Should NBR be blamed for the revenue shortfall?

Sunday, Nov 22, 2015

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The revenue collection for the first quarter — between July and September — of fiscal year (FY), 2015-16, or FY16, has significantly fell short of the target. According to press reports, the National Board of Revenue (NBR) revenue collection for July-September was Taka 309.05 billion (30,905 crore). The total revenue underlines a shortfall of Tk 58.03 billion (5,803 crore). It amounts to a 9.5 per cent year-on-year growth, falling way short of the 30 per cent growth target set for FY16.

Why has the revenue performance been poor? The revenue performance and the shortfall should be seen from several angles and in a broader macroeconomic context. Revenue outturn is largely an outcome of the overall macroeconomic performance of the economy including growth in the level of economic activity which we often refer to as real gross domestic product (GDP) growth, growth in import payments, profitability of the banking and other corporate sector, etc. Yes, relative to 30 per cent growth-target, a near 10 per cent growth is indeed a matter of concern and cannot be considered as consistent with the overall NBR revenue target, stated in the FY16 budget. It is also a matter of concern that, when compared with recent performances, the first quarter revenue growth in FY16 was, in fact, the lowest since FY10. Simultaneously, we must admit that a 30 per cent growth-target for

NBR revenue is highly ambitious given its previous performances. Only once in the last decade has the country recorded a close-to 30 per cent revenue growth. It was 27 per cent in FY11.

Against this background, the question arises: what are the factors contributing to the low revenue? In light, it is perhaps unfair to blame it all on NBR. A rush to judgment is rather misleading, if we do not examine the macroeconomic context, developments in international commodity prices and an outdated tax regime, in terms of policy and administration. One needs to look at all these factors while ascertaining the first quarter revenue performance of the NBR.

A number of important factors contributing to the poor NBR revenue performance are briefly discussed below:

INTERNATIONAL COMMODITY PRICE DEVELOPMENTS: Global economy is passing through a major phase of major commodity price collapse, with general commodity price index declining by 34 per cent in FY15. Crude oil prices fell from levels of more than $85 to $45 per barrel, iron and steel fell from $80 to $56 per metric ton, rice fell from $431 to $358, wheat fell from $209 to $ 163 per metric ton, and, edible oil fell from $721 to $590 per metric ton. Likewise, most other commodities and products (like cotton, yarns of both synthetic and natural fibers, steel, other food, manufactured products, etc.) recorded sharply lower prices in the global commodity exchanges and international markets.

As ad-valorem taxes, import stage value added tax (VAT) and the supplementary duties and customs duty are directly dependent on import values. Since value of imports has gone down by 3.0 per cent over the corresponding period last year, it is not surprising that tax collection at the import stage through customs houses is not expected to remain buoyant. On the flip side, Bangladeshi consumers are enjoying lower prices. Simply put, the consumers are reaping the benefits of lower prices (except for petroleum products where the government is getting the benefit) and the government has to take the hit in terms of lower revenue growth.

DOMESTIC PRICES: Domestic prices across the board are usually influenced by international price developments, because the raw materials for almost all products, from biscuit to soap to textiles to construction materials, are imported. Domestic VAT, the largest component of

NBR revenue, is therefore affected. Since VAT is an ad-valorem tax, the low VAT base resulting from relatively lower domestic prices have contributed to a lower VAT revenue from the domestic sources.

OVERALL DOMESTIC ECONOMIC ACTIVITY: When domestic economic activity is strong, tax revenue is usually buoyant. Tax revenue is directly connected to the level of economic activity as tax buoyancy in Bangladesh is slightly over 1 (one) (i.e., elastic). Since NBR tax revenue grew by less than 10 per cent, one may legitimately ask: how strong has the economy been?

Since, no quarterly data on GDP is published by Bangladesh Bureau of Statistics (BBS), we have to draw inferences from other available high frequency economic indicators regarding the strength of the economy. Some indicators frequently used for assessing the level of economic activity include: opening and settlement of letters of credit (LCs), export performance, and bank credits to private sector. All these indicators have been growing very slowly, remained stagnant or even declined compared with the corresponding period last year.

