

# Examining the Impact of Tax Evasion and Tax Revenue on Economic Growth of Afghanistan: An Empirical Investigation

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## Abstract

The level of taxation is imperative for the development of a country, but from the last decade, countries have failed to collect taxes up to the maximum because of evading and avoiding the nature of taxpayers. As such tax evasion is connoted as a serious problem that causes governments of different nations to lose revenues at various levels. The issue of tax evasion has received considerable attention from researchers and policy-making institutions over the past decades. Various studies have been conducted on tax evasion and its effects on income inequality and economic growth. The main purpose of this study is to examine the effect of tax evasion and tax revenues on economic growth. For this reason, Afghanistan is taken as a critical case covering the data from 2010-2020 by using the OLS approach to estimate the results. In the first step, using the monetary approach, an index for tax evasion for Afghanistan is estimated. In the second step, the effects of tax evasion and tax revenues on economic growth are studied. The results show that tax evasion and income tax rate have a U shape relationship. That is, as the tax rate increase the probability of tax evasion would also increase. Furthermore, it is found that tax evasion leads to economic instability, and more tax revenues will be beneficial for better economic conditions.

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## Introduction

In both, developed and developing nations, the government holds company owners, government employees, service providers, and other organizations accountable to pay taxes. To corroborate this, consider Benjamin Franklin's famous remark, "nothing is certain but death and taxes." This remark affirmed that every citizen is subject to tax law and is required to pay taxes from their earnings. Collecting taxes from citizens is important for governments in order to build big dams, establish transportation infrastructure, and offer excellent social services to the community (Saxunova and Szarkova, 2018). Taxation is a benchmark and a turning point in a country's overall growth, transforming lives and increasing productivity in regular concerns. The tax collecting system in developing and third-world nations is not comparable to that of rich nations, since taxes account for a 35% of gross domestic product in rich nations, whereas taxes account for 15% and 11% in poor nations, respectively. This implies that in third-world countries, the percentage of revenue derived through taxes is negligible (Mughal, 2012).

There have been substantial issues made about why tax collection is so low, referring to the answer that taxpayers evade and avoid taxes, and, as such Afghanistan is not an exception to this. Additionally, tax evasion also causes some other problems being adverse to economic development. For example, tax evasion distorts the tax system, increasing the deadweight loss. While increasing the government's law enforcement costs, it also reduces the government tax revenue and the ability to repay. In the developing and undeveloped world, the method of collecting taxes is prone to loopholes, which taxpayers use in order to avoid paying taxes. There are several arguments given as to why the predicted revenue cannot be increased. Among the causes, the inefficiency of the tax operation system, tax evasion and lack of taxpayer knowledge are the commonly held reasons (Fagbemi et al., 2010). As the world has changed, tax compliance has taken a second seat, with tax avoidance and evasion at the top of the taxpayer's priority list. Tax evasion is the use of unlawful methods to lower one's tax responsibility, whereas tax avoidance is the use of legal methods to decrease one's tax responsibility (Alleyne & Harris, 2017). Tax evasion is a threat to the community; governments and international organizations have been working to combat unwanted phenomena associated with taxes, such as tax evasion or tax fraud (Saxunova and Szarkova, 2018).

Tax evasion causes a severe loss to the country's GDP at the micro-level, and it has become a contentious issue for tax collectors (Aumeerun et al., 2016). Participants in tax evasion have been chastised by various persons and organizations for the harm they do to the country's economy (Alleyne & Harris, 2017). According to Dalu et al. (2012), there are two distinct devils in the tax system: tax evasion and tax avoidance, which make it difficult for the government to collect taxes from taxpayers. Many countries, like Afghanistan, have struggled to meet their annual budgets and build various infrastructures as a result of the budget imbalance caused by tax fraud (Turner, 2016; Wani and Kabir, 2016; and Alleyne & Harris, 2017). Scholars, particularly economists, felt that tax evasion is a technical issue in the tax collecting system, but psychologists argued that tax evasion is a social issue for countries (Terzi, 2017). When compared to rich countries, tax evasion techniques in emerging countries are worsening. Tax evasion is a plague for countries since they are powerless to regulate it. As a result, governments were significantly impacted by tax evasion in their efforts to enhance the living standards of their population and allocate a budget for public expenditure, and it became a sickness for the country's economy, costing an estimated 20% of income tax revenue (Ameyaw et al., 2015; Palil et al., 2016). A variety of circumstances may motivate taxpayers to participate in tax evasion. Major determinants include tax knowledge, tax morale, the tax system, tax justice, compliance cost, attitudes toward conduct, subjective norms, perceived behavioral control, and moral duty (Alleyne & Harris, 2017; Rantelangi & Majid, 2018). Other elements that influence taxpayers' willingness to participate in tax evasion include capital intensity, leverage, fiscal loss, compensation, profitability, contextual tax awareness, interest rate, inflation, average tax rate, gender, and ethical tax awareness (Annan et al., 2014; AlAdham et al., 2016; Putra et al., 2018).

