january 2003

fiscal FRONTIERS

a journal of

BCS (customs & excise)

association

Fiscal Frontiers

Fiscal Frontiers

A Journal published by the
Bangladesh Civil Service (Customs and Excise) Association
in connection with the
International Customs Day
January 26, 2003

Editor
Mohammad Alam

Fiscal Frontiers
A Journal of the Bangladesh Civil Service (Customs and Excise) Association
published in connection with the International Customs Day 26th January 2003

january 2003

Editor
Mohammad Alam

Co-Editor
Faizul Latif Chowdhury
Ahmed Munirus Saleheen

Produced by
Yusuf Hassan
ROOP, 15 Naya Paltan, Dhaka-1000, Bangladesh.

Price : Tk. 100 (Abroad : US $ 5.00)

Contents

Editor's Note

It gives me great pleasure to announce the publication of the 5th issue of the *Fiscal Frontiers*, a journal of B.C.S (Customs & Excise) Association of Bangladesh, on the eve of the International Customs Day on 26 January, 2003. It has been a decade since the first issue of *Fiscal Frontiers* was published on 26 January of 1993 - once again on the eve of the International Customs Day 2003.

Even though we could not bring out the *Fiscal Frontiers* regularly and at shorter frequencies our endeavor to contribute to the understanding of the issues like tax policy, development, globalization of international trade, exports growth, duty evasion, smuggling, customs duty, VAT and tax reforms continues through the articles of the *Fiscal Frontiers*. In this context it is very relevant to quote economist Richard Bird: *"O Indeed, the central problem of tax policy in developing countries is how to obtain the necessary revenue while at the same time providing some correction for a typically high degree of inequality in the distribution of income, but without interfering unduly with private saving and investment"*. In this very difficult task of formulating tax policy in a developing country like Bangladesh, the articles of *Fiscal Frontiers* help the policy makers to have a more in-depth and wider insight into the problems of tax collection as this journal contains articles of not only economists and fiscal policy experts but also valuable contribution from the members of the B.C.S (Customs & Excise) Association who are directly involved in tax administration and collection of revenues at the grass root level.

We are thankful to the B.C.S (Customs & Excise) Association for their sponsorship of the publication of this journal. My heartiest thanks go to Mr. Faizul Latif Chowdhury, a member of the Association for his relentless effort in bringing out this publication to light. It is our earnest hope and wish that *Fiscal Frontiers* will continue to play a vital role in understanding the intricate tax issues by the policy makers, experts and general readers.

Mohammad Alam
Commissioner of Customs, Dhaka

Input Tax Credit System in Bangladesh VAT

AHMED MUNIRUS SALEHEEN

There is no denying the fact that it is the credit mechanism that has made the Value- Added Tax an unparalleled tax phenomenon in the history of taxation, sweeping the world in about fifty years. Though the credit mechanism- the system of taking credit of prior stage tax by the taxpayer on the basis of self assessment- outlined in VAT theory rarely varies, the treatment of the credit system in different countries varies to a large extent. And this is in line with the process of adaptation that a VAT has undergone in a country. The pivotal concern of the credit mechanism is input which has fraught the VAT administrators with a number of disturbing problems. The administration of input tax credit poses special problems in developing countries. The apparent discrepancy between the legal provision and the administrative practice coupled with the budgetary expectation has delved the VAT officials into their reluctance of giving input tax credit.

Input in VAT?

The economist's definition of input does not necessarily commensurate with that of the VAT administrator. While the goods or services which are used in for the production of goods or services are called input in economics, the definition of 'input' in the VAT Act of Bangladesh is a rather truncated one leaving a number of bonafide entries outside the purview of input viz. labour, land, office equipment, building etc.[1]

The principle of input tax credit

The principle of the treatment of credit mechanism in Bangladesh VAT has been outlined in the VAT Act, 1991.In section 9 (1) of the VAT Act, it says that with the exception of some cases, the supplier or the businessman of taxable goods or the provider of taxable service may take ***credit of the input tax against the payable output tax*** on goods supplied or service rendered by them. In the following cases, input VAT is not creditable:

a. VAT paid for the purchase of input of exempted goods;

---

[1] The Value-Added Tax Act, 1991 defines 'input' as:
" All raw materials, any kind of gas, any matter used as fuel, packing material, service and machinery and spares, excepting land, labour, building, office equipment and vehicles." [Section 2 (gha)]

b. Turnover tax paid on input procured from turnover tax enlisted person;

c. Supplementary duty paid on the purchase of input;

d. VAT paid on re-usable packing materials other than on its first use;

e. VAT paid on BMRE and the purchase or of repair of all kinds of furniture, stationary items, air conditioner, fan, light fittings, generator, and on architectural planning and design;

f. Vat paid on account of traveling, entertainment, and against the welfare and developmental expense for the staff;

g. Taxpayers paying VAT on truncated base;

h. Taxpayers paying VAT on the basis of tariff value;

i. VAT mentioned in a bill of entry or a VAT challan issued in favour of someone other than the taxpayer himself;

That is to say, as per the VAT Act 1991, in order to get credit of input VAT, a registered person *must*

i. Not pay his/her VAT on truncated base or on the basis of tariff value

ii. Not take credit for purchase of input from turnover tax payer or from an exempt unit

iii. have a tax invoice in prescribed form (Musak-11) or a bill of entry issued in favor of the taxpayer VAT registration number along with the name and address of the same and the amount of VAT being clearly stated on it

iv. Take credit only on those input defined in the VAT Act.

