Information Kit on
the National Budget of Afghanistan

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2011

Contents

Key Points

Fiscal Year: March 21- March 20 (based on Solar Calendar)
Legislature: National Assembly (Bicameral)
Lower House: House of the People (Wolesi Jirga)
Upper House: House of Elders (Meshrano Jirga)
Grand Assembly: Loya Jirga
Currency: Afghani (AFG)

Acronyms

PFEML:	Public Finance and Expenditure Management Law
MoF :	Ministry of Finance
PFM:	Public Finance Management
MoEc:	Ministry of Economy
ARTF:	Afghanistan Reconstruction Trust Fund
UNDP:	United Nations Development Program
ADB:	Asian Development Bank
ANDS:	Afghanistan National Development Strategy
LOFTA:	Law and Order Trust Fund
DAB:	Da Afghanistan Bank
MTFF:	Medium-term Fiscal Framework
MYR:	Mid Year Review
GDP:	Gross Domestic Product

1. Structure of the National Budget

1.1. Introduction

The term 'budget' is derived from a French word 'bougette', which means a leather bag. The term attained popularity when the Chancellor of Exchequer/Minister of Finance carried a leather bag to Parliament and presented the government's financial plan for approval for a particular financial year. The budget represents the financial plan and hence is the most significant policy instrument of the government for establishing macro economic stability, fiscal efficiency and strategic priority, and more importantly, for ensuring the equitable distribution of resources in the country. Simply put, it is a policy-making tool of the government to translate the government's objectives into programs and services to achieve socio-economic developments of the country.

The system of budget and budgetary processes in Afghanistan is still at nascent stage as compared to other countries. It is because the politics in Afghanistan has historically consisted of power struggles, bloody coups and unstable transfers of power. The country has been governed by nearly every system of government-monarchy, republic, theocracy, and communist state. The frequent political and social instabilities have affected the economy of the country severely and hence there has been no systematized effort to build the modern day institutions of public finance management in the country. However, the Afghanistan of twenty-first century has seen glimmer of hope as it is experimenting with democracy and rule of law. This has accelerated efforts for institution and nations-building in the country.

The term "Budget" is mentioned, although not clearly defined in the Constitution of Afghanistan. Many commonly used budgetary terms like Consolidated Fund, Public Accounts Fund, Revenue Account, Capital Account, Charged Expenditure, Voted Expenditure, Vote on Account, Appropriation Bill, Finance Act, and Money Bill, have also not been referred or defined in the Constitution of Afghanistan. The Constitution does not discuss explicitly the financial matters of the State like constitutions of other South Asian countries. However, the chapter on 'Government' in the Afghan Constitution, *Article Seventy Three* clearly states that "the government shall have the duties to prepare the budget, regulate financial conditions of the state as well as protect public wealth", and "devise and implement social, cultural, economic and technological development programs" of the country. Hence the responsibility of formulating the annual budget fully rests with the government. After ratification of the Constitution in 2003, the Afghan government has enacted the Public Finance and Expenditure Management Law (PFEML) in 2005 for the organization and management of financial affairs, protection of public assets, preparation of budget, and management of public expenditure in the country.

In Afghanistan, the Ministry of Finance (MoF) prepares and presents the Annual Budget to the National Assembly every year at the start of financial year for approval. The National Assembly, after approving the budget, authorises the government to execute it. ***The financial year in Afghanistan starts on 21st March and ends on 20th March of the next year***.[*]

1.2. Structure of Budget:

The national budget of Afghanistan consists of the Core Budget and External Budget. The Core Budget comprises the Core Operating Budget and Core Development Budget. It is approved by the Cabinet and National Assembly. It consists of funds that flow through the government's treasury apparatus, and is subject to the government's Public Finance Management (PFM) systems. The External Budget by contrast includes expenditures disbursed directly by donors and hence is outside the government's PFM system.

The structure of public budget of any country can be comprehended on the basis of 'Receipts' and 'Expenditure'. The 'Expenditure Budget' denotes the resources the government intends to spend and on what (prioritisation of expenditure) in the

[*] Afghanistan follows ***'Solar Calendar'*** rather than the 'Gregorian Calendar'.The Afghan calendar is a 'Persian Solar Calendar', based on Islamic era which begins with emigration (Hijrat) of Prophet Mohammad from Mecca to Medina in 622 A.D. Afghan solar year begins on March 21, which is New Year's Day. The year 2000 in Gregorian calendar corresponds to the Persian solar year 1378.

financial year. The ’Receipts Budget‘ on the other hand presents information on how much the government intends to collect as its financial resources for meeting its expenditure requirement and from what sources in that financial year. While formulating annual budget, the government tends to focus primarily on the expenditure line-items of the budget and then go after the required resource collection to meet the expenditure proposals.

1.2.1. Expenditure Budget: Operating Expenditure and Developmental Expenditure

There are two important terminologies relating to budgetary expenditure in the budget documents of Afghanistan. These are *Operating Expenditure* and *Development Expenditure.* The operating expenditure is the expenditure which covers the recurring expenditures and hence is important for the maintenance of the governance structure. Recurrent expenditures are classified into the following five categories: (a) Compensation of employees (Salary and Wages), (b) Goods and services, (c) Subsidies and grants, (d) Interest payment, (e) Acquisition of non-financial assets (Capital Expenditure).

Developmental Expenditure includes all funding flowing through the Government’s Single Treasury Account and consists of provisions for investments in development projects such as infrastructure and reconstruction. This is financed from variety of sources-Investment Window of Afghanistan Reconstruction Trust Fund, Counter Narcotics Trust Fund, Donor grant financing direct to the Treasury and Confessional programme and project loans. The line ministries after preparing the development expenditure part of the budget submit it to the Ministry of Economy (MoEc) to be considered, scrutinised and subsequently incorporated in the annual budget document.

The operating budget is largely financed through the revenue generated by the government of Afghanistan. The developmental budget is co-financed by the government and donor agencies. The donor contribution to the core development budget comprises of the discretionary and non- discretionary financing based on the conditionalities imposed by the donor agencies.

