distribution and Allocation Branches of budgetary policy. The objective of the tax must be to increase real savings and investment. Under the present arrangement, higher gains from productive investments will bear a graduated tax liability of up to 40 percent; while gains from real estate and buildings will bear a considerably lower tax liability, as they increase. Assuming a 10 percent rate of return on investment, the one percent transfer tax is equivalent to only 10 percent tax on income from the transfer of such properties. This method may be advantageous to small investors, receiving small amount of capital gains, but this is not what the economy is in particular need of. It discriminates against greater productive investments. Within the same sector, it discriminates infavour of large property/

property owners rather than small ones. It might even impair replacement value of assets, say, for owner-occupied houses. It appears to be contrary to the ultimate aim of the planners, to promote large amounts of capital investment in the productive sector. Capital will tend to shift from the productive sector to investment in land and buildings, the value of which may be increasing much faster than that of risky assets. The following example will best illustrate this line of argument:

Investment in Industrial assets (Shares of stock)

(Capital gains subject to the progressive income tax schedule. In Afs.)

Investment in land and real estate

(Capital transfer subject to a one percent tax at the market value.)

Asset Purchased	Sold	Gains + or Loss −	Tax	Property Purchased	Sold	Gains + or Loss −	Tax
1000	1100	(+ 100)	4	1000	1100	(+ 100)	11
1,000,000	2,000,000	(+1000000)	300000	1000000	2000000	(+1000000)	20000

Should the one percent tax have affected and lowered the annual rate of return and thus capital value to the seller, then the purpose and objective of the tax would have been served and fulfilled.[71] But, the rise in the price level during the past ten years, the expansion of the urban population, the attraction of tourists, the influx of a growing number of labour force into the cities, and the land and construction requirements of industries, all have, undoubtedly, had a rising effect on the prices of these properties. Under these circumstances not much of the tax, however nominal, may be borne by the seller. On the contrary, the foregoing factors have caused immovable property, particularly urban land and buildings, to rise in value much faster than the level or prices would depict. This is especially true in the/

71. Capitalisation of a tax is likely to reduce the value of the asset concerned by a multiple of the tax. For example, a piece of land yields an annual 4% rate of return and has a capital value of £3000. The 1% tax on the capital value of the piece of land levied, when transfer takes place, is expected to reduce the return to £90 and as such the capital value is lowered by the capitalised value of the 1% tax, i.e. by 30/.04 or £750. The value of the land is thus reduced by this amount to £2,250. In other words, an amount equal to £2250 is needed to raise a net of tax rate of return of £90, representing 4%, i.e. 90/.04 or £2250.

the Capital and Provincial cities. Land prices in the Capital city, have increased by more than two thousand percent over the past twenty years. This percentage is even higher when the price of land in the business areas is considered.

The lack of an organised capital and property markets is one of the difficulties inherent in the taxation of capital gains, based either on actual gains, such as is the case with shares of stock, or the capital value of the asset in question, such as land and buildings. The exact value and the real gains may be difficult to obtain. The prevalence of a considerable amount of concealment and understatement of gains renders the effectiveness of the tax more difficult. No tax measure will be void of administrative difficulties. Part of the problem will be handled by the nature of the tax itself, especially in the understatement of gains. The revenue office will benefit from the conflict between the interest of the seller and the buyer. But, in as far as the determination of the initial value is concerned, the keeping of records and reporting to the tax offices need considerable improvement. Until the development of securities and exchange markets, with an adequate register and recording facilities, the Revenue Department will have to take the initiative in maintaining such records through income tax returns and the help of Court Registrations. This requires, in addition to an increase in the revenue staff, a greater degree of co-operation between the Revenue Department and all the other appropriate agencies and offices involved.

(b) Concessions to Companies:

Owing to the unique nature of the corporate form of enterprise, profits are often treated, for tax purposes, in a different manner than income generated from other sources. Corporate profits, have always enjoyed a preferential tax treatment to individual income. The obvious reason is to promote and encourage further capital formation and a higher level of corporate type of business organisation. It will, also help bring more resources/

resources under the control of the public sector, where records and accounts of such organisations are easily inspected by the public authorities. The corporate sector is more easily taxed, and its savings behaviour controlled, (discouragement of dividend distributions). This is mainly so as a large share of corporate income is normally saved and reinvested instead of going into consumption and/or unproductive investment. Where a certain fixed level of dividend distribution is to be maintained, in order to ensure and promote equity share investment, the tax treatment of the residual income, at the corporate level, becomes more crucial to the success of the corporate type of business enterprise, and the process of capital formation. This becomes even more important where the availability of external funds, through the medium of the banking system, page 38-47, or the machinery of the capital market seems inadequate.

A relatively moderate level of corporate taxation has existed under the Afghan Income Tax Law since 1944, when such a tax was first instituted. The various features of the system, aside from those incorporated in the Private Investment Encouragement Law, have undergone necessary changes to suit the requirements of the corporate type of organisation. The following pages will deal with some of the most important of these features, serving as forms of incentives intended to affect the level of corporate savings and investment.

<u>(i) Tax Rates:</u>

The general level of the tax has not undergone considerable changes since 1945. In 1945, corporate profits were subject to a flat rate of 20 percent tax, page 91. It was reduced to a maximum of 10 percent in 1954. It was not until 1957/58, that a radical change was introduced, involving a combination of a fixed and progressive tax rates. As a concession to industry, industrial establishments were subject to a lower fixed tax rate. Whether/

72. Schedule (F), page 156

Whether the rise in the number of new industrial establishments, from 27 in 1957 to 92 in 1966, may partly be attributed to this factor is difficult to maintain. On the other hand, total net private investment, within the second Plan Period was not substantial, in spite of the increase in the number of new enterprises. It amounted to a total of Afs.400 million, or about 1.6 percent of total development expenditures during the entire period of 1962-1967.[73] Private investment outside the plan reached a total record level of over Afs.12 billion over the period[74]. This aggregate covers investments in all sectors of the economy, including industry. However, industrial investment has been very low, Table 33, page 278.

In order not to have checked the expansion of the most successful enterprises and to have eliminated the preferential treatment between the industrial and commercial enterprises and among enterprises in the same sector, the progressive tax rates were, as examined earlier, replaced in 1967, by a flat rate of 20 percent on undistributed profits. Under the pre-1967 Act, corporate source income was first subject to a maximum rate of up to 22 or 27 percent corporate income tax, and a further individual income tax, ranging from 13 to 72 percent, on dividend distributions. Altogether, total distribution of corporate source income, which was subject to a maximum rate of around 92 percent tax before 1967, can now be treated at a maximum rate of as low as 40 percent. It affects the payout ratio of companies in favour of retained earnings. This feature, plus the fact that dividends are deductible from corporate taxable income, is likely to allow for a larger portion of undistributed profits which will, in turn, facilitate internal finance, providing funds for both fixed and working capital requirements.[75]

---

73. Government of Afghanistan, Third Five Year Plan, 1968, p.48

74. Ibid., p.186.

75. Reference is made to pages 297 and 298.

(1)An industrial enterprise with a total taxable income of Afs.18,000,000 would have to pay taxes in the following manner under both systems, i.e. before and after 1967.

(a) - Under the income tax law of 1958 - the tax will be:

	Taxable income Afs.		Taxes Payable Afs.
	18,000,000	18,000,000	
1. Fixed tax	05 percent	900,000	900,000
	17,100,000		
Exemption	50,000		
	17,05,000	17,050,000	
2. Progressive Tax	17 percent	2,898,500	2,898,500
	14,151,500	14,151,500	
3. Municipal Tax	01 percent	141,515	141,515
	14,009,985	14,009,985	
Dividend distribution at 40% of profits net of corporate taxes	40 percent	5,603,994	
	5,603,994		
Assuming an average rate of 55 percent tax =	55 percent 3,082,196		3,082,196
Total undistributed profits		8,405,991	7,022,211
Total dividend net of tax	2,521,798		

(b) - Under the 1967 tax law the tax will be :

	Taxable Income Afs.		Taxes Payable Afs.
	18,000,000	18000000	
Dividend deduction[1]	33 percent	5940000	
Taxable corporate income	12,060,000		
Corporate Tax	20 percent		2,412,000
	9,648,000		
Municipal Tax	01 percent	5940000	96,480
Dividend Tax		at 40%	2,376,000
Total undistributed profits	9,551,520		
Total dividend net of tax		3564000	
Total tax paid			4,884,480

(1) Assuming no significant change in the absolute level of dividend distribution is expected and as such it is kept at around the same level.

As capital and money markets are so undeveloped, and an adequate volume of savings from individuals (household) is not likely to come forward at a rapid rate anticipated, retained earnings, encouraged by the new corporate tax reform, are likely to be one of the most important and effective sources of finance,. Due to the lower tax rates, larger amounts of dividends net of individual income taxes, are expected to provide greater investible funds for new equity subscription at the hands of individual shareholders.[76] The revenue loss resulting from these sources is expected to be compensated for through the imposition of certain indirect taxes, such as excises and sales taxes, and in the long run, by the growth in the total volume of corporate profits. Although the net result still remains to be seen, the pace at which private sector has promptly responded in raising the level of private investment, over the past two years, may be considered satisfactory. This feature of the system seems to be more favourable to large and more successful enterprises. New and small enterprises, particularly unincorporated ones subject to the individual income tax rates, despite its lower marginal rates and the availability of concessions covered under the provisions of the Private Investment Encouragement Law, and who have no option in adopting smaller or larger distribution and retention policies will find it relatively difficult to rely on internal sources of finance as compared to their rivals, i.e. the corporate sector. Despite the growth of large establishments, future stages of Afghan industrial growth will largely depend upon the creation and performance of such small enterprises./

---

76. It is not likely that the propensity to consume at higher levels of income will always stay the same. As people's income increases, both propensities to consume and save in absolute terms are likely to increase, particularly in the less developed areas. There will still be a larger share of income saved than before. The type and nature of investment will obviously vary, and it is here that the inducements are more important.

enterprises. Factors, such as the size of the market, the lack of adequate and competent management the meagre financial resources obstructing the creation of large enterprises may help small scale establishments. Furthermore, the potential auxiliary nature of such small scale enterprises in serving the large industrial establishments, supplying them with raw material, providing repair services, etc., are all likely to result in the growth of small sized enterprises. For long and short term capital requirements, resort to outside sources of finance is necessary. As dividends received by companies, from "franked investments" are taxable at source and at the hands of the recipient company, the effective rate of return and the possibilities of external finance are reduced. However, chances of loans through debentures and credit may not be over-ruled. The existing commercial and specialised financial institutions, particularly the Industrial and Agricultural Banks, will therefore, have to devote, under appropriate loan or investment policies, much of their time and resources to satisfying the needs of such small but pioneering groups of enterprises.

(ii) Depreciation Allowances:

A second factor which affects and determines the level of internal resources available for capital expenditure is the degree of depreciation and/or amortisation of capital assets, allowed under the income tax law. The more progressive the tax, the higher the discount rates, the longer the useful life and the shorter the economic life (for tax purposes) of the asset, the greater[15] the effect of depreciation on the level of internal finance. The method deducting depreciation charges, in this respect, acts as a hidden subsidy. In order to further increase these benefits, assets are, at times, allowed to depreciate at various accelerated rates: through the straight-line method, initial allowances, investment credit, or a combination of various measures. Such measures, which save tax and so provide for a rapid recovery of the capital, have been a common post-war feature of/

of many tax laws.[77] Where the ratio of depreciable assets to total capital is high, as in mining and other heavy industries, changes in the depreciation policy will render such investments more attractive. Such an accelerated depreciation scheme has the following main advantages:

(1) It is likely to reduce the present value and, hence, the effective burden of the tax through tax savings.

(2) It provides the investor with an immediate increase in liquidity.

(3) In a period of rising prices, a fast write-off increases the real value of the depreciation allowance. The opposite holds if prices fall.

(4) A shorter depreciation period renders the depreciation allowances more valuable, if the investor attaches a penalty discount to more distant returns, due to increasing uncertainty.

(5) Since, in the absence of a full loss offset, the investor may not be certain that there will be sufficient future income from which to deduct the depreciation at the permissible time, the sooner he can deduct these charges the more certain he is that he will be able to deduct at all.[78] Moreover, the acceleration of depreciation charges will not only provide an "interest free loan", as it is usually referred to,[79] but if the rate of return is high and the pattern of investment is so recurrent as to give taxpayers a control over the period of this tax free loan, neither the tax, nor part of the loan, will be paid back. The treasury, therefore, incurs a net loss of revenue. The larger the firm's depreciable assets, the greater the tax and interest benefits and the lower the level of public revenues. The practice may be more favourable under progressive/

---

77. Richard Goode, "Accelerated Depreciation allowances as a stimulus to Investment", Quarterly Journal of Economics, pp.191-220.(Vol. LXIX, 1955)

78. Further reference on these points and the significance of tax saving from a depreciation policy may be made to A.R. Musgrave, Op.Cit., pp.336-346.

79. Heller and Kaufman, Op.Cit., page 156.

progressive income tax schedule than under a proportional one, as tax saving under the former is obviously related to the level of marginal tax rates. However, even under a proportional tax rate, the benefits of such a scheme to a small and new enterprise, and those whose capital turnover is slow, may not be so great due to low level of profits, capital assets and retained earnings. Nevertheless, where the money and capital markets are undeveloped, some degree of acceleration in depreciation charges will not only provide greater liquidity and cash inflow, which will help internal finance, but should further funds be necessary, loans supported by such collaterals, i.e. acting as "leverage", may be negotiated on easy terms.[80]

Although the low share of capital in the Afghan industry may be an obvious indication of the extent of depreciation charges as a source of internal finance, the amendment, under the new tax law, affecting the magnitude of these charges are worth evaluating.

Depreciation allowances, in Afghanistan, have been on a straight-line basis, extending for a period of 16.5 years for machinery and plant equipment. Although a distinction is made regarding the various types of depreciable assets in different industries, the period in general is a lengthy one, and does not take into account the adverse effects arising from the reduced cash proceeds. It will prolong the recoupment of the capital invested, particularly, when the "pay off period" method of depreciation is adopted by the investor, irrespective of the fact that the useful life of the asset extends for a longer period of time. It will equally adversely affect the profitability of the investment when other/

80. R. Goode, Quarterly Journal of Economics, Op.Cit., p.201

other methods, such as the DCF or the Net Present Value of investment appraisal are employed, owing to a high degree of risk and the time discount factor applied to future earnings. An investment worth £10,000 depreciated for different periods, with no salvage value, under a straight-line basis, at a constant rate of interest of 10 percent, and a tax rate of 20 percent will clearly indicate the significance of a scheme which allows a rapid recovery of the capital. It is obvious that the highest present value, of either earnings including depreciation charges, or tax savings on depreciation charges alone, arises under the shortest depreciation period.[81] The net absolute savings arising from one method as compared with another may not be a substantial percentage of the initial capital outlay. But, as the rate of interest is very high the provision of this tax saving (interest free loan) device is very helpful indeed. The relative benefit appears to be greater when compared with the tax savings under lengthy depreciation schemes. The longer the period, the lower is the tax savings. With an instantaneous depreciation allowance scheme an advance, almost equal to the/

---

81. Under a one year depreciation scheme, (depreciation allowed upon the acquisition of the asset) a 20% tax and a 10% rate of interest the present value of tax savings on the £10,000 would be £1,818.