Besides, in case of the following services, the input VAT is partially (60%) creditable:[1]

a. telephone
b. Internet
c. fax
d. audit & accounting firms
e. procurement provider
f. water & sewerage
g. electricity
h. advertisement
i. warehouse
j. insurance
k. clearing & forwarding
l. freight forwarders
m. security
n. legal advice
o. transport, and

[1] See Section 9 (1)(cha)

p. banking service for opening of letter of credit

This is because of the fact that all these services are simultaneously used for business and non-business purposes. But, since there is no watertight compartment between business and non-business use, a notional method of credit allowance has been adopted.

Irregularity and anomaly in input tax credit

Inflating the claims to deduct VAT paid at the earlier stages has been identified as one of the simplest ways of VAT evasion. In Netherlands, is has been estimated that 44 percent of all VAT fraud involved fake claims for prior-stage tax. No such study in Bangladesh has so far been known to have been done. But it is thought that evasion of VAT involving undue input tax credit would be quite high in an evasion prone tax culture like ours. Some of the glaring examples of irregular credit claims detected so far are as follows:

a. a big VAT unit claimed credit for purchases that are not creditable: it claimed credit for VAT paid on the insurance premium of its factory premises (there is blanket prohibition against allowing credit for buildings, etc.)

b. a unit claimed tax credit for the purchase of footwear for its staff

c. credit has been claimed for invoices from unregistered suppliers like internet service provider

d. VAT paid against entertainment bill in a hotel has been claimed

e. A reputed hotel claims credit for customs duty and supplementary duty paid for its purchase (only input VAT is creditable)

f. Huge amount of VAT has been deducted against bills of entry issued in favour of persons other than the taxpayers who are engaged in the business of reconditioned vehicles [violation of section 9(1)(nio)]

g. A government enterprise has been found to have credited VAT for the purchase of finished goods that have not undergone any manufacturing process.

Some Problems encountered by taxpayers in taking input tax credit

According to the existing system, persons paying VAT on tariff value or on truncated base are debarred from taking credit against VAT paid for the purchase of input. This is because of the fact that tariff value or truncated base is determined taking only the amount of value added into consideration. But taking input credit against the purchase of goods assessed on the basis of tariff value or truncated base has infiltrated a great deal of cumbersomeness in the VAT system. This situation could best be illustrated by an example:

The tariff value of per metric ton of edible oil is 4000 taka. And the net VAT payable on this amount is 600 taka. When this edible oil is used as an input in the production of butter oil, what amount of VAT would the butter oil manufacturer take as input credit? The creditable amount of input tax should be the amount of VAT showed in the VAT invoice issued by the edible oil dealer, i.e. 600 taka. But this answer is not too simple to serve the butter oil producer's interest, nor does it comply with the basic principle of avoiding double taxation in VAT system. How? In an ideal situation:

i.	Import price of CDSO	30,000
ii.	VAT paid @15%: 9,000/ Net VAT	9,000
iii.	Value added at the manufacturing stage	4,000
iv.	VAT-able price of soybean oil at the manufacturing stage	34,000
v.	VAT paid @15% at the manufacturing stage: 9,600/ Net VAT:	600
vi.	Value added by the Butter oil manufacturer	1,000
vii.	VAT-able price by the Butter oil manufacturer	35,000
viii.	VAT paid @15% at the manufacturing stage: 9,750/Net VAT	150
	Total government receipt	**= 9,750**

On the other hand, let us assume VAT on soybean oil at the production stage is paid on the basis of tariff value (i.e. a notional value determined by the National Board of Revenue taking the value added into consideration) –

i.	Import price of CDSO	30,000
ii.	VAT paid @15%	9,000
iii.	Net VAT	9,000
iv.	Tariff value of soybean oil	4,000
v.	Net VAT	600
vi.	VAT-able price of Butter oil made of soybean oil	35,000
vii.	Gross VAT paid by the Butter oil manufacturer	5250
viii.	Net VAT	3,600
	Total net VAT at the end of the process: (iii + iv + viii)	**13,000**

In this instance, the Butter oil manufacturer does not get full credit of input VAT paid on input at different previous stages, i.e. at the import stage and the stage of manufacturing soybean oil. The tariff value at the latter stage has broken the credit chain making a glaring scope for double taxation. In order to avoid the anomaly, there should be a system that would enable the

30000 Import
4000 Mfg. soybean
1000 B.O. Mfg.
3500

taxpayers to credit the input VAT paid by the manufacturer of soybean oil at the time of his importation of CDSO as well. The same dilemma is experienced in taking credit for purchase of services and goods in which case VAT has been paid on the basis of truncated base.

Time for taking input tax credit

The most crucial aspect of the treatment of input tax credit is perhaps the *time* i.e. when the input taxes becomes/should being creditable? The philosophy of taking *input tax credit against output tax* outlined in the preamble of the relevant section seems to have been contradicted in what has been stated in the following proviso which connotes the taking of input tax credit as soon as the input enters the business premises. More or less the same connotation is apparent in the VAT Rules where the procedure of crediting input tax has been elaborated in detail. The VAT rules suggest that input VAT can be credited as soon as the input enters the business premises or the input is entered in the purchase register. While most of the taxpayers credit the input VAT immediately after the inventories are made, they have to yield to the persistent pressure from the field officers to make some treasury deposit irrespective of whether there is enough balance in his account current to meet the tax liability. This apparent dichotomy- allowing taxpayer, in one hand, to credit input tax as soon as the input enters the business premises and asking them to make treasury deposit, on the other- requires a threadbare examination.

In an ideal VAT system; one of the features of the VAT is the possibility of generating huge balances in favour of the taxpayer through credit mechanism. Had the balances been of clearly temporary nature, it does not become a problem at all: they would be offset by debit balances in a relatively short period of time. There are situations in which the credit balances not only are created but once created keep growing. Since these situations are very recurrent in Bangladesh economy and government cannot afford to go without fresh treasury deposit for a long time, the taxpayers are compelled to make treasury deposit, whether or not they have enough balance to pay the dues in the from of output tax.

