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Revenue Mobilization through Tax: A Comparative Study of Bangladesh and Pakistan

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Abstract

This paper aims at analyzing and comparing the prevailing tax structure in Bangladesh and Pakistan in terms of their contribution to the economy. The study is based on tax data from 2005-2006 to 2014-2015. The results show that in both the countries Tax GDP ratio is one of the lowest among the SAARC countries. Considering the limited scope of direct taxes, revenue largely depends on indirect taxes like value added tax, customs duty, sales tax and excise tax. Contribution to indirect taxes to total revenue has an erratic trend. The study reflects the issue that tax evasion and avoidance, poor tax administration is the main problem of poor tax performance. But, Bangladesh and Pakistan have a very good opportunity to improve its tax performance by taking necessary reform measures.

Keywords: Tax Structure, Tax revenue. Direct tax, Indirect tax, Tax GDP ratio

1. Introduction

The government of any country has to perform several functions to run a country. Some of the functions are obligatory (e.g. defense, maintenance of law and order situation etc.) and others are optional (e.g. providing various facilities to its citizens like infrastructure, health, environment etc.). In order to perform these duties and functions government require large amount of resources that is known as public revenues of which tax is one of the most important sources. Shil et al. (2016) explained that taxes are imposed on individuals, business or corporate bodies, by constituted revenue authorities for resources used by the government in the maintenance of safety, security, economic growth and development and social welfare for the benefit of the public. It is a compulsory payment to the government without expectation of direct benefit or return by the taxpayer (Lymer and Oats, 2009). Once any tax is imposed by the government, failure to pay will be punishable by law. Taxes can be classified under many dimensions. On the basis of who bears the burden, taxes are either direct or indirect. There are different views about the definition of these two types of taxes. In simple words, direct taxes are those taxes which are paid entirely by those persons on whom they are imposed i.e. the burden cannot be shifted and contrary to this if the burden of taxes is ultimately shifted to others, they are called indirect taxes.

According to Article 152(1) of the Constitution of Bangladesh, taxation includes the imposition of any tax, rate, duty or impost, whether general, local or special, and tax shall be construed accordingly. The National Board of Revenue (NBR) is the central authority for tax administration in Bangladesh. NBR collects almost 80% of total government revenue of the country. Bangladesh tax structure consists of both direct and indirect taxes. Income tax is the main source of direct taxes and from VAT, Customs duty and supplementary duty most of the indirect taxes are collected. Some major tax laws are the Income Tax Ordinance 1984, The Value Added Tax Act 1991, and The Customs Act 1969.

On the other hand, The Federal Board of Revenue (FBR) is the semi-autonomous and supreme federal agency of Pakistan that is responsible for auditing, enforcing and collecting revenue for the government of Pakistan. FBR collects almost 71% of total government revenue of the country. Unlike Bangladesh, Pakistan tax structure also consists of both direct and indirect taxes. Income tax is the main source of direct tax and there are several others that may be included in it such as property tax, poll tax and foreign travel tax etc. Of indirect taxes, sales taxes, customs duty and excise duty contribute maximum. Some major tax laws are the Income Tax Ordinance 2001, the Sales Tax Act 1990, and the Federal Excise Tax 2005.

2. Literature Review

Tax revenue is the principal source of government revenue. Taxes are, of course, levied not only for revenue purposes but are also used to counter income inequality, improve economic stability and change the allocation of resources (Steenekamp, 2011). The existence of an optimal tax policy is a vital tool for the economic development of a country. Regardless of country size, tax has become a dominant factor in mobilizing resources in any country for development, either from direct or indirect sources. From the revenue view, Wang (2007), Padovano and Galli (2002), and Brown (2002) argued that tax has a significant impact on economic growth. As per Bilquees (2004), taxes are the financial blood supply in the economy, being a major source of financing contributing towards country's public expenditures (Social, political and economic costs) for improving the living conditions and social welfare.

