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Impact of Tax Laws and System on Afghanistan Economy

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ABSTRACT:-
Background: Revenue Generation is a very critical aspect of the economic fortunes of any nation. For any country to experience a strong and viable economy, its revenue base must be efficient. And a very important aspect of the revenue base of any nation is its tax system. Hence, the main of this study was to assess the impact of taxes on the economic growth of Afghanistan.
Materials & Method: The study employed quarterly data from 2006-2017. The data employed were sourced from the World Development Indicators (WDI) 2019. The Generalized Method of Moments (GMM) and Johansen's Cointegration were used to estimate the Models.
Major Findings: It was found that Income taxes, External Debt, and Credit to the private sector significantly impacted economic growth in the study area.
Conclusion: The study concludes that for the economic recovery of the country especially after a series of civil unrest, the tax system is very critical.

Keywords: Tax Revenue, Tax, Tax System, Economic Growth
JEL CODE: G15, G18, H2, H25, H27, H3

I. INTRODUCTION

The Afghanistan economy has been bedeviled by a plethora of problems, chiefly due to slow and weak economic growth. Economic growth is very critical to the development progress of any nation. According to Rodrik (2007), ‘historically nothing has worked better than economic growth in enabling societies to improve the life chances of their members, including those at the very bottom.’ Sen (1999) has stated that economic growth is an important pathway for expanding the substantive freedoms that people value, which are strongly associated with improvements in the general standards of living, such as greater opportunities for people to become healthier, eat better and live longer. Hence, when growth in output is not strong enough, the general economy suffers.

Causes of this poor growth of the Afghanistan economy are majorly severe droughts and intensifying insecurity (World Bank, 2020). Severe drought reduces both labor and agricultural productivity, while insecurity reduces investments. This insecurity has further led to the internal displacement of people and refugee returns which continues to pose a great risk of the general wellbeing of the economy. Dellal & McCarl (2010) states that drought has effects ranging from economic (income losses, loss to industries directly dependent on agricultural production, decreased land prices, unemployment from drought-related declines in production, the strain on financial institutions (foreclosures, more credit risk, capital shortfalls) and agriculture (affecting crop and animal production). Put differently, "a major drought can reduce crop yields and crop hectarage because less water and soil moisture are available for crop growth" (Ray, Fares, & Risch, 2018). Hence, the effects of this drought on the Afghanistan agricultural space were that agricultural production growth slowed to 0.8 percent during late 2017 and early 2018 leading to losses in livestock productivity and grain crops.

Also, investor and business confidence weakened significantly due to uncertainties on the duration and level of international security assistance and also the outcomes of the 2019 presidential elections (World Bank, 2020). Bakari (2017) opines that investment is a very critical component of the process of growth and economic growth itself and the main engine of the economic cycle, hence, making it an as an aspect where every government pays and should pay attention to, because of the enormous benefits that can enjoy therein. That is, investment a channel through large economic gains can pass through and any factor that negative influences investment indirectly affects the economy. Essien, Tordee, Abuba, & Felix (2015) stated that insecurity stagnates the growth of investment in an economy especially FDI, hence being one of the major problems of the Afghanistan economy.

This twin problem drought and insecurity led to poverty rates increasing especially among rural households as a result of low income from agriculture and investment. It further led to weaker exports and increased imports widening the country's trade deficit to about 35 percent of the GDP in 2018. Statistics from the World Bank show that for instance in 2018, the rate of growth slowed down to 1.8 percent. Macroeconomic management has remained relatively strong, with sustained revenues and moderate inflation. Domestic revenues increased almost by 12 percent from 2017 to 2018. This strong revenue according to the World Bank was tied to improved tax administration, increased budget execution, and low public debt. This study, therefore, intends to investigate the effect of taxes on the Afghanistan economy.

Taxation in the Afghanistan Context

Taxes are compulsory payments levied income-earning and generating aspects of the economy. Taxes play a very significant role in the economy of any nation. It is a major part of the revenue base and strategy of any economy. Furthermore, it is also used as a fiscal policy instrument when the economy needs to be stimulated, managed and/or saved. For any nation to be viable economical its tax system must be very efficient and sustainable. Large economies around the globe are those whose tax systems are effectively and efficiently managed.