An examination of Tax Returns of 10 VAT units in Chittagong Commissionerate show (Table 1) that all of them made treasury deposit despite the fact that they had enough credit balance to meet the tax liability of the concerned tax period. All these units have been requested by the concerned VAT officers to make treasury deposits equivalent to the monthly budget target fixed for them regardless of whether they have credit balances or not. This is because of the fact that in the NBR revenue target is based on treasury deposit rather than the gross VAT paid by the taxpayers.

Table 1

Unit	Credit balances available in the tax period	VAT payable in the concerned tax period	Treasury deposit
A. Chemical Industries	1,21,24622.00	18,77,686.00	9,06,000.00
B. Tea Producer	67,898.00	25,204.00	10,000.00
C. MS product unit	11,06,226.00	2,39,224.00	1,00,000.00
D. Steel Industries	26,79,785.00	6,02,520,.00	1,25,000.00
E. Chemical Complex	13,29,805.00	6,07,048.00	3,00,000.00
F. Steel Casting Industries	44,70,706.00	20,20,320.00	9,00,000.00
G. Re-rolling Mill	4,84,94,265.00	93,32,849.00	3,00,000.00
H. Engineering Works	1,16,80,796.00	1,07,22,749.00	25,00,000.00
I. Chemical works	2,13,976.00	1,00,989.00	85,000.00
J. MS products	13,87,140.00	3,16,916.00	1,00,000.00

With the exception of multinational units and government enterprises, most of the tax units honor the VAT officers' verbal requests for making treasury deposits good enough to meet the unit-wise budget target, again, fixed by the local VAT office. The unit-wise budget projection is, of course, determined on the basis of the respective unit's previous year's collection of revenue in the form of treasury deposit.

In order to facilitate the collection of VAT in the form of treasury deposit, or, for that matter, to compel the taxpayer to do so, the Chittagong VAT Commissionerate has issued a local order that the amount of net VAT payable on the supplied quantity of goods and services in a particular tax period must be deposited in the treasury, whether or not the unit has the obligation of doing so. The formula for computing the net VAT has been prescribed as:

Net VAT = amount of value added per unit×quantity of units supplied in the tax Period × 15% (rate of VAT)

The system makes sure that regardless of how much balance derived from input tax (i.e. VAT paid against the purchase of input) one has in

one's account current, one will have to pay Net VAT in the form of treasury deposit. On the other hand, because of unexplained reason, some units tend to pile up huge stock of inputs and carry on business without depositing net VAT in the form of treasury deposit for months together.

This system of depositing net VAT is akin to the principle of *input tax credit against output tax*, which can be described as buffer rule that was originated in France and later was adopted, with some changes, in some Latin American countries, such as Argentina and Uruguay. The original French approach meant that the tax paid on purchases could be credited against the tax due on sales and up to the latter's amount and that any excess over the tax on sales was not creditable.[1] However incongruous this treatment of credit balance to the ideal VAT system may seem, so far as the treasury deposit –oriented revenue target is concerned, it is essential that this system of proportionate credit be followed throughout the country.

In fact, the basic principle of the treatment of credit laid down in the Bangladesh VAT Act is to allow " the credit of input tax against output tax" is akin to the French or Argentine practice. This basic principle appears to have been negated, as has been mentioned earlier, in some other provisions of the legislation. But unless the method of 'input tax credit against output tax' is followed, the NBR revenue target should be based on gross VAT rather than on treasury deposit.

Two main arguments that the idealists put forward *against* the treatment of 'input tax credit against output tax' are:

a. failure to credit input VAT immediately alters the nature of VAT by making it, in part, a tax on business rather than on consumption
b. it causes to squeeze business liquidity

Another argument is the problem of operating the system: it would be difficult to maintain daily account of input VAT and output proportionately. In fact, the ultimate reasoning against this treatment rests on theory rather than reality- this system does not fit into the ideal VAT practice. Now the question is: is there any country that implemented VAT without some sort of adaptations? The answer is 'no'. And , in Bangladesh, there is no denying the fact that a number of adaptations in the VAT administration have been made in order to fit it into our socio-economic fabric.

[1] Value -Added Tax: International Practice and Problems; Alan A. Tait; International Monetary Fund, Washington, D.C. ; 1988

If we bear some of the following aspects of Bangladesh VAT scenario in mind, the defense of adopting the input tax credit against output tax may sound more logical:

a. All capital machinery is exempt from VAT. Hence, no input VAT is paid to be creditable against the purchase of capital machinery. This is a big deviation from international VAT practice in order for the business entrepreneurs not to block a considerable amount of their capital on account of input VAT.

b. In case the input VAT exceeds the output VAT, no refund can be claimed

c. There are a number of items such as corrugated iron sheet, edible oil etc. where VAT is collected on the basis of tariff value; manufacturers of these items cannot credit the input VAT as the tariff value is determined taking only the value added into consideration.

The treatment of input tax credit only against output tax will work as an incentive and obligation to go for more production and sale; this system may force the taxpayers to avoid the tendency of having unnecessary inventories at the cost of valuable foreign exchange keeping input in the business premises idle for months together. This system will reduce the misuse of bonded warehouse facility, which allows deferred payment of duties and taxes involved. Mention should be made of the fact that most of the industrial raw materials are imported.

The ideal VAT principle that "all excess of input tax over output tax should be refunded at once" is not followed in many VAT- adopting countries as in Bangladesh. In fact, the VAT legislation in Bangladesh under no circumstances entertains negative value addition resulting in the refund of VAT paid on purchases.[1] Hence, the adoption of the policy of '*input tax credit only against output tax*' would not only be an appropriate adaptation in Bangladesh VAT but would also reflect the budgetary expectation of the country. Even if the *Chittagong model* of depositing net VAT in a tax period is followed throughout the country, there is every likelihood that the revenue collection would increase to a considerable extent- and that would not be at the mercy of the taxpayer, as the case nowadays is.