Mukarram (2001) also mentioned in her study that direct tax and sales tax have much more potential to be effectively utilized and they will contribute most to the revenue in near future if proper strategy will be used. Furthermore, changes in policy will give significant impact on revenue elasticity besides changes in real income growth and inflation (Creedy and Gemmell, 2004).

The problem faced by most of the developing countries -- and this of course includes Bangladesh and Pakistan-- is that developing countries face many generic and specific obstacles in implementing tax systems that can meet their unique needs and that will also finance the necessary level of public spending in the most efficient way (Tanzi and Zee, 2000). It is not uncommon that half or more of potential income tax remains uncollected (Bird, 1998). Tax policies in practice differ dramatically between richer and poorer countries. Richer countries rely primarily on broad-based income and consumption taxes and make little use of tariffs as source of revenue. Poorer countries, in contrast, make much less use of broad-based taxes, relying on excise taxes and tariffs. Corruption and red tape are also more common in poorer countries (Gordon and Li, 2005).

While personal income taxes form a significant proportion of tax revenues in high-income countries (around 9-11% of GDP), developing countries raise only around 1-3% of GDP from personal income tax (Peter, Buttrick and Duncan, 2010). Administrations are often under-resourced, resources are not effectively targeted at areas of greatest impact and mid-level management is weak. Domestic and customs coordination is weak, which is especially important for VAT. Weak administration, poor governance and corruption tend to be associated with low revenue collections. As such, the quality of public services and trust in government tends to improve with rising tax effort (e.g. see Bergman, 2002; Leite and Weidmann, 1999). With low or no domestic taxation and a heavy dependence on resource taxation, this link is ruptured (Knack, 2009).

Developing countries have an informal sector representing an average of around 40%, perhaps up to 60% in some countries (Schneider, Buehn and Montenegro, 2010). Tax collection from the informal sector is almost zero. Moreover, Chand and Moene (1997) argue that fiscal corruption is a key factor behind the poor revenue performance in a number of developing countries. There is also strong evidence to suggest that measures taken to reduce corruption could be expected to enhance tax revenue significantly (Gupta, 2007). Tanzi and Shome (1993) argued that tax evasion lowers productivity, results in biased views and behavior of people about public sector in most of developing countries. The strict enforcement of law, quick case processing in court and higher penalties to tax offenders will definitely alleviate the scope of tax evasion and avoidance as found by Fishlow and Friedman (1994).

Most of the tax gap in developing countries comes from noncompliance by individuals and businesses participating in officially recorded economic activities, who are either failing to file tax returns, underreporting tax owed on tax returns, or failing to pay taxes due on time (Rahman and Yasmin, 2008). But the tax gap also includes tax evasion by participants in illegitimate activities in the subversive financial system (Rashid, 2007), that is, the portion of economic activity that goes unrecorded in official economic statistics. These groups are informal suppliers, such as moonlighting professionals who work ‘‘off the books’’ and do not report income or taxes owed (Chowdhury, 2008).

Lutfunnahar (2007) identified the determinants of tax share and revenue performance for Bangladesh along with 10 other developing countries for the 15 years through a panel data analysis. The results obtained suggest international trade, broad money, external debt and population growth to be significantly determinants of tax efforts. The study concluded that Bangladesh and other countries have low tax effort (less than unity index) and are not utilizing their full capacity of tax revenue and therefore have the potential for financing budgetary imbalance through raising tax revenue.

Shil et. al. (2016) mentioned, attaining an optimal tax structure is one of the most important issues for the government to increase the revenue generation from taxes for accelerating growth and to improve the quality of life of the citizens.