Developmental support and reconstruction funds for Afghanistan are channeled through two primary instruments: (a) the Afghanistan Core Budget including the Afghanistan Reconstruction Trust Fund (ARTF) and (b) The External Budget. The ARTF was established at the 2002 Tokyo Conference with contributions from around 27 countries. The management of the Fund is supervised by the World Bank and decisions are jointly taken through a consultative process of the World Bank, UNDP, ADB, Islamic Development Bank, Government of Afghanistan. Government does not decide upon the fund flow into the fund and does not decide how to use the funds. So far, it is not a direct budget support to the Government of Afghanistan.

The Government's expenditure programmes are planned within a pragmatic and sustainable medium term macroeconomic and fiscal framework. Enhancing revenue mobilisation, as part of this framework, is a necessary condition to provide the required resources to support the implementation of the Afghanistan National Development Strategy (ANDS). ANDS is a documented five years plan and all the expenditures will be channeled to the line ministries and other institutions through this plan.

1.2.2. Financing of the Budget

The financing of the budget is done through two sources: Domestic Revenues and financing from Donors.

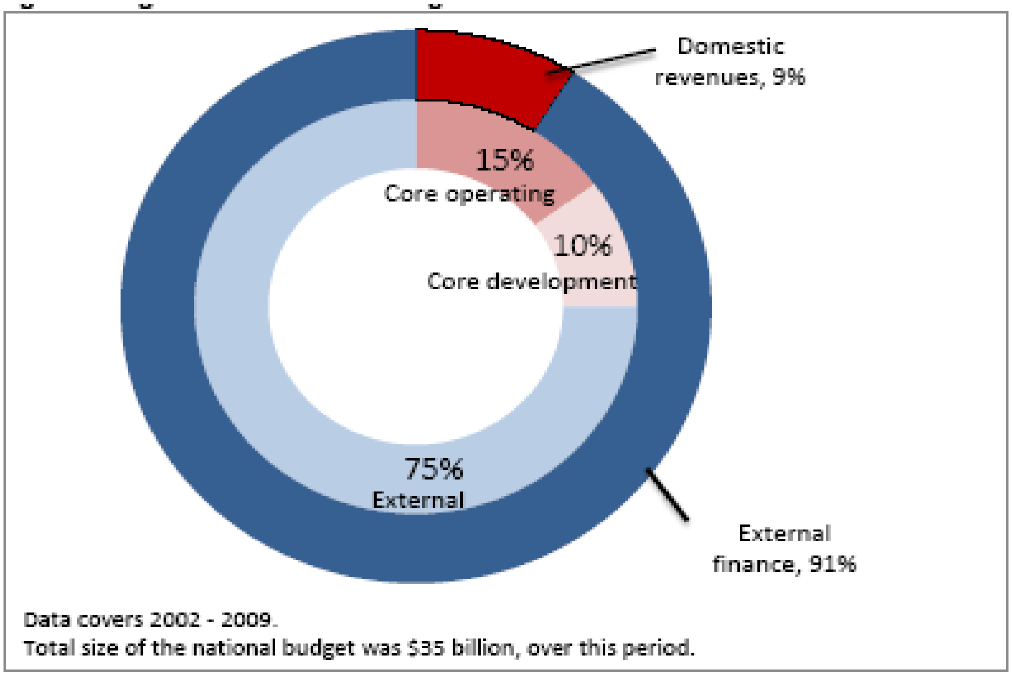
The total domestic revenue is classified as follows: Tax Revenue and Non Tax Revenue. The examples of tax revenue are fixed taxes, income taxes, property taxes, sales taxes, excise taxes, customs duties, and others. The non-tax revenues and others include the social contributions, income from capital properties, sale of goods and services, royalties, non tax fines and penalties, sale of land and buildings. In Afghanistan, the revenue generation as proportion to GDP has been an insignificant

7%. The Domestic Revenue generation are not enough to meet the operating expenditure of the budget.

Financing from Donors is crucial to sustenance of Afghanistan Budget. It funds the development budget completely and also a part of the operating/recurrent budget of Afghanistan. There are various means through which external finances are routed to Budget- multilateral and bilateral funding. The Afghanistan Reconstruction Trust Fund (ARTF), Law and Order Trust Fund (LOFTA) and Combined Security Transition Command-Afghanistan (CSTC-A) are significant multilateral funding sources which can be seen in the Afghanistan Budget. ARTF which is the largest contributor to the Afghanistan Budget is administered on behalf of 27 donors and is managed under the supervision of a management committee comprising of the World Bank, IMF, ADB, Islamic Development Bank, United Nations Development Programme (UNDP).

The Government of Afghanistan adheres to a strict policy of no domestic or non-concessional foreign borrowing for fiscal purposes. The only borrowing undertaken is to finance development projects and only if it is on concessional terms. Current loans include those from the Saudi Fund for Development, the Asian Development Bank, the Islamic Development Bank and the World Bank.

Financing of National Budget



Source: U.S. Department of Treasury.

Core Budget	
1. Total Financing	1.1. Domestic Revenue 1.2. Donor Assistance
2. Total Expenditure	2.1. Operating Budget Expenditures 2.2. Core Development Expenditure
3. Budget Deficit	3.1. Operating Budget Deficit 3.2. Core Development Budget Deficit
Total Core Financing /Receipts	
1. Domestic Revenue	1.1. Tax Revenue • Taxes on Income, profits, property and capital gains • Taxes on International Trade and Transactions • Domestic Taxes on Goods and Services • Other Taxes 1.2. Non-Tax Revenue (User fees) • Social Contribution

	• Income from capital property • Sales of goods and services • Administrative fees • Royalties • Non-tax fines and penalties • Sales of land and Buildings • Other Revenues
2. Donor Financing	2.1. Balances from previous years 2.2. New Financing • Afghanistan Reconstruction Trust Fund (ARTF) • Law and Order Trust Fund of Afghanistan (LOTFA) • World Bank funding • Asian Development Bank Funding • Total Other Funding (Ex. Funding from India)
Total Core Expenditure	
3. Operating Budget Expenditure	3.1. Compensation of employees (Salary and Wages) 3.2. Non-Wages • Goods and services • Subsidies and grants • Interest payment • Acquisition of non-financial assets (Capital Expenditure)
4. Core Development Expenditure	4.1. Discretionary Projects† 4.2. Non-Discretionary Projects‡

† Discretionary projects are financed through available government funds

‡ Non-Discretionary projects (conditional) are submitted to donors by government, donors funds fully spent on these projects.