In this purview the current study endeavors to study and examine the effect of tax evasion and tax revenues on economic growth in Afghanistan from 2010-2020. The rest of the study presents the literature review in section 2, section 3

presents the research methodology, followed by analysis, discussions and conclusions in sections 4 and 5 respectively.

## **2. Literature Review**

The rise in tax evasion in recent decades has prompted a significant quantity of research into the subject, concentrating on its source, impact on macroeconomic policies, and impact on the country's economic growth. To explain the causes, a significant variety of ideas and research have been created in recent years. These ideas identify a variety of factors that may explain the rise of tax evasion and its consequences are presented in subsequent sections.

### **2.1 Theoretical Review**

Benefit Received Theory of taxation established by Wicksell (1896) and Lindahl (1919) focuses on the efficacy of tax revenue in providing public services and encourages government at all levels (federal, state, and local) to generate revenue from a variety of sources in order to adequately deliver public goods and services. The idea assumes a tax-payer-government exchange relationship, in which governments collect taxes from both individuals and businesses in order to provide basic utilities such as water, housing, education, health care services, security, transportation, and communication, among other things (Omodero & Dandago, 2019). The government is obligated to provide fundamental services to the people, and the public is supposed to reciprocate by paying taxes that are proportionate to the benefits received (Bhartia, 2009). According to Anyanfo (1996), taxes should be levied depending on the government benefits obtained. Individuals and businesses, according to the notion, should pay taxes according to their ability to pay and the number of advantages they get. In other words, individuals and businesses who obtain more advantages pay more taxes. This notion, however, has not been completely implemented in any scenario since the government has also failed to quantify the advantages obtained by individuals and firms with the services rendered (Ahuja, 2012).

If the benefits received theory is applied in practice, the issue of tax evasion will not be witnessed, as the participants in underground economy activities that are spread across the country would have found reasons to formalize their businesses and voluntarily comply with their tax obligations. Due to the government failing to provide the basic amenities required for businesses to flourish and expand, taxpayers found tax evasion and avoidance as an ethical practice (Ibadin & Eiya, 2013). The principle of tax morale states that citizens have the moral right to pay their taxes as part of their civic responsibility to the government. If the benefits received hypothesis is followed in practice, tax evasion would not be an issue in Afghanistan since participants in the country's underground economy will have found reasons to formalize their companies and willingly comply with their tax responsibilities. Due to the government's failure to supply the fundamental necessities for businesses to thrive and develop, taxpayers saw tax evasion and avoidance as an acceptable activity (Ibadin & Eiya, 2013). According to the idea of tax morale, taxpayers have a moral need to pay their taxes as part of their civic responsibilities to the government.