This is the highest in relation to a straight-line depreciation for four years, which is £1596, or £1228 and £988 for ten and 16 years, respectively. Tax savings under the 16 years scheme amount to almost one half of savings expected under the one year, or 9% of the initial capital value. Earnings other than depreciation, including salvage value of the asset, are not considered in this case, as we are not so much concerned with the net present value of different projects and or their internal rate of return for purposes of feasibility and profitability study. The net difference of interest income arising due to time lag between the receipt of Investment Credit and the payment date of corporate income tax is also not accounted for. In determining the overall profitability of a project, all these factors will have to be taken into consideration. One of the reliable and satisfactory methods is through the flow of funds analysis using both the Net Present Value and Internal rate of return or yield approach, where the question of the profitability and internal rate of return appear to be more significant. For a review of these methods reference may be made to A.J. Merrett and A. Sykes,

(a) "The Finance and Analysis of Capital Projects", Chapter V, p.148
(b) "Capital Budgeting and Company Finance", pp.98-122.

the tax rate on the total amount invested, is made, disregarding for the moment the time lag involved. This implies that the effective initial cost of the investment is reduced by that amount, or the investor's rate of return is increased. The salvage value of the asset, if any, will no doubt affect future tax liability. Even then, as capital has been recouped, the after tax benefits of the salvage value are net gains.

To have minimised the disadvantages of the lengthy depreciation period, a direct credit which is often regarded as "Investment Credit", is provided under the Afghan Income Tax Law. The credit allowed is equal to 15 percent of any new capital outlays, in mining and manufacturing, obtainable over a period of five years, and at a maximum rate of not more than five percent, or one-third of the total allowance per year.[82] The specified percentage is deductible from tax liability and not from taxable income. It is meant to accelerate the pace at which depreciation charges are in fact deducted. It will improve the liquidity position which is extremely important in the light of the lack of money and capital markets. It is an outright gift and, as such, does not reduce the basis of subsequent depreciation/

82. This is in line with similar measures adopted in certain other countries. The United States introduced a 7% capital allowance under the 1962 Tax Bill; India offers 25% rebate on capital investment. Heller & Kaufman, Op.Cit.; Venezuela ties the rate of this credit to the percent of profits reinvested. A 10% tax credit is given for the reinvestment of 10-20% of profit; a 25% tax credit is given for the reinvestment of between 90 and 100% of profits. R.M. Sommerfield, Op.Cit., P.99. A tax credit, in the writer's view is more desirable to Investment Grants, which although eliminates the effects of uncertainty on decision-making, still shifts the responsibility of decision-making to the Public Authorities. This may increase problems and complicate an already poor and inefficient administration, the controlling power of which may be resented by the private enterprise. Reference on Investment Grants may be made to "Investment Appraisal" H.M.S.O. 1966, and to "Investment Incentives", Cmnd.2874, H.M.S.O. January, 1966.

depreciation charges allowed. The provision is expected to, partially, compensate for the effect of any rise in the price level on the cost of replacement, particularly as the depreciation charge is computed on an historical cost basis. The credit is allowed on a discriminatory basis for additional investments in the already established manufacturing and mining enterprises, where the risk is high and capital requirements more. This will affect the quality of investment and will channel into the manufacturing and mining industries more funds from the more conservative and traditional areas, such as commerce, real estate and buildings and the like. It draws no distinction between growing and stable enterprises within the same area of activity. However, the implications are that a larger benefit will be conferred upon enterprises with a larger rate of growth in their capital outlays, as against a non-growing firm. Tax savings, under an instantaneous depreciation charge, according to the illustration cited above, page 303, will only be about four-fifths of the combined tax saving from depreciation at 6.5% per annum and investment credit of the total 15 percent.[83] The advantages of the longer depreciation period, under these circumstances, is obvious, as the depreciation charges still reduce the effective tax burden by the amount of the tax saved. This raises the rate of return, particularly under a proportional income tax. To encourage retention of profits and promote internal finance, the amount of the 15 percent investment credit allowed each year must be made more flexible and must be tied up to the percentage of profits reinvested during/

---

83. It must be pointed out that the discounted present value of the 15 percent of £10,000 in the illustration above, page 303 , allowed over 3 years at 10 percent interest rate is only £1,243, (£500 x 2.48685), which is 17 percent lower than the initial value of the 15 percent, due to the effect of the discounting factor. In this particular case, the effective rate of Investment Credit is thus reduced to only 12.43 percent of the initial £10,000 investment outlay, instead of the staturory 15 percent.

See Harold Bierman, Jr., and Seymour Smidt, Op.Cit., p.126 and A.J. Merrett and A. Sykes, Op.Cit., pp.51-57.

during these years, page 304 , note(82). Whether under an accelerated depreciation method or the combined depreciation - credit allowance scheme, the deduction of any permissible charges presupposes the existence of adequate earnings during the period concerned. The inadequacy of such earnings requires a loss offset provision, which will allow outstanding balances to be offset against future income. Under the present Afghan Tax Law loss offset, as noticed earlier, is allowed for a period of three years. An extension of this period will, undoubtedly, prove beneficial to both, new and already established enterprises, and will maximise the benefits of the concessions provided, page 307 below.

The present depreciation, however, lacks the provision for a rapid wear and tear of assets due to a double, and triple shifts. Industries and factories operating on a more than one shift schedule should be allowed a rapid wear and tear of their assets. Equally, no provision is made for the obsolescence of equipment. In the light of the present day's rapid technological achievements, a provision covering the normal life of an asset is not adequate. The 16.5 years depreciation period renders this issue extremely important. The efficiency of modern industry largely depends on the effective and adequate utilisation of technological achievements.

A further shortcoming of the investment credit, like the import duty exemption on capital goods and raw material, page 263, is that no precaution is taken regarding the subsequent sale of such articles to unqualified parties. In order to emphasise the importance of these concessions, it must be clearly stated that, in the event of a subsequent sale to unqualified parties, the whole, or part, of the exempted tax must be collected, depending upon the usage and remaining life of the asset, so as not to stifle modernisation when and if needed. The technical studies and findings of the proposed Industrial Development Centre, page 262 , will be

of/

of great importance regarding obsolescence and the question of modernisation

(iii) Loss Off-set :

One of the factors closely associated with the tax incentives provided under the law, and which greatly influence investment decisions and risk taking, is the loss offset provision. As noted earlier, the Afghan Income Tax Law provides that business losses sustained in any one year and not offset, may be carried forward for three years [84]. Under such a partial loss offset, the income effect is likely to induce investors, influenced by an optimism, to take up more risk and recover that part of the income which is bound to be reduced by the tax, assuming a rising marginal utility of income as its level falls. But, the substitution effect, influenced by the lack of a full loss offset provision, may push the investor towards taking less risks, as the reward for risk taking is reduced where the government only takes part in gains and leaves risk uncovered. This is particularly important for individuals as well as companies under a progressive income tax rate, which did exist in Afghanistan up to 1966/67. It is possible that a rise in the level of prices may work against the substitution effect, by making cash holdings less profitable. Although profits will be rising the taxation and treatment of dividends, retained earnings and capital gains and losses once again come into the picture. A favourable treatment of capital gains and losses, may in the context of the Afghan economy, induce investments and reduce cash holdings. An unfavourable/

---

84. This period appears the lowest among a number of countries. The United Kingdom Tax Law permits an indefinite carry-forward, and a three years carry-backwards on cessation of a business. In the United States a loss may be carried back three years and forward five years. Under the Canadian tax legislation, losses may be carried back one year and forward five years. K. Carmichael Op.Cit., pp.377-414, and Report of the Royal Commission on Canadian Taxation, Op.Cit., pages 252-255 and 291. Mexico and Puerto Rico allow a loss carry-forward period of five years each; Israel allows seven years, while Ceylon does not specify a fixed period. UNIDO, Op.Cit., page 21.

unfavourable treatment of capital gains in risky ventures, works against this eventuality; that is, where they are taxed as ordinary income and where losses are only partially provided for. Therefore, both the inflationary and the deflationary, effects in the economy will work against investment in areas where the realisation of these effects fall within the sphere of income taxes, with none or partial loss offset. In order to retain the beneficial effects of the tax holiday, dépreciation allowances, investment credit and other such incentives, provided under the Afghan Tax Law , a more liberal carry forward of losses must be recognised. This is necessary on both equity and economic grounds. It is needed in spite of the elimination of the progressive corporate income tax, where the treatment of loss was bound to have a considerable impact on the level of earnings and tax liability. Losses from trading operations, of any one year, should immediately be carried forward and set off against any profit arising in the future from such activities. Such a loss offset scheme will also add to the effectiveness of the built-in flexibility feature of the tax system.

It is obvious that these suggested provisions may involve a further loss of revenue to the Treasury. It is also true that one of the economic objectives of the tax system in the country would be to partly transfer certain amount of purchasing power from the private to the public sector. This may be to the immediate and ultimate national advantage only when and where public savings and investment would contribute more to the process of economic growth than the utilisation of these resources by the private sector. The provision of investment allowances of the type outlined above, does not conflict with this overall objective, provided they are granted to industries, such as mining and manufacturing, whose development has not only been given priority in the long term objectives, but who are expected to add to capacity production. Furthermore, resources cannot be/

be readily mobilised, in large areas of the economy, except through participation of the private sector, the motivation of which, therefore, appears to be a prime necessity. In the absence of the private sector's contribution, the fulfilment of these development objectives will bring the government into the picture, with even greater capital requirements. The secondary (multiplier) effects of any induced investments, resulting from a tax concession, may compensate for the immediate loss of revenue. In order not to allow tax revenue sacrifice to be greater than the benefits from induced investments, the selectivity and discretionary features of these concessions must be emphasised together with administrative efficiency whereby each one of these concessions is carefully evaluated during different intervals. Wherever these concessions prove ineffective, they must be promptly terminated in order to prevent further loss of revenues, unnecessary sacrifice of equity and waste in the allocation of resources in the economy. Moreover, as a pre-requisite for the success of any concessionary measure, however selective, the shortcomings of the tax structure in general, and the income tax law in particular, covered in this and the previous chapters must be remedied. It is pointless to enumerate on these concessions, at the expense of revenues, equity and even growth objective, when the tax system carriers certain basic weaknesses.

Certain fundamental policy lines, which affect the private sector's contribution to the process of capital formation, ought to be clearly defined. The basic philosophy underlying the economic development of Afghanistan, as defined in the Country's development programme, as early as the thirties, and reaffirmed in the most recent programmes since 1958, has been the acceptance of the principle of a "mixed and guided" economy. Both the private and public sectors have been expected to, simultaneously, work towards securing a high standard of living. On the other hand, looking at the application of such a philosophy in a dynamic sense, the scope and interpretation of the concept of "mixed and guidance", and the relationship/

relationship between the private and public sectors' sphere of operations become vital, in so far as the continuity of such a co-operation is concerned. Ambiguities, arising from the very general nature of such a concept, are apt to reflect themselves in the form of conflicts of attitudes and performance, which will render the concerted efforts of all parties concerned less co-ordinated, and liable to fall apart. This is extremely vital for an economy where the State occupies a much smaller part of income, than does the private sector. This difference, as noticed above, in magnitude, is of the general order of 10 percent State and 90 percent the private sector. It is important and necessary for the common goal that one understands the behaviour of the largest element in the mixture, viz. the private sector, which is governed by market forces, however imperfect such a market may be under the present circumstances. This remains valid despite the commitment to a development policy which conceives of the government as being a more dynamic and guiding sector in the economy. This is understandable from the emphasis laid down in the Third Five Year Plan, where a relatively greater share of investment is assigned to the private sector than what it has had in the past. No doubt it may be from an understanding of this fact that the foregoing incentives, and concessions, intended to motivate the private sector towards greater investments, have been adopted. Yet, in order to render these measures more effective and successful in helping private enterprise to carry its share in future investment programmes, the economic policy of the government, in this respect, must be clearly defined. The question likely to be raised is whether entrepreneurs will be willing to make substantial investments, in any sector, before the government clearly defines the areas of its own interest, and gives adequate assurance that no drastic and frequent changes will be made in this direction. It is clear that the pattern of future expenditures and their finance, has been laid down in such a manner as to improve/

improve output with a minimum effect on the price level, thus ensuring stability in the currency and economic activities. Economic stability, coupled with political stability, will further help the pace of investment decisions. In order to expect the optimum benefits from all these factors, and the general public will find it equally necessary to understand where it stands vis-à-vis the government in the sphere of economic activities, terms such as mixed or guided must be more explicitly defined.

The word "mixed" can be interpreted to mean the joint participation of both public and private, capital, in economic organisations, or in areas of operations. Furthermore, it may not be sufficient to define the private and public sectors' appropriate areas in terms of light and heavy industries. A policy statement, clearly specifying the type of activities which are generally vested in a public interest, and therefore fall within the public sectors sphere of operation, has to be made. For example, industries connected with national security, the generation of electricity for sale, basic metal industries, coal, petroleum products, government printing and a few others, should be specified and reserved for the public sector, at least for the time being. The rest may be declared to fall within the scope of private enterprises. Such a policy statement is believed to contribute to the effectiveness of all the incentive measures outlined, and recommended above.

CHAPTER EIGHT

THE ADMINISTRATIVE ASPECTS OF THE AFGHAN INCOME TAX SYSTEM

The Administrative Aspects of the Afghan Income Tax System

1. Adequacy and Clarity of the Law.

2. Lack of Book-keeping and Auditing of Accounts.

3. Administration of the Tax.

    (a) Organisational Structure

    (b) Recruitment Practices

    (c) Employees Remuneration

4. Collection and Enforcement.

In many less developed countries, the problems of economic growth, generally, stem from a typical cycle proceeding from low income and a high propensity to consume, leading to low rates of savings and capital formation, which result in a continuation of a low level of income. As indicated earlier, a rise in the level of income necessitates an increase in the proportion of resources (both domestic and foreign) saved and invested in the more productive areas and sectors of the economy. The limitations in resorting to foreign aid, deficit finance, surpluses of state economic enterprises and/or other such revenue items, call upon taxation to fulfil the task. On the operational level, the success of such a mission requires improvements in the structural and administrative aspects of the tax system in general, and of income taxes in particular. The growing revenue requirements of the government, to meet the objectives of ambitious development programmes, must be met from additional yields, arising out of necessary structural changes and improvements in the administration of the tax system.