2. Budget Cycle in Afghanistan

The budget is a document that includes the government's expenditure and revenue proposals, reflecting its policy priorities and fiscal targets. However, the budget document is the culmination of an on-going budget decision-making process, and a country's system for managing and assessing its spending and tax policies. Looking at any one aspect of the overall budget system in isolation misses the important interaction between the various parts. Therefore, a discussion on the budget cycle is imperative. The Budget Cycle consists of the major events or stages in making decisions about the budget, and implementing and assessing those decisions.

The budget cycle usually has four stages:

- Budget formulation: when the budget plan is put together by the executive branch of government.
- Enactment: when the budget plan may be debated, altered, and approved by the legislative branch.
- Execution: when the policies of the budget are carried out by the government.
- Auditing and assessment: when the actual expenditures of the budget are accounted for and assessed for effectiveness.

In Afghanistan, MOF follows strictly a time-table for the preparation of its annual budget whose details can be seen in the following table.

The Budget Preparation Timetable
with focus on ANDS Integration

21st March-20th April	Finalise the budget calendar in consultation with the Budget Committee. Circulate it to primary budget units, National assembly, donors and publish it on the MoF website
21st April-21st May	Issue the ***Budget Circular One*** to budgetary units by May 1st, which is prepared by Ministry of Finance and Ministry of Economy. The Budget Circular One requests budgetary units to prepare their intended list of programs/projects and their links to ANDS priorities for the 1389-91 (2009-2011) periods (with outputs/outcomes) and indicative costs for the medium term A workshop for the budgetary units to explain the preparation for the annual budget. Line ministries discuss their ANDS Sector priorities, projects and programmes through Inter-Ministerial Committees (IMCs) with MoF and Ministry of Economy

	(MoEc)
22nd May-21st June	Budgetary units according to the guidelines prepare their draft ANDS priorities reflected programmes and project their assistance from Ministry of Finance and Ministry of Economy. Budgetary units submit their inputs for development budget to the Ministry of Finance in response to the Budget Circular One by June 15, 2009. Ministry of Finance then organises a Donor Financial Review and ask for their financial commitments for the budget. MoF and MoEc in consultation with the key stakeholders (donors) revise the MTFF/ budget prioritisation and framework and incorporate in "Mid-Term Budget Framework (MTBF)". The MTBF report defines the broad fiscal and budgetary priorities of the government with sector/ministry budget ceilings by end June 2009. Negotiation between MoEc, MoF and budgetary units take place to finalise the development budget ceilings for years 2009-11.
22nd June-22nd July	MoF and MoEc analyse submission by the line ministries and review proposed priorities (most important priorities) which will be contributing to the ANDS outcomes and can be financed from the available resources. Organise meeting with donors on funding of the priorities, finalise Donors' Financial Review Report
23rd August-22nd Sept.	By 5th September, MoF issues the ***Budget Circular Two*** (Traditional Circular for all budgetary units and Programme Budget Circular for programme budget pilots) to budgetary units with budget ceilings, budget instructions, and required forms. The circular includes broad priorities set in the MTBF MoF issues the MTBF including ministries budgetary framework report, along with budget ceiling. From 1-15th Sept. Budget Committee starts mid-year expenditure review of the current budget. The mid-year expenditure review report goes to the Cabinet and National Assembly for scrutiny by the end of September.
23rd Sept.-21st Dec	Budgetary units prepare detailed projects using recommended templates, of MoEc and MoF, for their sectors/ministries. Those line ministries that are implementing programme budgeting prepare programmes and activities as per the guidelines by the MoF. Both MoEc and MoF work with the line ministries to (1) develop their projects in line with the ANDS outcomes and priorities and consistent with the ceilings; (2) develop meaningful programme budget documents. Budgetary units submit their development budget through MoEc and operating budget directly to MoF. MoEc and MoF discuss the key fiscal issues with the donors; similarly, the budgetary units hold discussion with donors for their financing priorities and fiscal issues. Budgetary units submit their budgets by mid-December.
22nd Nov.-30th Dec.	MoF starts analysis of the ministry submission in last two weeks of November MoF organise second round of Donor's Financial Review by end November/early December. Budget hearings starts from 10-31st of December
22nd Dec.-	Finalise budget documents and submit to the Cabinet for consideration.

19 Jan.	
20th Jan-20th March	Cabinet approves the budget by end January. Submit Budget to the National Assembly by early February. Approval of the budget by National Assembly by March.

Source: Ministry of Finance, Budget Department, Government of Afghanistan

2.1. Formulation Stage:

The initial formulation of the budget occurs almost exclusively within the executive branch of the government, though it can include a number of actors within the branch. Typically, the Ministry of Finance coordinates and manages the formulation of the budget, requesting information from individual departments and proposing the trade-offs necessary to fit competing government priorities into the budget's expenditure totals. This process can take a few weeks to several months, largely depending on the extent to which departments are involved and their views are taken into account.

The quantum and size of the budget are largely determined by its projections of key parameters — such as economic growth, inflation, or demographic changes, priorities and gravity of welfare measures — that will influence overall revenues and expenditures. The contours of a budget are also influenced by consideration of goals, such as maintaining the deficit or debt at a certain level, raising or reducing taxes, or increasing expenditures for certain priority areas.

