AFGHANISTAN RECONSTRUCTION TRUST FUND

**INCENTIVE PROGRAM 2015-2017**

ADMINISTRATOR'S THIRD TECHNICAL REVIEW

DECEMBER 15, 2016

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## Summary Assessment

This is the third technical review of the 2015 – 17 program undertaken by the World Bank as Administrator. Findings of the technical review include:

- The economy continues to be affected by on-going conflict and political instability. Growth in 2016 remains low and prospects of economic recovery in the short-term are dim. However, the macro-fiscal policy framework remains robust and adequate for continued disbursements through the program.
- Program performance remains strong. Government is expected to overreach its revenue targets in 2016 for a second year in a row. O&M spending appears to be on track of reaching the budget target, supported by strong efforts in O&M management and provincial budgeting. Government has de-bottlenecked important investment climate reforms and managed to significantly improve the ability of the Afghanistan revenue administration to address system vulnerabilities and process inefficiencies. Most reforms supported by this program are now on track or can be implemented with slight delays.
- In this round, the Government met two 2015 reforms benchmarks with delay, and three benchmarks within the 2016 timeline. Based on the assessments undertaken for this technical review, the Administrator recommends the disbursement of $83.5 million.

## Part I: Program Background

1. The Incentive Program (IP) 2015-2017, part of the Recurrent Cost Window (RCW) of the ARTF, is a three-year, rolling operation supporting a series of economic policy reforms deemed critical to achieving greater fiscal self-reliance. The IP incentivizes achievements of results and timely implementation of reforms to improve domestic revenue mobilization, expenditure management and growth prospects.
2. The overall financing envelope of the Incentive Program 2015 – 2017 is $ 900 million and represents the global financing ceiling. Incentive funds can be accessed through three complementary facilities: (i) the structural reform facility; (ii) the revenue matching grant facility; and (iii) the operations and maintenance (O&M) facility. Annual allocations to the program are only indicative and can vary from actual disbursements depending on program performance. Detailed information on each of these facilities, description of the structural benchmarks, and timetables are contained in the Memorandum of Understanding (MoU) from September 6, 2015.

**Table 1: Indicative Allocation through the Recurrent Cost Window and the IP (US$ Million)**

| | Allocation | | |
|---|---|---|---|
| | **2015** | **2016** | **2017** |
| **Baseline ARTF RC support** | **$125** | **$100** | **$75** |
| **ARTF IP** | **$275** | **$300** | **$325** |
| Structural Benchmarks | $200 | $225 | $250 |
| Revenue Matching Grant | $75 | $75 | $75 |
| O&M Facility | Float/balance | Float/balance | Float/balance |
| **Total ARTF RCW** | **$400** | **$400** | **$400** |

## Part II: Assessment of Macro-Fiscal Policy Framework

3. **Afghanistan's economic growth continues to be lackluster**. After rapid growth for more than a decade, real GDP growth slowed to 1.3 percent in 2014 and 0.8 percent in 2015. Recent agriculture surveys suggest a slight weather-induced decline of agriculture production by 0.5 percent in 2016. Over the first half of 2016, the number of new firm registrations dropped by 30 percent, suggesting that business confidence continues to be affected by uncertainty over the security situation and market conditions. However, exports increased in the first half of 2016, by around 6 percent compared to the same period last year, due to an increase in horticulture and dried fruit exports. Counting on continued growth in the construction sector, projections show a marginal increase in economic growth to 1.2 percent in 2016.

4. Consumer prices inflation increased from 0.2 percent (year-on-year) in December 2015 to 6.7 percent in October 2016. On a 12-month average basis, the inflation rate increased from a negative –1.5 percent to 4.3 percent between the same months. Both food- and non-food prices have contributed to the increase. The surge in prices could also be caused by lagged effect of currency depreciation which began in mid-2014. Afghanistan's currency depreciated by around 15 percent against the US dollar between October 2014 and October 2016.

5. **The fiscal position is improving**. Following three years of poor performance, revenue collections increased significantly in 2015, with performance remaining strong throughout 2016. Domestic revenues amounted to Afs 113.4 billion[1] as of end-October 2016, nearly 21 percent higher than the figure recorded for the same period last year. Public expenditures increased by 8 percent over the same period, with security spending and recurrent civilian expenditures increasing by respectively 4.5 percent and 13 percent. Development expenditures also increased by around 11 percent in the first 10 months of the year compared to the same period last year. However, the execution rate of the

[1] The figure excludes one-off transfers received by the Ministry of Finance in 2016 up to September 2016.

development budget, which was 35 percent as of end October 2016, is lower by around two percentage points y-o-y. The budget is expected to be balanced by year-end.

6. **The medium-term outlook points towards a slow economic recovery**, with real GDP growth expected to gradually increase to around 3.6 percent by 2019. Stronger growth in out-years is predicated on improvements in security, achievement of political stability, reform progress, and continued high levels of aid.

7. **Continued inflows of aid will support Afghanistan's growth prospects.** The Brussels Conference on Afghanistan, held on October 4, 2016, resulted in total aid pledges of US $15.2 billion through 2020, exceeding initial expectations. This level of aid support is adequate to sustain current levels of service delivery and to preserve development gains in Afghanistan. However, achieving higher growth rates will require major efforts by both the international community and the Government. The Government will need to implement a range of vital policy reforms and adopt a careful and strategic approach to all resource allocation decisions, and to pursue all available means to increase its fiscal space. The international community will need to continue to pursue means to increase the proportion of civilian aid on budget in order to ensure better alignment with Government priorities, improve cost-effectiveness and ensure that service delivery systems continue to expand.

8. On 20 July, the IMF Executive Board approved a three-year Extended Credit Facility (ECF). This agreement comes after a successful nine-month Staff Monitored Program, which was completed in April 2016. The program under ECF will focuses on institution building, fiscal and financial reforms, and measures to combat corruption. The first review of the program is scheduled for early February.

## Part III: Progress on Revenue Mobilization and Collection

9. The Revenue Matching Grant (RMG) Scheme under the IP provides an incentive for improved performance in revenue mobilization and collection. It is anchored in the annual revenue targets agreed in advance between the Ministry of Finance and the International Monetary Fund (IMF). Revenue growth over the previous program year triggers incentive funds which are calibrated at the annual indicative allocation, i.e. full achievement of the target would trigger a disbursement of $75 million (100 % of the annual indicative allocation). Disbursements increase proportionally to revenue growth towards the revenue target. The disbursement eligibility of the Revenue Matching Grant is only assessed once a year.