The capacity of Afghanistan to readily absorb tax increases cannot at the present, be reliably estimated. This is due to the lack of adequate data upon which such estimates may be based. Nevertheless, the analysis carried out in the earlier part of this paper serves as a rough guideline to the tax potential of the Country. It has been generally established that the ratio of total government tax revenues to national income, for the more developed economies, ranges from 25 to 35 percent, and from between 8 to 15 percent for the less developed countries, page 81. As indicated above, this ratio is substantially lower in Afghanistan than in other comparable economies. It may be mentioned that the tax revenues for 1966/67, and for previous years, for which national income figures are available, could have been substantially increased by over a billion Afghanis, without creating a tax impact upon the people in excess of that sustained/

sustained in the more lenient comparable economies. Based on this comparison and on the study and analysis of the tax system made in the foregoing chapters, it is conceivable that tax revenues may be substantially increased, not only through the revision of the entire tax system, but also through its administration. Reliance upon custom duties, particularly on imports, as the principal source of revenue has, during the past decade, provided a suitable expedient for periodically increasing the amount of revenue needed. As indicated above, it fails to serve other purposes of a tax policy, namely those dealing with efficiency and equity aspects. Export taxes, coupled with various other levies directly imposed on certain major items of the export mix, such as Karakul, also warrant serious consideration for the same reason given in connection with import levies. The livestock tax assessment deserves adequate consideration also. Land taxes too, as has repeatedly been emphasised throughout this study are demonstrably insignificant due to the lack of revision, either in the base or rates over the past fifty years; despite the fact that the major benefits from the government's past and projected development programme accrue to the land owners group. These are some of the areas that appear to warrant immediate consideration and reform, if a major breakthrough is to be expected in the structure and form of the age old revenue system of the Afghan government.

Income taxes have been the only category of taxes which have undergone a series of systematic changes since the inception of the system. In spite of all these changes, one point remains certain, that revenues from these taxes have not absorbed more than a small fraction of the increase in national income. The results of our findings on the elasticity of the tax system further explains this phenomenon. It is also understandable that, under the present circumstances, drastic upward changes in rates tend, not only to defeat their purposes, but will also discourage private investment/

investment at a time so urgently needed. The apparent anomalies and discrepancies, indicated above, form barriers to the introduction of further measures at increasing revenues, as well as, serving the other objectives of fiscal policy. While this fact may be appreciated, it should not overshadow the possibilities of improving on the structural weaknesses of the income tax system, which renders the scope and extent of this important tax, possessing a great growth potential, very limited. Improvements on the administrative and enforcement aspects of the income tax system need equal consideration. Weaknesses in either one undermine various aspects of the tax. Among other effects, they both give the prospective taxpayer to withhold the necessary information, or present false and distorted facts. This is done either through the structural loopholes, resulting in the avoidance of the tax, or through a deliberate act owing to a poor administration, causing the evasion of the tax. By so doing, the act will result in partly or totally preventing tax payments, particularly when the difference between avoidance and evasion is only a matter of degree due to the existing standard of efficiency in administration and enforcement of the law.

This chapter will be confined to an examination of the impact of some of these factors on the efficiency of administration and enforcement of the income tax system.

1. Adequacy and Clarity of the Law:

Inadequacies and ambiguities, both in the scope and wording of an income tax law, are bound to hamper the effectiveness and success of that code. It will undoubtedly contribute to creating loopholes, which will, in turn, result in avoidance and evasion of tax liability. It does not only waste administrative time and efforts in coping with the enormous volume of queries regarding the interpretation of these ambiguities and discrepancies, but also destroys taxpayer morale, which further adds to the problems/

problems of an already inefficient administration. This is to a large extent one of the major factors making it both legally and administratively almost impossible for the government to enlarge the tax coverage and reach those who would normally be subject to the tax. The low level of tax collection in such a circumstance will have no relevance to the taxable capacity of the economy. The Afghan case is no exception to this rule. The Income Tax Law and its ad hoc revisions, since its inception, have rendered the tax a complex piece of legislation, making it impossible for an average taxpayer to find out his approximate tax liability, and creating a pile of paper work for the inadequate and ill-equipped administration to cope with. No doubt, the failure to define, clearly and precisely, the area and extent of taxable items, effective and applicable rates, exemptions, penalties and other related issues, has added to the ineffectiveness of the law. Vagueness and ambiguity have left great areas of discretion open to tax administrators in the application of the law, over a vast area with poor means of communication. Some degree of collusion as well as conflict between the taxpaying public and tax collectors are inevitable consequences of such a system. The Schedular system, introduced in 1957/58, without any manual or interpretation of the different provisions had, until 1966/67 been a major source of queries and confusion to the taxpaying public and tax offices.[1] The high turnover of tax officers and the lack of a comprehensive and clear interpretation of the law, in the form of a manual, added further to the administrative and enforcement difficulties. As a result of this confusion and inconsistency, a major part of the administrative staff's time, in the central as well as secondary offices has been occupied in attending to queries from provincial and district tax offices, and in handling unduly complicated cases. These repeated enquiries, sometimes from the same source, amounting to more/

1. H.H. Hinrichs, Certainty as Criterion, Op.Cit., pp.139-54.

more than a hundred cases each year, occupied the valuable time of high ranking officials, which would otherwise be devoted to policy issues. This is one of the explanations why the government has resorted to the easiest and least costly ways of raising revenues, i.e. through indirect levies. The administrative complexities, in relation to the amount of revenues raised from such other sources, fell way behind that experienced under the income tax administration. On the other hand, this frequency of enquiries from secondary and tertiary tax offices does not suggest the questioning of a centralised system of revenue administration. A significant degree of authority, and control, must exist at the central level if effective reforms are to be initiated and extended. Decentralisation of authority, an important requirement in administering a nationwide programme, must not mean abandonment of control over provincial offices by the central office. The success of the system depends on factors other than a diffusion of authority. It presupposes the existence of clear directions, manuals and procedures worked out and put at the disposal of the secondary and tertiary tax offices throughout the country. A periodic inspection and audit will help in establishing connection between these offices and the centre, as well as facilitating the enforcement of such directives and procedures. It is apparent that to operate a revenue system effectively, and economically, the good-will and conscientious co-operation of the taxpaying public is necessary. Although voluntary compliance with regard to income tax return is required of everyone whose income exceeded the minimum exemption limit, the number of such returns filed has been very small, indeed. Owing to the inefficiency in the administration and enforcement, the self-employed have avoided taxes by not filing any return. This may, in part, be attributed to the lack of communication between the tax offices and the general public. It is necessary that the taxpayers, too, must be extended every possible assistance to help in the understanding and enforcement of the law, and to create/

create the best possible relations with the general public. Until very recently, not much of all this had been done. It is a truism that the individual's compliance with the law in the highly developed economies is associated with the existence of a high level of education, a high degree of law enforcement and the availability of adequate interpretation of the law which aid in its effective administration. The shortcomings of these social and legal institutions, within the less developed economies, are likely to render the administration of any law, however well designed, more difficult, particularly under democratic practices. As far as the enforcement of the income tax law is concerned, the persistence of this situation, coupled with a narrow coverage of the tax, is not likely to help improve general taxpayer morale and consciousness. The existence of discriminatory features in the entire tax system adds to the problem. The results have been an adverse effect on the yield capacity and economic efficiency of the tax system. It also violates equity considerations in taxation. Nevertheless, measures can be taken to improve the situation and render the administration and enforcement of the tax law more effective. The relationship of the different parties concerned, whether in a highly developed or less developed economy, is such that interests do not always coincide and, as a result, the apparent struggle between the law enforcing body and its subjects becomes more eminent. However, it is a matter of degree.[2] It was on these grounds that the income tax law of 1966/67 was accompanied by an elaborate manual, which is expected to help both the tax officers and the general public. Provisions are made, which incorporate into this manual any further interpretation arising from an unforeseen eventuality. One of the measures for the prevention of avoidance and evasion is the introduction of the withholding scheme. It has taken the income tax system one more step closer to convenience, simplicity and economy/

---

2. For a brief review of some of the legislative and administrative aspects of the British Tax System, reference may be made to: R.W. Maas, "Uncertainty in the United Kingdom Tax System Today", <u>Accountancy</u>, February, 1970, pp.93-100

economy in taxation. The method, applying to income from wages and salaries, also extends to dividend income. Taxes on salaries and wages are withheld on a monthly basis according to a graduated withholding table, calculated and prepared by the Revenue Department on hypothetical levels of annual taxable income from such sources. Since the amounts withheld are only a nearest approximation of one's ultimate tax liability, and when such a level of income may not be materialised, the employer is allowed to make necessary adjustments to arrive at the final tax liability, without resort to the tax office.[3] As such an employee whose total income from work is taxed at source, has no other income, and who has not been employed by more than one employer during the taxable year, has met his tax obligation, and does not need to file an income tax return.[4] In order to obtain a tax receipt, the taxpayer, under these circumstances, will only file, within six months after the taxable year, his salary and tax statements issued and certified by his employer, to the tax office concerned. The objective behind such a scheme is that the administration is not plagued by assessments, and adjustments at the end of the year, by minor tax refunds or by collecting small under-deductions. This may save time, but it is extremely important that fiscal responsibilities must rest with the tax authorities and not get diffused among tax offices and employers' accounting departments. It is desirable to retain the withholding feature of the tax system, but in order to avoid confusion, a possible loss of revenues, reduction of frequent field inspections and above all, elimination of the possibility of employers' complaints, employees must be required to file an income tax return to the appropriate tax/

3. In Sweden, the method of collecting the tax at source does not represent a discharge of final tax liability. In the United States, the withheld tax is calculated at a flat rate of 18%. When wages or salaries are higher than the 18%, the tax withheld is only a partial payment of one's total tax liability. The latter is similar to the withholding of taxes on dividends in Afghanistan, where a flat rate of 20% is applied.

4. Income Tax Law, Op.Cit., Article 69.

tax office, where the amount of monthly tax liability is calculated and communicated to the employer for withholding. The administrative efficiency required in this respect may be achieved through the facilities of data processing services. To further improve the withholding scheme, the Department of Revenue could prepare and issue a sample explanation, free of charge, to all taxpayers, on the schedule of tax rates, the withholding tables, together with the sales promotion brochures on savings bonds and the like. This may serve a better purpose if distributed at the beginning of the taxpayer's fiscal year, when forms on compiling information regarding personal status, and other data, are filed. This will keep the taxpayer informed of his tax liability which will, in turn, help in the management of his finances. It will also indicate to him the chances of investing in the proposed "savings bonds", and, thus, reduce his tax liability. To have facilitated the application of the scheme, income, as the tax base, has been restricted to cash earnings only, and does not include employee remuneration in-kind, the valuation of which is difficult and costly. It is worth noting, at this point, that in order not to outweigh the advantages of the above scheme, the administration and enforcement of the law over other taxpaying groups must be improved and strengthened. It may be recalled that salary and wage earners, under the previous law, enjoyed the advantages of a relatively low tax rate, and voluntary compliance in filing an income tax return. This has been replaced by the withholding scheme. As income from all sources is treated equally, the introduction of the above scheme, covering one specific group of taxpayers, necessitates further improvements in other areas of the administration and enforcement of the law. This is necessary in order to prevent a tax differential developing against such a group. Unless this precaution is taken, and the administrative staff, so released, is engaged in other areas to scrutinise the procedures and plug the administrative loopholes, the new law and its scheme will, eventually and inevitably/

inevitably, discriminate against earned income, in favour of rentiers and others, irrespective of the existence of the personal exemption. A tax which improves the formal legal structure, equally depends, for its success, upon improvements in its entire and overall administrative aspect. Changes in the form and structure of the law however, necessary, unaccompanied by equal administrative improvements, may be considered meaningless and wasteful.

(2) Lack of Book-keeping and Auditing of Accounts:

The efficiency and enforcement of an income tax system in a less developed economy suffers most from the lack of a proper system of books and accounts. This is often attributed to a low level of literacy; however, it need not be the cause of poor, unreliable and diversified sets of records, among the small group falling within the 10 to 15 percent literacy score of the population. The remaining vast majority of the population consists of farmers, artisans, craftsmen and other similar occupations, who do not maintain records, and, at the moment, it does not appear feasible to require them to do so. The experience with individual businesses and partnerships has not been satisfactory. There are no clear sets of accounting methods and procedures. Commercial, industrial or cost accounting methods are still alien to the majority of the income taxpayers. As a result, where accounts and records are required, there is a lack of uniformity both in the accounting practices and the language. This is not only particular of the individual tax paying groups, but, also, covers companies and other juridical entities. Furthermore, the shortage of an adequate and competent revenue staff either renders these records and accounts useless, or creates an atmosphere of distrust and suspicion which in turn causes misunderstanding and disagreements between taxpayers and tax offices.[5] It has been due to this very reason that the present arbitrary/

5. H.H. Hinrichs, Op.Cit., page 146.

arbitrary 7 percent taxable profit, to total turnover of these specific groups of individual income taxpayers, i.e. proprietors, partners and others has evolved. This gradual increase to the present 7 percent does not prevent the taxpayer from recovering that extra increase which the tax office is likely to collect. In an imperfect market, particularly, where prices are not easy to control and books and accounts are not available to reveal the true situation, a partial shift of the tax to consumers cannot be over-ruled. Moreover, the fact that a certain percentage of turnover is specified as a minimum legal taxable income, businesses, whose rates of return exceed this limit, will deliberately file a return indicating only the minimum requirements. Annual inspection and audit of their accounts reveal this phenomenon. There is , normally, no field audit. However, the authority to do so may be issued by the Ministry of Finance. Therefore, all accounts and books are subject to an office audit and inspection. A post audit of the accounts and records of the individual businesses for the 1963 indicates that over 80 percent of the total 2,289 businesses, maintained inadequate records, which necessitated an adjustment in the volume of their total activities.[6] Revenues from this source constitute a considerable portion of total fines and penalties, page 115. It is true that a small business lacks the expertise and knowledge that would enable it to use accounting data as a guide to analysing the prospects of the business and help in decision-making. Furthermore, expenses on such operations, according to their interpretation of cost, seem unproductive and unprofitable. The adoption of a proper system of accounts will reveal some of the secrets of their businesses, which they consider very important. Nevertheless, if income tax is expected to play its full role as a fiscal instrument, none of these factors should prevent the tax authority from improving the situation.