In case the principle of input tax credit against output tax is followed, necessary changes have to be made in the Account Current register (Musak-18) so that proportionate tax credit can be taken only against output tax. On the other hand, if the system of crediting of input VAT is

[1] See section 5 (2)

In case the principle of input tax credit against output tax is followed, necessary changes have to be made in the Account Current register (Musak-18) so that proportionate tax credit can be taken only against output tax. On the other hand, if the system of crediting of input VAT is
to continue, the principle should be corrected accordingly and the budget target or, for that matter, the revenue statistics needs to be gross -VAT (i.e. output tax) oriented rather than treasury deposit- based.

Tax Compliance Record of Privatized Firms: Results of an Empirical Inquiry

TANWEER AKRAM*

Tax compliance records of a small sample of privatized firms in Bangladesh are examined. Not all firms are registered for tax purposes. Some firms are not registered because they are not operating. The weakness of tax administration's capacity also allows some firms to escape the tax net. Firms that face managerial turmoil following privatization show declines in tax payments. Tax payments of firms that are engaged in loan defaulting decline. In some cases, reactivated privatized firms begin contributing again to the exchequer. Firms that are under able management, or have benefited from favorable market demand conditions, show increases in tax payments. To obtain greater tax revenue payment after privatization both the firm's management and the effectiveness of the tax authorities have to improve. (*JEL* L33, H20, H25, H26)

Introduction

This paper analyzes the tax compliance record of a sample of privatized firms. It investigates the tax compliance and payments history of 13 privatized firms between 1991 and 1996. These firms specifically selected in a recent World Bank study (Dowlah 1997 and 1998). There are several justifications for conducting this study. Firstly, the Bank-sponsored study does not examine their tax compliance records, it is of scientific interest to extend the knowledge concerning these firms by investigating whether their tax payments have increased or decreased after privatization. Secondly, the present study contributes to the literature of post-privatization performance in *low-income developing*

* *Academic Address*: Department of Economics, Columbia University, New York, NY 10027, USA; and Centre for Policy Dialogue, 6/A Eskaton Garden, Ramna, Dhaka, BANGLADESH. *Correspondence Address*: 362 Riverside Drive, Apt 10A2, New York, NY 10025, USA. *E-mail*: ta63@columbia.edu. Phone: +1 (212) 932-3059

Acknowledgments: The author thanks the National Board of Revenue, numerous tax officials, and the management of the concerned firms for providing access to data. The author benefited from Visiting Research Fellowship at the Centre for Policy Dialogue. *Disclaimer*: While every effort has been made to ensure the reliability of the data used, neither the author nor the tax authorities shall be held accountable for any remaining errors or omissions. The author is solely responsible for all opinions expressed in this paper.

n) a statement that disclaims

countries, in contrast to Galal *et al* (1992), another Bank-sponsored report, which draws on case studies of 12 firms, mostly utilities and oligopolies, from *high* and *medium income countries*. Thirdly, methodologically this study proceeds from an empirical investigation of the tax compliance records of selected firms to generalized remarks about privatized firms' tax payments and post-privatization performance, rather than from the arbitrary *a priori* conviction or implicit assumption that privatization will bring about social gains. Again Galal *et al* (1992) provides a typical contrast because they use the case studies mainly as illustrations of the success of privatization although such conclusions are highly dependent upon the construction of counterfactuals and specific values of parameters. Fourthly, firms' tax payments for assessing post-privatization performance have been rarely used in the literature on privatization. This paper contributes to the literature by using tax payments to infer post-privatization firm performance and conduct.

Methodology and Limitations

Firstly, data on tax registration status of the selected firms are obtained from the country's tax authority, National Revenue Board (NBR) of the Ministry of Finance of the Government of People's Republic of Bangladesh. Secondly, after securing permission to investigate the tax records of privatized firms, detailed tax information is obtained from the field offices of the relevant Tax Commissioners. Thirdly, whenever feasible, records are obtained from either public corporations of which the firms were part of during its public ownership phase or the firms' own records. Fourthly, the tax payments records are carefully analyzed in conjunction with any other relevant variables from the available information set. Finally, addition information, concerning the debt-default status of the 13 selected firms, is obtained directly from the central bank.

The main objectives of the analysis are to determine if there has been any change in tax payments and infer, on the basis of tax payments, the change in the level of a firm's activity (output). While the amount of tax payments can be readily determined from the records, the determination of the firm's output from its tax payments is much more tenuous. Firstly, due to the weakness of the tax regime, firms are able to avoid and evade taxes. Thus, tax payments may understate the amount of production and actual profits. Secondly, even with reliable data, it is both difficult and tedious to calculate the value of the output because it depends on the choice of parameters, changes in output mix and product types, and so forth. Despite these limitations, such an exercise is not without merit; if carefully used, it can indicate the direction of change in the level of output.

For this study, the authorities gave access only to indirect taxation data, such as customs duty, supplementary duty, and VAT. This study is based on inferences that can be made on the basis of analyzing indirect tax payments and other available information. Direct tax payments are used for the four public limited companies in the set. Direct taxation figures, which are obtained from their annual reports, are used to compare pre-privatization and post-privatization tax contributions. However, direct tax payments are not available for privately held firms. While information about direct taxes payments of all the firms would have been quite useful, this does not pose a serious limitation in positing the level of activity generated by the firm. A more serious problem for the study is that many of the firms have been unable to provide a good time series about their tax payments. Hence, conjectures about the level of activity are based on rather limited number of observations. Whenever that is the case, the author compensates this loss of data by detailed discussions with tax officials monitoring the firm and, if possible, with the firm's management to learn about the change in firm's tax payments and performance. This study was carried out during the Fall of 1998. In order to ensure privacy, the actual identities of the firms are not revealed here.