In Afghanistan, as in other countries, budgeting is a multi-stakeholder process. The process includes repeated interactions between MoF, MoEc, line ministries, the National Assembly and a large number of international donor institutions. The PFEML (2005) specifies the processes and responsibilities of different authorities. The government is responsible for preparing the budget with MoF leading the process. Within the first month of approval of annual budget, MoF finalises the budget calendar for the preparation of next year budget. MoF in the subsequent month circulates the Budget Circular to various budgetary units requesting them to prepare the programmes/projects list linking to ANDS priorities and also indicative costs for the medium terms. During the process between months of May to

September, various consultation processes initiated among MoEc, MoF, budgetary units with donors communities about budgetary, fiscal priorities of the government in the medium term budgetary framework and as a result of which the sector/ministry ceilings of both the Development and Operating budget of country is decided. Crucial to this process is organising the Donor Financial Review in which the MoF submits its financial proposals for donors commitments for the budget. The line ministries after consultation with donors, MoF, MoEc, finalise their respective development and operating budget proposals, and submit the same to the MoEc and MoF respectively by December. After this, MoF calls the budget hearing committee comprised of the ministry of finance, the ministry of economy, ministry of foreign affairs and representatives from Office of the President. The committee debates budget and proposes allocations to various programmes and projects. After required hearing over the budget, the budget is submitted by the MoF for Cabinet approval. Once the budget is passed by the cabinet, the MoF submits it to the National Assembly during the fourth quarter of the fiscal year (by early week of February) for its approval. It is presented to the National Assembly, 45 days prior to the start of the Fiscal Year. After necessary deliberations in the legislature, it gets approval for execution.

2.2. Enactment stage

The second stage of the budget cycle occurs when the executive's budget is discussed in the legislature and consequently enacted into law. This stage begins when the executive formally proposes the budget to the legislature. The legislature then discusses the budget, which can include public hearings and votes by legislative committees. The process ends when the budget is adopted by the legislature, either intact or with amendments. The budget also can be rejected by the legislature and, in some countries, replaced by the legislature's own proposal.

The budget is submitted through Meshrano Jirga 45 days prior to the commencement of the new fiscal year. The Minister of Finance introduces the budget bill with a speech in both the houses which covers the revenues and expenditures of the government, the debts and loans, the fiscal framework of the budget and the like.

The budget is debated in the Upper House for 15 days, discussed in the Budget and National Economy Commission and is debated in the plenary session. The Upper House sends the draft bill with advisory comments to the Lower House.

The Lower House comprises of various standing committees, which are responsible for analysing their relevant sector budget. Theses committees give their recommendations to the budget and finance committee. The committee prepares its report and presents it in the plenary session of the Lower House. The Lower House continues its debate for a month and the draft bill is either accepted or rejected as a whole. In case of rejection, the Lower House has to give reasons for the same.

Once the draft bill is passed by the National Assembly, it is sent to the President for his final approval which is sent to all ministries for implementation.

2.3. Execution/Implementation Stage

The next stage of the process occurs once the budget has been enacted. Governments differ widely in how they regulate and monitor spending to ensure adherence to budgets. In some cases, the Treasury (or Finance Ministry) exercises strong central control over spending, reviewing allocations to departments and approving major expenditures. Where departments enjoy more independence, treasuries will monitor expenditures by requiring, for instance, regular reporting by each department of its spending.

In practice, budgets are not always implemented in the exact form in which they were approved; funding levels in the budget are not always adhered to and authorised funds are not always spent for the intended purpose. Deviations can result from conscious policy decisions or in reaction to changing economic conditions, but concerns arise when there are dramatic differences between the allocated and actual budgets that cannot be justified as reflecting sound policy. While these cases can result from outright abuse by the executive, they may also reflect the effects of a poor budget system and technical problems that make it difficult for the executive to implement the budget in line with what was enacted into law. For instance, the budget may not be clear about the intended purpose of particular funds, while weak reporting systems can limit the availability of information that the executive needs to monitor the flow of expenditures.

The implementation phase of the budget starts with a circular from the Ministry of Finance in which the budget decree is sent to all spending units. The spending units start the procurement process and award contracts for its investment projects as well as the allotment for the first quarter of the fiscal year for the recurrent costs of the government. The procurements take place in the centre as well as the provinces based on the size of the contract value. The line ministries or spending units send the request for allotments on special formats prepared by the MoF. These requests are duly signed by an authorised person; the MoF analyses those requests, sees the progress report as well as copy of the contract of the project. The funds are channelled to the bank accounts of the awarding company. The budget department uses development budget allotments as a commitment and cash management instrument.

The MoF has a special branch for execution and track records of all contacts, payments and expenditures. The MoF conducts a mid-year review of the budget and brings necessary changes in the budget. The procurement takes place in accordance with the procurement law of the country. The spending units can not spend money which is not reflected in the budget.

2.4. Audit: Monitoring and Control Phase

The last stage in the budget cycle includes a number of activities that aim to measure whether there is an effective use of public resources. This stage of the Budget Cycle is known as monitoring and control of the expenditure as undertaken by the line ministries. Ideally, the executive branch should report extensively on its fiscal activities to the legislature and the public. These fiscal activities should also be subject to regular review by an established independent and professional body, such as audit institutions or an Auditor General. The audit office should have the capacity to produce accurate reports in a timely manner.

In Afghanistan, the monitoring and control phase is divided into the following:

Internal Control: The MoF has assigned a controller in each spending unit who rectifies the errors and assures financial regulations before the allotments are sent to the MoF. These controllers also control the expenditure of resources in the line spending units. The process is also controlled by the MoF when a request for allotment is sent to the budget and treasury departments. All codes, sub-codes, progress reports, copy of the contract and procedures are strictly followed.

External Control: There is an independent audit and control office, which has the responsibility to see the annual performance of the government. The department audits the accounts and procedures of the government, points out deviations and misuse of budget allocations. The office reports to the President directly.

The donor money that is channelled through the government single treasury accounts are also audited by the respective donors. If donors are not comfortable with the process of a ministry in regards to its capacity, transparency and the alike, it has the right to withdraw the money or allocate it to some other priority programs in consultation of the ministry of finance.

3. Institutions/Actors Influencing the National Budget

The budget of any country is rarely the standalone project of the executive/bureaucratic branch of the government. It is a dynamic document and evolves with the process itself. From the stage of formulation to monitoring and control, which is the last stage of the budget cycle, there are many institutions/actors involved in shaping the nuances of the national budget. Many such actors/institutions are authorised by the constitution/law of the land, while others are external actors-interests and pressures groups and fall outside the purview of the Government's accountability.