Simplified/

6. Revenue Department, Afghan Ministry of Finance, 1965.

Simplified systems of commercial and industrial accounting, with elaborate manual of operation, mainly covering purchases, sales, inventories, depreciations and other items of income and expense, must be devised by the Revenue Department and issued together with business licences. The Chamber of Commerce may be given the responsibility to conduct pilot training programmes on these systems for any businessman in need of help regarding the application of these systems. At the moment, there are no independent audits of accounts by certified public accountants and auditors. The present state of affairs explains the inevitable situation arising from the lack of this vital service. As a second step, it is necessary that such independent auditing bodies, operating on internationally accepted codes of ethics must be created. In order to ensure and justify the economy of their operation, as well as help establish lower rates of audit fees, accounts of all taxpayers above a certain level of capital and income in whatever area of business, should be subject to the independent audit. Auditors could be made responsible to the tax office, thus ensuring the reliability of the taxpayers accounts and reducing avoidance and evasion to the bare minimum. Although audited accounts will facilitate the work of tax offices, they are not totally fool-proof and, as such, incapable of eliminating all likelihoods of fraud,. This shortcoming may be remedied by devising a self-checking, single comprehensive consolidated return which will contain information on every individual taxpayer. It will include all the necessary information on both income and wealth from all sources. It will not only provide a possible basis for instituting an estate duty, inheritance or a wealth tax, but will serve the Municipalities as a good basis for property taxes, as the capacity and ability of the municipalities to assess and collect taxes have been very poor.

There is a shortage of trained personnel in the entire area of revenue administration. Few have any accounting and tax education, or any training prior to taking positions in the revenue offices either in the Ministry/

Ministry or out in the provinces. There has been, virtually no in-service training on the tax system and procedures. On the other hand, the limited number of personnel are fully engaged in trying to scrutinise to the best of their ability, the income tax returns, so as to ensure that they comply with the tax law. As a result, few personnel are available to pursue the potential revenue lost through tax evasion, particularly those potential taxpayers who may have never filed returns in spite of the repeated appeals by the Revenue Department. The standard of auditing and inspection at tax offices needs to be sufficiently improved. Not only more college graduates are necessary to be recruited, but a continuous training programme on accounting, auditing and costing needs to be maintained at the Revenue Department, to train tax officers prior to taking up a job and after a certain period of practice in the field. This should be supplemented by training on the theory and practice of the different aspects of taxation, by senior tax administrators. This will be more effective and will contribute more to the enforcement of the tax than for authorities to raise tax rates or find new revenue areas to meet revenue requirements.

(3) Administration of the Tax System:

The level of tax revenue and the morale and consciousness of the taxpayer are greatly affected by the organisation, adequacy of personnel and efficiency of administration in the tax office.

(a) Organisational structure:

Internal revenues in Afghanistan contribute to two levels of government; the central and the provincial. The national or central government, and the twenty-nine provincial and district governments are supported by the centralised and commonly administered national revenue structure, Charts (A) and (B). Such an organisational structure requires a system of co-ordination inside each one of these offices, and between them and the central/

ORGANIZATION CHART OF THE MINISTRY OF FINANCE AND THE REVENUE DEPARTMENT

CHART A

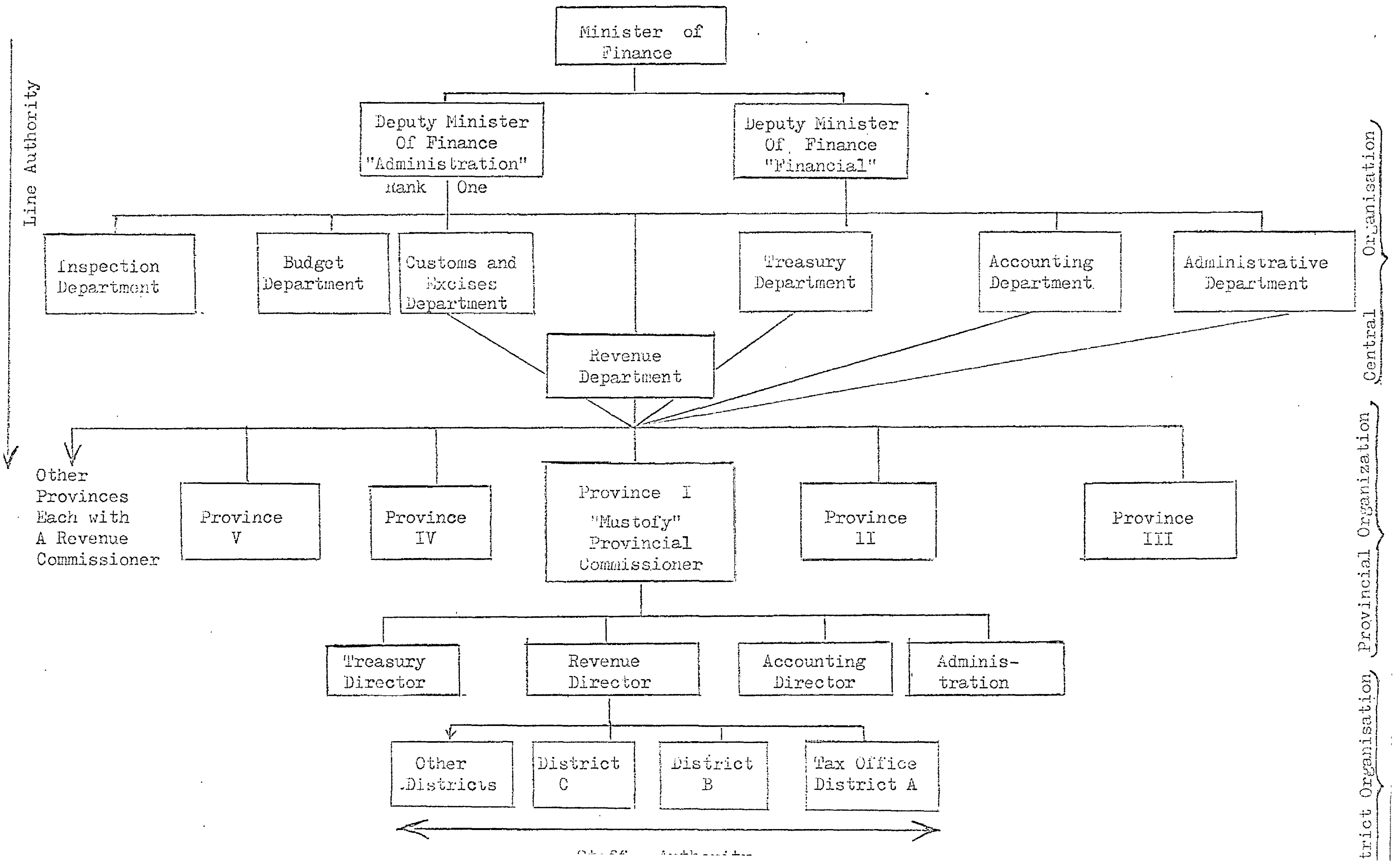
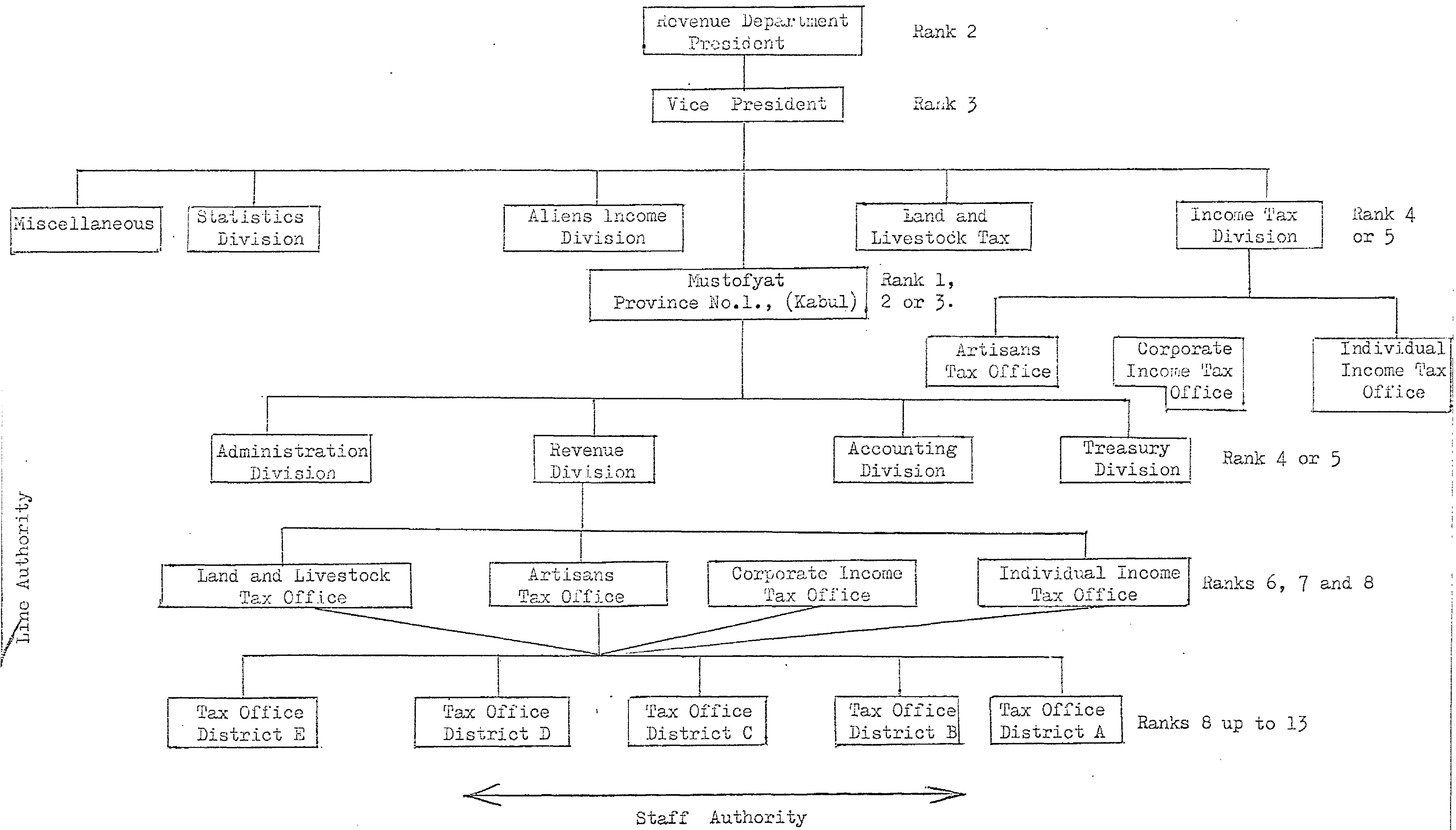


CHART B

ORGANIZATION CHART OF THE REVENUE DEPARTMENT AND MUSTOFYAT



central office,. The lack of adequate and immediate contacts, mainly due to the difficulties of prompt communication between these offices adds to the problem. The provincial and district branches, divided into four divisions, are staffed according to the population and the area administered.[7]

(b) Recruitment procedures:

Recruitment, appointment and other aspects of personnel administration, including employees of the Central Office, are seldom considered the function of the Central Revenue Department. There is no Civil Service examination. Such personnel matters are handled by the Department of Administration, through the authority of Deputy Minister of Administration according to the vacancies arising in the various Departments of the Ministry. This adds to the difficulty of establishing a basis for contact and co-ordination between the Central Revenue Department and the provincial tax offices. Appointments, promotion, rewards and punishments of all tax officers must always remain a responsibility of the Revenue Department and must be acted upon with the consent of this Department. It is only logical that while the Central Revenue Department is held responsible for the volume of revenue collection, the enforcement of the law, the behaviour of senior and junior tax officers and the like, they must, also be allowed to give decisive opinions and recommendations regarding the appointment, removal, reward or punishment of tax employees. An Annual Convention recalling all the Revenue Commissioners at the Commisariats - called "Mustofiat", the provincial counterpart of the Ministry of Finance - for presenting reports and policy consultations, as well as outlining the future objectives of the Revenue Department, will considerably contribute towards/

7. These offices handle separately, livestock and land tax, specific and small business or artisan tax, individual income tax and corporate income tax. As such there existed, until 1967, little administrative co-ordination among these offices mainly because of the schedular system. Whether or not theglobal system will improve the situation remains to be seen. However, the legislative move has been in the right direction.

towards increasing the level of co-operation between the Central Revenue Office and the Secondary Offices throughout the Country. All minutes and resolutions of the meetings will have to be communicated to all tax offices and parties concerned. Such an experience has been exercised only a couple of times in the entire history of the Revenue Department. This must be pursued vigorously and regularly in the future. It will not only establish and improve co-ordination between the tax offices concerned, but will also help to emphasise the responsibilities of individual Commissioners and tax officers.

(c) Employee Remuneration:

Equally important is the pay scale of tax personnel. The salary scale in civil service is generally low (Table 35.) The basic salary for a University graduate starts at rank 8 with Afs.1500 or less than £14 (U.S.$33.3 at the official rate) per month. To this is added Afs.200 per month for the academic qualifications. High School and primary school graduates, constituting almost the entire tax personnel throughout the country, are employed at initial ranks of 10 and 13 respectively. A rise in the salary scale of tax personnel may be recommended, but such a move will implicitly belittle the nature of other branches of civil service. Any concession to one particular group, unless working under unbearable working conditions, is likely to affect other closely related areas. However, where it seems impracticable to provide an overall pay increase, the efficiency of the tax personnel may be boosted through incentive devices, both monetary or otherwise, such as bonus payments, orders, promotion and other compensations, depending on the level of individual performance. This is vitally important for the efficiency of administration in a job which requires implicit trust, while carrying little in the way of prestige or popular acclaim for the services rendered.

One/

One of the most important factors which affects the level and standard of administration is the inadequacy in the number of personnel. Although the amount of revenue at least under current prices, i.e. not deflated for the rise in the level of prices, has shown a considerable increase, so has the collection cost/revenue ratio, even though the number of tax personnel was reduced, by an act of the Parliament in at attempt to cut down government current expenditures, from 1993 in 1966/67 to 1881 in 1967/68.[8] Table 36 reveals this relationship over a number of years. The effects of the withholding scheme and the rise in the level of prices reflecting itself in higher levels of taxable income have not been considered either. As a result, the ratio appears to be high by the standards of both a less-developed and an advanced country.[9] The wide gap explains, among other things, the general low level of taxable income, inefficiency in administration and enforcement procedures. It is true that the introduction of new income tax law will reduce the volume of administrative work by way of the withholding scheme, the raising of minimum exemption level, the elimination of the schedular system and the like. The staff's time so spared is expected to be utilised in other areas. At the same time, the rise in the number of taxpayers may occupy this entire time saved. Taxpayers' books and records, submitted for purposes of post-audit and adjustment of taxes, will have to wait for a long time before they are attended to. Average cost of collection per employee in 1967/68 has been almost 13 percent of revenues collected. Although the cost is high an increase in the number of tax personnel in areas that have not received much attention will prove beneficial in terms of net revenue earnings, and most likely improve taxpayer compliance and consciousness./

8. Ministry of Finance, Kabul, 1969.

9. In Egypt, for example, this ratio has been around 10 percent. In the United Kingdom it has been only 1.32 percent in 1967/68, and 1.39 percent in 1966/67.