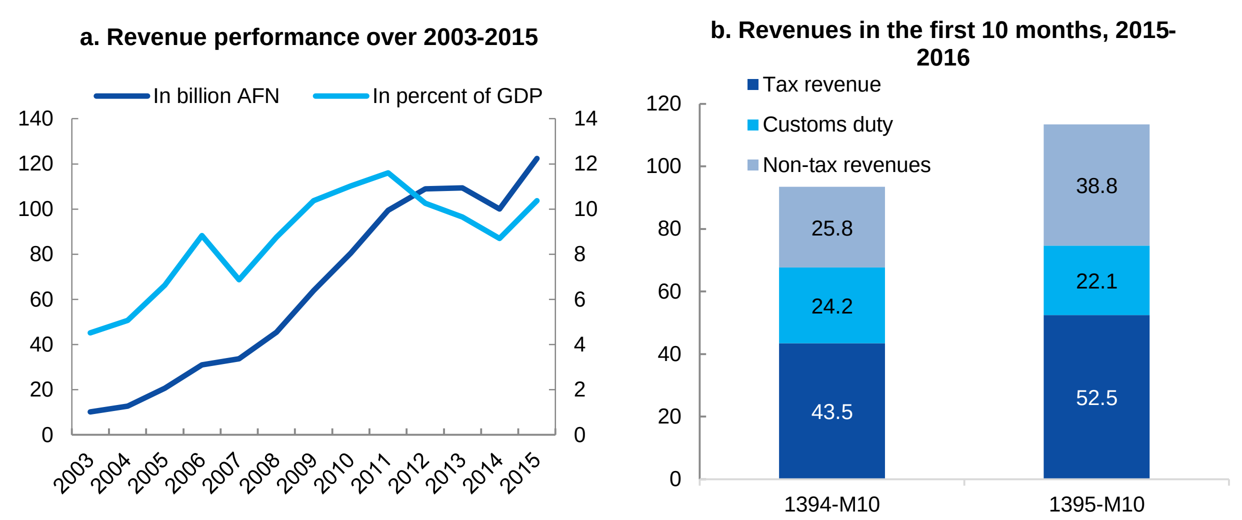
10. **Revenue collection in FY 1395 (2016):** As indicated above, domestic revenues amounted to Afs 113.4 billion[2] by end-October 2016, nearly 21 percent higher than the figure recorded for the same period last year. Preliminary data suggest that the increase in revenue is mainly the results of an increase in tax and non-tax revenues, while customs revenues appear to be declining.

[2] The figure excludes one-off transfers received by the Ministry of Finance in 2016 up to September 2016.

11. The increase in both tax and non-tax revenues is largely the result of: i) improvements to tax administration and increased compliance; and ii) the introduction of new tax measures in the second and third quarters of 2015. While some of the increase in non-tax revenues was the result of a temporary surge in government services, such as the increased demand for passports (on which the Government levies fees), it is expected that most of the other increases can be sustained. The decline in customs revenue is likely to be driven by import trends. While in 2015 the collection of tax arrears contributed significantly to the overall non-tax revenue performance, this has not been the case in 2016. Re-classification of revenues is pending, and final revenue figures would need to be confirmed in early FY 2017.

12. The revenue target, agreed between the MoF and IMF for 2016, is Afs 132.6 billion. As of end-October, over 85 percent of the revenue target has been met. Revenues are expected to exceed the revenue target by around 5 percent by end-year.

**Figure 1: Revenue collection performance**
*(billion AFS)*




Source: Ministry of Finance (Afghanistan Financial Management Information System [AFMIS])

**Incentives Payments under Revenue Matching Grant (RMG) for 2016:** The 2016 revenue assessment will be concluded in early 2017. No incentive payments will be disbursed in this round.

## Part IV: Progress on Operations and Maintenance Spending and Management

13. The Operation & Maintenance Facility (OMF) aims at improving the operation and maintenance of public assets in key areas such as education, health, and rural/urban infrastructure and, thus, enhancing their sustainability. To this end, the O&M facility incentivizes increases in O&M spending. The facility refunds incremental O&M civilian spending above a pre-determined baseline (which is sensitive to revenue growth) and provides an additional incentive of $0.5 on each the dollar of incremental spending to reward improved O&M management. The disbursement eligibility of the O&M facility is only assessed once a year.

14. **O&M activities in 2016:** Capacity to plan, safeguard and execute O&M spending was critically low at the beginning of 2013. Since then a number of reforms in provincial budgeting and O&M capacity building activities, especially over the past years, have achieved significant turnaround. Activities in 2016 included:

    - 29 out of the 55 Government entities with an O&M budget have received training in O&M budgeting and implementation policies.
    - O&M budget norms and costing were expanded to four additional ministries.
    - Several coordination mechanisms have been established to support O&M spending: (i.) a Fiscal Deconcentration Working Group in Kabul to help coordinate and plan provincial budgeting, and (ii.) an O&M working group to support O&M activities. At subnational level, Provincial Public Finance Management Committees have been established to help provinces with costing, budgeting and execution of O&M funds.
    - Trainings were provided to the subnational committees in all 34 provinces.
    - O&M Policy orientation workshops were conducted in the 29 new government agencies and ministries.

15. **Trends in O&M spending:** The end-Oct Treasury report indicates that civilian O&M spending amounted to Afs 12.8 billion which is only marginally higher than spending over the same period in 2015. However, allotment and execution figures by the budget department reports significantly higher O&M spending. Typically, O&M spending accelerates in the last quarter of the budget year which should make it possible to reach or even supersede the 2016 O&M baseline of Afs 18.2 billion. The next technical review will include a detailed full-year assessment of O&M spending.

**Table 2: Trends in O&M Spending**

(in Billion Afghanis)

| Expenditure Category | 2013 | 2014 | 2015 | 2016 (base) | 2016 (proj.) |
|---|---|---|---|---|---|
| Domestic revenues | 109.4 | 100.1 | 122.4 | 132.6 | 140.7 |
| Total expenditures | 278.3 | 301.0 | 318.8 | 374.7 | 375.2 |
| Recurrent expenditures | 198.0 | 228.3 | 235.9 | 268.4 | 268.9 |
| Security | 119.8 | 137.4 | 143.6 | 170.8 | 170.8 |
| Civilian | 78.3 | 91.0 | 92.3 | 97.6 | 98.1 |
| Operations and maintenance | 18.0 | 16.3 | 17.3 | 18.2 | 18.7 |
| *Civilian O&M:* | | | | | |
| In percent of total spending | 6.5 | 5.4 | 5.4 | 4.9 | 5.0 |
| In percent of recurrent spending | 9.1 | 7.1 | 7.3 | 6.8 | 6.9 |
| In percent of civilian recurrent | 23.0 | 17.9 | 18.7 | 18.6 | 19.0 |
| In percent of revenues | 16.5 | 16.3 | 14.1 | 13.7 | 13.3 |

**Incentives Payments under O&M Facility for 2016:** The 2016 assessment will be concluded in early 2017. No incentive payments will be disbursed in this round.

## Part V: Performance Assessment of the Structural Reform Benchmarks

16. **Performance assessment of 2015 benchmarks:** The last technical review (March 15, 2016) indicated that six out of ten 2015 structural benchmarks experienced delays and were pending completion. The score card in Annex 1 provides a brief assessment of all pending structural benchmarks. Based on the evidence received up to November 20, 2016, we confirm the achievement of two more benchmarks related to tax policy and doing business reforms. The verification protocols annexed to the technical review provide more detail on the completion of these benchmarks. This leaves four 2015 benchmarks pending completion including

- tax administration: cabinet approval of the ARD reform plan
- pension reform: preparation and presentation of pension analysis
- electronic payment system: issuance of the APS license, and
- land management: cabinet approval of the ARAZI law.

The Reform Score Card (Annex 1) indicates the reasons for the delays but also shows that 2015 reforms continue to progress. In principle, there is no technical obstacle to completing the reform actions related to tax administration, the Electronic Payment System (issuance of the APS license) and land management. A higher level of Government attention to these three benchmarks could help to achieve the last mile to completion.