3. Methodology:

The study is mainly descriptive in nature. The main objective of the study is to have a comparative picture of resource mobilization through tax revenue in Bangladesh and Pakistan. To fulfill the main objective, the study has aimed at achieving the following specific objectives regarding the comparison between Bangladesh and Pakistan:

- To have a comparative view of their current economic status
- To identify the common features of Bangladesh and Pakistan tax Structure
- To compare the overall tax performance of two countries
- To compare between direct and indirect tax performance

The study is based on secondary data and archival resources. To fulfill the objectives, the study has considered ten fiscal years statistical data covering period from 2005-2006 to 2014-2015. For Bangladesh, tax data and relevant other information was collected from different editions of Bangladesh Economic Review, National Board of Revenue (Bangladesh) Annual Reports, Bangladesh Bank Annual Reports and CIA World Factbook. On the other hand, in case of Pakistan information was collected from the different editions of Pakistan Economic Survey, Federal Board of Revenue (Pakistan) Annual Reports and CIA World Factbook.

In the study, tax structure of Bangladesh and Pakistan was analyzed to have a comparative picture using descriptive statistics, tabular analysis and graphical presentation. The overall tax performance was considered in terms of Revenue-GDP ratio, Tax-GDP ratio, tax revenue collection vs. non-tax revenue collection, share of direct and indirect taxes in the total tax revenue with respective growth rates, Ease of Paying Taxes, Tax performance among SAARC countries etc.

4. Bangladesh vs. Pakistan: A Brief Review of Current Economic Status:

Bangladesh is a lower income, least developed economy located in South Asia with current estimates of its population being around 157.8 million in an area of 148,460 square kilometers. However, with limited land area it is the eighth most populous country in the world with a population density of around 1,252 persons per sq. km. In 2016, Bangladesh's GDP was $221.42 Billion (current) which grew at 7.1% in 2016 which places it 44th ranking in the world based on World Bank 2016 figures (CIA World Factbook, 2017; World Bank, 2016).

On the other hand, Pakistan is a lower-middle income, medium-sized economy located in South Asia with a population of around 204.9 million in an area of 796,095 square kilometers. It is the sixth most populous country in the world with a population density of 251 persons per sq. km. In 2016, Pakistan's GDP was $283.7 Billion (current) which grew at 4.7% in 2016 and placed 40th ranking in the world based on World Bank 2016 figures (CIA World Factbook, 2017; World Bank, 2016). The following table depicts a comparative idea between the economy of Bangladesh and Pakistan:

Table – 1: Bangladesh vs. Pakistan: Current Economic Status

Area of Comparison	Bangladesh	Pakistan
GDP at current market price (PPP)	$628.4 billion (2016)	$988.2 billion (2016)
GDP real growth rate	6.9% (2016) 6.7% (2014-2016)	4.7% (2016) 4.3% (2014-2016)
GDP per capita	$3,900	$5,100
Industrial production growth rate	8.4%	6.8%
Unemployment rate	6.1%	4.9%
Population below poverty line	29.5% (2013 est.)	31.5% (2010 est.)
Tax GDP ratio	10.5	14.2
Budget deficit	5.1% of GDP	4.1% of GDP
Inflation rate (CP)	6.4%	2.9%
Exports	$33.32 billion	$20.96 billion
Import	$39.17 billion	$38.25 billion

Source: CIA World Factbook, 2017

5. Findings and Analyses

5.1 Common Features of Bangladesh and Pakistan Tax Structure

The tax structure of both the countries consists of both direct and indirect taxes. Both the tax systems have undergone through significant reforms over the last two decades leading to the modernization of direct and indirect taxes. Some of the common reform measures are, redrafting complex and outdated tax laws, rationalization of various tax rates, introduction of self-assessment scheme for income tax filing, expansion of consumption taxes scope (e.g. VAT & sales taxes), rationalization of customs duty and tariff structure, introduction of automation and use of IT etc. Moreover, both the countries have taken several comprehensive and continuous plans to re-structure and modernize the entire tax administration and customs operations. Despite the aforementioned reform measures, the ability of the governments to raise tax revenue is constrained by a number of factors which in turn have contributed to the very low level of tax collection. The tax GDP ratio of both the countries is below 15 percent, whereas international empirical evidence on tax-GDP ratio has 40 per cent, 25 per cent and 18 per cent as the average tax ratios for high, middle and low-income countries respectively (Gallagher, 2005).