Case Study Method: Its Relevance

Case study method is suitable for this inquiry, given the small number of firms in the sample. Case by case approach allows specification of the relevant factors affecting the firm, and close observation of the behavior of the firm.

Before and After Comparisons: Few Caveats

Any kind of before and after comparison of pre-privatization and post-privatization variables must proceed with caution because exogenous factors, rather than the change of ownership, might be responsible of significant differences. Demand conditions can vary due to economic fluctuations, sector specific shocks in tastes, and other factors. Supply conditions too can vary because of changes in technology, cost of inputs, and so on. Even if output is held constant tax payments will rise (decline) if tax rates increase (decrease) or the surveillance capacity of the tax authorities in Bangladesh improves (deteriorates) over time.

The Basic Issues and the Scope of the Study

Privatization of public enterprises in Bangladesh is justified on numerous grounds. One of the main argument is that private ownership of the firm will lead to better management of capital and labor, infusion of additional and appropriate investment, choice of right technology, and so on. Privatization will increase turnover, output, and profit. This will be beneficial not only for the private owner of the firm but also for the state since better and efficient management of the private firm would eliminate the need for continuing state financed equity injections and credit support presently devoted to public enterprises. Indeed, if the privatized firm becomes more profitable and has a higher level of activity under private management, then the authorities would be able to collect more tax revenue from privatized enterprises and instead devote its resources to poverty alleviation. The proposition that tax revenue will increase after privatization is based on some crucial assumptions. Firstly, after privatization the firm will increase its output and profits. Secondly, the management of the firm shall comply with the appropriate tax regulations and shall not avoid or evade taxation. Thirdly, the tax administration will properly monitor privatized firms and will collect the due amount of tax. This paper closely examines, using a small sample of firms, whether privatized firms tax payments have any increase following privatization. It indirectly examines whether the firm's output and profits have increased following privatization.

Bangladesh has privatized a large number of firms. Since 1979 to 1995, according to Sen's (1997) survey, over 200 medium and large firms were privatized. As mentioned earlier, in this study, the tax compliance of only selected 13 firms privatized during 1991 to 1995 are examined. This present work complements recent studies on related issues. Akram (1998), using tax registration data from different offices of the National Board of Revenue (NBR), shows that many privatized firms are not meeting even the minimum registration requirements of tax compliance. Akram (1999) examines the tax registration status of a large sample of debt-defaulting firms in Bangladesh.

The Data Set

The sample of firms selected for analysis consists of the 13 firms that were privatized during 1992-96. NBR databases are used to identify the firm's Taxpayer Identification Number (TIN) and Business Identification Number (BIN). If neither identification number is detected for the firm, then it may be inferred that the firm has been liquidated or is out of operation or has slipped out of the tax net. If the firm is missing both forms of registrations, then it is not paying the applicable taxation. If the firm is found to have either TIN or BIN or both, then a survey questionnaire is sent to the relevant Tax Commissioner's Office in the field. The author visited the relevant Tax Commissioner's Office to explain the questionnaire and objective of the inquiry. The authorities extended full cooperation to the author. An official notification, directing officials to give access to information, was issued by the tax authorities. The management of the firms also helped to complete the questionnaire. Despite full cooperation, the management of some firms was often unable to provide any pre-privatization data because they did not possess such data. In that case, the relevant public corporation was contacted through the Tax Commissioner's Office to obtain the data. In some cases, this yielded results, while in others it did not. Although the questionnaire provided the management of the firms an opportunity to write detailed comments, most firms' officials chose not to comments. If search on the NBR databases did not yield any TIN or BIN then after a revised search with NBR database, a notice is sent to the relevant field office to ascertain the status and the existence of the firm. The following section gives the results of the survey.

In general there was no major increase in the tax rates for the concerned firms during the period studied in this survey. However, VAT was instituted in place of most excise duty since 1991-92. The VAT regime has subsequently been strengthened and its coverage has progressively increased. Thus, some of the gains in tax payments could be due to the increased capacity of the VAT administration to obtain revenue.

Additional data regarding the firms' debt default status, obtained directly from the Credit Information Department of the Bangladesh Bank, the country's central bank, is also provided.

Tax Compliance Records of Selected Firms

Table 1 provides a summary of the tax registration status and compliance of the firms in the sample. It also provides information about the firms' debt-default status: Three firms in the sample are reported to have accumulated overdue loans equal to or greater than Taka 10 million each.

Table 1

Tax Compliance Profile of Privatized Firms

Case	TIN	BIN	Indirect Tax Receipts	Direct Tax Payments	Production Information	Debt-Default	Comments
Firm A	Yes	No	Up	not available	Production Resumed		Resumed Recently
Firm B	No	Yes	Up	not available	Production Resumed		Resumed Recently
Firm C	Yes	Yes	Up	not available	Production Resumed	Defaulter	Resumed Recently
Firm D	Yes	Yes	Up	Down	Production Declined	Defaulter	
Firm E	No	Yes	Down	Down	Production Declined	Defaulter	Major Rentier
Firm F	Yes	Yes	Down	Down	Production Declined		Managerial Problems
Firm G	Yes	Yes	Up	Up	Production Increased		Increased Demand
Firm H	No	Yes	Up	not available	Production Resumed		Production
Firm I	No	No	Zero	not available	No Production		Shut down; & Liquidated.
Firm J	No	No	n.a	not available	not available		
Firm K	No	No	Zero	not available	Outside Indirect Tax		Cottage Industry
Firm L	No	No	n.a.	not available	not available		
Firm M	No	No	Up	not available	not available		

Firm A

The firm has both TIN and BIN. Although the firm was privatized in April 1994, its production has resumed only recently. Its BIN has been approved on July 19, 1997. The firm applied for value approval in November 1998. It also recently obtained permission from the Drugs Administration approving its line of products. The firm's management has been unable to give any definitive pre-privatization tax payments data because the firm had been shutdown for sometime and the ownership changed hands. For many years the firm was not producing anything. The firm has been producing goods and paying taxes starting from the financial year 1997-98.