## **2.2 Empirical Review**

Bahadur (2018) studied the impact of tax evasion on overall tax income and Nepalese economic growth. The study used correlation and linear regression analysis to determine the link between tax evasion and the dependent variables (total tax revenue and GDP), as well as its impacts over a 9-year period. According to the findings, tax evasion has an adverse connection with Nepal's economic growth and tax income. According to the report, tax evasion has a detrimental influence on total taxable income and Nepal's GDP. Carlos and Lars (2018) examined the link between tax evasion and economic development using a theoretical model and a dynamic OLG model of tax evasion. According to the study, a higher tax rate increases aggregate tax evasion and the number of tax evaders. At the same time, GDP per capita exhibited a positive association with tax morale, whereas evaded taxes over GDP decreased when a country's GDP increased. Konstantinos, Pantelis, and Vangelis (2018) provided empirical data on the link between aggregate production growth, stated tax rate, and tax monitoring expenditures for a basic endogenous growth model with public capital accumulation supplemented with tax evasion for a period covering 2000-2007. The study's findings revealed that high stated tax rates above the elasticity of public capital and extra tax auditing expenditures as a way of combating tax evasion were ineffective owing to the recession. Mehrara and Farahani (2016) used panel data to analyze the impact of tax evasion and tax collections on economic stability in 29 OECD nations from 1990 to 2013. The study first used the monetary approach to estimate the tax evasion index before looking into the effects of tax evasion and tax revenues on the economic stability of the countries studied. According to the findings, tax evasion causes economic instability, whereas increased tax revenues tend to improve the economy. Wani and Kabir (2016) established the relationship between public debt and economic growth of Afghanistan, through regression analysis. Domestic debt is attributed to tax evasion practices in Afghanistan and study recommends privatization program of public corporations, for boosting the economic growth. Mughal and Akram (2012) investigated the causes of tax evasion and avoidance in Pakistan using primary data gathered through the administration of questionnaires and descriptive statistical tools. The findings revealed that all variables representing the causes of tax evasion and avoidance in Pakistan were accurate, and the study variables had a 100 percent positive relationship.

## **3. Research Methodology**

This section sheds light on the methodology of the study covering research design, and nature of data collection, data and methodology, model specification and estimation procedure.

### **3.1 Research Design, Data Collection and Data and Methodology**

The quantitative method is more regulated, more structured, closely connected to the range specified by social scientists, and more clearly controlled than the qualitative approach (Creswell & Clark, 2007; Kumar & Phrommathed, 2005; Leedy & Ormrod, 2005). As a result, this research incorporates the use of a quantitative research strategy. As the goal of this study is to generate empirical evidence, the study relied on secondary

data. The secondary data for the variables included in this study spanned the years 2010 through 2020. The GDP was used as a proxy for economic growth, whereas the independent variables were tax evasion and tax revenue, along with additional control variables such as money volume (M1), liquidity (M2), inflation (INF), currency in circulation ratio (CU), and velocity of money (V1). Tax evasion is defined as tax that should have been paid but was illegally avoided or minimized instead of being paid. In order to quantify tax evasion, the common understanding about the term is the sum that the government should have raised but couldn't. To determine how much tax was evaded, the difference between what should have been collected based on the model and what was actually collected based on the IMF database should be utilized. Afghanistan's GDP was used to assess economic growth. A time series data model for Afghanistan from the World Bank, Trading Economics, IMF, and UNCTAD is used to investigate the connections between economic growth, tax evasion, and tax revenue for the period 2010-2020. The standard deviation of GDP is used as a metric of economic stability, with a greater standard deviation indicating a less stable economy. The Guttman monetary method, which is the ratio of money in circulation to demand deposit, is used to assess the rate of tax evasion. GDP and inflation are control variables that are used as proxies for government size and economic openness.

#### 4. Results, Findings and Discussions

This section presents the estimation and discussion of the results by employing E-Views statistical package version 8.0. This section offers the procedure of assessment in 4.1 followed by the Unit root test in section 4.2, co-integration analysis in section 4.3, model estimation in section 4.4, and discussion of the empirical findings in section 4.5.

##### 4.1 Estimation Procedure

###### 4.1.1 Estimating the underground economy size (Tax evasion)

Tax revenue (TAX), gross domestic production (GDP), the volume of money (M1), liquidity (M2), inflation (INF), the ratio of currency in circulation (CU), and velocity of money are all variables used to estimate the level of tax evasion (V1). The following calculation is used to calculate the currency ratio incorporating tax factors (CU/M2) (Kemal, 2003).

$$(CU/MT)_t = \alpha + \beta(TAXREV/GDP)_t + \gamma(Growth)_t + \theta(Inflation)_t + \delta(CU/M2)_{t-1} + \varepsilon_t \text{-----(1)}$$