The weaknesses in the tax system and tax administration have contributed to the very low level of tax collection, undermining the government's capacity to ensure the social welfare and necessary public services. Notwithstanding the various fiscal reforms of the recent past, both the tax systems continues to suffer from a number of major weaknesses namely structural weaknesses including narrow tax base, inconsistent tax policy, low compliance level, excessive exemptions, low coverage and weak audit and enforcement, poor co-ordination among various tax departments which are responsible for low tax to GDP ratio. Tax evasion and avoidance, the extent of the informal economy and lack of transparency is also a major problem in the current tax systems (Rasheed, 2006; Shil et. al 2017).

5.2 Bangladesh vs. Pakistan: Overall tax performance

Despite taking several reform measures, both the countries have been suffering from poor tax effort which put them even below to the low income country's tax effort. The following tables depict a comparative idea about the overall tax performance of Bangladesh and Pakistan for recent ten years (2005-06 to 2014-15):

Table – 2: Revenue-GDP ratio

	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Bangladesh	9.3	9.0	9.6	9.8	10.0	10.4	10.9	11.6	11.7	10.8
Pakistan	13.1	14.0	14.1	14.0	14.0	12.3	12.8	13.3	14.5	14.3

Source: Bangladesh Economic Review 2017 & Pakistan Economic Survey 2016-17

Table – 3: Tax-GDP ratio

	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Bangladesh	7.5	7.1	7.6	7.9	8.0	8.6	9.1	9.7	9.7	9.9
Pakistan	9.8	9.6	9.9	9.1	9.9	9.3	10.2	9.8	10.2	11.0

Source: Bangladesh Economic Review & Pakistan Economic Survey (2002-2013)

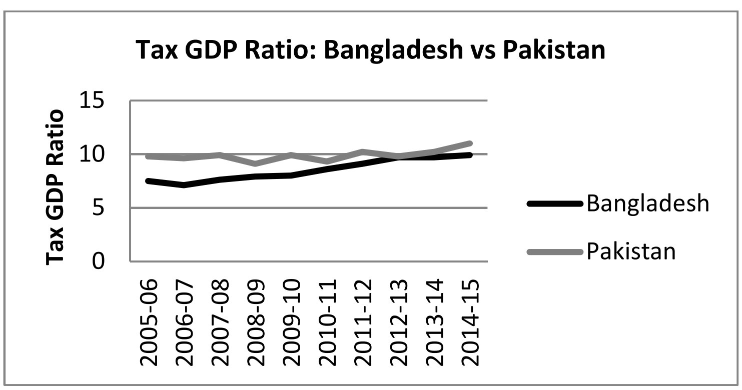
Table – 4: Non-tax-GDP ratio

	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Bangladesh	1.8	1.9	2.0	1.9	1.9	1.8	1.8	1.9	2.0	1.5
Pakistan	3.3	4.4	4.2	4.9	4.1	3.0	2.6	3.5	4.3	3.3

Source: Bangladesh Economic Review 2017 & Pakistan Economic Survey 2016-17

Table 2, 3 and 4 depicts it clearly that throughout the period there was an increasing trend in the revenue-GDP ratio in Bangladesh. On the other hand, although the ratio was more in case of Pakistan during the period, the trend was uneven.