17. **Performance assessment of 2016 benchmarks:** The Government succeeded in meeting three out of ten reform benchmarks within the deadline for the 2016 program, including reforms on tax administration, doing business, and provincial budgeting (see verification protocols in Annex 3). We are encouraged by rapid progress in tax administration and doing business reforms which at the beginning of 2016 appeared stuck.

18. The remaining seven 2016 benchmarks are mostly on track to be fully implemented over coming weeks (see scorecard in Annex 2). Alone, the pension reform benchmarks cause concerns. Initial discussion and coordination around the pension reforms have been difficult, despite high-level Ministerial attention. Progress on pension reforms is unpredictable. Finally, uncertainty remains regarding the institutional role and reporting lines of the new customs enforcement wing.

19. **Incentive Payments under the Structural Reform Scheme:** Based on the above assessment, the Government met two 2015 benchmarks with delay and three 2016 on time. Discounts apply to the original allocation of the 2015 benchmarks as indicated in table 3. In total, the Government qualifies for incentive payments in the amount of $83.5 million under the Structural Reform Scheme. 'Losses' under the structural benchmark scheme now amount to $91 million. $ 6 million could still be disbursed if the pending 2015 triggers were achieved during December.

**Table 2: Reform Implementation at a glance**

| | | 2015 | 2016 | 2017 |
|---|---|---|---|---|
| 1 | Customs: HR Reforms | √ | 🟡 | ⚪ |
| 2 | Customs: Enforcement | √ | 🟡 | ⚪ |
| 3 | Revenue Adminsitration | 🔴 | √ | ⚪ |
| 4 | Tax Policy | √ | 🟢 | ⚪ |
| 5 | Land Governance | 🔴 | 🟡 | ⚪ |
| 6 | Doing Business | √ | √ | ⚪ |
| 7 | Pension | 🔴 | 🟡 | ⚪ |
| 8 | Electronic Payment Systems | 🔴 | 🟡 | ⚪ |
| 9 | Provincial Budgeting | √ | √ | ⚪ |
| 10 | Budget Accountabililty | √ | 🟢 | ⚪ |

**Table 3: Incentive Payments under the Structural Reform Scheme**

| Benchmark | Allocation | Delay | Discount | Eligible Amount |
|---|---|---|---|---|
| **2015** | | | | |
| (4) Tax Policy | $ 25 m | 3 months | $ 6.25 m | $ 18.75 m |
| (6) Doing Business | $ 17.8 m | 9 months | $ 13.35 m | $ 4.45m |
| **2016** | | | | |
| (3) Tax Administration | $ 20.1 m | -- | -- | $ 20.1 m |
| (6) Doing Business | $ 20.1 m | -- | -- | $ 20.1 m |
| (9) Provincial Budgeting | $ 20.1 m | -- | -- | $ 20.1 m |
| **Total** | | | | **$ 83.5 m** |

## Part VI: Administrator's Disbursement Recommendations

20. As of the time of review, disbursements of the 2015 -2017 IP have totaled US$254.3 million, representing 28.2 percent of the total IP allocation (table 2).

21. As a result of this review**, we recommend the ARTF Management Committee disburse US$ 83.5 million** in incentive funds out of the ARTF Incentive Program allocations.

22. Disbursements following this review will increase the disbursement ratio of the Incentive Program to 37.5 percent as of July, 2016. Given current progress on revenue growth and O&M spending, the Government remains well on-track to receiving 100% of the global allocation to the IP ($900).

**Table 2: Disbursement through the Recurrent Cost Window and the IP as of Dec 2016 (US$ Million)**

| | Disbursements | | |
|---|---|---|---|
| | **2015 (1st Review)** | **2016 (2nd Review)** | **2016 (3rd Review)** |
| **ARTF IP** | | | |
| Structural Benchmarks | 60.6 | 17.8 | 83.5 |
| Revenue Matching Grant | 33 | 83.2 | - |
| O&M Facility | 0 | 59.7 | - |
| **Total ARTF RCW** | **93.6** | **160.7** | **83.5** |
| **IP Disbursement in % of Total (accum.):** | **9.6** | **28.2** | **37.5** |
| **Remaining IP Balance** | **806.4** | **645.7** | **562.2** |

## Part VI: Key Issues for Management Attention

The Administrator would like to bring the following issues to the attention of the Ministry of Finance and the ARTF Working Group for follow-up:

- While the allocation for the remaining 2015 are almost fully discounted at the time of the review, we encourage Government to continue implementing the reforms and quickly resolve "last mile issues", especially with regard to the issuance of the APS license and the ARAZI law.

- We encourage Government to re-affirm its commitment to pension reforms and propose a timeline for follow-up discussions. Our teams stand ready to support Government in the dialogue around options for reform.

- Should the uncertainty persist, we suggest to issue a formal directive to clarify any unresolved issued regarding the direction of custom enforcement reforms.

# Annex 1: Scorecard and Progress Report on FY 2015 Benchmarks

Status: December 10, 2016

| 2015 Benchmarks | | Progress |
|---|---|---|
| **(1) Customs HR Reforms**<br><br>The Cabinet approves a comprehensive a HR reform policy for ACD. The policy will allow ACD to develop a roadmap for the establishment of a new HR platform and will provide authority to ACD to conduct an HR review, take HR actions on existing customs staff, introduce a transparent and competitive recruitment process, determine hiring and commissioning requirements as well as to deploy performance management and related remuneration packages. | ✓ | **Achieved November 2015, and disbursed following the 1st technical review November 2015.** |
| **(2) Customs Enforcement**<br><br>The Cabinet approves the establishment of a Preventive and Enforcement wing within ACD with powers of search, investigation and arrest throughout Customs territory. | ✓ | **Achieved November 2015, and disbursed following the 1st technical review.** |
| **(3) Tax Administration: Re-Organization and Modernization**<br><br>(i.) ARD fully rolls-out SIGTAS to the five most populated province, and introduces risk-based compliance audits in all tax payer's offices in Kabul.<br><br>(ii.) The Cabinet approves a plan for the re-organization and re-structuring of ARD, including the proposal, policy procedures and a new organization structure. The re-organization aims at providing the ARD with more autonomy in decision making, reducing the fragmentation of ARD functions across ARD HQ and provincial tax offices, and at strengthening relevant reporting lines. | | **Delayed**.<br><br>(i.) The first sub-trigger was completed successfully. SIGTAS rollout has been completed in Kabul's large, medium and small taxpayer offices, and eight provinces (Herat, Balkh, Nangahar, Kunduz, Kandahar, Parwan, Faryab and Paktia). Maintenance and operations of these systems is a major challenge which is being addressed through other technical assistance programs and which will also require support from MoF internal resources. Risk-based compliance audits have been rolled out in the Small, Medium and Large Taxpayer Offices. Case managers register risk scores for all returns using risk guidelines. On this basis, Compliance Committees select cases for audit. Copies of SIGTAS reports have been received.<br><br>(ii.) The reform plan has been drafted but has not been approved by Cabinet. Technical modifications were adopted by the ARD in June 2016 to adjust the plan to respond to the MoF's management objectives (i.e. without full autonomy) and to outline a roadmap of technical assistance. The ARD reports that the document has been translated and sent to the Chief of Staff of the Office of H.E. the Minister of Finance, and through that office to Cabinet for approval. However, the reform plan has not yet been included into the agenda of the cabinet meetings. |
| **(4) Tax Policy**<br><br>(i.) As part of the revenue measures agreed with the IMF under the SMP, MoF decrees the introduction of a mobile telecommunication top-up fee, an increase in the Business Receipt Tax and an increase in the fuel and toll fees.<br><br>(ii.) MoF establishes and the cabinet authorizes an inter-Ministerial and inter-departmental committee | ✓ | **Achieved as of End-March 2016.** See verification protocol for details |