In Afghanistan, Brooks (2017) states that the taxation system has been improving partly due to pressures from the World Bank, bilateral and multilateral donor institutions to ensure that its collected tax revenue system is growing to the point it becomes fully, financially self-sufficient and eventually sustainable, and the National Unity Government (NUG) doggedness and focus in increasing its own "domestic resource mobilization or DMR" revenues by pursuing more aggressively tax cheats and individuals and organizations who try to shield or hide wealth from taxation inside the country. However, much still needs to be done to have a good working tax system especially this period of national political and socio-economic recovery.

The country was ranked 177th out of 190 countries for enhancing business activity in the World Bank's ranking of tax systems—consisting of its tax rates, laws, and processes, which officials from the World Bank, State, and the Afghan government have noted that the rankings are partial as a result of Afghanistan's burdensome business environment, including regulations, taxation, and their enforcement (Special Inspector General for Afghanistan's Reconstruction, (SIGAR) (2020). According to SIGAR November 2009, the Afghan government adopted the 2009 Income Tax Law to create a unified tax system governing all aspects of the government's revenue collection. The law contains five primary taxes associated with income earned by all companies operating in Afghanistan namely, Business receipts tax—a levy on all revenues a company receives in a given year. Corporate income tax—a levy on the profits a company earns annually. Employee withholding tax—a levy on the wages of a company's employees that varies depending on the annual salary of each employee. Contractor withholding tax—a levy on any work performed by, or products purchased from, companies that vary depending on the income and license status of the companies used. Rental withholding tax—a levy on landlords of the property leased for business use that varies based on the value of the rented property. The Afghan tax law requires each contractor to calculate its tax liability and pay the Afghan government applicable taxes.

However, a major problem facing the Afghanistan Tax regime is its relationship with its strongest ally, the United States of America (USA). The USA has been supportive of the Afghan government especially in terms of military and social developmental aids. The USA has a high presence of both military personal and investors in Afghanistan. And usually, part of the US aid policies includes a degree of tax-exempt. Put clearly, Brooks (2017) states that "under U.S. law, no U.S. assistance is taxable by the host government that receives this assistance through implementation by U.S. foreign policy/assistance implementing organizations like DynCorp or Chemonics or by international NGOs like Save the Children or Islamic Relief." However, contractors have revealed to SIGAR that the Afghan government has imposed and assessed inappropriate taxes and tax-related penalties on their work performed under tax-exempt contracts in Afghanistan and that this taxation may have hindered U.S. reconstruction activities in the country.

Fazli (2016) outlines about six areas where revenue collection is hampered in the Afghanistan economy. These are economic, political, legal, technological, social and environmental. Political inhibitors include contractual agreements that include waivers granted to taxable firms from some countries. economic factors include issues that could affect the behavior of taxpayers such as changes in taxation, inflation, economic growth, and interest rates. Technological factors include logistical and financial burdens incurred as a result of the use of orthodox paper collection mechanisms. Environmentally, the security situation and lack of functioning infrastructure inhibit the free movement of taxpayers and tax collectors; twenty-one of Afghanistan's 34 provinces are currently in a state of conflict or partial conflict. Legally, certain government policies are discriminatory and favor particular communities and political groups and negatively impact the tax collection process.

Second Group of Standard Integrated Government Tax Administration System (SIGTAS)

Second Group of Standard Integrated Government Tax Administration System (SIGTAS) This system was inaugurated and executed all through service in Khost Provincial Revenue Directorate (PRD=Mustofyat). The Implementation procedure of the second gathering of SIGTAS began the August 24th of 2019 and finished on September nineteenth of 2019. The system inaugurated with the participation of Baryalay Shinwari Director of Khost commonplace revenue directorate, Abdul Razzaq Himmat common director of Independent Administrative Reform and Civil Services Commission (IARCSC), and other governmental officials. Mr. Baryalay Shinwari during the inauguration said in his discourse: "With the implementation of this system, taxation laws will be actualized similarly, and meanwhile will acquire straightforwardness all organizations." Naqibullah Mohmand and Mohammad Nader Fazili the implementations referenced second gathering and representatives of Afghanistan Revenue Department/Ministry of Finance (ARD/MOF) attended the service, and communicated the objectives and advantages of the executed system, and expressed gratitude toward the Khost commonplace revenue director for the multilateral cooperation in the implementation of the system.