3.1. Ministry of Finance:

PFEML makes the Ministry of Finance (MoF) responsible for setting the financial and expenditure policy of Afghanistan; reporting the government and National Assembly on its implementation; proposing the adoption of regulation to the government. It is the nodal ministry vested with the responsibility not only for preparing the budget but also looks after the execution aspect of it. MoF also takes measures against those ministries that do not implement their budgets on time and according to budgetary and accounting rules and regulations. It is also charged with the responsibility of realising transparency and administrative and financial management system of the budget as it can take measures if not satisfied with the working capacity of Administrative, Finance and Planning staff of ministries and budgetary units.

3.2. Ministry of Economy:

It is a very important ministry entrusted with the responsibility of managing the development budget in the country. With the help of MoF, it prepares and issues the Budget Circular to the budgetary units/line ministries. It is the nodal ministry for looking into the implementation of the ANDS and its suitable incorporation in the budgetary heads of sectoral budget. It along with the MoF plays a crucial role in the process of consultation with donors and helps revising the MTFF/budget prioritisation and decides upon the ceilings on the development budget of the budgetary units. It examines the development budget of the line ministries and submits to the MoF for its final inclusion into the Annual Budget.

3.3. Da Afghanistan Bank (DAB):

DAB is the Central Bank of Afghanistan. Its role is significant in the context of maintaining price stability and establishing a sound financial system conducive to macro-economic stability and broad-based economic growth in the country. There are some basic tasks that DAB performs:

- Formulate, adopt and execute the monetary policy of Afghanistan.
- Hold and manage the official foreign exchange reserves of Afghanistan.
- Print and issue Afghani banknotes and coins.
- Act as banker and adviser and fiscal agent of the State.
- License, regulate and supervise banks, foreign exchange dealers, money service providers, payment system operators, securities service providers, and securities transfer system operators.
- Establish, maintain and promote sound and efficient systems for payments, for transfers of securities issued by the State or DAB, and for the clearing and settlement of payment transactions and transactions in such securities.

3.4. Treasury:

Treasury department plays an important role in the management of revenue and expenditure in Afghanistan. The PFEML specify the role of the Treasury in the following terms:

- Efficient management of the State's financial resources through a centralisation of budgetary revenues, efficient financial planning and timely management of budget expenditure.
- Managing the Consolidated Fund.
- Implementing financial plans.
- Managing cash assets.
- Implementing the budget and performing expenditure controls in accordance with revenue and expenditure plans.

3.5. Standing Committees:

There is a provision to constitute standing committees in both the houses of the National Assembly. They are entrusted with the powers such as (1) Reviewing draft bills referred to it by the President, (2) **Proposing amendments to draft bills and to the budget,** (3)Preparing reports and recommendations to the entire Assembly. They play key role in the scrutinising budgets of the sectoral ministries and report to the plenary sessions of each house for detailed discussion.

3.6. Auditor General of Afghanistan:

The Auditor General of Afghanistan is entrusted with auditing of all ministries, departments, state agencies, banks and municipalities of the country within six months of the end of the fiscal year. It has the right to acquire all information necessary for independent auditing. Its independent audit report includes the certification of the appropriation accounts and recommendations for sanctions consistent with the PFEM law. After conducting audit, it submits its report to the MoF , which subsequently lays it before the National Assembly for its consideration and discussions.

3.7. External Donors:

Donors are influencing the Annual Budget of Afghanistan in particular, than any other institutions in the country. In the post-Bonn agreement period, Afghanistan has received billions of dollars through different commitments at different international conferences. The influence of donors can be better gauged from the fact that their contribution is approximately 91% of the National Budget as external finance which is un-reported in the budget documents; while the reported financing has been more than 75% of the budgetary expenditure.

Overview of Official Developmental Assistance (ODA) to Afghanistan

Year	Conference	Amount
2002	Tokyo	US $ 5.1 billion
2004	Berlin	US $ 5.6 billion

2006	London	US $ 8.7 billion
2007	Rome	US $ 0.04 billion
2008	Paris	US $14 billion
	Total Supplemental Pledges	US $ 28.6 billion
	Grand Total Pledges	**US $62.04 billion**

Source: Donor Financial Review, Ministry of Finance, Govt. of Afghanistan, 2009

4. Relevant Policies Shaping the Budget of Afghanistan

4.1. Afghanistan National Development Strategies (2008-13)

The ANDS is the blueprint for the development of Afghanistan for a period of five years and outlines the government's strategy for achieving its long term development vision, including the Afghanistan's Millennium Development Goals (MDGs) and the benchmarks of the Afghanistan Compact.

Afghanistan Compact is the outcome of the London Conference on Afghanistan where international community agreed to cooperate in creating conditions allowing the people of Afghanistan to live in peace and security under the rule of law, with a strong government which protects human rights and supports economic and social development in the country. The ANDS emphasised that security, macroeconomic stability and growth, human and infrastructure development and partnership between the government, the civil society, and donor community are the key over-arching requirements for poverty reduction. In addition, the ANDS identified improving governance and building institutional capacity as important objectives in the medium term fiscal framework. Investments are structured around the six sectors (infrastructures and natural resources; education; health; agriculture and rural development; social protection; economic governance and private sector development) which form the pillar on socio-economic development. The Compact has set up benchmarks and time lines especially for roads, air transport, energy, mining and natural resources, water resource management, urban development, environment, education (primary and secondary), skill development, health and nutrition, agriculture and livestock, comprehensive rural development, counter narcotics, poverty reduction, humanitarian and disaster response, and to the disabled people, refugees, and vulnerable women.

4.2. Medium-term Fiscal Strategy (2008-2013)

The government has embarked upon the Medium-term fiscal strategy to ensure that domestic resources are adequate enough to finance the operating budget and the recurrent cost associated with the gross capital formation of the government. The prudent fiscal spending through the fiscal strategy is expected to help the government to maintain macro-economic and fiscal stability, poverty reduction and sustained economic growth.