Table 36

COST OF REVENUE COLLECTED FROM
DIRECT TAXES, INCLUDING TAXES ON INCOME
1962/63 - 1967/68
(In Million Afs.)

Year	Cost of Collection (1)	Revenue Collection (2)	(1) as Percentage of (2)
1962/63	41,000	320,000	12.7
1963/64	57,600	375,100	15.3
1964/65	62,500	447,800	13.9
1965/66	71,900	574,901	13.0
1966/67	73,200	602,000	12.1
1967/68	54,600	417,000	13.0

Source: Ministry of Finance, Kabul, 1969.

consciousness. In addition to increasing field staff, particular officers or committees of an investigating and advisory capacity, must be established. Besides the implementation of the law, they are to investigate, through its intelligence unit, the cases and areas where taxes evaded, and where the revenue potential of a particular area or tax structure requires necessary revisions. It is important that efficiency in tax administration, as part of the improvement in the entire administrative set up, must be geared towards the long term dynamic trend of the economy.

(4) Collection and Enforcement Procedures:

The collection of income taxes is complicated by the age old payment procedures laid down in the tax offices. When returns are presented and taxes are calculated, the taxpayer is required to take the same to the inspection or audit section, for the review of its accuracy. From there it proceeds to the collection section, where the liability is recorded and copies of a payment form prepared and given to the taxpayer. He must then take the form to the Bank of Afghanistan, or to the authorised agent of the Treasury within a specified period of time, i.e. thirty days, pay the tax, obtain a receipt which he is required to return to the tax office as evidence of payment, should a certificate of payment from the Ministry of Finance be considered necessary. This procedure can be very irritating to taxpayers of a small or large tax obligation. The procedure may be shortened and improved so that payment may be made at the tax offices, which will, in turn, deposit the amount to the bank at certain hours of the day.

In order to safeguard the rights of taxpayers, appeals can be made against assessments at various levels: An appeal is first made to the Commissioner (Mustofy) of the province concerned, who will take a decision. If the taxpayer does not agree to the decision of the Commissioner, the case may be referred to the Ministry of Finance for further consideration, in which case/

case, the President of the Revenue Department, the Minister of Finance and/or the Staff Committee of the Ministry of Finance may take the decision which is binding. To facilitate the process of appeal in remote provinces the case may be referred by the Commissioner to the Provincial Consultative Committee, which includes the Governor as the chairman, and mustofy and district judge among its members. Their findings and resolutions must be sent to the Ministry of Finance for approval. If the taxpayer disagrees with these decisions he can resort to the Primary Court of Commercial Disputes within thirty days after the final determination of the Ministry of Finance, by giving a bond or cash deposit for twice the amount of the tax assessed, the excess of which, if the case is won by the taxpayer is refunded or credited to the taxpayer.[10] If the taxpayer loses the case, after having deducted the tax, penalties and court charges, the remaining, if any, will be refunded or credited to him.

A tax not paid within the specified period of thirty days, will be subject to a penalty at the rate of 2 percent per month from the due date, in addition to any further penalties specified under the provisions of the Income/

---

10. Income Tax Law, Op.Cit., Articles 100 and 101.

Income Tax Law, is imposed.[11] The 1967 Reform covers a wide range of eventualities as far as penalties are concerned. The pre-1967 Law penalised delinquent tax cases at a rate of 2 percent per month. After six months, the amount automatically doubled to 24 percent, which failed to make a distinction between the 6th month, plus one day, and twelve months. However, such a sudden rise and harsh treatment was effective in as far as due payments were concerned. The mild progression of penalty rates at 2 percent, under the 1967 Law, may be more agreeable, but it may not be as effective. Revenue collection always reached its peak in August the end of the six months' allowance period,. This particular time is, as may be recalled, neither the calendar nor the taxable year. The rise in the level of revenues came, primarily, from income taxes; in spite of this, the number of delinquent tax cases, and the volume of taxes due, has accumulated to a sizeable amount for the past two decades or so, Table 37. Arrears have not only increased as a ratio of total tax/

---

11. Additional penalties provided under the Articles 102-2 of the Law are as follows: " (a) administration: (1) If a taxpayer voluntarily files a delinquent return or voluntarily pays any delinquent tax, without any evidence of an intention to evade the tax, the penalty shall be the sum of Afs.50, or 50 percent of the entire tax, whichever is greater, (2) If any taxpayer files or pays any delinquent tax after demand by the Ministry of Finance, the penalty shall be the sum of Afs.100 or 25 per cent of the entire tax due, whichever is greater, (4) If any taxpayer seeks to evade payment of the tax by being false, deceitful or dishonest, there shall be collected a penalty of Afs.500 or 50% of the entire tax whichever is greater, (5) If any part of a deficiency or tax due is attributable to careless, indifference and disregard of the Laws and Rules, a penalty of 25% of the total amount of the deficiency or tax due may be collected, (b) Criminal: Any person who wilfully fails to make a return, keep any record, or supply any information as required necessary shall be guilty of a misdemeanor, and upon conviction shall be fined not more than Afs.5000 or imprisoned for not more than one year, or both, together with costs of prosecution. Failure to comply with the withholding is also subject to the above provision. In addition, the withholding deduction may be disallowed. Article 102. Regulation 102-1 through 102-5 of the Income Tax Regulations, 1968/69.

Table 37

TAX ARREARS OVER THE PAST TWO DECADES

1945/46 - 1967/68

(In Million Afs.)

Years	Amount	As Percent of Tax Collected
1945 - 46	2,349,051	-
1955 - 56	7,380,181	-
1965 - 66	23,383,335	0.85
1966 - 67	28,125,852	0.86
1967 - 68	33,457,646	1.07

Source: Revenue Department, Ministry of Finance, 1968/69 tax collection, but their annual percentage increase has been larger than the percentage increase in tax revenues. This, partly, reflects on the efficiency of the administration and enforcement of the tax system.

In cases of fraud, the pre-1967 Law charged a two hundred percent penalty on taxes assessed and doubled to fourfold, when such a fraud was repeated. Penalties under the 1967 Law covers a wide range of eventualities. The penalty increases depending on the magnitude of the offence. Although total penalties on repeated acts of default amount to half as much as it was under the previous law, they are likely to be more effective in differentiating among cases that would otherwise have been similarly treated, irrespective of the degree of offence. The reform has also introduced a new feature into the Tax Law; allowing the Ministry of Finance to prosecute cases of default in the law court, demanding for cash penalties and imprisonment. The overall system of penalties have introduced an element of equity in tax treatment,. At the same time, it imposes on the Revenue Department the obligation of improving certain aspects of administration, particularly those pertaining to the responsibilities and obligations of taxpayers, the up-grading of tax officers standard of education and other relevant subjects as well as their practice. If these relatively milder penalties are to be effective, the appropriate measures indicated as pre-requisites ought to be given adequate consideration. A practice which has had precedence in certain other countries,[12] may contribute in reducing the number of cases, which will fall under the penalty clauses. It is advisable that figures on income and taxes paid must be made available to the general public. Should the revealing of one's income and wealth be considered undesirable, the list of taxpayers and their taxes paid should be annually or bi-annually published in a special tax journal or report put out by the Ministry of Finance. To add to the effectiveness of the penalties, finalised cases of fraud and where/

12. World Tax Series, "Taxation in Sweden", Boston, Little Brown & Co., 1959, p.601.

where the tax has been collected, should be published. This may help improve the taxpayers' morale and add to their consciousness, the creation of which is one of the main objectives of an income tax system.

C H A P T E R   N I N E

SUMMARY

CONCLUSIONS AND RECOMMENDATIONS

Summary

Conclusions and Recommendations

The past decade of development has brought in considerable changes in the socio-economic structure of Afghanistan. Although development plans aimed at no specific rate of growth, in the national income, (owing to lack of adequate national income statistics and experience in planning techniques and practices) national income estimates, during much of the period 1962-67, increased at an annual rate of 8 percent in current prices. In constant prices, however, this rate falls to a negative level. Developmental expenditures have not contributed to the aggregate level of output. Agricultural output, constituting almost 75 percent of national income, increased by a total of only 1.6 percent, during the entire period. Obviously, this is below the modest two percent annual rate of population growth. Production of the major crop, wheat, not only lagged behind the Second Plan target, but also fell by over 3 percent below the level attained during the First Development Plan, 1957/58-1961/62, Table 1, page 18. Although industrial output, during this period, increased by more than 70 percent, it constituted a little over 8 percent of national income. The Balance of Payments reveals that the level of exports has almost stagnated while imports and the balance of capital accounts represent a growing obligation.

Such a pattern of output, accompanied by increased money demand, reflected itself in the level of prices, at a rate of 27 percent per annum. The persistent deterioration in the value of currency made frequent devaluations inevitable. Instruments of Monetary and Fiscal Policies have been inadequate and ineffective in maintaining stability in the economy.

A closer examination reveals that the prime objective, under both the First and Second Five Year Plans, has been the completion of certain expenditure programmes aimed at creating the necessary infrastructure in the economy, page 65. Foreign aid, which consisted largely of credits, Table 16, page 76 , constituted around two-thirds of the total resources mobilised

to/

to meet this objective. This raised debt service obligation in 1967/68 to almost U.S.$11 millions or over 17 percent of total export earnings. A sizeable increase in domestic sources of finance is essential in meeting the rising debt obligations and the growing requirements of development programmes. Apart from foreign aid, the Afghan government relied largely on credits from the Central Bank in financing development programmes and covering recurrent budgetary deficits. Not much of all these expenditures has been directed towards achieving an immediate increase in the level of output. In spite of the low money/national income ratio, the rise in the level of effective demand, has resulted in an inflationary situation not conducive to the process of economic growth. The "structural" rigidities accompanied by a low rate of investment in productive areas, coupled with unemployment problems have accentuated the inflationary spiral. Instruments of monetary policy have been incapable of dealing with the problem. Revenues, both taxes and transfer of profits, from State Economic Enterprises have declined over the past decade. Total transfer of taxes and net of tax profits from these Enterprises to the Treasury Accounts, over the past 28 years, has been a little over 40 percent of total taxable profits, Table 17, page 80. To facilitate the transfer of a larger portion of profits from these enterprises to the Treasury, it would be advisable for tax purposes to treat them as individual enterprises subject to the progressive income tax rates.

Parallel to foreign aid and deficit finance, the growth in Sources of Government Revenues, has been characterised by an increasing reliance on Indirect Taxes. Custom Duties, both on imports and exports constitute the bulk of Indirect Taxes. It appears that the foreign trade sector is used mainly as a revenue raising medium rather than aiming at integrating the dualistic nature of the Afghan economy and promoting growth. Although exports/

export proceeds have almost stagnated, total revenues from export taxes have shown a considerable increase, mainly due to the foreign exchange taxes and the compulsory surrender of export proceeds at less than the official exchange rate. The adverse effect of this on the main export items, i.e. Karakul, Cotton and Wool, has been accentuated by the recurrent devaluation without having taken into consideration the effects of the overall inflationary trend. The results have been an inevitable decline in the export of these items in real terms. The frequent devaluations and the introduction of multiple exchange rates, ranging from the official to the free market rates, governing export proceeds, have resulted in some degree of export diversification at the expense of neglecting the importance of some of the major export items. No significant improvement in the balance of trade has been achieved. Receipts from exports have, virtually, stagnated and have failed to meet the growth in total import requirements. This leaves the prospects of an improvement in the Country's Balance of International Payments still very grim. The end of the moratorium on foreign debts will involve real hardship, in as far as foreign exchange earnings and the servicing of such loans and credits are concerned, page 76. As an initial step, the "specific price list" , maintained for tariff purposes, particularly on imports, must be regularly adjusted, preferably to an ad valorem basis. Owing to the persistence of inflationary pressure export taxes must be minimised in order to eliminate their adverse effect on the volume of exports, having no or very little monopoly powers, the expansion of the exchange sector and growth of the economy. It may be suggested that in an economy such as Afghanistan's, where foreign trade is initially a small ratio of national income, and with an almost stagnant export sector and growing foreign exchange requirements, the inevitable decline of revenues from this source must be met from other sources. With the growth of the Afghan/

Afghan industrial output and rising imports, an increasing reliance may have to be placed on excises, sales taxes and custom duties on a selective basis over as wide an area as possible, in order to give them greater buoyancy than they have had in the past, page 130.

The increasing emphasis placed on Indirect Taxes, as a main source of domestic government revenues and the ad hoc alterations of some direct taxes, and total neglect of others, all added to the anomalies of the tax system and resulted in a gradual decline of revenue from these sources. The results of the analysis, both under the time rate of growth series and the regression function, reveal an income elasticity of only a little over unity, both for income as well as indirect taxes. This indicated, particularly, the ineffectiveness of the Schedular Income Tax System, both in terms of tax base and progression of the rate schedule(s), and the extent to which effective demand is affected. Owing to the narrow coverage of the income tax and the "structural" rigidities in the dualistic character of the Afghan economy, the stabilisation effect of the tax has been virtually nil. In view of such a growth pattern of the revenue structure, the Afghan Government initiated in 1967, various improvements in the Income Tax Law. Although a detailed account of the various aspects of this Reform has been made in our analysis of the System, the following pages will conclude this paper by briefly outlining some of the most feasible measures aimed at further improving the role of Direct Taxes and particularly of Income Taxes in the revenue structure of Afghanistan.