The amount of LCs opened in the first quarter of FY16 ($9,778 million), was $1,056 million less from last fiscal year's first quarter. The private sector credit year-on-year growth during July-September was limited to 12.5 per cent. The growth is significantly below the target for FY16, to support a 7.0 per cent GDP growth, set by Bangladesh Bank (BB). In other words, the growth in private sector bank loans has been slow. The year-on-year quarterly export edged up by merely 0.8 per cent, which was much slower than the annual target export growth of more than 8.0 per cent. This export performance was even slower than the very sluggish 3.3 per cent year-on-year growth recorded in FY15.

REVENUE FROM CIGARETTES: One mentionable source of revenue for NBR is the supplementary duty from tobacco. Like most other developing countries, taxation of tobacco products in the form of supplementary/excise duty is a major revenue source for the government. The sector has been suffering from the very low prices for the lowest segment of cigarettes. Attracted by the lower prices, smokers are opting for the cheaper brands.

In 2006, the market share of the low-segment cigarettes was about 30 per cent, which by

2015, had jumped up to 66 per cent. The sharply higher market share of the low segment cigarettes was manifested in the form of a significant loss of tax revenue. This is a well-known problem. But there is a collective failure in addressing it because of political lobbies mounted by the manufacturers of low segment brands to maintain the status-que.

Despite the efforts to change the trend, the price of low-segment cigarettes in FY16 budget was not increased by enough to serve the purpose. In fact, in the first quarter of FY16 the share of the low-segment cigarettes has rocketed up to 80 per cent in less than a year (from 66 per cent in the preceding year). This massive shift to the low tax low segment has led to a catastrophic impact on NBR revenue from this source in FY16. The loss in revenue every month is estimated to be about Tk. 4.00 billion (400 crore) and growing. This catastrophic situation can easily be reversed, but the Government must have the political will to do it. Unfortunately, blaming the NBR will not help the cause.

REVENUE FROM DIRECT TAXES: The major contributors to direct taxes are: financial sector institutions like commercial banks and telecom sectors' corporate profitability. In both the sectors, corporate institutions have recorded lower profits. In banking sector, profitability has been sluggish because of the "loan loss" provision requirement, governance problem in the sector, and excess liquidity in the banking system due to slower demand for credit which is also a reflection of sluggish economic activity. There are also market pressures to lower lending rates because the prime customers are moving towards US dollar-denominated borrowing attracted by lower interest rates in dollar-denominated loans. In the telecom sector, the first quarter profits declared by Grameen Phone, the largest corporate entity in Bangladesh, displays a downward trend. And, the outlook for the remainder of the year is also not promising. Its customer growth has slowed down, revenue per customer has not increased as expected, and there is intensified market competition from other telecom service providers.

In addition to the mentioned two sectors, profit announcements by the listed companies for the third quarter of 2015 also were also sluggish. The much expected rebound in corporate profits proclaimed by the stock market commentators and participants did not materialise. In sum, the Bangladesh Inc. did not contribute much to NBR revenue in the first quarter of FY16.

A number of initiatives were announced in the budget to increase the direct tax revenue. The noteworthy ones are: taxation of rental income, and broadening the withholding tax on income at source. These announcements were done without preparations. The information base and administrative preparations required for the initiatives on the NBR side were not there. Therefore, despite high hopes, nothing significant has materialised on these fronts.

Withholding of income tax is administered in a very relaxed manner. There is no modus operandi and it essentially operates on the basis of voluntary participation by the employers. There is no serious administrative follow-up. The share of withholding of direct taxes, out of total direct tax revenue, in industrial nations ranges from more than 60 per cent to 85 per cent. In contrast, the corresponding share in Bangladesh is about 2.0 per cent-3.0 per cent. Not much has changed in past year in terms of withholding tax administration except for some newspaper announcements. Meanwhile, the government is being deprived of revenue from a potentially very important source.

A review of relevant data indicates that NBR’s revenue performance in the first quarter might not have been out of line with the developments in overall economic activity. When all major indicators are showing that economic activity has not picked up enough, and at the same time global commodity price developments are depressing the tax base for VAT and customs and supplementary duties, it is unrealistic to expect that NBR revenue will increase at 30 per cent rate envisaged in the FY16 budget under a business as usual scenario.

Blaming the NBR for the low revenue collection is easy. But the policy makers must take a deeper look and objectively analyse the overall economic environment in which the NBR is operating. What NBR really needs is fundamental reforms in the VAT and direct tax systems, modernisation of tax administration along functional lines, greater emphasis on broadening the tax base, and automation of business processes. Political authorities must spend some political capital to undertake the needed reforms.