The first stage of the fiscal planning tools is the ***Medium-term Fiscal Framework (MTFF)*** which was developed in 2005. The MTFF has set forth a multi-year (five years) fiscal path for the Government to make progress toward a sustainable fiscal position for the country. It outlines the fiscal framework based on projections for broad fiscal aggregates that are consistent with key macroeconomic variables and fiscal targets. Broad fiscal aggregates-revenue and expenditures- are projected based on macroeconomic variables such as growth, inflation, donors' pledges and commitments, and policy measures. The implementation of the MTFF has close linkages with both ANDS and the annual budget process.

The second stage of Medium-term Frameworks (MTFs) is the ***Medium-term Budget Framework (MTBF)*** which has been recently initiated. It goes further beyond MTFF by allocating spending envelopes across different sectors and by giving the line ministries and agencies a green signal for prioritising their needs based on their relevant sectors' strategy and under the country's overall development priorities set under the ANDS and MDGs.

The third and final stage of MTFs is ***Medium-term Expenditure Framework (MTEF)*** that assists in sectoral allocation of spending across different programmes and projects based on detailed costing. The MTEF also provides indication of output and outcomes under a programme. Ministry of Finance is leading the process of implementing the Medium-Term Fiscal Strategies across all line ministries in the country.

With a commitment to reach fiscal sustainability (covering increasing operating budget with domestic revenues), the government has entered into the Poverty reduction and Growth Facility (PRGF) with International Monetary Fund (IMF). Under this facility the IMF lends to the world's poorest countries. This is a replacement of IMF's Enhanced Structural Adjustment Facility. Given this commitment, the Afghan Government has to make some hard choices in allocating resources among sectors and budgetary units. In this context, the ministries are maintaining strict fiscal discipline to use existing resources as effectively and possible and absorb additional resources from existing funds rather than proposing any new expenditures in the budget.

5. Documents Related to the Afghanistan Budget

Core Budget Documents:

5.1. Budget Speech: A report, presented by the Ministry of Finance, the Islamic Republic of Afghanistan in the National Assembly, highlighting key receipt and expenditure budget proposals.

5.2. National Budget: This is the core and comprehensive budget document prepared, produced by the Ministry of Finance every year. This document contains details of the policy framework for budgeting, macroeconomic and fiscal outlook, budget reforms and past budget performances, analysis of different sectors of the economy and assets and liability position of the economy. This document also contains an executive summary statement explaining provisions of the medium term fiscal strategies. In Afghanistan, National Budget document is not available to the public until it is approved by the National Assembly. Once it is approved by the National Assembly, the national budget document is available to the public. It is available in English, Dari and Pashto languages.

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1. Executive Summery
2. Policy Framework for Budgeting
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Good Governance and Rule of law Sector
Health Sector
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Provincial Budgeting

5.3. Mid Year Review of the National Budget:

The MoF conducts a Mid Year Review (MYR) of the whole National Budget every financial year. It provides summary of various aspect of the execution of both operating and developmental expenditures of the government of a particular fiscal year and also contains the resource position of the government in the same year. The Ministry, after getting necessary cabinet approval, submits it for scrutiny and approval of the National Assembly every year. A detailed discussion takes place in the National Assembly before giving final approval. It is available in English, Dari and Pashto languages.

<u>Contents of the Mid Year Review (MYR) of the National Budget</u>

1. Budget Execution Guidelines
2. Budget MYR Analysis Summary
3. National Budget summary
4. National Budget Financial Resources Summary
5. Operating Budget Financing Budget Description Table
6. Development Budget Financing Resources Summary Table
7. Development Budget Financing Resources Description
8. Operating Budget MYR
9. Total Budget MYR Table
10. Budget MRY Comparative table

5.4. Statement on Revenues Foregone: A statement on revenues forgone as a result of tax exemptions etc. in Afghanistan prepared and made available by the Ministry of Finance, Islamic Republic of Afghanistan. The report explains in detail provisions of revenue forgone due to tax holidays, tax concessions and exemptions as well as revenue forgone due to tariff exemptions.

5.5. Budget Circular/Calendar: The Treasury Department of the MoF makes available publicly and circulates a detailed calendar for the preparation of budget among the budgetary units/line ministries. The circular gives detailed accounts to the line ministries on what to do and when to do/submit their respective operating and development budget to MoF and MoEc in different timeframe.

Supporting Budget Documents:

5.6. Public Finance & Expenditure Management Law: It is a document produced by the Islamic Republic of Afghanistan consisting of 65 articles. This document contains nine chapters explaining details of the financial provisions and expenditure management principles for the Islamic Republic of Afghanistan. The first chapter narrates the general provisions related to expenditure and revenue administrations including responsibilities and authorities of the Ministry of Finance. The second chapter deals with the obligations of the state authorities including treasury responsibilities. Chapter three describes details of the articles relating to the public money and receipts including tax expenditure principles. Investment of public money and articles related to opening of the official bank accounts is dealt with in chapter four. Chapter five describes details of the borrowing and lending principles including grant provisions to the local authorities as well as loans given by the state. Chapter six of the report provides detailed procedures of budget preparation and approval. While detailed provisions on execution of appropriations of the budget narrated in chapter seven; chapter eight of the report explains auditing principles related to the accounting principles and control of the budget. Chapter nine of the report deals with relevant articles on the final provisions including oversight of the budget and treasury.

5.7. Donor Financial Review (DFR): The DFR report represents tangible evidence of the partnership between Afghanistan and other development partners in reconstruction and development works of Afghanistan. It also provides a vital tool for the measurement of the effectiveness of development assistance, national budget planning process and the implementation of the Afghanistan National Development Strategy. It is a critical tool for both the Government and development partners to assess and forecast levels of official development assistance and successful implementation of the ANDS. It also provides crucial data for the Medium Term Fiscal Framework (MTFF), a tool developed by the Government of Afghanistan to provide a medium term rolling forecast of the interaction between government spending and revenues and the wider economy. This report is brought out by MoF and is an extremely helpful document in understanding of aid effectiveness in developmental expenditure of Afghanistan Budget.

Contents of the Donors Financial Review

5.8. Afghanistan National Development Strategy (ANDS) Paper (2008-13): The strategy paper has been a core paper for Afghanistan's developmental budget. It is a Millennium Development Goals (MDGs) based plan that serves as Afghanistan's

Poverty Strategy Paper (PRSP). This paper is an outcome of the extensive consultation between Afghanistan Government and the international community(particularly the Donors).