To the extent that even after privatization production was not resumed for a rather long period of time (1994-1997), there is clearly a loss in terms of output and tax revenue. But the enterprise had been closed down since around 1991 prior to privatization. Other data show that firm was a losing concern from 1985 to 1990, with declining sales revenue. As a result, its tax payment was zero for many years prior to its recent reactivation.

As a result of privatization and reactivation following privatization, presently the firm is now making a contribution to the exchequer. If the management is able to ensure smooth continued production henceforth then there is prospect of increased tax receipt from the firm.

Firm B

Database search did not yield a TIN for the firm. However, in the survey the management reported that it had a TIN and claimed that the firm filed corporate tax returns for the last financial year. But the management did not write down its TIN in the survey questionnaire. The firm has a BIN and is paying VAT.

The firm was privatized in 1994. Figures for three financial years are available. For the 1997-98 figures are till March 1998. The data suggests that tax revenue has increased each year since privatization. The management was unable to provide pre-privatization tax data. The Tax Commissioner's Office was unable to provide any past records, and the relevant public corporation was contacted through the Commissioner's Office but it was also unable to give any data. The management of the firm claimed that its tax payments have increased since privatization.

Firm C

The firm was privatized in August 1994. It has both TIN and BIN. The firm has started production very recently. It began paying VAT since the financial year 1997-98. The data suggests that the firm's level of activity is quite high. The management is unable to provide any pre-privatization tax data. But production related information made available by the Privatization Board suggests that its present output exceed production under public enterprise regime. However, it should be noted that the firm, under its former name, is listed among the leading debt-defaulting firms.

Firm D

The firm has both TIN and BIN. The firm was privatized in August 1993. It reported to have filed corporate tax returns for the financial year 1996-97. The management reported that its tax payments have increased following privatization. Data from financial year 1992-93 to 1997-98 (till April) is available. The data shows that following privatization indirect tax payments have increased steadily over the years. It made provision for income tax until late 1980s. Since late 1980s, it has not paid any income or corporate taxes. Other data shows that for the firm's production from 1988-89 to 1992-93 has steadily declined. Thus, tax payments have increased because either tax rates have gone up or the VAT regime has become more effective, or the prices have gone up. The industry in which this firm operates has experienced a boom due to increased demand, but it also faces more competition from foreign imports due to trade liberalization.

It should be noted that the firm is among one of the leading debt-defaulting firms. Moreover, according to news reports and information provided by the Credit Information Department of the Bangladesh Bank (the country's central bank), the business group with which the firm is tied is a major beneficiary of state directed credit. It not only owes a lot of overdue debt to the nationalized commercial banks but also to its suppliers and small businesses.

Firm E

The firm has multiple BIN. Search in NBR database showed no TIN. The firm's management reported that it filed corporate tax in the last financial year but did not write down its TIN. A good time series was available for the firm from the financial years 1978-79 to 1997-98 thanks to the information provided by the Tax Commissioner's Office. There has been clear and definite decline in indirect tax payments, as acknowledged by the management and seen in the data. Output has declined sharply following privatization in 1993. The firm made direct tax payments until 1990-91 after which it has made no direct tax payments.

The firm is listed among the leading debt-defaulting firms. Indeed, this firm is widely believed to be one of the major debt defaulters with a huge overdue loan that has been intentionally incurred precisely because the owner faces no credible possibility of bankruptcy. The firm is often cited as a classic case of an entity engaged in *rentier* activities taking advantage of distorted financial system and state interventions of various kinds.

Firm F

The firm has both TIN and multiple BIN. The firm filed corporate tax returns for the last financial year. The firm was privatized in December 1994. Although the management reported that its tax payments since privatization has remained the same, but close analysis of the data and the comments provided by the management show a definite decline in its tax payments, compared to early 1990s. Until mid-1980s, it made small direct tax payments. However, since late 1980s, it has not paid any income or corporate tax.

The management's comments (this was the only firm that provided any additional comments) reveal that there has been a loss of output. The management blames the delay in the transfer of control as a major factor in the accumulation of debt, change from positive cash flow to negative, and so forth. According to the management, the firm also faced serious labor problems, desertion of clients, and legal problems. Irrespective of the cause of problems encountering the firm, the management has been unable to overcome the difficulties. The management has failed to anticipate the risks involved in dealing with the authorities and in running an enterprise in Bangladesh. As a result, output has decreased since privatization and correspondingly tax payments have declined.

Firm G

The firm has both BIN and TIN registration. The firm was privatized in June 1992. Both the corporate tax data, obtained from its annual reports, and the indirect tax data, obtained from the survey, show that the tax payments and output has increased since privatization. Indeed, it is a highly profitable firm. Regarding the indirect tax payments, it should be noted that in some years the firm made advance indirect tax payments which were adjusted in subsequent years. The company has been paying good amount of income tax for many years. Its income tax was decreasing from 1991-92 to 1993-94; but it began increasing in 1994-95. Its income tax provision more than doubled in 1995-96 and rose again in 1996-97.

The firm's increase in output and tax payments is indeed impressive thanks to the boom in the construction sector as witnessed by increased building activities in the country, large import of cement, entry of new firms in anticipation of profits, and so forth. However, cross-sectional

data from other firms seem to imply that the rise in output is due to the increase in demand, and not due to improvement in firm efficiency. The firm will face more domestic competition in the future since the industry has witnessed private sector entries.