| | | |
|---|---|---|
| for tax policy. The main function of the committee, which may have a flexible structure, should review, discuss and advise on all major tax policy proposals in a time-bound manner prior to approval by cabinet and ensure that all relevant stakeholders are consulted. | | |
| **(5) Land Administration and Management**. The Cabinet approves the new land management law. The new law will include provisions that moves land titling from a court-based to an administrative system, improves security of tenure for various land users (incl. communities, women and private investors), as well as strengthens rights and mechanisms for the restitution of public and private land. | | **Delayed**<br><br>The draft law (now called the "Arazi law") is, in principle, ready for cabinet submission. It was first tabled during a Cabinet meeting in May 2016, together with the draft land acquisition law and the draft law on the Registration of Urban Informal Properties. However, an incorrect version of the draft laws was presented. As a result, the laws were not approved and the decision was delegated to the High Council of Water and Land for review. The High Council of Water and Land met in November to review the laws but they were again turned back for further changes – mainly to the Informal Properties law - to ensure that the legislation adequately reflects the new land allocation plan (for returnees and IDP). The laws will be presented again in December 2016 or January 2017. |
| **(6) Doing Business Reforms:**<br><br>The Cabinet approves a road map which includes a description of all required institutional and regulatory changes for the establishment of a unified business registration system which provides the right to invest, trade and conduct usual business activities to the license holders as well delineates the roles, ownership and management responsibilities of MOCI and AISA in relation to business registration and licensing. | ✔ | **Achieved as of September 2016.** See verification protocol for details. |
| **(7) Sustainability of Pension and Social Benefits**<br><br>i) MoF and MoLSAMD conduct a review of the pension and social benefits system which lays out the fiscal implications of the current pension schemes (Civil Servants, Security, Martyrs & Disabled) with recommendations on how to ensure that pensions and social transfers remain fiscally sustainable in the future. The findings of the review will be presented to the President, the Council of Ministers as well as the Cabinet.<br><br>ii) MOLSAMD has introduced biometric verification / proof of life for the public pension beneficiaries registered in the PMIS. | | **Delayed.**<br><br>**(i.) MoF shared a draft analysis of the fiscal implications of the current pension schemes for civil servants and security personnel** in September 2015. The financial projections in the report were based on a MoF pension model that provided projections consistent with the Bank's pension model for Afghanistan. However, the recommendations in the initial report were not comprehensive enough to address the fiscal impact of pensions. After various technical discussions with the World Bank team the policy paper was revised to include additional policy options.<br><br>However, In July 2016, the Ministry of Labor and Social Affairs requested further technical level discussions on the policy options involving senior officials of both the ministries. The World Bank team suggested to organize an Afghanistan specific 2-days workshop featuring the pension reform options to facilitate the discussions. While the World Bank will continue to support the MoF – MoLSAMD efforts to agree on a reform proposal, the risk that this trigger will not be met by end-2016 is very high.<br><br>(ii) **Achieved on August 15, 2016:** Biometric verification / proof of life for public pension beneficiaries at the Pension Department was introduced on August 15, 2016. Based on reports from the Pension Department, the system so far has captured around 400 pensioners' bio- metrics. |
| **(8) Electronic Payment Systems**<br><br>DAB issues a clear and transparent regulatory framework for payment system providers (PSP) and | | **Delayed.** |

| | | |
|---|---|---|
| payment system operators (PSO) and issues an appropriate license to the Afghanistan Payments System (APS) | | The benchmark is largely met. DAB has issued two dedicated regulations for PSOs in February 2016 and later in the year issued another regulation for PSPs that regulates the "Electronic Money Institutions".<br><br>The DAB is in an advanced stage of the licensing process for APS. DAB's executive board decided that the license to APS will be issued by the Financial Supervision Department of (FSD) of DAB. APS has submitted the application along with the required documents to FSD and the application is currently under processing. DAB has completed the on-site audit and submitted the final report to DAB's executive board for due decisions. The process of issuing the APS license is expected to conclude within the next weeks. |
| **(9) Fiscal Deconcentration and Provincial Budgeting:**<br>(i.) The Cabinet approves the Provincial Budgeting Policy, allowing budget allocation of discretionary resources to provinces, based on clearly defined norms (developed by central line ministries) and in consideration of the capacity of the receiving Ministries as well as overall fiscal space.<br><br>(ii.) MoF establishes a Fiscal Deconcentration Working Group that oversees the implementation of the provincial budgeting policy. | ✓ | **Achieved November 2015, and disbursed following the 1st technical review.** |
| **(10) External Audit:**<br><br>(i) The Supreme Audit Office (SAO) develops and agrees on a framework and methodology for Performance Audits in line with INTOSAI Auditing Standards.<br><br>(ii.) SAO prepares and presents a report to Parliament and President on the status of outstanding audit observations and compliance with the audit recommendations of the least three years by each line ministry and government department. With assistance of the Ministry of Finance, SAO notifies an audit follow-up mechanism requiring the line ministries to implement the agreed audit recommendations. | ✓ | **Achieved January 2016, and disbursed following the 2nd technical review.** |

# Annex 2: Scorecard and Progress Report on FY 2016 Benchmarks

Status: December 10, 2016

| 2016 Benchmarks | | Progress |
|---|---|---|
| **(1) Customs: HR Reforms**<br><br>ACD begins implementing the HR reforms in line with the approved HR policy including changes to recruitment, promotion, mobility, remuneration and provisions on restrictions and exemptions to lateral entry. ACD ensures that 25% of existing grade 2,3 and 4 customs officers will have passed the Customs Academy and qualify to remain in ACD, that all new recruitments will be subjected to competitive process and that any lateral entries follow the procedures laid down in the new HR Policy | | **Risk of Delay**<br><br>ACD has completed a first draft of the HR procedures, but progress in setting up HR unit in ACD was delayed. The new Customs and Tax Academy has been inaugurated in December 2016. The proposal for HR autonomy was approved by Finance Minister, but progress in implementation has been slow. |
| **(2) Customs: Enforcement**<br><br>(i.) The Cabinet approves amendments to the Customs law. The amendments will include provisions that regularize ACD's new enforcement wing, in particular regarding the power for Customs to exercise their powers on the Afghan customs territory.<br><br>(ii.) The Civil Service Commission approves the new Tashkeel for the ACD Preventive and Enforcement Wing.<br><br>(iii.) ACD prepares and begins implementing the Preventive and Enforcement Plan which will cover provisions on organizational structure, training and deployment of staff. | | **Risk of Delay**<br><br>Progress Amendment of Article no 164 and paragraph No 1 of Article No 191 of Customs was finalized and approved by H.E President of Islamic Republic of Afghanistan during the official winter holidays 1394 through a legal decree. The Tashkeel of 1395 of ACD (which included Customs Law Enforcement Directorate) was approved by the Directorate of Administrative Reforms and Civil Services Commission, but implementation has been slow. The transfer and deployment of officers in Enforcement department has already started and the enforcement department's teams have gone through the short term capacity building courses at ANCA and some special trainings for Customs Police are going on at the Academy.<br><br>Discussions over the institutional role and reporting lines of the new customs enforcement wing have caused some uncertainty over the directions of customs reforms. The objective of the 2015 reform benchmark was to strengthen ACD's enforcement power. However, this will require that customs operations and enforcement work towards shared goals and clearly defined, common reporting lines. Recent interactions with MoF indicated that issues around reporting lines of the enforcement wing will soon be resolved. The WB team encourages MoF to issue a formal directive to inform ACD of any decisions taken on the future role of enforcement wing. |
| **(3) Tax Administration: Re-Organization and Modernization**<br><br>(i.) ARD fully roll-outs SIGTA and risk-based compliance audits, to at least five additional (key) provinces;<br><br>(ii.) ARD streamlines tax payment and reporting procedures to remove obstacles to taxpayer compliance. This includes the issuance of tax clearance certificates irrespective of planned or active audits and reducing the number of | ✓ | **Achieved as of December 2016.** See verification protocol for details |