At the finish of the program, Khost commonplace revenue director and common director of IARCSC communicated their appreciation for the endeavors and cooperation of the referenced group, and officially inaugurated the second gathering of SIGTAS. Furthermore, the Filing unit built up in Khost common revenue directorate, which can hold archives for as long as ten years, and through utilizing this system give opportune and snappy access to stored reports.

Challenges to Standard Integrated Tax Administration System (SIGTAS) system implementation at Afghanistan revenue department

The Standard Integrated Government Tax Administration System (SIGTAS) is an integrated information system that is difficult to execute. It is a useful tool for governments to automate taxes and to permit administration. SIGTAS is being executed at the Afghanistan Revenue Department, it is set to transfigure their capacities and increment their authority overstate revenue.

Afghanistan Revenue Department is focused on offering quality types of assistance by helping taxpayers to comprehend and in meeting their tax obligations through executing law without being impartial and in an equitable way. Afghanistan Revenue Department (ARD) gathers all revenue due at the least cost conceivable while rendering a professional help extends the tax base by identification of rebelliousness and sets up an optional consistence taxpaying condition dependent on self-appraisal by taxpayers with a piece of adequate information.

Principle Challenges To (SIGTAS) System Implementation at Afghanistan Revenue Department

The implementation of the Standard Integrated Government Tax Administration System (SIGTAS) in Afghanistan faces numerous deterrents as it has a few prerequisites that should be satisfied.

Financial Barriers

Right off the bat, Afghanistan is intensely subject to guide an international guide to funding its occasional and improvement spending plans. Afghanistan can't continue its present spending, tax and different approaches over the long haul without putting government dissolvability in danger of defaulting on scarcely any liabilities or uses.

Disregarding the ascent in revenues, the government wants to hugely depend on givers for the coming a very long time as their budgetary targets are probably not going to be met in such a limited capacity to focus time. The Government of Afghanistan's (GoA) essential assignment is to build revenue for government use.

Challenges Related to Collection Of Taxes

Afghanistan experiences an issue concerning the collection of taxes from the neighborhood workers of outside government offices. A few international safe havens are being cooperative while the majority of them are most certainly not. On the off chance that these government offices cooperate, at that point, the measure of yearly annual tax can increment by a considerable lot.

A broadly well-known explanation of not paying tax is because of the degenerate system and negative exposure, be that as it may, if they begin making good on taxes and make the government independent, at that point the government may have the option to actualize SIGTAS easily and cater the economic, social and political situations of the nation.

The Standard Integrated Government Tax Administration System (SIGTAS) relies on the utilization of an exceptional Taxpayer Identification Number (TIN), which is basic in its appropriate working; a minor mistake will have expensive repercussions. TIN utilizes a 10 digit interesting number to recognize every taxpayer and credit his record when taxes are paid, in this manner making the tax specialists subordinate upon the TIN to get nearby taxpayer records, distinguish resistant taxpayers and deal with their action (Department, n.d).

The issue as referenced before brings a boundary up in executing SIGTAS as the economic situation of Afghanistan doesn't permit the tolerance of such danger of blunders and acquire these additional expenses.

Afghanistan's tax system has been founded on 'self-evaluation' for example the taxpayers are deciding what amount ought to be paid based on salary records and obligations according to law. This has been occurring since 2005 and if the Standard Integrated Government Tax Administration System (SIGTAS) is actualized, at that point the taxpayers should relinquish this "self-evaluation At" conduct and let the system accomplish its work. This is inclined to permeate disorder among the taxpayers.

Economic factors

Afghanistan's present Gross Domestic Product (GDP) positions as one of the most minimal on the planet keeping the nation from the accomplishment of financial manageability.

The implementation of the Standard Integrated Government Tax Administration System will present high upkeep costs, which should be met consistently. SIGTAS will require ceaseless supervision and normal updates, the invitation to additional costs is obviously, a hazardous arrangement.