In spite of the Reform, the results emerging from the detailed examination of the Income Tax System reveal that the base of the tax still remains very narrow indeed. Although the global feature and improvements in the progression of tax rates, under the 1967 Income Tax Reform, are expected to result in a relatively higher income elasticity than the preceding

Schedular/

Schedular System, its narrow coverage and comparatively low initial rates will still render this elasticity factor insignificant in relation to the level of national income. It is vitally important that the coverage and the base of the tax system must also be expanded, so as to affect a substantial part of the increments,. It is the responsiveness of the base that is very decisive for the elasticity and buoyancy of the tax system. Income from agricultural pursuits, the largest sector of the economy, is totally tax exempt. In 1966 tax revenue from agriculture, both land and livestock, which is by far the largest sector of the economy, amounted to only 3 percent of tax and 1.7 percent of total public revenues, and only 0.3 percent of national income. No structural changes have been introduced in agricultural taxation for almost half a century now. Taxes, imposed almost half a century ago, constitute at present only a nominal property tax related to neither the value of the land nor its actual output or income. Income from agricultural pursuits, in whatever form, is tax exempt. As a result, revenue contribution from this source is negligible, and fails to distribute tax burden more equitably within the sector itself. In any predominantly agricultural economy, land is the major source of output. The analyses carried out in Chapters 3 and 6 reveal that the shift in tax burden, however immediate, has been in favour of the agricultural sector and against commerce and industry. This remains valid even though one may argue that the benefit of the development programmes are mainly enjoyed by the "modern" sector. Large agricultural units and owners of other real properties who have equally benefited from the process of growth, have failed to make a corresponding contribution. Land taxes must reach the available (or potentially available) marketable surpluses and should be considered a promising source of public finance during both the reasonably short and long run periods. Changes in prices, mainly of agricultural produce, have eroded the age old rates and rendered agricultural taxes less than what they should be, either in the light of an historical/

historical relationship and/or in the light of the urgency of needs for development finance. Under the present circumstances, land taxes offer the highest revenue potential, compared to any other source.

In order to make land tax a more effective instrument of fiscal policy, both in terms of agricultural output and revenue yield as well as to make it equitable, in relation to taxes on other sectors and within the agricultural sector itself, it is necessary that diligent measures, aiming at the up-grading of land and livestock tax rates, must be initiated. Completion of the thorough going Cadastral survey programme, which has been under way for a while now will enable the government to establish an appropriate basis and a long term solution to the problem of agricultural taxation. But, there are still many obstacles to be overcome, and much time may, as it has so far, elapse before this cadastral programme will show any results in revenue collection. Alongside the cadastral survey, the Land Registration programme, which was launched in 1963/64, must be expedited. This will add more acreage to the land register. Up to 1967, over one-third of the land had not been on the land tax roll. This must be followed up by an immediate programme of updating effective land tax rates, based on potential output, which will also agree with the results of the comprehensive cadastral survey. Such a land tax programme based on size holdings and variable base rates, may be outlined in accordance with the findings and recommendations of chapter three of this paper. Supplemented with a progressive feature, either by way of introducing the income tax rate schedule or a surcharge arrangements on large individual holdings with exemptions for reinvestments, may reduce assessment problems and render the "income effect" of the tax strong relative to the "substitution effect". The higher the yield above the estimated level of output, the greater will be the income of the agriculturalist. In addition to a more productive use of such large holdings, the tax will also provide for

and/

and facilitate the distribution of land, without any drastic land reform. It will depress land prices and make them reflect productivity which will in turn, favourably affect the level of output, alongside such an agricultural taxation programme, based on the size of holdings and average real (as against potential) output, further improvements of services rendered to this sector is of paramount importance for the success of such a programme. The mere legislation of the tax, particularly based on the "ability to pay" approach unaccompanied by the provisions of further necessary requisites is not likely, owing to structural rigidities, to favourably affect aggregate output to a great extent. The provision of adequate capital (through extension of credits) material and above all technical know-how must be facilitated in order to enable the agriculturalist to take advantage of the "income effect" favourable to work effort. Although the "benefits" arising from these pre-requisites may confer subsidies particularly to the relatively small units in the subsistence sector, their ultimate result is beneficial to the economy as a whole through increasing monetisation aimed at integrating the subsistence and modern sectors. It is further necessary that such a move be accompanied by legislation, governing rental contracts and tenancy relationships, so as to avoid any immediate shift of part of the land tax burden to the tenants.

In addition to the exclusion of agricultural income from the income tax base, the inadequate definition of income and the coverage of its concept renders the tax base narrow and limited. Although the abolition of the Schedular System accompanied by various allowances and deductions, has improved equity considerations, which also help the revenue objective, legislative and administrative loopholes still account for much of the inadequacies of the present Income Tax System. Income must be adequately defined from the viewpoints of revenue, stabilisation and distribution objectives/

objectives, involving both the "horizontal" and "vertical" aspects of equity. It is true that the word "income" and its concept is of an elusive nature and, as such, difficult to provide for an all-inclusive and satisfactory definition; but, a detailed description of the various classes of income will widen the scope of its concept and, where possible, brought under the provisions of the Income Tax System. The exclusion of interest income on Government Bonds and Bank Deposits from the tax base cannot be defended, neither on equity nor on economic grounds. The exemption is inequitable in the sense that it means little to someone whose income, from all sources, appears to be small, as compared to someone else whose income puts him in a higher income tax bracket. From an economic point of view, it is difficult to assert that the exemption of interest income on deposits has contributed much to the level of deposits with the Afghan Banking System. The wide gap between the money rate of interest in the organised sector of the money market and the effective rate of interest in the rest of the economy, accentuated by the inflationary pressure, bears ample evidence to the ineffectiveness of this measure in attracting further deposits. A more acceptable alternative is the re-examination of the entire interest policy aiming at maintaining a realistic and flexible rate of interest. It remains uncertain whether or not the initiation of a government bond programme will have much success in this respect. It may be recalled, page 141, that at present, the number of income tax assessees reached only 14,000 or almost 0.1 percent of population declaring less than 3 percent of national income. The tax base must be enlarged to include such income of both individuals and corporate bodies. To avoid discriminatory treatment, the 5 percent tax on corporate gross receipts, (chapter three, page 100) including interest income on bank deposits, or loans to others must be abolished. Although this is a deductible item in determining taxable income, but by reducing after tax rate of return, both deposits and loans may be discouraged. In an economy where/

where the level of bank deposits and volume of credit to the private sector are very low, the existence of such a tax can hardly be justified.

The extent of in-kind compensations must be fully specified and provisions of the Labour Code observed. Increases of subsidies, in whatever form, are likely to put higher demands on the benefit payments, thus appearing as negative taxes, rendering the objectives of the distribution branch of budgetary policy more difficult to achieve. It will adversely affect revenues by limiting an already narrow base of income taxes. Taxing benefits received beyond certain limit narrows the scope of such in-kind compensations in the monetised urban sector. In order to limit the extent of in-kind compensations, benefits offered beyond a certain minimum level must be taxed at source under the individual income tax schedule. The employer, while transferring the withheld tax, will then appropriate the residual among their employees. In the rural sector, wherever possible, such in-kind receipts, which fall outside the monetised sector, e.g. tenant farmers who normally obtain about one-third of the agricultural output for their labour, must also be assessed and in-kind tax payments may be demanded, pages 111-112 .

Much more emphasis has to be placed on improving the method of assessing and taxing the income of individual merchants and real and personal property owners. Income of those engaged in some of the most profitable liberal professions, such as architecture, law, engineering, medicine and the like, who have, until this very date, not filed a single return or paid any taxes must be brought under income taxes.

These minor or major items of individual income ought to be brought within the scope of the income taxes and effectively treated if the 1967 Income Tax Reform is to succeed and make a headway. Therefore, to widen the coverage of income taxes, a more comprehensive definition of income must be provided. All efforts must be made to relate closely revenue

sources/

sources of Charitable Organisations and Municipal Authorities to the advances and transfer payments made through the government budget. This is necessary for best serving the various branches of budgetary policy, and establishing a close relationship between the revenue sources of the government and some of these organisations as they both rely on the same source, i.e. income taxes, for generating part of their revenues, pages 112-113.

Declaring interest income on bonds and bank deposits taxable, the withholding scheme may be extended to cover such receipts,. However, to allow the tax system, and particularly the withholding scheme, to establish themselves fully, the "refund" feature must be made an integral part of the tax system. Wherever over payments are involved, provisions for refund must be made. If a refund in cash is not acceptable, or practical, for the time being, refunds in the form of either an interest bearing receipt or bond may be made, which will be acceptable for discharging tax liability and/or repayment of loans to the government. However, a date for filing claims for such over payments must be set in order not to cause unnecessary inconveniences to both the taxpayer and tax authorities.

The present level of personal exemption is established in an arbitrary manner. It is important that studies on family budgeting, particularly essential expenditure items, must be made. The pricing of these items will give a fairly accurate estimate of what the level of exemptions ought to be. It will be geared to the level of prices and may be duly adjusted for different groups of taxpayers mostly affected by changes in the price level. Revenue losses resulting from the increase in the level of personal exemption, may be compensated for by a rise in tax rates. The tax schedule must start with a relatively higher rate of about/

about 8 to 10 percent at the initial bracket of taxable income. This is necessary if the effectiveness of the tax, both in terms of revenue and stabilization objectives, over lower levels of income is to be established. In so doing, the present feature of the schedule, which does not allow rates between brackets to vary more than two percent above its immediate predecessor, must be maintained, for reasons given in Chapters 4, and 7, pages 154 and 296 , respectively, with respect to revenue, stabilisation and incentive effects of the tax system. The rise in the initial income tax rate may push up marginal rates, all along the scale, by as much as the increase brought into the present four percent rate applicable on the initial level of taxable income. Both the lowest initial and the highest marginal rates, will, however, still remain lowest compared to the separate schedules of the Schedular System.

The implications of the increase in the level of personal exemption may be to lead to a rise in the consumption level of the low and middle income groups, and to the development of a "substitution effect" adverse to work efforts, mainly due to an increase in the disposable income. The likelihood of such a possibility can be checked; first, by the higher and increased rates of income taxes, and, second, by way of necessary outlay taxes on a selective basis. The study made on family income and expenditure budgeting, to determine the level of personal exemption, and the grouping of such expenditures into essentials and non-essentials or luxuries, will serve as an appropriate base for the selectivity of the indirect taxes. Such a selective feature will further increase the buoyancy and stabilisation effects of these taxes.

In addition to the modest rise in the level of marginal income tax rates, the initiation of an "inheritance" tax is highly desirable for purposes of revenue, equity and economic expedience,. Since such a tax is expected to encourage the division of the estate among a large number of beneficiaries/

beneficiaries, higher tax rates are required than if the estate were taxed under an estate duty. It is desirable that the tax rate should vary according to the line of succession. It will have to be higher than the present standard income tax schedule, which applies to gifts and other inter vivos transfers, as well as capital gains. This is helpful in encouraging the distribution of property and wealth during the life of the donar. It will best serve this purpose with regard to land and other real property since they have been passing from one generation to another without a change in the structure and pattern of ownership or tax obligation. A tax on wealth, through inheritance, even when such an asset is transferred on death, will serve to take the system closer to the applicability of the principle of the "ability to pay", which the income tax fails to achieve by itself alone, since income and wealth taxes can hardly substitute each other. They serve the above principle best when they supplement each other. Valuation of a transfer without a monetary value may create administrative difficulties. As a first step, the records of the Commercial Courts regarding the transfer of similar properties may be used. The frequency of such transfers, however, may as a second step necessitate the establishment of certain governmental departments to assess continuously the value of any kind of immovable property. This may start with the province of Kabul and may be extended to function on a nation-wide basis.

Although the capital gains tax introduced in 1967 is not prohibitive and its imposition restricted to realised gains meant to serve the egalitarian objectives, one wonders how far its justification, on equity grounds, can be fully defended, particularly when no wealth tax, estate duty or an inheritance tax exists. Moreover, the arbitrary treatment and distinction between gains realised from real estate properties and those obtained from corporate assets adds to its inequitable feature, and renders the tax economically/

economically ineffective in influencing the level of saving and investments in particular areas. The economic objective of the household is to add to its consumption and accumulation of the most profitable forms of wealth. The role of the tax system in this respect must be to reduce that portion of income which goes towards conspicuous consumption, while inducing the accumulation of productive wealth. The arbitrary treatment of gains will increase the level of conspicuous consumption by encouraging accumulation in the more traditional, but safe, type of assets, promising higher income, which escapes taxes under the present income tax system. This inducement becomes stronger, particularly when such wealth accumulations enjoy a favourable tax treatment or escapes taxation altogether. Although a feature of averaging gains or income generated over a number of years is provided with regard to shares of stock or any other industrial asset, the fact that such gains still remain subject to higher progressive rates, compared to land, both urban and rural, and buildings, is, by itself, a discouragement to the accumulation of wealth in productive areas. If the process needs to be reversed, a heavier, annual real estate property tax, with the exemption of owner occupied houses, will have to be introduced over and above the transfer levy of one percent. An alternative would be to allow gains from industrial assets an exemption when such assets are possessed for a specified period of time, i.e. five to ten years, or when realised gains are reinvested in other similar assets within a specified period of time. The limit beyond which urban land or owner occupied houses may become taxable will have to be in line with the proposed agricultural tax scheme.

A tax on the use of automobiles must be levied in addition to the existing tax imposed on the commercial use of such vehicles. The present tax, either on private or commercial use of motor vehicles, as seen page 99 is very low. Further increases in the price of petrol and/or road toll may/

may be attempted when other less harmful ways of taxation have been exhausted. A vehicle tax, usually has a direct effect on the owner, compared to the above two levies. Here, too, administrative improvements are urgent so as to prevent avoidance and evasion which abuse the law. Penalty provisions must be diligently carried out.

To accelerate the growth of national income, it was argued that an increasing proportion of the increments, whether accruing to the public or private sector, must be channelled from consumption to saving and investment of a developmental nature. The function of taxation in this respect is; first, to ensure in the event of a lack of voluntary investment of the required nature, that a larger share of this increment is tapped off and directed to capital formation, either at the public sector or through government balances, in credit institutions, by entrepreneurs in the private sector; second, where the encouragement of voluntary savings and investment at the private sector level, both individual and juridical entities, prove successful, efforts must be made to achieve this objective by deviating from the "neutrality" principle of taxation, page 254, and to incorporate a series of carefully designed incentive measures.

Although the revision of the Private Investment Encouragement Law, in 1967/68 and the 1967 Reform of the Income Tax Law have almost entirely been made with the above objective in mind, further improvements are still necessary to enable these measures to prove successful. In an attempt to accord equal treatment to domestic and foreign capital, the question of double taxation arising beyond national boundaries must be carefully considered. Double taxation and/or tax deferment agreements, covering the different aspects of private foreign investment in and from Afghanistan must be concluded. Such agreements will either remove or partly cover, some of the unfavourable factors that are beyond the jurisdiction of

Afghan/

Afghan legislation governing private investment. They are necessary if foreign private investment, for which other less developed countries vigorously compete, is expected to benefit from and respond to, the various concessions provided in the law. In addition to the agreements covering possible investment disputes, arising between foreign nationals and a State, the government of Afghanistan must conclude investment guarantees aimed at protecting foreign, private capital against any possible development, other than the failure of the business.