Contents of Afghanistan National Development Strategy (ANDS) Paper

1. Introduction
2. Our Achievement Since December 2001
3. Current Conditions and Challenges
4. Preparing the Afghanistan national Development Strategy (ANDS)
5. Goals of the ANDS

   Pillar 1: Security

   Security: Achieve nationwide stabilisation, strengthen law enforcement, and improve personal security for every Afghan.

   Pillar 2: Governance, Rule of law, and Human Rights

   ANDS Goal: Strengthen democratic practice and institutions, human rights, the rule of law, delivery of public services, and government accountability.

   Pillar 3: Economic and Social Development

   Reduce Poverty, ensure sustainable development through a private sector-led market economy, improve human development indicators, and make significant progress towards achieving the MDGs.

   Cross cutting Issues:

   Counter-narcotics
   Anti-corruption
   Capacity Development
   Gender Equity
   Environment
   Regional Cooperation

6. Macroeconomic Framework.
7. Partnerships for Financing the ANDS
   Costing and prioritisation of the ANDS sectors
   Expected assistance for AND implementation

8. Aid Effectiveness
9. Implementation, Evaluation and Reporting
10. Conclusion

6. Explanatory Note on Budget Terminology

Accounting Systems: Accounting systems record financial transactions. The two major accounting systems are cash accounting and accrual accounting. Cash accounting systems recognize transactions and events when cash is received or paid; they do not recognize non-cash events. Accrual accounting systems, on the other hand, record payments and receipts when parties enter into a commitment, not when cash changes hands. For instance, an accrual accounting system would record the purchase of naval helicopters when the government signs a contract to buy the helicopters, not when the helicopters are actually delivered and paid for (which would be the case in a cash accounting system). An accrual accounting system views the commitment, rather than the exchange of cash for goods or services, as the event that has economic significance. Most governments rely on cash accounting systems.

Appropriation: Appropriation refers to the legal authority granted to the executive by the legislature to spend public funds. Appropriation legislation varies in terms of its detail some provide funds for an entire department, while others provide funds for specific programs. Appropriations typically provide spending authority for a single fiscal year. However, permanent appropriations or standing appropriations provide spending authority over a series of years. Supplemental appropriations are sometimes granted subsequent to the annual appropriation law if the amounts provided in that appropriation prove to be insufficient to meet the intended purpose.

Budget: A budget is a comprehensive statement of government finances, including spending, revenues, deficit or surplus, and debt. The budget is usually the government's main economic policy document, indicating how the government plans to use public resources to meet policy goals. As a statement of fiscal policy, the budget shows the nature and extent of the government's impact on the economy. The budget is prepared by the executive and then generally is submitted to the legislature to be reviewed, amended, and adopted as law. The budget preparation process begins many months before the start of the fiscal year covered by the budget, so that it can be enacted into law before the fiscal year begins.

Capital Expenditure: A government's assets could be financial (e.g. investments, loans/ advances given, equities) or physical (factories, bridges, school buildings, hospital buildings). Almost all financial assets provide future monetary benefits, while some of the physical assets may also provide monetary benefits in future. On the other hand, a government's liabilities are by nature financial and they are amounts owed to other parties (e.g. borrowings and advances received by the government). Capital Expenditure incurred by any government is usually meant for increasing the government's assets or reducing its liabilities.

Debt: Government debt is the outstanding amount that the government owes to private lenders at any given point in time. Governments borrow when they run deficits, but reduce outstanding debt when they run surpluses. Thus debt essentially represents the total of all annual deficits, minus any annual surpluses, over the years. Governments can borrow by taking out a loan directly from a financial institution, such as a bank. Governments can also issue bonds that are purchased by domestic and foreign businesses and individuals. Purchasers of government bonds are essentially lending money to the government with an agreement that the amounts will be repaid on a certain date and that interest will be paid periodically. The interest payments, also known as debt service costs, are a line-item in government budgets. Particularly in developing countries, debt service costs can consume a large share of total spending, reflecting the significant debt accumulated by these countries as well as the high interest rates they must pay to borrow.

Earmark: When funds have been earmarked, it means that they have been dedicated to a specific program or purpose. In some cases, a particular stream of revenue is earmarked for a specific purpose. For instance, revenues resulting from taxes on fuel are frequently dedicated to transportation-related expenses, such as road construction or mass-transit subsidies.

Expenditure: This refers to government spending (or outlays). Expenditures are made to fulfil a government obligation, generally by issuing a check or disbursing cash. Expenditures may pay for obligations incurred in previous fiscal years or in the current year. Expenditures are sometimes distinguished between capital and current. Capital expenditures are investments in physical assets, such as a roads and buildings that can be used for a number of years. Current expenditures reflect spending on wages, benefit payments, and other goods or services that are consumed immediately. Actual expenditure may differ from the amounts established by the budget. Significant and persistent differences between actual expenditure and budgeted amounts are a sign of weakness in a country's budget and expenditure management systems.

Extra-budgetary: The term generally refers to government transactions that are not included in the annual budget presentation. A wide variety of extrabudgetary arrangements are used, including funds set up under separate legislation that are financed by revenue earmarked specifically for that purpose. In other cases, state-sponsored businesses such as utilities or airlines have independence in certain respects, but the government may ultimately be responsible for bailing out these businesses when they run into financial trouble. Extra-budgetary activities may not be subject to the same level of scrutiny or accounting standards as programs in the annual budget (though they should be).

Finance Accounts: Finance Accounts, sometimes called Annual Accounts of the government, is compiled by controller general of accounts (CGA). It incorporates comprehensive accounts of receipts and expenditures of the government. It classifies transactions under respective heads pertaining to all approved heads of government accounts and is kept in two parts. Part one comprises the accounts of total receipts and expenditures, the resultant revenue surpluses or deficits, the capital expenditures, including transactions related to temporary and permanent debts, deposit transactions, and money adjustments. Part two exhibits accounts of debts, deposit transactions, and money remittances. The accounts commence with a certificate of the C&AG that represents and authenticates CGA's reports and accounts.