| | | |
|---|---|---|
| administrative steps to pay taxes by cash and by wire transfer | | |
| **(3) Tax Policy:**<br><br>The Cabinet approves amendments to the Corporate and Personal Income Law. The amendments, based on recommendations from a detailed review, will address current weaknesses with respect to tax efficiency, equity, and incentives for compliance. | | **On track**<br><br>Following a review by the WB, the draft ITL law has undergone another round of consultations with the private sector to address concerns. Changes were made and the draft was submitted to the WB and the IMF for review. It is expected that the draft law will be approved by Cabinet in early January. |
| **(4) Land Administration and Management**<br><br>(i.) The cabinet approves the new land acquisition law. The new law will include a resettlement and compensation framework in accordance with international good practice.<br><br>(ii.) ARAZI establishes a fully operational complaints and grievance redress unit, including an anti-corruption and complaint hotline. | | **Risk of Delay**<br><br>The draft law is, in principle, ready for cabinet submission. It was first tabled during a Cabinet meeting in May 2016, together with the draft ARAZI law and the draft law on the Registration of Urban Informal Properties. However, an incorrect version of the draft laws was presented. As a result, the laws were not approved and the decision was delegated to the High Council of Water and Land for review. The High Council of Water and Land met in November to review the laws but they were again turned back for further changes – mainly to the Informal Properties law - to ensure that the legislations adequately embed the plans for the new land allocation plan (for returnees and IDP). The laws will be retabled again in January 2017. |
| **(6) Doing Business reforms**<br><br>The Government unifies and implements the business and investment licensing and registration systems under the Afghanistan Central Business Registry (ACBR) across the country. | ✔ | **Achieved as of December 2016.** See verification protocol for details |
| **(7) Sustainability of Pension and Social Benefits**<br><br>(i) The Cabinet approves amendments to the pension related laws in line with recommendations from the pension review<br><br>(ii) MoLSAMD has introduced biometric verification / proof of life for the M&D beneficiaries registered in the MDMIS | | **Risk of Delay**<br><br>This trigger will be pending until achievement of the trigger for the 2015. The policy recommendation from the pension review are yet to be presented to the cabinet for discussion/approval. The cabinet may consider amendment to the pension related laws after approval of the pension policy recommendation on parametric changes to the public pension program. Given the speed of progress to develop initial pension reform recommendations, the risk is high that legislative changes will not be achieved in 2016.<br><br>A management information system for the Martyrs and disabled (M&D) benefit program is being developed. Biometric verification / proof of life for the M&D beneficiaries will be built in the new MIS. It was expected that the MIS and the system of verification / proof of life for the M&D beneficiaries will be in place by the end of December 2016. But based on the recent reports from MoLSAMD, the system will be functional only in Feb- March 2017. |
| **(8) Electronic Payment Systems**<br><br>(i.) Dab finalizes the functional specifications of ATS and policy framework for operation of ATS.<br><br>(ii.) DAB and MoF transfer 20% of central | | **Risk of Delay**<br><br>A workshop was held in Dubai to draft the functional specifications of ATS and is being currently finalized by the technical teams in DAB in order to present to the executive board for approval then have it announced as a public document. |

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| ministries public salary by existing electronic means | | ATS contract should be completed by end of 2016. The contract is being implemented and the functional specification document (FSD) have been finalized. The hardware will be delivered after the FSD is developed and approved. The transfer could begin in early 2017. |
| **(9) Fiscal Deconcentration and Provincial Budgeting**<br><br>MoF shifts the delegation of budget authority from central Ministries to provincial directorates for four ministries, in line with the budget policy and financial regulations. | ✓ | **Achieved as of June 2016.** See verification protocol for details |
| **(10) External Audit**<br><br>**(i.)** The Supreme Audit Office (SAO) carries out Performance audits of core functions of two ministries in line with INTOSAI standards. As part of the audit process, SAO develops mechanism for citizen participation in audits and issues a policy governing citizen participation in public oversight of public funds.<br><br>(ii.) In line with the notification letter, four key Government ministries implement at least 40% of the agreed audit recommendations in FY15 Audit reports. | | **On Track**<br><br>In 2016, the SAO has started implementing the developed framework for the performance audit which was developed in 2015 as part of the program. The SAO has now conducted the performance audit of core functions of two line ministries, the Ministry of Energy and Water (MoEW) and Ministry of Labor, Social Affairs, Martyrs and Disables (MoLSAMD). In MOEW, functions of procurement and HR have been selected while in MoLSAMD, the team has selected procurement, HR functions. The audit teams have completed the strategy and audit planning phase and have conducted the audit field work in both the ministries. The draft performance audit reports have also been prepared.<br><br>Progress of the 2016 benchmark remains on track. The SAO should be able to complete the performance audit reports and policy for citizen participation in public oversight requirements within the set deadline.<br><br>The SAO has selected four key Government Ministries (Public Health, Defense, Interior and Education) for the implementation of 40% audit recommendations in the FY15 audit reports. SAO has conducted 64% of audit recommendations in these ministries by December 1, 2016. This supersedes the requirement for IP.<br><br>After reviewing the evidence provided on the progress of achieving the IP triggers for external audit, we can conclude that both the IP triggers have been substantially completed, with the only exception being the delay in conducting the study tour which may impact on the drafting policy of citizen participation. We have communicated our concerns and have requested the SAO management to expedite the study tour plan and drafting of the citizen participation policy within the deadline of December 31, 2016. |

