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Fiscal frustrations

With economy stuck in a debt-inflation snarl-up, Pakistan's ever-aggravating fiscal pains have pitted the ruling Pakistan Tehreek-e-Insaf (PTI) against the ginormous challenge of overhauling its tax apparatus marred by corruption, while increasing revenue collection by leaps and bounds at the same time.

This ongoing slowdown is hammering the economy into a stagflationary one. With contraction of Large Scale Manufacturing (LSM), the revised estimates for GDP growth plumped from 3.3 percent in last fiscal to 2.9 percent in revised figures.

The Ministry of Finance has projected real GDP growth at 2.5 percent, while inflation is projected touching 13.5 percent for the current fiscal year.

To some extent, someone is really thinking at the Ministry of Finance as it seems that the renewal of license fee, which was delayed last year and parked in the ongoing fiscal year, has paid off and as a result Rs70 billion has been received as non-tax revenues. The Regasified Liquefied Natural Gas (RLNG) plants would also be sold out within first half of the current fiscal year so it would also provide government some leverage to achieve the International Monetary Fund (IMF) targets.

However, it's a daunting task for the Federal Board of Revenue (FBR) to collect Rs5.5 trillion in the current fiscal year against a collection of Rs3829 billion, indicating that the FBR requires a growth of over 44 percent. Through internal arrangement, the FBR's devised plan showed that for achieving the desired revenue collection, the FBR would have to materialise a revenue growth of 55 percent in the last quarter (April-June) for achieving its cumulative target of Rs5.5 trillion by end June 2020.

The size of Pakistan's economy stands at Rs38 trillion and rough estimates showed that with general sales tax (GST) rate at 17 percent, the FBR could collect Rs2,500 billion. There is potential of Rs4,500 billion and another Rs4,500 billion can be collected through income tax. So the real potential stands at Rs9,000 billion. But this potential can be materialised where there are no exemptions. In Pakistan the agriculture sector contributes around 19.5 percent into Gross Domestic Product (GDP) but its share in tax collection is negligible. The manufacturing sector does contribute to revenues, while services sector, which is the domain of the provinces under the constitutional arrangement, pays very little taxes.

Within the existing fiscal arrangement, improvement is only possible with effective enforcement through use of technology. The FBR high-ups argued that the number of tax returns touched 2.5 million and they are targeting 4 million in near future. In population of over 200 million, the potential target for taxpayers stands up to 6 million. With the current workforce, it is not possible to monitor economic activities through manual arrangement so solution lies in adoption of technology. Whether the FBR can do it in a smooth manner it is yet not known. The FBR has again convinced the government to borrow $400 million from the World Bank. Can reforms take place with borrowed money? It is a hundred million dollar question that only time will answer. However, the experience in the past showed that without local ownership and political backing from top to bottom the reforms cannot be implemented. The reforms can only take place if the FBR parts from its practices of the last so many decades. The modernisation in the brick and mortar cannot bring reforms in any institution. The capacity of human resource can bring the real and permanent change.

With this background, the performance of the FBR has become immensely important under the latest $6 billion bailout agreement struck by the PTI-led regime with the IMF. Under the performance criteria, the FBR's target for first quarter (July-Sept) is Rs1,071 billion and it has collected Rs580 billion in first two months (July and August) against the target of Rs644 billion so the shortfall stood at Rs64 billion. Now the FBR will have to collect Rs491 billion in the ongoing month (September 2019) to meet the target.

In their background discussions, the FBR authorities have made it clear they could touch Rs1 trillion-mark in the first quarter so the government is making efforts to convince the IMF for adjusting its targets. Although Ministry of Finance has dismissed any renegotiation on the targets with the IMF through a press release, the realities cannot stay hidden too long. During the first meeting of the National Assembly's Standing Committee on Finance, secretary finance Naveed Kamran Baloch, responding to the parliamentarians queries about renegotiation of the IMF program, had said, "Let's see what happens".

The FBR high-ups argued that a push to collect up to Rs1,071 billion would weigh down heavily on growth. So there is a need to convince the IMF on this front.

In a video conference held last week between Pakistani and IMF team, the idea was floated to make adjustments in fiscal targets without making any change in the overall targets. The economists say reduction in primary deficit in the range of 3 percent of GDP will be simply impossible to achieve in a year so at any stage the government will have to request to the IMF to make these changes to align the programme with new emerging realities on the economic front.

The IMF team will be here in Islamabad on September 16.

"There is no room for increasing tax rates at this juncture as the economy is already in ICU (intensive care unit) and cannot absorb further burden and suffocation," said former finance minister and renowned economist Dr Hafeez A Pasha.

Ministry of Finance in a statement said the reforms agenda pursued by the government with the support of IMF Extended Fund Facility (EFF) was aimed at putting the economy on a sustainable growth trajectory and the progress on nearly all the performance and structural benchmarks during Q1 FY20 was so far very encouraging with strong indication that all the targets would be met.

The IMF's first review was expected to take place in November 2019 so everything would become clear by then. The fiscal ills cannot be fixed with mere slogans so the government will have to perform on this front. The choices are limited and the best one is a combo of 'increase revenues as much as possible' and 'reduces expenditures wherever possible', especially in the aftermath of 18th constitutional amendments.

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