The journey for harmony in Afghanistan is progressing and the appearance of the Standard Integrated Government Tax Administration System (SIGTAS) can end up being as clamorous if the economic condition falls any further. The fall in the economy will trigger a negative reaction from the nations supporting Afghanistan. The cessation of international help will acquire Afghanistan a state of disarrangement and prevent their quest for harmony and thriving (Mohmand, 2012).

Effective workforce-related challenges

A test looked by Afghanistan is the absence of gifted people to complete their assignments productively and effectively. SIGTAS requests prepared people to utilize the software and deal with each part of the tax executive’s procedure. The staff should be prepared to utilize SIGTAS, another choice will be to enlist gifted people yet Afghanistan won't have the option to manage the cost of their wages. With an altogether new system, the revenue department should utilize individuals to run SIGTAS, this will bring about further administration costs as the department must comprise of pertinent talented staff.

II. OPERATIONAL TAX LAWS IN AFGHANISTAN

Operational till date they are three current tax laws in operation in Afghanistan this include

1. **The Income Tax Law 2009**
2. **Tax Administration Law 2015**.
3. **The Value Added Tax Law 2016**

Thus, having given an introit to the application of the value-added tax law in Afghanistan in the introduction its is importation to explain in detail the other two operational laws in Afghanistan to date.

Income Tax Law 2009

This law requires taxpayers to keep up and preserve business records (Article 36). All common or legitimate persons with taxable income in a taxable year must keep records identified with all transactions, all movable and immovable property, and all income important to get ready total and exact tax returns. Records include records, diaries, vouchers, fiscal reports and records, and income tax records. They are to be supported by source documents. Records normally condense the information contained in the source documents. Source documents include sales invoices, purchase receipts, contracts ensure, bank store slips, checks and so on. They additionally include sales register slips and charge card receipts, purchase orders, work orders, import and export documents, delivery slips, messages and general correspondence in support of the transaction. The Afghanistan Revenue Department doesn't indicate the books and records you have to keep. You may pick an arrangement of record-keeping that is fit to the reason and nature of your business.

However, these records should unmistakably mirror your income and consumption. Your records must be:

- Reliable and finish
- Provide the correct information vitally
- to compute your tax obligations and privileges
- Be supported by source documents to verify the information contained in the records
- Include other documents, for example, arrangement books, logbooks, income tax returns, business receipts tax returns, lease withholding tax returns, wage withholding tax restores, certain bookkeepers' working papers, that help with deciding your obligations and qualifications

Fixed Taxes

There are fixed taxes instead of income tax forced on certain business and transaction types. Now and again the fixed tax is a prepayment of income tax yet doesn't relieve the taxpayer from the need to document an income and/or business receipts tax return. The accompanying fixed taxes are

i. Fixed tax on imports
ii. Fixed tax on the transport of goods or passengers for business purposes
iii. The fixed tax of contractors
iv. Fixed tax on exhibitions
v. Fixed tax on small businesses
vi. Fixed Tax on Imports (Article 70)

Persons who import goods are dependent upon a fixed tax on the cost, including customs obligations, of the imported goods. Persons with a present business permit are dependent upon a 2% fixed tax. The tax paid is permitted as a credit in the income tax evaluation for the year in which it is paid. Persons without a business permit are dependent upon a 3% fixed tax which is payable rather than income tax. The fixed tax on imports is paid when and where the traditions obligations on imported goods are paid.
Fixed Tax on the Transport of Goods or Passengers for Business Purposes (Article 71)
Persons who transport passengers or goods for business purposes are required to pay an yearly fixed tax before restoration of their vehicle registration.

Fixed Tax on Imports (Article 70)

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Fixed Tax on the Transport of Goods or Passengers for Business Purposes (Article 71)
Persons who transport passengers or goods for business purposes are required to pay an yearly fixed tax before the reestablishment of their vehicle registration.