Firm H

The firm was privatized in February 1995. It has a TIN but NBR database search did not yield any BIN. After inquiry with the relevant Tax Commissioner's Office, it was found that the firm has obtained license for Excise. Data for the firm before 1993-94 was not available. Compared to 1993-94, when the firm was under public management, the firm's tax contribution has improved substantially. But during the transition period, in 1994-95 and the first half of 1995-96, the firm was out of operation. For 1996-97 and 1997-98 there has been substantial improvement in revenue payment.

Firm I

The firm was privatized in March 1992. Search using NBR databases did yield a TIN for the firm. However, upon inquiry with the relevant Tax Commissioner's Office, it turned out that the TIN provided by NBR was spurious. The Commissioner's Office has no information about the firm: The firm is non-operational and therefore cannot be paying any tax at all. A survey questionnaire sent via post to the address of the firm was returned marked 'addressee not found,' which strongly suggests that the firm has been liquidated.

Firm J

The firm was privatized in 1994. Initial search using NBR databases showed no record of any TIN or BIN for the firm. When the relevant Tax Commissioner's Office had been contacted to inquire about the tax registration and compliance of the firm in question, the office was able to provide the firm's TIN. The firm has obtained Excise license. The firm reported filing corporate tax returns for the last financial year. Data for the firm from 1989-90 to 1997-98 were available. The firm's tax payment had been declining in years prior to privatization from 1989-90 to 1993-94. In the year of its privatization, the tax payments fell substantially. However, its tax payments have increased after 1994-95 and exceed its record payments before privatization. Following privatization, the firm has been paying other indirect taxes besides excise.

Firm K

The firm was privatized in February 1995. Search using NBR databases showed no record of any TIN or BIN for the firm. Upon further inquiry with the relevant Tax Commissioner's Office, it was discovered that the firm is producing a commodity that is not taxed under present policies. Therefore, it does not file any documents with the tax authorities on a periodic basis. But the firm is not even filing income tax or corporate tax returns.

Firm L

The firm was privatized in March 1994. Although search using NBR databases showed no record of any TIN or BIN, further inquiry with the relevant Tax Commissioner's Office revealed that the firm is registered for excise duties. The firm's management claimed that it filed corporate tax returns although it did not provide its TIN.

Data for two financial years prior to privatization was available for the firm. The records show a sharp decline in its tax payments in the year prior to privatization. In 1994-95, the financial year in which the firm was privatized, it did not make any tax contribution. Since then, however, its tax payments have been increasing although it is yet to surpass its tax payment in 1992-93.

Firm M

Search using NBR databases showed no record of any TIN or BIN. However, further effort at the relevant Tax Commissioner's Office revealed that the firm is registered and is paying taxes: It is paying Excise (turnover) taxes only.

The firm was privatized in 1994. Data for the firm prior to its privatization was not available. Its tax payments increased for two years after privatization. But its tax payments in 1997-98 declined compared to the year before.

The firm's management claimed that the firm does have a TIN but did not provide it, claiming that this information is available from the company's head office only. The survey question asking whether the firm paid any income/corporate tax in the financial year was left unanswered.

Debt-Default Status

The World Bank (Dowlah 1997) recently conducted a study of 13 selected privatized firms. Although this Bank study regards the privatization experience in Bangladesh as successful and the Bank's economic advice to the authorities endorses rapid and extensive privatization, Dowlah's (1997) study does not analyze the debt-default status of privatized firms. This is a serious gap, given the importance of the loan defaulting phenomenon in Bangladesh. Thus, here information, as of March 31, 1998, concerning those firms are obtained from the central bank and analyzed. Information on 11 firms of the 13 firms is available. Of these 11 firms, as shown in *Table 2*, 5 firms have overdue loans; three firms have outstanding loans but no overdue loans; and only three firms have neither overdue nor outstanding loans. The total amount of loans given to 8 firms is over Taka 1 billion ($21 million), of which Taka 793 million ($17 million) is overdue. The ratio of overdue to outstanding loans is 79 percent. The average (mean) amount of outstanding loans per firm is Taka 126 million ($2.7 million). The total sum of loans given to the 5 firms with overdue loans amounts to Taka 825 million ($17.8 million), of which nearly Taka 793 million ($16.9 million) is overdue. The average (mean) amount of loans given to the firms with overdue loans is Taka 165 million ($3.5 million), of which Taka 158 million ($3.4 million) is overdue. The three firms that have outstanding but no overdue loans have outstanding loans of Taka 189 million ($4.2 million); the average (mean) amount of outstanding loans owed by these firms is Taka 63 million ($1.3 million) per firm. The range breakdowns of outstanding and overdue loans are given in *Table 3a & Table 3b*. Some of these firms have a fairly large amount of loans. The first firm has an outstanding loan of Taka 507 million ($10.8 million), of which Taka 504 million ($10.7 million) is overdue. The second firm has an outstanding loan of Taka 224 million ($4.7 million), all of which is overdue. The third firm has an overdue loan of Taka 61 million ($1.3 million). Two other firms have small amounts of overdue loans. The inability or the unwillingness of the privatized firms to service their debt suggests that these firms have not had any profound improvements in performance after privatization.