Figure – 1: Tax GDP Ratio: Bangladesh vs Pakistan



In case of Tax-GDP ratio, Bangladesh managed to continue the upward trend whereas Pakistan's performance was not consistent although it has always exceeded Bangladesh. The non-tax revenue-GDP ratio was almost stable in 2 percent during the whole period in Bangladesh whereas in Pakistan it varied from 2.6 to 4.9. Table 5 provides us with the status of Bangladesh and Pakistan's Revenue-GDP ratio among SAARC countries which indicates their inefficiency in revenue mobilization comparing to other countries:

Figure – 2: Tax GDP Ratio: SAARC Countries

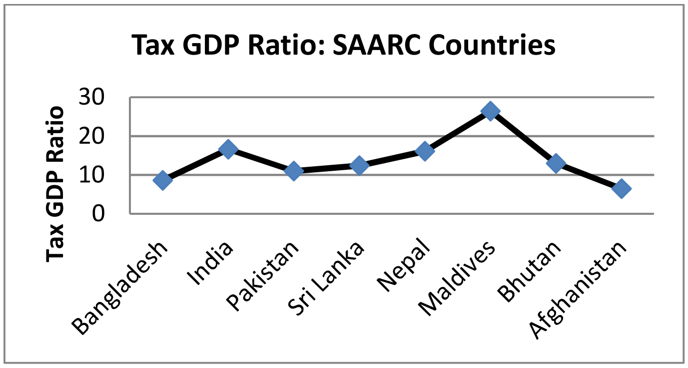


Table – 5: Tax-GDP ratio in South Asian (SAARC) Countries - 2015 (% of GDP)

Bangladesh	India	Pakistan	Sri Lanka	Nepal	Maldives	Bhutan	Afghanistan
8.6	16.6	11.0	12.4	16.1	26.4	13.0	6.5

Source: Heritage 2017 Index of Economic Freedom

Table – 6: Revenue collection

Years	Bangladesh					Pakistan				
	Tax Revenue (Crore Taka)	Non-Tax Rev. (Crore Taka)	Total Revenue (Crore Taka)	Tax revenue (% of Total Rev.)	Non-Tax rev. (% of Total Rev.)	Tax Revenue (Rs Million)	Non-Tax Revenue ((Rs Million)	Total Revenue (Rs Million)	Tax revenue (% of Total Rev.)	Non-Tax rev. (% of Total Rev.)
05-06	36175	8693	44868	80.63	19.37	715712	306992	1022704	69.98	30.02

06-07	39247	10225	49472	79.33	20.67	839598	374445	1214043	69.16	30.84
07-08	48012	12527	60539	79.31	20.69	1009419	393349	1402768	71.96	28.04
08-09	55526	13654	69180	80.26	19.74	1180462	603141	1783602	66.18	33.82
09-10	63956	15528	79484	80.46	19.54	1483046	568899	2051945	72.28	27.72
10-11	79052	16135	95187	83.05	16.95	1634800	509700	2144500	76.23	23.77
11-12	96285	18600	114885	83.81	16.19	1945700	478500	2424200	80.26	19.74
12-13	116824	22846	139670	83.64	16.36	2048500	726800	2775300	73.81	26.19
13-14	130178	26493	156671	83.09	16.91	2374500	1037500	3412000	69.59	30.41
14-15	140677	22964	163371	86.11	13.89	2811800	850800	3662500	76.77	23.23

Source: Authors calculation of data collected from Bangladesh Economic Review 2017 & Handbook of Statistics on Pakistan Economy 2015 (State Bank of Pakistan)

Table – 7: Growth in Tax Revenue Collection

	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	Avg.
Bangladesh	8.49	22.33	15.65	15.18	23.60	21.80	21.33	11.43	8.07	16.43
Pakistan	17.31	20.23	16.94	25.63	10.23	19.02	5.28	15.91	18.42	16.55