Business Receipts Tax (BRT) A 2% business receipts tax is forced on net receipts of a wide range of income of corporations and constrained obligation organizations and individuals whose income is more than 750,000 afghanis for each quarter, aside from specific sorts of income depicted beneath where the BRT rate is 5% or 10%. There is additionally a 2% BRT on imports, payable to the Customs House where and when the traditions obligation is paid. This BRT is treated as an advance installment of the quarterly BRT appraisal. 10% BRT is payable on net receipts from the provision of the accompanying services:

a. International passenger airline services
b. Telecommunications services, including Internet services
c. Hotels providing superior services
d. Restaurants providing superior services

Other lodgings and eateries with the income of 750,000 afghanis or more for every quarter and clubs and lobbies (event venues) pay 5% BRT. The business receipts tax paid is deductible from net income in arriving at taxable income for income tax purposes (Article 67) Tax forms and payments are expected on a quarterly premise utilizing the sun-powered schedule. Tax payments are made at Da Afghanistan Bank no later than the fifteenth day following the finish of the sunlight based quarter in which the sales were made (Article 88).

The Income Tax Law 2009 provides the Ministry of Finance with the entirety of the enforcement powers important to gather the taxes that are legitimately due.

1. Assessments – the Ministry of Finance may alter tax appraisals (or tax appeared on tax comes back) to correct intentional or inadvertent errors. The Ministry may likewise raise an appraisal for tax dependent on assessed income where no arrival has been documented.
2. Property actions – The Ministry of Finance may put restrictions on the offer of movable and immovable property, place liens or encumbrances on property or hold onto the property for the motivation behind deal. These actions might be taken upon approval of the courts.
3. Director and investor risk – The Ministry may under specific conditions gather the tax obligation of the organization from its directors, certain investors, and outsiders who have received resources from the debtor organization.

4. Collection from outsiders – The Ministry can give an order (at times known as a garnishee order) to gather sums owed to the tax debtor by outsiders. These outsiders could include clients, budgetary institutions, businesses, inhabitants, and so on.
5. Departure Prevention Order – This is an order to the fitting authorities to limit or prevent an individual (including an evaluated director, investor or outsider) who has unpaid taxes of more than 20,000 afghanis from leaving the nation.

Corporate Tax Reform

The government is focused on making Afghanistan attractive to investors and has continued to reform corporate taxation consistent with international standards and best practices. The Income Tax Law 2009 includes provisions for quickened depreciation (over four years for structures and two years for other resources) and the capacity to convey misfortunes forward for a boundless period until completely recovered. Other corporate tax reform estimates which have been actualized include:

i. Taxing parts of foreign organizations on a similar premise as backups of foreign organizations.
ii. Tax incentives for extractive ventures.
iii. Extending the 20% withholding on dividends to include withholding for intrigue, sovereignties, and other comparative payments.
iv. Deductions permitted based on the attribution of genuine costs between the branch and the non-inhabitant person
v. Ensuring a manageable distance evaluating between related elements.
vi. Implementing a general enemy of avoidance rules to address tax avoidance rehearses.
vii. Quarantining foreign misfortunes against foreign income

Tax Administration Law 2015

To advance voluntary consistency with Afghanistan's tax laws, the Ministry of Finance is working to reform the Revenue Department and other Ministry offices to make a more proficient and effective tax administration. The new organization will be more service-oriented, understanding that education and information are the foundations for consistency. Simultaneously, the organization will be developing present-day enforcement programs along with international standards that will help guarantee a reasonable tax framework. Above all, the Ministry is working to wipe out corruption and set up a straightforward administration that effectively utilizes planned assets. This is a long term responsibility, and the resulting organization will do a lot to make a superior business atmosphere in Afghanistan.

Taxpayer Identification Number (TIN) To make tax administration more effective and to guarantee appropriate crediting of taxes paid to taxpayer accounts, the Ministry of Finance has executed an exceptional taxpayer identification number (TIN) program. Every person, organizations, and organizations which are, according to the Income Tax Law and Customs