As an effective measure to raise the level of public revenues, and encourage savings of the household, as well as to facilitate the establishment and growth of an organised money and capital market, a scheme of "Saving Bonds" must be initiated,. Such bonds will bear an appended quarterly interest coupon and will be directed to appeal to low levels of income, preferably, employees in the public and private sectors. Parallel to this, a short term Treasury Bill, with such desirable features as acceptance for tax payments, repayment of other debts to the government, prompt renewal or redemption upon maturity, may be introduced. The latter will provide the government with adequate funds to meet the seasonal shortages arising from an unevenness of tax revenue collections.

Provisions covering depreciation charges, which have a significant effect on the gross and net of tax rate of return, through the recovery of capital and the rate of reinvestment, need to be reconsidered. The long period set for depreciation of plants and machinery further fails to provide for multiple shifts and rapid wear and tear of capital assets. It will not only render replacement more difficult, on the basis of historical cost, but will adversely affect productivity and efficiency, the important determinants of industrial growth. A relatively shorter period may be appreciated, particularly in small individual businesses, where/

where the choice between retention for expansion or distribution of profits does not exist, except after taxes.

Although the provision of "Investment Credit" allowed to certain specific areas of industry, may help a rapid recovery of part of the capital outlay, the provision of a partial loss offset may not allow the taxpayer to obtain the full benefit of this concession. To reduce uncertainty and encourage risk taking, a longer period of loss offset must be provided for ordinary business losses and losses from capital transactions.

To render all these concessions effective in helping to raise the level of voluntary savings and investments, as well as enabling the private sector to carry out its due share in future investment programmes, the government economic policy must be made clear. The scope and areas of activities, appropriated between the public and private sectors, must be specified. A feeling of confusion and uncertainty will outweigh the benefits of most of the financial concessions embodied in the respective laws, at present and/or introduced in the future.

Last, but not least, a dynamic programme of administrative reform is necessary to ensure, both to the Revenue Department and the taxpaying public, the prompt realisation of the benefits expected from the latest income tax reforms and the propositions advanced in this paper. The structural reform of a law, unaccompanied by adequate administrative improvements, is better not attempted. Although legislative ambiguities have been considerably reduced, in view of the improvements brought into the law, accompanied by an elaborate manual of operations, administrative capacity to comprehend and enforce these changes still remains an equally important aspect of the matter.

Particular/

Particular emphasis must be placed on the recruitment of tax personnel, the improvement and upgrading of tax education, and knowledge of related and necessary subjects, such as accounting, costing and auditing. This is vitally important whether taxes are assessed on the basis of facts presented to the tax authorities, or whether they are imputed on the basis of observations, investigations and value judgments. The Revenue Department must assume full responsibility, in this respect, and arrange necessary formal and on-the-job training programmes which will be supplemented by an effective systems of rewards and punishments.

Although improvement in taxpayer consciousness and compliance with the provisions of the law may prove a lengthy process, owing to environmental and institutional shortcomings, there is no reason why tax administration should not take part in contributing towards the enhancement of this process. This is as much the responsibility of tax administrators as it is of the taxpayers themselves.

Since the prompt enforcement of an income tax law suffers most from the prevelance of a relatively high rate of avoidance and/or evasion, schemes and methods can be designed to remedy these anomalies. They may not be entirely fool-proof, but they are likely to reduce the frequency and extent of such undesirable practices. To help improve the reliability or credibility of the facts and material presented for purposes of tax assessment, accounting methods that are brief and simple to understand and use, may be initiated by the Revenue Department on a pilot scheme. After improvements, with time, they must be applied to a wider area. The establishment of independent audits certifying taxpayers' accounts, whose capital investments may exceed or fall beyond certain limits, will further help in the implementation of such a pilot scheme.

To/

To facilitate the enforcement of the law, the collection process must be accompanied by adequate announcements. This will help in establishing tax consciousness among the people. Strict adherence to the penalty clauses will ensure the revenue efficiency of the tax and improve tax morale, which is crucial for the success of an income tax system.

SELECTED BIBLIOGRAPHY

SELECTED BIBLIOGRAPHY

A. AFGHAN GOVERNMENT PUBLICATIONS:

Bank of Afghanistan — "Economic Bulletin", Kabul, November, 1961.

"Economic Bulletin", Kabul, 1967.

"Afghan Financial Statistics", 1967/68

Constitution of Afghanistan — "Constitution of Afghanistan", Kabul, October 1964.

Government of Afghanistan — "The Five Year Economic Development Plan", Kabul, 1957.

"The Second Five Year Economic Development Plan", Kabul, 1962.

"The Third Five Year Economic Development Plan", Kabul, 1967/68

"The Income Tax Law of Afghanistan", Kabul, 1966/67.

"The Law of State Economic Enterprises", Kabul, 8/12/43.

"The Present Economic Situation in Afghanistan", (Government Presentation to the President of the World Bank, Kabul, November, 1968.)

Ministry of Commerce — "Afghanistan's Foreign Trade Statistics, revised, 1335-1340" Kabul, March, 1963

"Foreign and Domestic Private Investment Encouragement Law", Kabul, 1967/68

"Licensing Regulations for Private Foreign Traders and Firms in Afghanistan", Kabul November, 1965.

Ministry of Finance — "Export Tariffs for Afghanistan", Kabul, 1968.

"Import Tariffs for Afghanistan", Kabul, 1968.

Department of Revenue, "Quarterly Revenue Reports", (unpublished), 1963/64, 1964/65, 1965/66, 1966/67.

"Forty Years activities of the Ministry of Finance", Kabul, 1964.

A/

Ministry of Finance

A proposed Revenue Administration improvement Programme for Afghanistan (PAS Memo), Kabul, 1958.

Income Tax Manual, (Special Report No. 137), Kabul, 1968.

"Watta", the monthly Bulletin of the Ministry of Finance, 1964-66

Ministry of Planning

"Afghanistan, Ancient Land with Modern Ways", Kabul, 1964.

"A Mid-term look at the 3rd Plan, III revised edition", Kabul, August, 1968.

"Foreign Trade Statistics", 1967, Kabul.

"Industrial Development in Afghanistan", by A.A. Strauss, Kabul, 1965.

"Quarterly Statistics on Balance of Payments with Multilateral Area", by Wilfred Lewis, Jr., Kabul, 1964.

"Framework of the Third Five Year Plan", (unpublished proposal), Kabul, 1965/66.

Population and Manpower Resources in Afghanistan, 1967.

"Survey of Progress 1962-64," Kabul, August 1964.

"Survey of Progress 1966-67", (in Persian) Kabul, 1967.

"Survey of Progress 1967-68", (in Persian) Kabul, 1968.

"Survey of Progress", 1967/68",(English) Kabul, 1968.

"Survey of Progress", 1968/69" (in Persian) Kabul, 1969.

Nathan, R.R. "Next Steps in Foreign Trade and Exchange Management", Kabul, 1965

Ministry of Press and Culture

"Afghanistan News", Volume V., March 1962.

"The Kabul Times Annual", Kabul, 1967

B. BOOKS AND PAMPHLETS:

Ambirajan, S., *The Taxation of Corporate Income in India*, New York, Asia Publishing House, 1964.

Barber, W.J. *The Economy of British Central Africa: A case study of Economic Development in a dualistic Society.* Oxford University Press, London, 1961.

Bauer, P.T. *Economic Analysis and Policy in Underdeveloped Countries*, Cambridge University Press, London, 1957.

Bauer, P.T. and Yamey, B.S., *The Economics of Underdeveloped Countries*, University of Chicago Press, Chicago, 1957.

Bierman, Harold Jr., and Smidt, Seymour *The Capital Budgeting Decisions* (Economic Analysis and Financing of Investment Projects) New York: The Macmillan Company, 1966.

Bird, R.M. and Oldman, O. (eds.) *Readings on Taxation in Developing Countries*, 1965.

Black, Duncan, *The incidence of Income Tax*, Macmillan & Company Limited, London, 1939.

Blum, Walter J. and Harry Kalven Jr. "*The Uneasy case for Progressive Taxation*", University of Chicago Press, Chicago, 1953.

Brown, C.V., and Dawson, D.A., *Personal Taxation, Incentives and Tax Reform*, Political and Economic Planning (PEP) Broadsheet 506, London, 1969.

Carmichael, K.S. *Income Tax and Profits Tax*, twenty-seventh edition, third impression, HFL (Publishers) Ltd., London, 1968.

Chelliah, R.J. *Fiscal Policy in Underdeveloped Countries*, George Allen & Unwin, London, 1960.

Dean, Joel *Managerial Economics*, Englewood Cliffs., N.J. Prentice-Hall, 1957.

Dillard, Dudley *The Economics of J.M. Keynes, the theory of monetary policy*, Crosby Lockwood & Sons Ltd., London, Ninth U.K. Printing, 1966

Due, John F. *Government Finance*, revised ed. Homewood, 1959.
Government Finance; economics of the Public Sector, fourth edition. Homewood, 1968.
"*Taxation and Economic Development in Tropical Africa*, Cambridge: M.I.T. Press, 1963.

Duesenberry, James S., *Income, Savings and the theory of Consumer Behaviour.* Cambridge, Harvard University Press 1949.

Eckstein, Otto., *Public Finance*, Prentice-Hall, Inc., New Jersey 1964.

Franck, Peter G., *Afghanistan between East and West.* National Planning Association, Washington, D.C., 1960.

Ghai, D.P., *Taxation for Development; a case study of Uganda.* East Africa Publishing House, Nairobi, 1966.

Goode, Richard., "*The Corporation Income Tax*", New York, John Wiley and Sons, Inc., 1951.
"*The Individual Income Tax*", The Brooking Institutions, Washington, D.C., 1964.

Griffiths, John C., "*Afghanistan*", Pall Mall Press, London, 1967.

Hansen, Alvin H., "*Public Enterprise and Economic Development*", London: Routledge and Kegan Paul Ltd., 1959

Heller, J. and Kaufman, K.M. *Tax Incentives for Industry in Less Developed Countries*, Cambridge: Harvard University Law School, International Tax Programme, 1963.

Hicks, R.J. *Social Framework*, The Clarendon Press, Oxford, 1960.

Hicks, R.J. *Value and Capital*, The Clarendon Press, second editor, Oxford, 1946.

Hicks, U.K., "*Development from Below: Local Government and Finance in Developing Countries of the Commonwealth.* Oxford, 1961. The Clarendon Press.
"*Public Finance*", Cambridge, The University Press, 2nd edition, 1955.
"*Development Finance; planning and control*", The Clarendon Press, Oxford, 1965.

Higgins, Benjamin, "*Economic Development*", New York, W.W. Narton Company Inc., 1959.

Hinrichs, Harley H. "*A General Theory of Tax Structure change During Economic Development*", Cambridge: The Law School of Harvard University, 1966.

Hirshman, Albert O., *The Strategy of Economic Development*, New Haven; Yale University Press, 1959.

Ilersic, A.R. "*Taxation of Capital Gains*", London, Staples Press, 1962.

Kaldor, N., "*An Expenditure Tax*", London; Allen and Unwin 1955.

Kimmel, Lewis H. "*Taxes and Economic Incentives*", The Brooking Institutions, Washington, D.C., 1959.

Kindlebergen, Charles P. *Economic Development*, McGraw-Hill, New York, 1958.

Krivine, David, (ed.) Fiscal and Monetary Policies in Developing States, Praeger Special Studies in International Economy and Development, 1967

Kuzyaniak, M. and Musgrave, R., The Shifting of the Corporate Income Tax, Baltimore, John Hopkins Press, 1963.

Lawson, G.H.L., and Windle, D.W. Capital Budgeting and the Use of DCF criteria in the Corporation Tax Regime, Edinburgh and London: Oliver & Boyd, 1967.

Lewis, Wilfred Jr., Federal Fiscal Policy in the Post-War Recession; Studies of Government Finance, Brooking Institutions, Washington, D.C., 1962.

Lewis, William A., "The Theory of Economic Growth", George Allen & Unwin Ltd., 1955.

McCraken, H., Keynesian economics in the stream of Economic thought, Louisiana State University Press, 1961

Machlup, Fritz. International Monetary Economics, George Allen & Unwin Limited, London, 1964.

Meier, Gerald M., Leading issues in Development Economics; selected materials and commentary", New York, Oxford University Press, 1964.

Merrett , A.J. and D.A.G. Monk, Inflation, Taxation and Executive Remuneration, Hallam Press, London, 1967.

Merrett , A.J. and Allen Sykes Capital Budgeting and Company Finance, Longmans Green & Co. Limited, London, 1966.

The Finance and Analysis of capital projects, Longmans, London, 1963.

Musgrave, R.A. The Theory of Public Finance: a study in Public Economy, Kogakusha Company Limited, Tokyo, 1961.

Fiscal Systems, (Studies in comparative economies) New Haven, Yale University Press, 1969.

Musgrave, R.A. and Allen Peacock (eds) Classics in the Theory of Public Finance, New York, The Macmillan Company, 1958.

Musgrave, R.A. and Shaup, C. (eds) Readings in the Economics of Taxation, London, George Allen & Unwin 1959.

Nurkse, Ragner "Problems of Capital Formation in Underdeveloped Countries", Oxford, Basil Blackwell, 1953.

Orewa, G.O., "Taxation in Western Nigeria": The Problems of an Emergent State, Nigerian Social and Economic Studies, No.4. Oxford University Press, London, 1962.

Paaw, D.S. Financing Economic Development; the Indonesian Case. The Centre for International Studies, M.I.T., 1960.

Peacock, A.T. (ed.) — Public Finance as an Instrument for Economic Development, O.E.C.D., 1965.

Peacock, A.T., and J. Wiseman — "The Growth of Public Expenditure in the United Kingdom, Princton University Press, Princton, 1961.

Prest, A.R., — "Public Finance in Theory and Practice", London Weidenfeld and Nicolson, 1960.

Public Finance in Underdeveloped Countries, London, Weidenfeld and Nicolson, 1962.

Rheim, Eberhard., & Ghausey, Abdul Ghaiuc, — Die Wirtshaftliche Entwicklung, Afghanistan, 1880-1965.

Rolph, E.R., and George F. Break — "Public Finance", New York, The Ronald Press Co., 1961.

Sahota, G.S. — "Indian Tax Structure and Economic Development" Bombay; Asia Publishing House, 1961.

Sayers, R.S. — "Modern Banking", Clarendon Press, Oxford, 1960.

Scherer, J. & Papke, J.A. (eds) — Public Finance and Fiscal Policy: selected readings. Houghton Mifflin, Boston, 1966.

Seligman, ERA — Income Tax, New York, 1911

On the Shifting and Incidence of Taxation, New York, 1910.

Seltzer, L.H. and Others — "The Nature and Tax Treatment of Capital Gains", NBER, New York, 1951.

Sen, S.E. — "Central Banking in Undeveloped Money Markets" Boakland, Calcutta, 1952.

