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## Growth in FBR Revenues

The outcome in terms of the level and growth of revenues collected by FBR up to October has been made public recently. Apparently, during the first four months of the current fiscal year these revenues have shown a growth rate of 16 percent. This growth rate is satisfactory by historical standards. However, there has been a sizeable shortfall already of Rs 167 billion in relation to the target for these four months.

A number of independent economists had already expressed concern about the targeted growth rate of FBR revenues in 2019-20. The target was fixed at Rs 5,555 billion in the Budget of 2019-20. This required a growth rate of 45 percent and an absolute increase in revenues of Rs 1,725 billion.The highest growth rate achieved during the last decade was 21 percent. More than doubling this peak growth rate was tantamount to grossly unrealistic targeting at a time when the economy had slowed down.

The motivation for setting such an ambitious target was the poor performance of revenues in 2018-19, when there was literally zero growth in FBR revenues. This was the fundamental reason why the budget deficit reached the peak level of 8.9 percent of the GDP. It had become clear that if fiscal stabilization is to be achieved then the growth momentum in tax revenues must be more than fully restored, especially in the presence of an IMF Program.

Consequently, the Budget for 2019-20 contains the largest ever package of taxation proposals. The revenue estimate from these proposals was put at Rs 516 billion by FBR and even more at Rs 675 billion by the IMF. This amounts to additional taxation of 1.5 percent of the GDP.

The question is why there has been a big shortfall already in the presence of heavy additional taxation? There are at least three reasons for the shortfall. First, the extremely ambitious target growth rate of 45 percent requires even greater imposition of additional burden of taxation. Given the projected nominal GDP growth of 16 percent in 2019-20, the normal growth of FBR revenues, with an unchanged tax system, was unlikely to exceed 16 percent. Therefore, to achieve the target growth rate of 45 percent, higher taxation is expected to provide for additional growth in revenues of 29 percent. This implies that enough taxation proposals were required in the 2019-20 Budget to yield Rs 1,110 billion. As such, even the heavy taxation proposed in the budget was inadequate by over Rs 435 billion. Therefore, already at the start of the year a minimum shortfall in revenues of almost 1 percent of the GDP was implicit in the budget.

Second, there are reasons to doubt the estimate of revenue yield from the taxation proposals. The FBR generally assumes that an enhancement in the tax rate leaves the tax base largely unaffected. This is clearly not the case. For example, the big increase in the rate of excise duty on cigarettes has led to a fall of output in this industry already by as much as 38 percent in the first two months of the current fiscal year. Therefore, there is a tendency for FBR to significantly overstate the revenue impact of taxation proposals.

Third, some taxation proposals remain unimplemented. The most recent example is that of broadening of the tax bases of both income tax and sales tax by bringing the trading community more into the tax net. However,the Government has relented under pressure and numerous concessions have been given to traders. This could imply an additional revenue shortfall of over Rs 50 billion in 2019-20.

Given the emerging trends in the economy, the prospects for FBR revenues in the remaining eight months of the year do not look very bright. The principal tax base is the large-scale manufacturing sector. It has contracted by 6 percent in the first two months of 2019-20. A disproportionate share of revenues is generated from industries like petroleum refining, cement, iron and steel and cigarettes.

All these industries have shown declines in the first two months of 2019-20 of 18 percent, 5 percent, 18 percent and 38 percent respectively.

Similar, imports which provide the tax base for almost 46 percent of FBR revenues have shown little growth. They have actually declined by 21 percent in dollar terms and even with depreciation of the Rupee increased only 1 percent in rupee value. Two groups of imports contribute disproportionately to revenues from imports. These are petroleum products and transport equipment. Imports are up in rupee value by only 6 percent in the case of petroleum products and have fallenby 14 percent in the case of transport equipment.

What then is the outlook for FBR revenues for 2019-20? The first scenario is one where the 16 percent growth rate is sustained. This will imply full year revenues of Rs 4,439 billion and a resulting shortfall of Rs 1,116 billion, equivalent to 2.5 percent of the GDP. The second scenario is one in which there is some improvement in the growth rate up to 20 percent in the forthcoming eight months. This will lead to the full year revenues of Rs 4,550 billion and a consequential shortfall of Rs 1,005 billion, equivalent to 2.2 percent of GDP.

Therefore, the magnitude of the shortfall is potentially very large. The budget deficit target of 7.1 percent of the GDP and a primary deficit of 0.6 percent of the GDP will begin to look very elusive. There is the risk that the deficit could even approach last year's record deficit. This could put pressure on the size of the current account deficit in coming months.

The on-going first Program review by the IMF Mission in Islamabad is probably focusing on the performance of FBR revenues and the emerging shortfall. There is need for the Mission to recognize that the forecast of FBR revenues was jointly made earlier by the Government and the IMF. The first error was assuming too high the revenues for the base year by almost Rs 320 billion. The growth rate targeted for was actually 34 percent not 45 percent. As such, expost, there is need for the target revenues to be brought down to Rs 5,150 million, a drop of just over Rs 400 billion, to reflect the lower base magnitude. This will reduce the shortfall by almost 40 percent.

The Government will then need present its case as to how much expenditure can be cut or non-tax revenues enhanced in relation to the budgeted magnitudes. Consequently, agreement may need to be reached on a deficit target close to 8 percent of the GDP and a primary deficit of 1.5 percent of the GDP.

There is need to emphasize that a mini budget this year to raise additional revenues will be ill-advised. The economy is floundering badly. Inflation remains high while unemployment is increasing. This 'stagflation' is taking its toll on peoples' lives and affecting the writ of the Government. If some breathing space is given for the economy to recover then the Budget of 2020-21 could focus on the second round of tax reforms. Fortunately, stabilization of the economy on the external front is proceeding well.

A final word for the efforts of the FBR management. Clearly, the Chairman and the Members of the Board have geared FBR up for a better performance. Unfortunately, there is the prospect that they may be held responsible for the large shortfall. This would not be a fair assessment. The expectation of a 45 percent growth in revenues was unfounded in the presence of a slowing down economy and a Government with limitedwrit to carry through difficult tax reforms.

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