Wage withholding tax

Managers with two or more workers are required to retain tax from their representatives' salaries and wages dependent on the above rates (Article 58). There is a monthly exemption of 5000 afghanis per person. Salaries and wages include ordinary compensation, overtime pay, money stipends (for example nourishment, transportation) and non-money payments. These rates are genius evaluated dependent on the recurrence of installment (monthly, week by week, and so on.). Wage/compensation workers with only one boss and no other wellsprings of income are not required to document a yearly tax return. A wage worker who has more than one business or additional wellsprings of income must record a yearly income tax declaration. The business is required to transmit to the State the sum retained no later than 10 days after the month's end in which the sums were retained (Article 60). The settlement is made straightforwardly to a part of Da Afghanistan Bank utilizing the fitting form. There are yearly reporting necessities for bosses both to the representative and to the Ministry of Finance (Article 61). For more information in regards to the wage withholding tax, Wage Withholding Tax, Sole proprietors self-utilized individuals must document a tax return and are permitted to deduct all ordinary and important business costs against their income to figure net taxable income.

Empirical Literature

Special Inspector General for Afghanistan Reconstruction (2018) in the third series of lessons learned reports on private sector development and economic growth issued by the Special Inspector General for Afghanistan Reconstruction examined how the U.S. government had supported private sector development in Afghanistan since 2001 through efforts led by the U.S. Agency for International Development, with additional significant roles played by the Departments of State, Defense, Commerce, and Treasury found that the country's significant economic gains in per capita income and growth in sectors such as telecommunications, transport, and construction were largely the result of post-conflict recovery and substantial foreign spending. Furthermore, it was found that at the start of reconstruction, sound macroeconomic policies and capacity for public financial management, allowed some successes and set the stage for future development in the country.

Abomaye-Nimenibo, Michael, & Friday (2018) carried out an empirical analysis of the effect tax revenue on economic growth in Nigeria from 1980 to 2015 using the Ordinary Least Square (OLS) econometric technique to analysis the time series data. The result from the regression analysis showed that there was no significant relationship between various forms of tax; petroleum profit tax, company income tax, custom and excise duties, and economic growth in Nigeria. Also, Padda & Akram (2009) studied the impact of tax policies on economic growth in three south-Asian economies namely Pakistan, India, and Sri Lanka by conducting time series analysis separately for each country. The data for the study was obtained from the International Financial Statistics (IFS) between 1973 and 2008. The result of the empirical analyses shows that changes in tax rates do not permanently alter the real GDP growth rate. This means that the effects of tax rate changes on the growth were transitory.

Saidin, Basit, & Hamza (2016) conducted a panel study to identify the role and impact of the tax on the economic growth of 27 selected Asian countries for 5 years time period. Although their findings aligned with recent findings of empirical studies, the findings they presented cast doubt on the robustness of this empirical result. Xing (2011) estimated the effect of changes in the structure of tax revenue-neutral to the level of income per capita in the long run by using panel data for 17 OECD countries over the period 1970 to 2004. Findings from their result showed that they did not find solid footing for the different types of tax terms' impact on growth.

Stoilova & Patonov (2012) conducted a comparative empirical investigation of the impact of taxation on economic growth in the European Union (27) member states during the period 1995-2010. The conclusion of the result from the regression analysis shows the efficiency of tax structures based on direct taxes in terms of supporting the economic growth in the EU countries. Macek (2014) using selected OECD countries evaluated the effect of individual types of taxes on economic growth by utilizing regression analysis on data for the period of 2000 – 2011. Measuring the Tax using the World Tax Index, the results showed that a negative relationship between these two variables was confirmed, however, it was the least quantifiable.

III. METHODOLOGY

The study utilizes time-series data from the World Development Indicator (WDI) (2019) on the variables used for the study. The data spans from 2006-2019 and would be converted to a quarterly form to have a sufficient sample size with more degrees of freedom. The variables used for the study include Gross Domestic Product (GDP), Governance proxied by control of corruption, Exchange Rate, Inflation rate, Foreign Direct Investment, Income Tax, Grants and another source of incomes, and credit to the private sector

The estimation technique adopted for this study is the General Method of Moments (GMM). The technique is chosen because of its numerous advantage in augmenting and correcting many problems that ensue in time series analysis. For instance, when there is a mixture of I(1) and I(0) variables as regressors, the GMM is still efficient and remain unbiased. In other words, it can account for the order of integration of variables even when they are not the same, hence the technique has the benefit of not requiring specific identification of the order of the underlying data. Another advantage of the GMM estimator is that it helps to correct for the problems of serial autocorrelation and endogeneous regressors which are mostly lag related since the estimator uses lags of variables as the instruments variable (Onwe, Adeleye, & Okorie, 2019).