# Annex 3: Verification Protocols

| Benchmark | (4) Tax Policy - 2015 |
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| **Agreed Benchmark** | (i.) As part of the revenue measures agreed with the IMF under the SMP, MoF decrees the introduction of a mobile telecommunication top-up fee, an increase in the Business Receipt Tax and an increase in the fuel and toll fees.<br><br>(ii.) MoF establishes and the cabinet authorizes an inter-Ministerial and inter-departmental committee for tax policy. The main function of the committee, which may have a flexible structure, should review, discuss and advise on all major tax policy proposals in a time-bound manner prior to approval by cabinet and ensure that all relevant stakeholders are consulted. |
| **Required supporting evidence** | 1. Copies of the gazetted decrees and satisfactory review by IMF staff<br>2. Copy of cabinet approved procedure and committee's ToR and minutes of cabinet decision |
| **Verification Process** | The WB reviewed the following documents submitted by MoF:<br><br>1. Copies of all gazetted decrees<br>2. ECF program document, July 2016<br>3. ToR of tax policy committee and minutes of cabinet meeting of March 30, 2016.<br><br>The WB team also participated in IMF ECF and staff-level meeting over the course of 2016. |
| **Conclusion** | The benchmarks have been fully achieved with a three-month delay. The revenue measures show strong traction on revenue mobilization. The new tax policy committee appears to be functioning well but needs to be further tested. |
| **Summary Assessment** | The first part of the benchmark – the revenue measures – were part of the IMF supported Staff Monitored Program (SMP) and were included in the ARTF IP in order to leverage progress towards a new Extended Credit Facility. The revenue measures were introduced and implemented, with some delay, in November 2015. Since then the measures have shown significant impact on revenue mobilization:<br><br>Following three years of poor performance, revenue collections increased significantly in 2015 reaching Afs 122.4 – a 22 percent increase compared to 2014. This increased the revenue to GDP ratio from 8.7 % in 2015 to 10.4 percent in 2015. Our analysis shows that the new tax measures accounted for 39% of the revenue increase.[3]<br><br>Preliminary analysis suggest that the revenue measures continue to fuel revenue growth in 2016. In the first eight months of the fiscal year, domestic revenues amounted to Afs 90.4 billion, nearly 30 percent higher than the figure recorded for the same period last year. Compared to the same period last year, tax revenues increased by 26 percent, while non-tax revenues increased by 70 percent. Projections indicate that the Government may overreach its revenue target of Afs 133.5 billion for domestic revenues by around 5 percent. However, the revenue measures were introduced against the backdrop of low growth. Given that growth recovery is slow, the revenue measures are pro-cyclical. Revenue and growth performance are monitored closely by the IMF and WB teams. |

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The second part of the trigger on establishing a tax policy committee was approved in cabinet meeting date 11/1/1395 (30th of March 2016). The ToR for this committee has also been finalized.

The objective of the tax policy committee is to ensure consultations across Ministries and relevant private sector or civil society groups on all new tax measures. The TPDC will be comprised of senior officials from Ministry of Finance, Ministry of Commerce and Industries, Ministry of Economy as permanent members. Other participants will be invited based on the thematic area of the tax measure under discussion. The committee has advisory functions to the Cabinet. The Macro Fiscal Department within MoF will act as the secretariat of the committee.

The tax policy committee has met in 2016 to discuss the draft income tax law. Due to concerns by the private sector, the draft law has been returned for further revisions. So far, the new coordination mechanism appears to be working. However, it needs to be further tested to assess the sustainability and the quality of the new process, especially for revenue measures that are initiated outside of MoF.

**Recommendations** Moving forward, the WB team recommends:

1. Carefully monitoring of the macro-fiscal framework in order to ensure that the revenue measures are not depressing private sector growth. Continued improvements in the tax administration, as a supporting measure, could help to mitigate and balance the concerns of the private sector.

2. Strengthen the capacity of MoF to conduct tax policy analysis.

## Benchmark (6) Doing Business Reforms - 2015

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| **Agreed Benchmark** | The Cabinet approves a road map which includes a description of all required institutional and regulatory changes for the establishment of a unified business registration system which provides the right to invest, trade and conduct usual business activities to the license holders as well delineates the roles, ownership and management responsibilities of MOCI and AISA in relation to business registration and licensing. |
| **Required supporting evidence** | Copy of the roadmap and minutes of the Cabinet meeting |
| **Verification Process** | The WB reviewed the following documents submitted by MoCI:<br><br>Copy of presidential decree of September 8, 2016 ordering the merger of the Afghanistan Investment Support Agency (AISA) and the establishment of the unified business registration system. The decree assigns the following tasks to MOCI:<br><br>(1) Within 4 months review all relevant laws and regulations and report any discrepancies to MOJ.<br>(2) All AISA assets to be transferred to MOCI.<br>(3) Integrate AISA staff into MOCI Tashkeel based on staffing needs.<br><br>The WB team met several times with DM Haqjo and his team to discuss proceedings on the merger of the business registration system. |
| **Conclusion** | The WB team validates that the benchmark has been fully achieved. The achievement of this milestone marks a very important and essential step towards the creation of a one-stop shop for business. It will bring more transparency into the licensing process and pave the way for streamlining licensing processes in the future. |
| **Summary Assessment** | Government and Development Partners have been working towards unifying the fragmented business registration and licensing system since 2012.<br><br>“Licensing” in Afghanistan is a complex matter. In most countries new businesses register for a permit once for legal and tax purposes. License are typically issued to business who are active in regulated markets (e.g. telecommunication, pharmaceuticals, banking) and are a means to ensure that business meet certain requirement or operate in compliance with rules and norms established for specific sectors (e.g. safety, consumer protection, prevention of crime). Afghanistan is unique in that business licensing is used to enforce tax compliance.<br><br>Until recently business were required to re-license annually after proving that their tax liabilities were cleared and paid. Moreover, licensing responsibilities were divided between AISA and MOCI. This fragmentation was intended to overcome capacity constraints within MoF in the early years of reconstruction: AISA – due its legal status of a limited liability company – was in a better position to hire qualified staff and manage the investment licensing system effectively.<br><br>However, this licensing practice - initially conceived to be a temporary arrangement - has evolved over time into a convoluted and cumbersome processes that presents serious obstacles to doing business in Afghanistan. Business frequently lose their license because of inefficiencies with tax administration and are subjected to rent-seeking along the lengthy process chain with limited bargaining power and few possibilities of recourse. Moreover, business had to pay a fee for the renewal of licenses which kept increasing over time, mainly because they constituted the sole source of income for AISA.<br><br>Government recognized that the licensing practice needed to be reformed. However, the reform proved very difficult as it required finding a new business model for AISA, unifying the licensing system to allow for further streamlining, and strengthening tax administration. As a first step in 2013, Government prolonged the validity |

of the licenses from one to three years. However, AISA did not follow the order and continued to issue licenses with one-year validity.

Discussions over AISA’s future role in business facilitation and its business model continued for several years with little agreement among involved parties. Momentum was gained over the past year under the NUG leadership. In February 2016 the cabinet tasked a technical committee consisting of Ministries of Justice, Commerce and Industries, Economy, Finance and AISA to look into issues surrounding business licensing and weigh different options. In late August 2016 the High Economic Council finally decided to merge AISA and MoCI and unify the licensing system. The merger initiated a process of migrating the licensing department of AISA to MoCI and the establishment of new one-stop shop facilities (under the authority of MoCI).

The merger and unification of the systems will finally pave the way for streamlining licensing process, including through allowing interfaces between the electronic licensing and tax administration systems, and enabling e-applications.