Source: Authors calculation

Figure – 3: Growth in Tax Revenue Collection: Bangladesh vs Pakistan

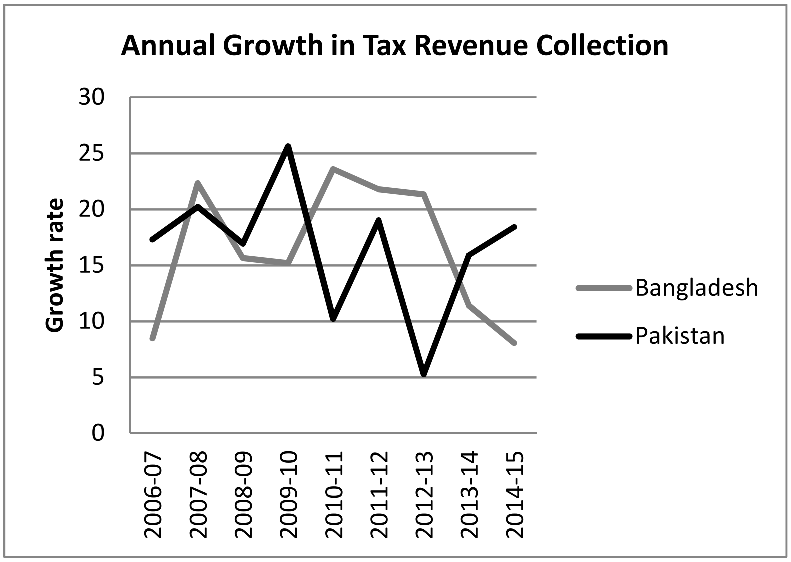


Table 6 and 7 represent that in Bangladesh, the contribution of tax to total government revenue was almost 85% during the period, with a minimum and maximum of 79.31% in 2007-08 and 86.11% in 2014-15. But in Pakistan it was below 80% in most of the years during the period with a minimum and maximum of 66.18% in 2008-09 and 80.26% in 2011-12. The growth in the tax revenue collection was positive with significant fluctuations in both the countries. For both the countries, the average growth rate in the tax revenue was around 16.5% during the decade.

5.3 Bangladesh vs. Pakistan: Ranking in Ease of Paying Taxes among SAARC Countries:

Paying Taxes 2017 is a unique study from PWC, World Bank and IFC. The study provides data on tax systems in 190 economies around the world, with an ability to monitor tax reform considering the full range of taxes paid by the company, measuring how the business complies with the different tax laws and regulations in each economy. According to the study, the ranking of Bangladesh and Pakistan is 151 and 156 respectively among 190 countries (4thand 5th respectively among the SAARC countries.). So considering the ease of paying Taxes, Bangladesh is in a better position comparing to Pakistan.

Table-8: Ranking of Bangladesh and Pakistan in Ease of Paying Taxes among SAARC Countries

Economy	Overall Ranking	Number of Payments	Time to Comply (Hours)	Total Tax Rate (%)
Afghanistan	163	20	275	48.3
Bangladesh	151	33	435	34.4
Nepal	142	34	339	29.5
Pakistan	156	47	312	33.3
India	172	25	241	60.6
Maldives	134	30	406	30.2
Sri Lanka	158	47	179	55.2
Bhutan	19	18	85	35.3

Sources: Paying Taxes 2017, PWC

5.4 Tax Performance in Bangladesh and Pakistan: Direct vs Indirect Taxes

Table – 9: Composition of Direct and Indirect Taxes in Revenue generation

Years	Bangladesh				Pakistan			
	Direct Tax (Crore Taka)	Indirect Tax (Crore Taka)	Total Tax (Crore Taka)	Total Revenue (Crore Taka)	Direct Tax (Million Rupee)	Indirect Tax (Million Rupee)	Total Tax (Million Rupee)	Total Revenue (Million Rupee)
05-06	8303	27872	36175	44868	225000	490712	715712	1022704

1214043	1402768	1783602	2051945	2144500	2424200	2775300	3412000	3662500
839598	1009419	1180462	1483046	1634800	1945700	2048500	2374500	2811800
518979	621919	719462	942646	1040100	1213800	1312700	1490400	1782600
320619	387500	461000	540400	594700	731900	735800	884100	1029200
49472	60539	69180	79484	95187	114885	139670	156671	163371
39247	48012	55526	63956	79052	96285	116824	130178	140677
28972	35510	40464	45175	54460	65274	78129	81857	87757
10275	12502	15462	18781	24592	31011	38,695	48,321	52,920
06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15