The above equation is estimated twice. Once, considering tax variables in currency holding ratio and the second time without including tax variables  $(CU/M2)_{wt}$  which by using these two estimations, the volume of money in the legal and illegal sector can be calculated using the following equations.

$$Illegal\ Money\ (IM) = \{(CU/M2)_t - (CU/M2)_{wt}\} * M2 \text{-----(2)}$$

$$Legal\ Money\ (LM) = M1 - IM \text{-----(3)}$$

$$\text{Velocity of Legal Money (LM)} = \text{National Income/LM} \text{ -----(4)}$$

$$\text{Underground Economy(UE)} = \text{IM} * \text{V} \text{ -----(5)}$$

$$\text{Tax Evasion (TE)} = \text{UE} * (\text{Total Tax/GDPN}) \text{ -----(6)}$$

Using a log-linear equation, expression (1) can be rewritten as the following and rest of the procedure is the same.

$$\text{IM} = \text{anti log} \{ \log (\text{CU/M2})_t \} - \text{anti log} \{ \log (\text{CU/M2})_{wt} \} * \text{M2} \text{ -----(7)}$$

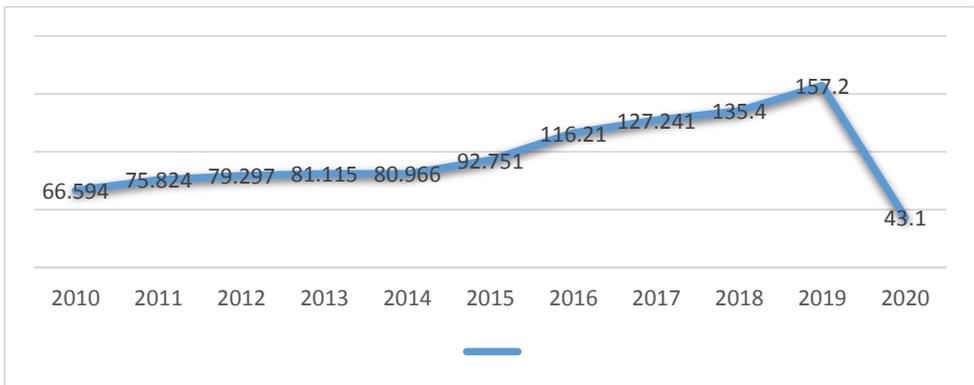
For estimating the tax evasion based on equation (1), time series OLS approach is used. Results of the model are reported in Table 3.

**Table 1. Estimation Results of Tax Evasion**

Variable	Coefficient	Prob
C	0.152	0.08
LCUM2(-1)	0.185	0.002
LTAXREVGDP	1.138	0.000
Growth	-0.053	0.001
Inflation	-0.011	0.004

*Note: Results obtained from estimating tax evasion equation (Dependent Variable is LCUM2; currency holding ratio to liquidity). The null hypothesis for the t-ratio is  $H_0 = \beta_i = 0$ ; Figures in parentheses are Prob indicate statistical significance at the 5% level. Source: Data output from E-views 12.0*

**Figure 1: Time Trend of Tax Evasion in Afghanistan (2010-2020) (US\$)**



Source: Data representation compiled from World Banka and MoF.

At 5%, the tax-to-GDP ratio coefficient is positive and significant, implying that the greater the tax rate, the more critical the currency holdings. The tax to GDP ratio coefficient reveals that a 1% change in the tax to GDP ratio causes a 1.24 percent change in the currency ratio. A negative and substantial relationship between inflation and currency ratio means a one percent increase in inflation causes a 0.02 percent drop in demand for currency holdings. The growth rate coefficient is negative, implying that greater levels of economic growth are projected to reduce demand for currency holdings. The significance of the significant level indicates that it has a substantial influence, and we may use it to forecast (estimate) the extent of the underground economy.