Like other instrumental variable techniques such as the Two Stages Least Squares (2SLS), the GMM estimator is only identified when there are as many instruments as the parameters in the model. Under this suitable and regular condition, the GMM estimator becomes reliable and consistent. According to Greene (2003), the GMM estimator has properties of other estimators such as least squares (both linear and non- linear), instrumental variable, maximum likelihood and method of moments. The GMM has received high commendations and acceptance especially for addressing the issue of endogeneity.

3.1 Model Specification

Our choice of the Gross Domestic Product growth rate as a measure of the progress of the Afghanistan economy is because it has been traditionally and widely accepted as the reflector at the least, of the economic condition of any economy and the first macroeconomic goal of economies.

GDP = f(income tax, credit, debt, corruption, exchange rate, grants, FDI, inflation)

$$\boldsymbol{GDP_t = \alpha_0 + \beta_1 Tax_t + \beta_2 Credit_t + \beta_3 Debt_t + \beta_4 Corruption_t + \beta_5 ExchRate_t + \beta_6 Grants_t + \beta_7 FDI_t + \beta_8 Inflation_t + \varepsilon_t} \quad \mathbf{1}$$

Eqn 1 is the model to be estimated. The first lag of the variables would be used as the instruments in the GMM estimation. First, we conduct the stationarity test using the augmented-dickey fuller (ADF) test. Then the

Johansen's cointegration test and then we estimate the GMM model. Variables such as the Credit to the private sector and external debt are logged before estimation.

IV. RESULTS

Table 4.1 Stationarity Test Results

Variable	ADF Critical Values	ADF Test Statistics	Stationarity
FDI	-2.925169	-2.937920**	I(0)
Exchange Rate	-2.926622	-7.090484***	I(1)
GDP	-2.931404	-6.150722***	I(1)
Debt	-2.938987	-4.131569**	I(1)
Credit to Private Sector	-2.926622	-6.646312***	I(1)
Grants and Other Incomes	-2.926622	-6.638116***	I(1)
Income Tax	-2.926622	-6.636563***	I(1)
Inflation	-1.947975	-2.219127**	I(0)
Corruption	-1.948140	-6.708204***	I(1)

Source: Researcher`s compilation from E-view (version 10)

$p < 0.05$, ** $p < 0.01$, ***

table 4.1 shows the stationarity level of the variables used in the study. Except for Foreign Direct Investment and Inflation rate which stationary at level, all other variables are stationary at first difference.

Table 4.2 Johansen's Cointegration Test Result
Unrestricted Cointegration Rank Test (Trace)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.500000	183.9985	159.5297	0.0012
At most 1 *	0.500000	152.8069	125.6154	0.0004
At most 2 *	0.500000	121.6153	95.75366	0.0003
At most 3 *	0.500000	90.42363	69.81889	0.0005
At most 4 *	0.470898	59.23201	47.85613	0.0030

Source: Researcher`s compilation from E-view (version 10)

Trace test indicates 6 cointegrating eqn(s) at the 0.05 level
 * denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values

The result from table 4.2 shows the cointegration test result. We conduct the cointegration test to ascertain if a long-run relationship exists among the variables. To ascertain if there is a long-run relationship among the variables the probability values should be less than 0.05. And from our results, there are about six cointegrating equations from the trace test (although we reported just five). This shows that there is a long-run relationship among the variables, hence we can make long run inferences.