**Recommendations** Moving forward, the WB team recommends

- To carefully assess staffing needs of MoCI and agree on socially sensitive transition arrangements with former AISA staff

| Benchmark | (3) Tax Administration: Re-Organization and Modernization - 2016 |
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| **Agreed Benchmark** | (i.) ARD fully roll-outs SIGTAS and risk-based compliance audits to at least five additional (key) provinces;<br><br>(ii.) ARD streamlines tax payment and reporting procedures to remove obstacles to taxpayer compliance. This includes the issuance of tax clearance certificates irrespective of planned or active audits and reducing the number of administrative steps to pay taxes by cash and by wire transfer. |
| **Required supporting evidence** | (i.) Copies of provincial SIGTAS reports; reports of the audit committee indicating details on the selection and results of the audits.<br><br>(ii.) Copies of decrees and directives. |
| **Verification Process** | On December 5, 2016, the ARD provided hard copies of the following documents:<br><br>1. Copies of SIGTAS user reports from five additional provinces to which it has been rolled out in 2016: Parwan, Laghman, Ghazni, Paktiya and Faryab. In addition, the ARD provided the administrative directives for roll-out to the provinces.<br><br>2. Reports of audit committees detailing selection of risk-based audit and audit results for five additional provinces: Nangarhar, Balkh, Kandahar, Herat and Kunduz. The documentation includes:<br>- A sample introductory letter from the rollout team from Kabul, which introduced risk-based audits.<br>- The dates and times of weekly audit committee meetings, and names of committee members (provincial directors of different departments). Each province has had several audit committee meetings.<br>- The taxpayer profile of companies that were selected for audit.<br>- Audit results in a table comparing 2016 to 2015.<br><br>3. Copy of the letter from the Revenue Department to Large, Medium, and Small Taxpayer, Complaints, Non-Tax Revenue, Provincial Office, and Systems introducing a new tax clearance procedure<br><br>4. Copy of the procedure and a detailed 8-page guideline. This letter directs these units of the ARD to separate the tax clearance certificate from the audit report.<br><br>5. Copy of the letter to Large, Medium, and Small Taxpayer Offices (LTO, MTO, STO), Complaints, Non-Tax Revenue, Provincial Office, and Systems introducing simplification of processes for payments. The letter directs these units of the ARD to use new simplified procedures. The units are provided with a five-page guidance note on the simplifications, which reduce the administration process for payment of taxes from five to three steps.<br><br>The World Bank tax team was in regular contact with the ARD technical and management staff over the reporting period. A complementary ARTF technical assistance program (P150632 - Second Public Financial Management Reform Program, Additional Financing (PFMR-II) equipped the ARD with supporting resources to meet its objectives. |
| **Summary Assessment** | The evidence provided confirms that the ARD has fully met the requirements of this trigger. The ARD demonstrated determined leadership, acting quickly to implement policy and technical actions to meet the revised 2016 ARTF-IP triggers. The achievement of this milestone will strengthen the capacity of tax administration to process information, better control compliance, and decrease taxpayers' burden to comply with tax obligations. Streamlining tax payment and reporting procedures will continue be |

instrumental in easing taxpayer compliance. In conjunction with the unified licensing system at MoCI, these measures should significantly reduce the time and cost of business license renewal.

**Assessment**

**SIGTAS:** Full automation of tax administration is key to enhance ARD's performance as part of its institutional transformation. Modernization of a tax administration requires continuous application of technology and increased automation of core business functions. Tax administrations must be able to process huge volumes of information in a timely and reliable way in order to reduce the costs of administration and compliance and increase reliability, accuracy, and timeliness of the information processed.

Full deployment of the new revenue administration management information system (SIGTAS) is thus a prerequisite for improved efficiency. The ARD faced the significant challenge of rolling out SIGTAS to five additional provinces while also addressing major technical and management challenges over the first half of 2016.

A World Bank diagnostic in early 2016 noted that a comprehensive plan was required to complete the implementation of SIGTAS. This plan would need to address new functionalities, including maintenance, e-services solutions, migration of data, training of staff, etc. It identified that a lack of ownership and lack of a change management program had inhibited system rollout. The assessment also indicated that the functionality of the SIGTAS system was at risk, with aging equipment and protocols threatening business continuity.

Remarkable progress has been made to address these challenges. Most importantly, the ARD demonstrated strong ownership of the system once it was able to access resources through PFMR II. ARD – with support by other MoF departments - re-allocated staff resources to address key issues. The ARD addressed the most urgent technical challenges such as software and equipment upgrades for the SIGTAS system to remain functional, while continuing deployment of the system. SIGTAS is now covering key business processes in key provinces.

Yet, many challenges remain with regard to system maintenance and operation which will require more resources to address. Going forward, additional progress is needed in the area of e-services and training of staff in the new tools.

**Risk-Based Compliance Audits**: An international good practice in tax administration is to use risk criteria to select cases for audit. Tax audits should be targeted to sectors and taxpayers that pose higher risk to revenue. This would also be conducive to decrease the compliance burden of compliant taxpayers, thereby improving the perception of fairness of tax administration in administering the tax system.

The key objective of tax audits is deterrence in order to foster voluntary compliance. Targeted tax audits based on risk assessment in combination with facilitation of compliance is the best strategy to increase taxpayer voluntary compliance with tax laws.

The procedure to conduct risk-based audits requires that case managers register risk scores for all returns using risk guidelines. On this basis, Compliance Committees select cases for audit.

Despite limited capacity in tax audit, it is a significant achievement for the ARD to start conducting risk-based audits both at the center and in the provinces. It will be vital to keep track of results of these audits in terms of additional assessments and litigation to better assess effectiveness of tax audit plans. The evidence submitted by ARD incorporates part of this information.

**Tax Clearance Certificates and simplification of tax payments**: Businesses are required to obtain tax clearance certificates to renew their business licenses. In the past, the ARD did not provide these certificates if an audit of the business was ongoing. As a result, many businesses were not able to renew their licenses for extended periods, resulting in a significant barrier to doing business.

Under the revised processes, tax audits do not have be completed to obtain an annual tax clearance certificate. This simple change should resolve a significant bottleneck. Tax audits involve careful planning and a significant amount of time and resources, while tax clearances are highly time-sensitive. This obligation is not only an undue burden on the taxpayer, but also a motivation for corruption. The issuance of tax clearance certificates irrespective of planned or active audits is a significant achievement in terms or removing obstacles to taxpayer compliance.

Moreover, ARD has significantly simplified tax procedures, easing the taxpayer compliance burden. The number of administrative steps to pay taxes has been reduced from five to three for cash and electronic payments which should significantly reduce the number of visits and delays for tax payers. The new tax payment procedure is as follows:

1. The taxpayer receives the declaration forms, which are entered in the system and stamped by the ARD. The taxpayer can now also download the forms online without coming to the office.

2. The taxpayer fills the declaration forms and makes payment to the bank. Previously, this was only available at one branch. Now, all the branches of the Central Bank accept payments and payments are accepted by wire transfer.

3. The taxpayer submits the completed forms to the tax administration office. They are not asked to wait; completed forms can be deposited in box at the tax office. The ARD staff do the data entry. If the balance is zero, the process is complete and the tax declaration form is issued and can be picked up. If there are documents missing or amounts are outstanding, the ARD contacts the taxpayers for follow-up. If unresolved, cases will be flagged for audit but the clearance letter will be issued regardless.