Fiscal Deficit: Fiscal Deficit of a government is the gap between its “Total Expenditure (including Loans net of Repayments)” and its’ “Total Receipts (excluding new Debt to be taken)”. Thus, Fiscal Deficit indicates the borrowing to be made by the government in a particular year for which the Budget is meant. If Total Receipts (excluding new Debt) exceed Total Expenditure of the government, then there would be a Surplus for the government, and hence, no need for borrowing.

Fiscal Policy: Fiscal policy refers to government actions with respect to aggregate levels of revenue and spending, and the resulting surpluses or deficits. Fiscal policy is the primary means by which the government influences the economy. An “easy” fiscal policy is intended to stimulate short-term economic growth by increasing government spending or reducing revenues. A “tight” fiscal policy restrains short-term demand by reducing spending or increasing taxes and is often intended to restrain inflation. The government sets and implements fiscal policy through the budget.

Fiscal Year: The fiscal year is the government’s 12-month accounting period; it frequently does not coincide with the calendar year. The fiscal year is named after the calendar year in which it ends. Function (as in functional classification) — International standards (such as the IMF’s Government Finance Statistics) exist for classifying government expenditures and revenue according to the broad purposes for which transactions are undertaken. A functional classification organizes government expenditure according to its various activities and policy objectives — such as health, education, and transportation.

GDP (Gross Domestic Product): This is the total value of final goods and services produced in a country during a calendar year. Economic growth is measured by the change in GDP from year to year.

Grants: Grants are funds that the national government disburses directly to lower levels of government, corporations, non-profit organizations, and individuals. Some grants are given for specific purposes, requiring the recipients to meet certain conditions or requirements. In other cases, the grants may be used for whatever purpose the recipient deems important. For instance, a national government may make general-purpose grants to state and local governments to support their operations or may provide grants targeted at specific programs, such as the construction of a road or the purchase of school textbooks.

Incremental Budgeting: Incremental budgeting typically refers to a budget formulation process that focuses only on one year and how the budget for each program differs from the levels adopted in the previous year. Incremental budgeting is often criticized as having a narrow focus, concentrating on funding changes to existing programs rather than having the flexibility to address the implementation of new policy priorities, or eliminating low priority programs.

Multi-year Budgeting: This term generally refers to budgets that take into account more than one year. In some cases, this means governments enact into law budgets that specify spending and revenue amounts for more than a single year. For instance, many U.S. states enact budgets that specify spending and revenue amounts for two years, and are known as biennial budgets. In other multi-year budgets, only spending and revenue amounts for one year are adopted, but the budget includes estimates for subsequent years that reflect the multi-year impact of its policies and plans; these estimates are not binding on future budgets. In some countries that enact a one-year budget, however, the forward estimates associated with the enacted budget do serve as the starting point for preparing the budget in the next year. This approach is typical in countries that employ a Medium-term Expenditure Framework (MTEF).

Outputs/Outcomes: The performance of government programs is assessed by examining whether they have delivered the desired outputs and outcomes. Outputs are defined as the goods or services provided by government agencies. Some examples include: teaching hours delivered, immunizations provided, or welfare benefits paid. Outcomes are a broader concept and include the impact of the program on social, economic, or other indicators, such as whether an increase in hours taught improved student test scores, whether more immunizations reduced sickness, or whether higher welfare benefits increased social equity. Outputs tend to be easier to measure than outcomes. Further, factors beyond the control of a government program can affect outcomes, making it difficult to assess the impact of the program. For instance, even at a time when welfare benefits are increased, the number of people in poverty could increase as a result of a slowdown in the economy.

Performance Budgeting: As a general concept, performance budgeting refers to a budget process that integrates information about the impact of government spending. In its simplest form, performance budgeting places more emphasis on the outputs and outcomes associated with government expenditure and takes this information into account when setting future funding levels. Performance budgeting is often associated with giving managers of government programs more flexibility to achieve specific policy goals within a set budget. Efficiency of expenditure therefore is an important goal. Developing countries (as well as many developed countries), however, often lack the data and other information necessary to fully assess performance objectives; gathering such information is a difficult task.

Revenues: Revenues or taxes are funds that the government, as a result of its sovereign powers, collects from the public. Typical revenues include individual and corporate income taxes, payroll taxes, value-added taxes, sales taxes, levies, and excise taxes. In contrast, user fees are paid voluntarily by the public in return for a government-provided service or good. Because the purchaser receives a direct benefit (the good or service) in return for paying the fee, the payment is not considered a tax. A tax that increases as a percentage of income as one's income increases is known as a progressive tax; while a regressive tax is one where a taxpayer pays a smaller percentage of income in tax as income increases.

Revenue Deficit: The gap between "Total Revenue Expenditure" of the government and its "Total Revenue Receipts" is called the Revenue Deficit. If Revenue Receipts are higher than total Revenue Expenditure, then the government would have a Revenue Surplus.

Revenue Expenditure: Revenue Expenditure incurred by the government generally does not have anything to do with creation of assets or reduction of liabilities of the government. Most kinds of Revenue Expenditures are recurring or current expenditures, since the government incurs those expenditures periodically from every Budget.

- Some examples of Revenue Expenditure:
- Government pays the Interest charges due on a loan from International Monetary Fund (no effect on the size of the original liability of Government)
- Government expenditure on Food Subsidy (no effect on assets/ liabilities)
- Government spending on Salary of its employees
- Government spending on procurement of medicines for its hospitals
- Government spending on operation and maintenance of its assets

Tax Expenditures: These are concessions or exemptions from a "normal" tax structure that reduce government revenue collections. These tax breaks are typically granted in order to achieve some government policy objective, though they also can result from targeted political pressure. Because the policy objective could also have been achieved through a subsidy or other expenditures, the tax concession is essentially regarded as equivalent to budget expenditure — hence the term tax expenditure. Estimating tax expenditures, however, can be somewhat more complex than estimating budget expenditures, in part because it requires a precise definition and estimation of revenues under the "normal" tax structure and subsequently the revenues lost as a result of the tax break.

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