The lagged dependent variable's coefficient is five percent positive and significant, reflecting effectiveness in capturing the impact. The  $R^2$  is 0.75, and the F-statistic is substantial, indicating that the specification factors account for considerable changes in the dependent variable. The H-Durbin statistic is 1.88, which is within the crucial range, meaning no significant autocorrelation. In addition, comparing pooled regression to OLS fixed effect, with the null hypothesis stating that fixed effect is redundant and as such F-stat and Chi-square cannot reject the null hypothesis. The trajectory of tax evasion calculated from equation 4 for Afghanistan is seen in the graph above. As can be seen, tax avoidance has grown slowly over the last 20 years. For example, in the United States, tax evasion has grown at a rate of only 5% during the time. The underground economy accounted for around 5% of GDP in 2013, which is lower than Guttman and Feige's GDP estimates in the under-developed economies. The percentage of tax evasion lacks in these nations and may suggest governments' ability to regulate economic instability through tax policy. It is explained in more detail in the following sections.

#### 4.2 Unit Root Test

In the presence of a unit root variable, it is possible to get seemingly significant correlations from unrelated variables while investigating the link between tax evasion and tax revenue and the relationship between these two variables and economic growth. As a result, the presence of unit roots in the data series must be determined. It is argued that a unit root test improves the power of the unit root test by giving more degrees of freedom and allowing for variability across individual series.

**Table 2: Unit Root Tests**

Variables	IPS Statistic	Prob
Tax Income	0.23	0.66
Tax evasion	0.75	0.72
Openness	-0.85	0.41
Size of government	1.54	0.73
Standard deviation of GDP	-5.87	0.00
Inflation	-4.23	0.00
Economic growth	-5.21	0.00

*Note: Levels and first order differences denote the IPS t-test for a unit root in levels and first difference, respectively. The number of lags was selected using the AIC criterion.*

*Source: Data output from E-views 12.0*

The unit root tests are shown in Table 2 at a 5 per cent significance level. The p-values for the IPS value demonstrate that the tax revenue-to-government-expenditure ratio, tax evasion, openness, and government size are all greater than 0.05. At a 5 per cent level of significance, variables are non-stationary. The null hypothesis is firmly rejected in these situations at first differences, and that these series are integrated of order one  $I(1)$  and the other variable is level stationary. The p-values corresponding to the IPS value obtained for the standard deviation of GDP, inflation, and economic growth are lower than 0.05 at levels with intercept and trend. At the 5 per cent level of significance, this suggests that this series of variables are stationary, and therefore these variables are static. As a result, it is

deduced that some variables are non-stationary while others are stationary at the level.

### 4.3 Co-integration Test

The linear combination was subject to co-integration to see if the variables of interest had a long-run connection. Table 3 shows the results of the Pedroni panel co-integration test.

**Table 3: The Pedroni Panel Co-Integration Test**

Test	Constant trend	Constant + Trend
Time $\nu$ -Statistic	0.000	0.000
Time $\rho$ -Statistic	0.897	1.000
Time $t$ -Statistic: (non-parametric)	0.991	0.768
Time $t$ -Statistic ( <i>adf</i> ): (parametric)	0.000	0.000
Time $\rho$ -Statistic	0.987	0.896
Time $t$ -Statistic: (non-parametric)	0.000	0.000
Time $t$ -Statistic ( <i>adf</i> ): (parametric)	0.000	0.000

*Note: All statistics are from Pedroni's procedure (1999) where the adjusted values can be compared to the  $N(0, 1)$  distribution.*