4.3 GMM Results from the model specification

Variable	Coefficient	Std. Error	T-Statistic	Remarks
INCOME TAX	0.300127***	0.087728	3.421091	Accept
CREDIT	11.39187***	2.525413	4.510892	Accept
DEBT	9.151018**	2.041864	4.481698	Accept
CORRUPTION	-12.96456	13.18946	-0.982949	Reject
EXCHANGE RATE	-0.815535**	0.326004	-2.501610	Accept
GRANTS	-2.197432***	0.460132	-4.775654	Accept
FDI	-5.662789***	1.399331	-4.046782	Accept
INFLATION	0.170505**	0.064702	2.635215	Accept

Reliability Test

R-Squared	*Adj-R2*	*F-statistics*	*Prob(F-stat)*	*Mean Dependent*
0.8169	0.7840	41.91	0.00	2.26

$p < 0.05$, ** $p < 0.01$, ***

Source: Researcher`s compilation from E-view (version 10)

Table 4.3 shows the regression results of the estimation done using the Generalized Method of Moments (GMM) from the results, all the variables used in the model were statistically significant except the governance indicator (corruption). Variables such as foreign direct investment, exchange rate, corruption, and grants and incomes from other sources had a negative relationship with economic growth. Whereas, income tax, credit to the private sector, external debt, and inflation all had a positive relationship with economic growth. The result shows statistically that for percentage increase in income tax, credit to the private sector, external debt, and inflation, economic growth will change positively by 0.30, 0.11, 0.91 and 0.17 percent respectively. and for a percentage increase in the exchange rate, grants, and other income sources and foreign direct investment, economic growth will decrease by 0.81, 0.21 and 0.56 percent respectively. The adjusted coefficient of determination (R^2) shows that 0.78 percent of the variation in the dependent variable economic growth is explained by the regressors.

V. DISCUSSION OF FINDINGS

Taxation remains a very critical tool in macroeconomics. Beyond a source of revenue to the government, it is a fiscal policy mechanism of monitoring and stabilizing the economy. hence, when properly managed, it is a very important tool in the economic progress of any nation. In the case of Afghanistan, the case is no different. The result shows that income tax increases the economic growth of the country. This means that an efficient tax system is highly desirable especially in these periods when the country is beginning to recover from wars and civil unrest. As aforestated, the tax system should be efficiently managed in such a way that it does lead to welfare losses either due to high-level taxes and/or retrogressive taxation.

The result further shows that external debt and credit to the private sector has also positively influenced economic growth within the study period. This means that external debt has been effective in improving the economic fortunes of the country. Especially in periods of the budget deficit, external debt is an important segment of deficit financing. However, the debt must be put into productive segments of the economy, and effectively managed, so that results can be tenable and debt servicing does not take major portions of future budgets. Similarly, the private sector is very critical in the economy. economies that have thrived have not done so without their private sectors. Usually, one of the challenges private individuals face is that of finance at all levels. hence, governments should make credit facilities available to individuals and private organizations to ease their burdens. For this credit to be effective, they must be well monitored to prevent issues such as bad debts. The private sector help in creating employment and thus reduce unemployment which is very critical for growth. The private sector remains a source of finance to the government for instance through tax revenues and even domestic debt.

However, findings reveal that the exchange rate regime practiced in the country has not been favorable to economic growth. The results reveal a negative relationship between exchange and growth. This possibly could be a result of the fact that the economy is fragile and lacks the capacity for the exchange rate regime either due to issues such as the negative balance of payments, lack a viable real sector or even monetary policy. Also, there exists an inverse relationship between FDI and economic growth. From the data available, the FDI for most of the was negative. A negative FDI implies that there have been net outflows compared to inflows. Especially for an economy that has been plagued by terrorism and civil unrest, most investors are likely to invest their resources outside and foreign investors are also likely not to invest such economies. And when this is the situation, FDI is will harm the economy since funds leave the economy more than it comes in.

VI. CONCLUSION

The study focused on the impact of the tax system and policies on the Afghanistan economy by investigating the relationship between income taxes and economic growth. The result shows that income taxes were beneficial to the economy of the country. Other variables in the study that showed a positive relationship with growth include external debt and credit to the private sector. On the balance, it means that a viable and working tax system will be critical to the economic progress of the country, especially at periods such as this where the economy is trying to recover from the effects of a long period of civil unrest.

It is highly recommended that the tax system be made more efficient to continually enjoy and improve on the gains of taxation. Furthermore, more credit facilities should be made available to the private sector and policies which would enhance their productivity should b given high priority to improve their capacities. Security remains a very critical tool investment. Hence the country should tackle all security challenges and make the economy attractive to foreign investors and also prevent local investors from investing outside the country so that FDI outflows will not be more than inflows.

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