Source: Bangladesh Economic Review 2017 & Handbook of Statistics on Pakistan Economy 2015

Table – 10: Proportion and Growth of Direct vs. Indirect Taxes

Years	Bangladesh					Pakistan				
	Direct Tax (% of Total Tax	Indirect Tax as a % of Total Tax	Direct tax growth	Indirect tax growth	Total tax growth	Direct Tax as a % of Total Tax	Indirect Tax as a % of Total Tax	Direct tax growth	Indirect tax growth	Total tax growth
05-06	22.95	77.05	-	-	-	31.44	68.56	-	-	-
06-07	26.18	73.82	23.75	3.95	8.49	38.19	61.81	42.50	5.76	17.31
07-08	26.04	73.96	21.67	22.57	22.33	38.39	61.61	20.86	19.84	20.23
08-09	27.85	72.15	23.68	13.95	15.65	39.05	60.95	18.97	15.68	16.94
09-10	29.37	70.63	21.47	11.64	15.18	36.44	63.56	17.22	31.02	25.63
10-11	31.11	68.89	30.94	20.55	23.60	36.38	63.62	10.05	10.34	10.23
11-12	32.21	67.79	26.10	19.86	21.80	37.62	62.38	23.07	16.70	19.02
12-13	33.12	66.88	24.78	19.69	21.33	35.92	64.08	0.53	8.15	5.28
13-14	37.12	62.88	24.88	4.77	11.43	37.23	62.77	20.15	13.54	15.91
14-15	37.62	62.38	9.52	7.21	8.07	36.60	63.40	16.41	19.61	18.42

Source: Authors calculation of data collected from Bangladesh Economic Review 2017 & Handbook of Statistics on Pakistan Economy 2015

Table 9 and Table 10 show that the tax structure of both the countries is dominated by indirect tax. In Bangladesh there is a decreasing trend in the share of indirect tax whereas in Pakistan the trend is uneven. Both the countries experienced a positive growth in both direct and indirect taxes. From the tables it is clear that both the countries have an effort to reduce the indirect tax burden by emphasizing direct tax collection.

6. Conclusion

The study has been conducted to compare the tax performance between Bangladesh and Pakistan, two of the SAARC countries. It has been observed that the tax GDP ratio of both the countries is around 10 percent which is one of the lowest in the world. In terms of Tax-GDP ratio, the position of Pakistan and Bangladesh is 6 and 7 respectively among the 8 SAARC countries which is an indication of inefficient tax administration coupled with lack of sufficient reform measures. Despite this situation still tax is playing a vital role as the main source of government revenue for both the countries.

There is positive growth in tax collection but growth rate is erratic in both the countries during the years considered. In Bangladesh, the annual growth rate in tax varied from 8.07% to 23.60%, whereas in case of Pakistan it varied from 5.28% to 25.63%. The average growth rate during the decade was around 16.5% for both the countries. Comparing to Pakistan, Bangladesh is in a better position in Ease of Paying Taxes Ranking among SAARC Countries. The tax structure of both Bangladesh and Pakistan is dominated by indirect tax with a share of around 63%. During the period Bangladesh was able to reduce the dominance from 77% to 63%, whereas in Pakistan the rate of reduction was not very significant. Both the countries experienced a positive growth in both direct and indirect taxes with a notable effort to reduce the indirect tax burden by emphasizing direct tax collection. Although Bangladesh and Pakistan has been suffering from a number of obstacles to improve their tax performance, a planned reform initiative with all-out effort for accomplishment can improve their tax-GDP ratio which will help them to tackle their continuous budget deficit.

7. Limitations of the research and future research-horizon

The study was an effort to compare only the tax performance of Bangladesh and Pakistan. It has not considered the non-tax revenue portion which is also an important source for government revenue. The study has also not addressed the identification of the determinants of tax compliance. It is believed that the findings of the study will help to understand the reality of poor tax performance in SAARC countries and to do show a direction to do some more studies regarding the comparison with some more countries.

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