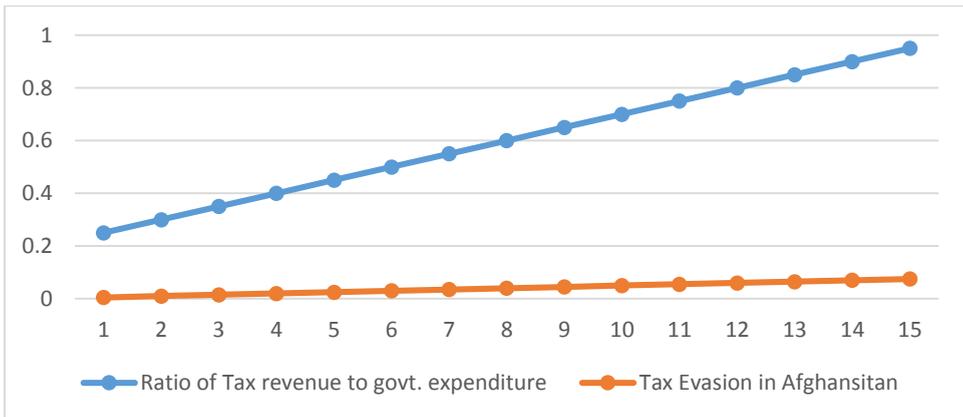
*Source: Data output from E-views 12.0*

The results of the cointegration test demonstrate that the variables move together over time. Given the time series nature of the study, there is a long-run steady-state relationship between our variables. The next stage is to estimate the connection, considering the presence of a long-run link between the variables.

### 4.4 Estimating the Model

Figure 2 shows that increasing tax revenues and rates lower the value of tax evasion initially. Still, when the ratio of tax revenues to government expenditure surpasses 0.70, the relationship reverses, implying that higher tax rates raise the value of tax evasion.

**Figure 2: U-Shape Relationship between Tax Evasion and Tax Revenues**



*Source: Data representation compiled from World Banka and MoF.*

Since there is a U shape association between tax evasion and tax revenues, OLS and time series least square models are employed to integrate the squared tax revenues influence on tax evasion to identify the suitable model. Because

dimension-specific effects are persistent in regressions, it is preferable to begin estimate with the OLS technique. The OLS regression coefficients have the anticipated sign. The F test is used to pick between OLS and fixed effect methods; the statistics from the F-test for the common intercept are analysed, and the test favours OLS regression. Table 4 shows the significant findings of the relationship between tax revenue and tax evasion. All explanatory variables are taken in level 1.

**Table 4: OLS Regression results (Dependent variable is tax evasion)**

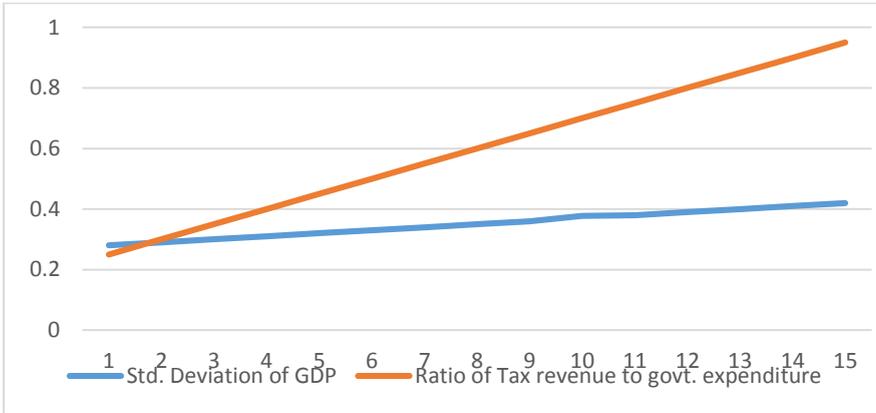
Variable	Coefficient	Prob
C	0.061	0.000
C LTAXGOV	-0.115	0.036
LTAXGOV^2	0.083	0.000

*Source: Data output from E-views 12.0*

Table 4 demonstrates that at the 5% level, all coefficients are significant. According to the LTAXGOV coefficient, a 1% rise in the tax-to-government spending ratio decreases tax evasion by 0.11 percent. Furthermore, the squared coefficient of the tax-to-government-spending ratio is positive and significant. These findings confirm the presence of a U shape link between the variables. The coefficient of determination (R<sup>2</sup>) is 0.82, and the F-statistic is similarly significant, indicating that the specification variables explain considerable changes in the dependent variable. The Durbin-Watson score is 1.89, meaning that the sample has no substantial autocorrelation. The third stage is to calculate how taxation and tax evasion affect economic development. There is a bit proven theoretical framework to build a model that explains the influence of taxes and tax evasion on economic stability and growth. The goal of this study is to evaluate how these variables affect economic growth empirically. Figure 3 shows a negative link between tax revenues and GDP standard deviation in the nations analysed. As a result, tax policies can be used to reduce GDP standard deviation. Higher tax income can contribute to a reduction in GDP standard deviation, according to statistical data in table 5. That is, with a well-coordinated tax system, raising the tax rate can result in a more stable economic condition.