Smithies, Arthur and J. Keith Butters (eds) — Readings in Fiscal Policy, Vol.I., Homewood, Illinois, Richard D. Irwin Inc., 1955.

Sommerfeld, Raymond M. — "Tax Reform and the Alliance for Progress", Austin, University of Taxas Press, 1966.

Simons, Henry C. — Personal Income Taxation. Chicago, The University of Chicago Press, 1938,.

Federal Tax Reform, Chicago, The University of Chicago Press.,1950.

Taylor, P.E. — "The Economics of Public Finance," New York: Macmillan, 1961.

Wald, Haskell, P., — Taxation of Agricultural Land in Underdeveloped Economies, Cambridge: Harvard University Press, 1959.

(ed.) — Papers and Proceedings of the Conference on Agricultural Taxation and Economic Development Cambridge: Harvard University Printing Office, 1954.

Watkin, V.G. "Taxes and Tax Harmonization in Central America" Cambridge: The Law School of Harvard University 1967.

Wilber, Donald N. Afghanistan, its people, its society, its culture, 1962, Hraf Press, New Haven.

Williams, A., Public finance and Budgetary Policy, George Allen and Unwin, 1963.

Vickery, W., "Agenda for Progressive Taxation", New York, Ronald Press, 1947.

Von Mering, O., "The Shifting and Incidence of Taxation, Blakistan, Philadelphia, 1942.

C. ARTICLES AND PERIODICALS:

Adler, John H. "The Fiscal and Monetary Implementation of Development Programmes, The American Economic Review, XLI, 2 May, 1952, 584-600.

Amatong, Juanita D. Taxation of Capital Gains in Developing Countries, IMF, Staff Papers, 1967, pp.344-384

Ayal, E.B., The Impact of Export Taxes on the Domestic Economy of Underdeveloped countries. Journal of Development Studies, Volume 1, No.4., July, 1965, pp.330-360

Bergson, A., The Incidence of an Income Tax on Savings. "Quarterly Journal of Economics" Vol.LVI, 1942, pp.337-341

Black, J., Investment Allowances, Initial Allowances and Cheap Loans as means of Encouraging Investment. Review of Economic Studies, 1954, pp.44-47.

Break, G.F. Income Taxes and Incentives to work; an empirical study. American Economic Review, XLVII (September 1957), pp.529-49

Break, G.F. Income Tax Rates and Incentives to Work and to Invest, in Public Finance and Fiscal Policy - selected readings, edited by Scherer, J., and Papke, J.A., Boston, 1966, pp.537-547

Bristow, J.A. Taxation and Income Stabilisation. Economic Journal, June, 1968, Vol., LXXVIII, pp.299-311.

Brown, C.V. Misconceptions about Income Tax and Incentives. "Scottish Journal of Political Economy", Vol. XV, February, 1968, pp.1-21.

Brown, E.C. The New Depreciation policy under the Income Tax: an Economic Analysis. National Tax Journal, VIII, March, 1955. pp.81-98.

Brown, E.C., and Richard J. Kruizenga. Income Sensitivity of a simple personal Income Tax. Review of Economics and Statistics. Vol. XLI, August, 1959. pp.260-269.

Buck, L., and Shimmin S., Is Taxation a Deterrent? Westminster Bank Review, 1959, pp.16-19.

Cohen, Leo An empirical measurement of the Built-in flexibility of the Individual Income Tax. American Economic Review, May, 1959, pp.532-541.

Domar, E.D. The Role of Taxation in Economic Development. Essays in Economic Policy, Vol.1 London, Duckworth, 1954, pp.225-54.

Domar, /

Domar, E.D. and R.A. Musgrave — Proportional Income Taxation and Risk Taking. Quarterly Journal of Economy, Vol.58, May, 1944, pp. 387-422

Dosser, Douglas — Tax Incidence and Growth, Economic Journal, 1961, pp.572-91

Fellner, I.N. — Two Propositions in the Theory of Induced Innovation. Economic Journal, 1961, pp.305-308.

Freedman, M. — The Welfare effect of an Income Tax and an Excise Tax. Journal of Political Economy, Vol.,LX, 1952, pp.25-33

Goode, R., — Accelerated Depreciation Allowances as a Stimulus to Investment. Quarterly Journal of Economics, Volume LX1X, 1955, pp.191-220

The Income Tax and the Supply of Labour. Journal of Political Economy, Vol.57., 1949, pp.428-437.

New System of Direct Taxation in Ceylon. National Tax Journal, XIII, (December), 1960. pp.329-340

Taxation and economic Development, in Readings in Economic Development. edited by Morgan, T., Betz, G., N. Chaudary, 1963.

Taxation of Savings and Consumption in Underdeveloped Countries. National Tax Journal, Vol.XIV, No.4., December, 1961, pp.305-322.

Graeme, S.D. — The Instruments of Monetary Policy in Countries without a Highly Developed Capital Market. IMF Staff Papers, Vol.12, 1955, pp.272-279

Gupta, S.P. — Public Expenditure and Economic Growth: a time series analysis. Public Finance, Vol.XXII, 1967, pp.423-461

Hall, Challis, A. Jr., and J. Tobin — Income Taxation Output and prices. Economia Internationale, 1955, pp.523-538 and 743-758.

Haig, R.M. — The Concept of Income - Economic and Legal aspects, in the Federal Income Tax. New York, 1921. Reproduced in R.A. Musgrave and C.S. Shoup, Readings in the Economies of Taxation, London, George Allen & Unwin, 1959, pp.54-76.

Hicks, U.K. — Direct Taxation and Economic Growth. Oxford Economic Papers, New Series, VIII, 1956, pp.302-317

The Terminology of Tax Analysis. Economic Journal, Vol.,LVI, 1946, pp.38-50.

Hinrichs, H.H. — Certainty as a criterion: Taxation of Foreign Investment in Afghanistan. National Tax Journal June, 1962, pp.139-154.

Hinrichs, H.H. and R. Bird — Government Revenue Shares in Developed and Less Developed Countries. Canadian Tax Journal Sept.-Oct. 1963, pp. 431 - 437.

Holt, C.C. Averaging of income for Tax Purposes: Equity and Fiscal Policy Considerations. National Tax Journal, 1949, pp.349-361

Johnson, B.F., and J.W. Mellor The Role of Agriculture in Economic Development. American Economic Review, September, 1961 pp. 571-81.

Kaldor, N. Will underdeveloped Countries learn to Tax?, in Essays in Economic Policy, Volume 1, pp. 255-265 (Originaly published in Foreign Affairs, January, 1963).

Lent, E.G. Tax Incentives for Investment in Developing Countries. IMF Staff Papers, Vol.XIV, No.2 July, 1967 pp.249-323

Lindholm, R.W. Degree of Progression: The Income Tax. American Economic Review, 1954, Vol.XLIV, pp.617-626.

Little, I.M.D. Direct vs. Indirect Taxes. Economic Journal Vol.LXI No.234, September, 1951. Reproduced in Readings in the Economics of Taxation (ed.) by R.A. Musgrave and C. Sharp, 1959, pp.123-131.

Lotz, J.R. Taxation in the United Arab Republic. IMF Staff Papers, Vol.XIII, No.1, March, 1966.

Lotz, J.R. and Marss, R.E. Measuring Tax Effort in Developing Countries IMF Staff Papers, Vol.XVI, 1967, pp.478-99.

Maas, R.W. Uncertainty in the United Kingdom Tax System Today. "Accountancy", February, 1970. pp.93-100.

Martin, A.M. & W.A. Lewis Patterns of Public Revenues and Expenditures. Manchester School of Economic and Social Studies. September, 1956. pp.203-244

Mishan, E.J. & Dicks-Mireaux, L.A. Progressive Taxation in an Inflationary Economy. American Economic Review, 1958, pp.590-606.

Musgrave, Pegg B., and Richard A. "Fiscal Policy", in Britain's Economic Prospects, by Richard E. Caves and Associates,. The Brooking Institutions, Washington, 1968, pp.21-67

Musgrave, R.A. and Miller, M.H. Built-in-Flexibility, in Readings in Fiscal Policy, (American Economic Association Series). 1955, pp.379-388.

Myint, H. Dualism and the Internal Integration of the Underdeveloped Economies; a lecture delivered at the University of Glasgow, September, 1969.

Nicholson, J.L. The Distribution of Personal Income. Lloyd Bank Review, January, 1967, pp.11-21

Nortcliffe, /

Nortcliffe, E.B. Taxation in India, The British Tax Review, 1960, pp.349-363 and 413-428.

Nove, Alec., The Explosive Model, Journal of Development Studies, Vol. 3, No.1, October, 1966, pp.2-13.

Nusbaumer, Jacques. Tax measures to stimulate monetisation of the Subsistence Sector in Developing Countries. Finanz-archiv,. Vol.26, No.1., March, 1967, pp.8-48.

Pechman, Joseph A. Erosion of the Individual Income Tax. National Tax Journal, Vol.X., No.1., March, 1957, pp.1-25.

Prest, A.R. The sensitivity of the Yield of Personal Income Tax in the United Kingdom. Economic Journal Vol., LXXII, September, 1962. pp.576-596

Shirley, David E. Income Tax for Less Developed Nations? National Tax Journal, Vol.XII, 1959,pp.265-269.

Smith, A.H. Income Tax in Ghana, The British Tax Review, 1960, pp.49-54

Streeten, P. The effects of Taxation on Risk Taking, Oxford Economic Papers, Vol., 5, October, 1953, pp.271-287.

Surrey, S.S. The Pakistan Tax Treaty and "Tax Sparing", National Tax Journal, 1958.

Tanzi, Vito, A Proposal for a Dynamically self-adjusting personal Income Taxes, Public Finance, No.4., 1966, pp.507-519

Tanzi, Vito and Ashheim Joseph Savings Investment and Taxation in Under-developed Countries, Kyklos, Vol.18, 1965. pp.205-225

Thorn, Richard S. The Evolution of Public Finance during Economic Development. Manchester School of Economic and Social Studies, No1., January, 1967, pp.19-51.

Tsiang, S.C. Tax, credit and Trade Policies to promote the Production and Export of Manufacture of Developing Countries. The Journal of Development Studies, Vol.1, Nos. 2, 3. January and April, 1965.

Tun Wai, Taxation problems and policies of Underdeveloped Countries. IMF Staff Papers, Vol.IX, 1962, p.428.

Wallich, H.C. Taxation of Capital Gains in the light of Recent Economic Development. National Tax Journal, Vol.XVIII, 1965, pp.133-150.

Wheatcroft, G.S.A. The Problems of Capital Gains Tax. The British Tax Review, Nov./Dec. 1964, pp.395-407.

Williamson, G.J. Public Expenditures and Revenues, an International Comparison. *Manchester School of Economic and Social Studies*, No.1, January 1961, pp.43-56.

D. PUBLICATIONS OF NATIONAL AND INTERNATIONAL ORGANISATIONS.

Government of Canada — Report of the Royal Commission on Taxation. (Carter Report). 6 Volumes, Ottawa, Queen's Printers and Controller of Stationery, Ottawa, Canada, 1966.

Government of India — Indian Tax Reform, Report of a Survey. Department of Economic Affairs, New Delhi, 1956.

Report of the Taxation Enquiry Committee, Volume II, 1955.

Government of Pakistan — Taxation in Pakistan, Central Board of Revenue Karachi, 1961.

Government of the United Kingdom — Investment Incentives, Cmnd.2874, H.M.S.O., 1966

Investment Appraisal, 1966

Reports of the Commissioners of H.M. Inland Revenue, Cmnd. 3508 1968 and Cmnd.3879, 1969.

Royal Commission on the Income Tax, Cmnd.615 London, H.M.S.O., 1920.

Royal Commission on the taxation of Profits and Income, Second Report Cmnd.9105, London, H.M.S.O. 1955.

Royal Commission on the Taxation of Profits and Income. Cmnd.9474, London, H.M.S.O. 1955.

Germany (Bundes Republic) Lander Bridite,
Allgemine Statistik Des Auslandes, 1966

American Universities Field Staff Reports Service.
Afghanistan, South Asia Services, New York, 1965

National Bureau of Economic Research,
Foreign Tax Policies and Economic Growth, New York: Columbia University Press, 1966.

International Bureau of Fiscal Documentation.
Tax News Service, 1965-1966
International Bureau of Fiscal Documentation, Amsterdam
Tax Treaties, Sections C* - C***
International Bureau of Fiscal Documentation, Amsterdam.

O.E.C.D. Draft Double Taxation Convention on Income and Capital
Report of O.E.C.D. Fiscal Committee. C(63) 87, 1963.

Draft/

O.E.C.D. Draft Double Taxation Convention on Estates and Inheritance. (Report of the O.E.C.D. Fiscal Committee), Paris, O.E.C.D., 1966.

Fiscal Incentives for Private Investment in Developing Countries No.19151, July, 1965.

United Nations:

Domestic Financing of Economic Development. New York, UN/Department of Economic Affairs, 1950.

The Effects of Taxation on Foreign Trade and Investment No.1950, XVII, 1.

International Tax Agreements, New York, UN.1948.

Measures for the Economic Development of Underdeveloped Countries, UN, 1951.

Taxes and Fiscal Policy in Underdeveloped Countries, New York, United Nations Technical Assistance Administration, 1954.

Statistical Year Book,	1963,	New York,	1964.
"	1964,	"	1965.
"	1965	"	1966
"	1966	"	1967
"	1967	"	1968

Labour Legislation in Afghanistan, International Labour Review, Vol.57, 1948. pp. 83-85.

Economic Survey of Asia and the Far East

Chapter 6, pp.57-64, ECAFE, Bangkok,	1954
"	1964
"	1965
"	1966
"	1967

"Tax Efforts" in Developing Countries, by Lotz, J.R. and E.R. Marss, in Finance and Development, Volume 6, No. 3., September, 1969, pp.36-39

Tax Potential and Economic Growth in the Countries of the ECAFE Region. Economic Bulletin for Asia and the Far East Vol.XVII, ECAFE, Bangkok, 1966/67, pp.29-48.

Taxation and Economic Development in Asian Countries. Economic Bulletin for Asia and the Far East. No.1966, pp.1-15.

Report to the Government of Afghanistan on the Possibilities of Agricultural Co-operative Organisations in Afghanistan. UN/FAO. Rome, 1957.

Proceedings of the 1968 Annual Meeting, UN/IMF. Washington 1969.

Stabilizing /

Stabilizing an Economy - Mali. by Reinhardt, Manfred, in _Finance and Development_, Quarterly Bulletin, UN/IBRD-IMF, Vol.IV, No.4., December,1967, pp.281-289

Tax Incentives for Industrial Development, UN/Industrial Development Organisation, ID/Conf., 1/B.2., May, 1967.