Continued deployment and development of the online system can further ease restrictions and administrative cost. This is a long-term objective to be achieved with the full deployment of SIGTAS.

**Recommendations**

Moving forward, the World Bank team recommends:

1. SIGTAS – the on-going IT assessment should be completed, including a functional review of SIGTAS. In parallel, the ARD should carry out a process mapping and business process reengineering exercise. These reviews will support continued simplification and automation.

2. Risk-based audit – The ARD should track tax audit cases selected using risk parameters to assess results. The outcomes of audits should be analyzed to continue refining risk parameters and to address compliance gaps through administrative and policy actions.

3. Tax clearance certificates – The use of these certificates is a strong enforcement measure. However, this practice has also been identified as a barrier to business registration. The ARD should analyze whether other enforcement measures could be implemented to replace the use of tax clearance certificates in the future.

## Benchmark (6) Doing Business Reforms - 2016

**Agreed Benchmark**

The Government unifies and implements the business and investment licensing and registration systems under the Afghanistan Central Business Registry (ACBR) across the country.

**Required supporting evidence**

Field visit report and registry report showing issuance of at least 250 business licenses renewed within 25 days from submission of complete applications per quarter

**Verification Process**

The WB reviewed the following documents submitted by MoCI:

1. A copy of unified business license with a 3 year validity
2. Report produced by the Afghanistan Central Business Registry database documenting the issuance of 712 new license and 1853 renewals across the country between October 01 and November 07, 2016.

WB confirmed during a visit at MOCI that licenses through ACBR get issued on the same day of application.

**Conclusion**

The WB team validates that the benchmark has been achieved. The electronic licensing systems of AISA and MOCI have been merged and unified Afghanistan Central Business registry is operating successfully. Licenses are issues within a day of application. Moreover, in conjunction with the recent procedural changes introduced by the Afghanistan Revenue Department, going through the entire tax payment and license renewal process should now take 14 days at most and significantly less if no issues are encountered during tax payment process.

**Summary Assessment**

Following the decision to merge AISA and MoCI in August 2016, the Government has rapidly followed through the agreed course of action. AISA's and MoCI's licensing departments relocated to the newly established One Stop Shop (OSS) in Kabul. The unified ACBR and one stop shop was formally inaugurated on September 28, 2016.

Since then MoCI made the following changes to the licensing process:

1. there is no longer a distinction between "business" and "investment" licenses
2. all licenses will have a 3 year validity
3. separate business registration certificate has been abolished
4. a flat fee of AFS 18,000 (sole proprietorships) / 30,000 (limited liability companies) for all new licenses and renewal has been introduced, effectively reducing the annual fee that ranged anywhere from $100 to $5000.

These are very positive steps into the right direction. Upon application at ACBR, a license is now issued or renewed within a day (see detailed process mapping in Annex I).

However, the licensing process is still plagued by a number of issues:

1. The merger of AISA and MOCI creates much uncertainty over roles and responsibilities between staff of the licensing departments and capacity differences between ex-AISA and MoCI staff is large. The situation affects the level of organization within the department, the morale of staff and ultimately the quality of services provided to companies.

2. The lack of a clear institutional structure and the lack of clarity of processes and procedures creates new governance vulnerabilities that are not fully controlled.

3. Initial assessments indicate that the unified ACBR is only functioning in Kabul, Balkh, Herat, Nangarhar and Kandahar. In many provinces, companies will send staff to Kabul or other large provinces to go through the licensing process which stretches the capacity of these offices.

Moreover, the benchmark required that the license renewal process will be shortened to 25 days from start to finish (the formulation of this requirement is not explicit but derives from the evidence). While this has been achieved for the actual license process at ACBR, the license renewal process in effect begins with the tax payment and clearance process at ARD. In this respect, the language of the benchmark is somewhat ambiguous. However, in conjunction with the recent procedural changes introduced by the Afghanistan Revenue Department (see verification protocol # 3), going through the process should now take 14 days at most and significantly less if no issues are encountered during tax payment process. The new system will need to be tested in early 2017. To this end the WB team will track progress and expand the process mapping to ARD, and will, if necessary, discuss remedial actions with both Ministries.

**Recommendations**

Moving forward, the WB team strongly recommends:

1. Review and establish relevant processes and procedures for the unified licensing system
2. Address staffing needs of the one stop shop in Kabul and provinces and better define and delineate roles and responsibilities of staff members
3. Assess and harmonize the functioning of provincial offices
4. Conduct a governance vulnerability assessment of the one-stop shop to inform actions to reduce opportunities for corruption

| Benchmark | (9) Fiscal De-Concentration and Provincial Budgeting – 2016 |
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| **Agreed Benchmark** | MoF shifts the delegation of budget authority from central Ministries to provincial directorates for four ministries, in line with the budget policy and financial regulations. |
| **Required supporting evidence** | Copy of budget circular that includes guidelines on delegation of budget authority to provincial directorates. |
| **Verification Process** | The WB team reviewed the following material submitted by MoF<br>• Guidelines on provincial budget policy. The guidelines provincial budgeting objectives, roles and responsibilities in planning budget, execution, procurement, capacity building and reporting mechanisms.<br>• Copy of letter indicating that the guidelines were sent to four ministries i.e. Ministry of Education, Ministry of Public Health, Ministry of Agriculture and Livestock, and Ministry of Rural Rehabilitation and Development.<br>• Budget Circular 1 and Budget Circular 2. |
| **Summary Assessment** | After reviewing the evidence provided, we conclude that the Government has achieved the IP trigger on fiscal de-concentration and provincial budgeting for 2016. |
| **Assessment** | The objective of this reform is to strengthen the budget process and improve allocative efficiency by transition more budgetary authority and responsibility for execution from central line ministries to their provincial line directorates. Reform progress in 2016 continues to be smooth and rapid:<br>1. The Government achieved progress in working with line ministries to delegate planning, procurement and budgetary authority to their provincial line directorates. For the 1396 (2017) financial year, the Government conducted trainings to central ministries and targeted line directorates in preparing budget circular 1 and 2 submissions. The provincial submissions were integrated into the national draft budget. This meets the requirements of the 2016 trigger.<br>2. The Government continues to work toward greater fiscal deconcentration in providing discretionary funding for provincial development priorities through an unconditional fund. The unconditional fund will be budgeted through the discretionary development budget. The Government is developing guidelines for the unconditional fund program implementation.<br>3. The Government has started work on revising the budget calendar to allow line ministries more time for consultation with their line provincial directorates.<br>4. The Fiscal Deconcentration Working Group is in place and is working, inter alia, on the terms of reference for the Provincial PFM Committees. These committees, once constituted, will be responsible for identifying capacity needs, improving coordination with the central ministries, among others. |
| **Recommendations** | The Government is moving forward in deconcentrating planning, procurement, and budgeting through delegation of authority. Going forward, the Government is planning to:<br>1. Review existing legislation and regulation to identify areas for clarification of the roles and responsibilities of the Ministry of Finance, line ministries and their provincial line directorates |

2. Harmonize fiscal de-concentration with the Subnational Governance Policy and laws relating to subnational governance bodies (e.g., provincial council)
3. Harmonize budgeting and reporting processes and procedures between national and provincial bodies