Martinez-Vazquez et al.'s (2009) analysis provide the starting point for the model's specification. The model is changed in this case, even though they utilized a panel data method. Table 5 shows the key findings on the link between tax revenues, tax evasion, and GDP standard deviation. These are the findings of "time series regression" (OLS) and "fixed effects" models. The F test is used to determine if the country variable effects are homogeneous. The null hypothesis that the fixed effect model is redundant versus the time series regression model does not reject is seen. As a result, the linear OLS technique is used to estimate the model. Table 5 demonstrates that at the 5% level, all coefficients are significant. According to the LTAXGOV coefficient, a 1% increase in the tax revenue to government spending ratio lowers GDP standard deviation by 0.15 percent. That is, taxation and economic stability are linked; higher taxes enhance economic stability. The supply-side theory, which stresses the influence of higher taxes on better economic stability, is supported by this study. The coefficient of TAXEV is likewise statistically significant and positive, indicating that a 1% rise in tax evasion decreases economic stability by 0.11 percent.

**Figure 3: Relationship between Tax Revenues and Standard Deviation of GDP**



Source: Data representation compiled from World Bank and MoF.

#### 4.2 Discussions

Over the last few decades, scholars and policymakers have paid a lot of attention to the problem of tax evasion. Various research on tax evasion and its implications on economic growth have been undertaken. The primary goal of this research is to look at the impact of tax evasion and revenue on economic growth. As a result, Afghanistan was included in the analysis, which covered the years 2010 through 2020. The findings are estimated using the OLS method. In the first phase, a tax evasion index for Afghanistan is calculated using a monetary technique. The impacts of tax evasion and tax collections on economic growth are investigated in the second stage. The results show that tax evasion and income tax rate have a U shape relationship. That is, as the tax rate increase, the probability of tax evasion would also increase. It has also been shown that tax evasion leads to economic instability and that more tax collections would lead to a better financial situation. All coefficients are significant at the 5% level, according to the results. According to the LTAXGOV coefficient, a 1% rise in the tax-to-government spending ratio decreases tax evasion by 0.11 percent. Furthermore, the squared coefficient of the tax-to-government-spending ratio is positive and significant. These findings confirm the presence of a U shape link between the variables. The coefficient of determination (R2) is 0.82, and the F-statistic is significant, indicating that the specification variables are essential.

Finally, the effect of taxation and tax evasion on economic growth is evaluated. There is hardly any established theoretical foundation on the specification of a model that explains the impact of taxation and tax evasion on financial stability or growth. In this study, the attempt is to observe the effect of these variables on economic stability empirically. It is further justified that there is a negative relationship between tax revenues and the standard deviation of GDP. Hence, it is possible to lower the standard deviation of GDP by using tax policies. Statistical results show that in Afghanistan, higher tax revenue can lead to a reduction in the standard deviation of GDP. For a coherent tax regulation, an increase in the rate of taxation can lead to a more stable economic condition. It is shown that higher income tax rates increase the rate of currency holdings, which in the monetary approach manifests the rise in tax evasion. These findings are in line with the classical view that higher taxation creates an incentive for people to

misrepresent their earnings to lower their tax liabilities. It is also found that higher tax revenues positively affect economic stability, and higher tax evasion harms economic stability. The findings satiate countries with a higher level of taxation experience a more stable economy. These results align with the results of Mughal and Akram (2019) and Joseph (2016).

Since Afghanistan has a tax-based budget system, during periods of recession, governments can manipulate tax policies such as tax exemptions, tax credits, and tax deductions as economic stimulators to compensate for the adverse effects of the recession. Tax revenue has been meagre over the years, and little physical growth has occurred, so the impact on the poor has been minimal. Many people believe that ineffective and incompetent tax administration is to blame for the loss of revenue caused by widespread tax evasion and tax avoidance in Afghanistan. The main concern is whether the government is making significant efforts to curb the underground economy without displacing people from their employment. The impact of the underground economy on government revenue is negative, but the participants are not to blame because the government fails to perform its functions. According to the report, the amount of tax collected in Afghanistan between 2010 and 2020 did not meet the planned tax collection goal. High tax rates, the complexity of tax laws, systems, and procedures, taxpayer perceptions of government ability to use tax collection for social welfare, limited resources and capacity of tax administration, low literacy and lack of tax education, poverty and nature of business/production, legal provisions in tax, and low tax morale were all linked to tax evasion.

## **5. Conclusion**

The primary goal of this research is to look at the impact of tax collections and tax evasion on economic growth. To that purpose, an index for tax avoidance in Afghanistan has been created. The link between income tax and tax evasion is investigated next, followed by the relationship between tax evasion and tax revenues and economic growth. Higher-income tax rates are proven to increase currency holdings, resulting in an increase in tax evasion in the monetary approach. The findings support the traditional idea that more outstanding taxes encourage people to lie about their incomes to reduce their tax responsibilities. This will become much more difficult if the underground economy grows in size and the value of tax avoidance rises. Because revenues do not rise in lockstep with government spending, the government may face a budget deficit. Increased tax collections are also found to have a beneficial influence on economic stability, whereas higher tax evasion negatively impacts. This indicates that countries with a more significant tax burden have a more stable economy. As a result, because these nations have a tax-based budget system, governments may use tax policies like tax exemptions, tax credits, and tax deductions as economic stimulators during periods of recession to offset the negative impacts of the recession. Tax evasion, in general, refers to the employment of deceptive tactics to avoid paying taxes. For accomplishing this, taxable revenue, taxable profits, or other taxable activities are concealed. The amount and source of income are misrepresented, or tax-reducing elements such as deductions, exemptions, and credits are intentionally exaggerated.

Tax evasion may happen as a one-time occurrence within otherwise legal activities. Alternatively, tax avoidance occurs in the informal economy, where the entire operation is conducted informally – this means that the company is not only evading tax payments but is also not registered as a formal enterprise. Tax revenue has been meager over the years, and little physical growth has occurred, so the effects on the poor have been minimal. Many people believe that ineffective and incompetent tax administration is to blame for the loss of revenue caused by widespread tax evasion and tax avoidance in Afghanistan. The main concern is whether the government is making significant efforts to curb the underground economy without displacing people from their employment. The impact of the underground economy on government revenue is negative, but the participants are not to blame because the government fails to perform its functions. According to the report, the amount of tax collected in Afghanistan between 2010 and 2020 did not meet the planned tax collection goal. High tax rates, the complexity of tax laws, systems, and procedures, taxpayer perceptions of government ability to use tax collection for social welfare, limited resources and capacity of tax administration, low literacy and lack of tax education, poverty and nature of business/production, legal provisions in tax, and low tax morale were all linked to tax evasion.

### **5.1 Recommendations**

In Afghanistan, tax evasion and avoidance is a significant problem. Every year, governments lose a substantial amount of money due to tax evasion and avoidance. This report suggests the following suggestions after reviewing all of the data and facts on tax evasion and avoidance:

- Tax rules should be reformed so that no one can take advantage of loopholes in the tax code.
- There is an urgent need to properly implement a fully automated tax collection system and the facilitation of e-governance.
- Corruption by tax officials should be dealt with harshly, and the severity of the penalty should be increased.
- GoIRA must implement Tax investigation programs.
- Improving the revenue board's performance, openness, and accountability would help increase tax collection.
- Rewarding the highest taxpayers would inspire people to pay their taxes rather than evade or stop them.
- Tax attorneys and chartered accountants are often accused of assisting taxpayers, including businesses and corporations, in evading taxes. Similarly, Clearing and Forwarding agents assist in the avoidance of Customs duties. The elimination of the human interface has been proposed as a viable solution to this problem.
- Organizing a tax fair would encourage taxpayers to pay their taxes.

- It is suggested to identify potential taxpayers and gather all relevant information on their income sources and find alternative sources of revenue for long-term taxpayers.
- Tax evasion is a criminal offense in almost every developed country, punishable by fines and imprisonment. The penalty may be as severe as the death penalty. It is commonly assumed that the degree of evasion is proportional to the severity of the punishment for evasion. As a result, the liability in our country should be so severe that no one might consider engaging in tax evasion.

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