Table 2

Debt-Default Status of 13 Selected Firms

(In million Taka)

	No of Firms	Amount	Av. Amount
Total number of firms	13		
Firms for which information is not available	2		
Firms for which information is available	11		
Firms with overdue loans	5	814.7	162.9
Firms with outstanding but not overdue loans	3	189.8	63.3
Firms with neither outstanding or overdue loans	3	0.0	0.0
Total	8	1,004.5	125.6

Source: Bangladesh Bank (1998)

Table 3.a

Outstanding Loans of Selected 13 Firms
Outstanding Loans

(In million Taka)

Range	No of Firms	Amount Outstanding	Av. Average
1 to 5	0		
5.1 to 10.0	1	8.4	8.4
10.1 to 20.0	1	13.8	13.8
20.1 to 50.0	2	75.5	37.8
50.1 to 100.0	1	61.4	61.4
100.1 to 500.0	2	338.0	169.0
500.1 to 1,000.0	1	507.4	507.4
Total	8	1,004.5	125.6

Source: Bangladesh Bank (1998)

Table 3.b

Overdue Loans of Selected 13 Firms

(In million Taka)

Range	No of Firms	Amount Overdue	Av. Average
Upto 5.0	2	3.6	1.8
5.1 to 10.0	0	na	na
10.1 to 20.0	0	na	na
20.1 to 50.0	0	na	na
50.1 to 100.0	1	61.4	61.4
100.1 to 500.0	1	223.7	223.7
500.1 to 1,000.0	1	504.2	504.2
Total	5	792.9	158.58

Source: Bangladesh Bank (1998)

Tax Payments and the Problems of Privatization in Bangladesh

Based on the above analysis of tax compliance records, in conjunction with what is known from earlier studies of privatized firms in Bangladesh (Sen 1997; and Akram 1998), the following observations can be made regarding tax compliance and payments of these firms.

A number of firms that were once under public ownership are not even registered for taxation. Clearly firms that have been liquidated or shut down do not register for taxation or make any tax payments. Privatization is not a remedy for non-viable enterprises, which have to be shut down. Some privatized enterprises that are shut down would be and have been transformed into service activities, outside the realms of current tax net, in accordance with the price and profit 'signals' provided by the market.[5] It is possible that some liquidated firms provide capital and labor that is acquired and absorbed by other firms that do produce

[5] Provided that private ownership of enterprises does not lead to the overall decline of industry, the level of activity and/or productive efficiency, the crucial issue is to attain optimal allocation of capital, labor, and other resources such that the ratio of the social marginal rates of return of the factors of production are equal throughout the economy. To allow this, there should efficient entry and exit policies. Where there are production externalities, or any strategic reasons for investment, the authorities may provide incentives and policy support to promote those activities while ensuring that such support is not 'captured' by vested lobbies and interest groups.

goods and services which are valued by consumer and are taxed by the authorities. If the liquidation of the firm releases resources which are then used in productive activity then the authorities may obtain revenue but not otherwise. Some firms that are reported to be operating may have managed to escape the surveillance of the tax authorities due to the weakness of the tax administration and the connivance of corrupt tax officials. It is also possible that some firms that should be paying VAT are instead paying (lower) Excise duties.

Of the 13 firms studied in this survey, indirect tax payments increased for 7 firms because many of these have resumed production after privatization. Many of these firms that had been shut down while they were in the public sector. These firms were reactivated with some delay after privatization. One firm's indirect tax payments increased although its output decreased. Indirect tax payments have decreased for at least two firms because their production have declined considerably. One of these two has incurred a huge debt that is not being serviced, and the other has serious management problems. Another two firms are not paying any indirect taxes because one of them has been either liquidated or is shut down and the other is producing goods that are not taxed under present VAT/Excise regime. Four firms out of 13 are publicly listed firms. Thus, data on their provision for income tax is available in the public domain from the annual reports filed with the Securities and Exchange Commission. Direct tax payments have declined for three out of the four publicly listed privatized firms in this survey. The fourth firm's income tax payments increased because of a price hike of the commodity it produces.

The survey results lend themselves to a few policy suggestions and observations about privatization in Bangladesh. Firstly, if privatization is to be carried out, the process must be speedy and well managed. Once the privatization process is set off, delays in the process can lead to production loss, accumulation of debt, exacerbation of labor problems, loss of clientele, and so on. Secondly, if privatization is to be effective and welfare enhancing the transition period must be well managed and short so that neither production process is disrupted nor there is any scope for capital depletion. Thirdly, firms that experience considerable managerial turmoil since privatization often show no increase and sometime substantial decline in tax payments. Firms that are engaged in *rentier* activities, such as obtaining loans from nationalized commercial banks with no intention repayment, do not make any effort to increase efficiency because the rate of profit from unproductive activity remains

higher than that of productive activity. In such cases the firm's production falls and its tax payments decline heavily. Fourthly, firms that encounter favorable market conditions or improve efficiency raise output. The authorities may be able obtain more revenue from such firms. It is not possible to determine how much of the increase in revenue owes to increased efficiency and how much to positive demand shock without studying and obtaining comparative cross sectional data of similar firms.

Two crucial factors that effect the possibility of increased tax payments after privatization. These are (a) the rate of the tax and (b) the level of output. Tax revenue critically depends on both[*]. If the tax rate is held constant, firm-level performance and output would have to rise following privatization for increase in revenue. But increased firm-level efficiency is not sufficient by itself. Tax authorities must maintain proper vigilance over privatized firms to ensure their compliance with the tax regulations and to obtain the due amount of revenue.

References

Akram, Tanweer (1998). "Tax Registration Profile of Privatized Firms: Results of an Empirical Investigation," *Center for Policy Dialogue Working Paper.*

Akram, Tanweer (1999). "Tax Registration Status of Defaulting Firms," *Center for Policy Dialogue Working Paper.*

Dowlah, C. A. F. (1997). "Privatization Experience in Bangladesh, 1991-1996." Dhaka, Bangladesh: The World Bank.

Dowlah, C. A. F. (1998). "Benefits of Privatization: Evidence from State-owned Enterprises Privatized in Bangladesh during 1991-1996," *Asia-Pacific Development Journal* 5(2): 45-66.

Galal, Ahmed; Leory Jones; Pankaj Tandon; and Ingo Vogelsang (1992). *The Welfare Consequence of Selling Public Enterprises.* Washington, D.C.: Oxford University Press.

Sen, Binayak (1997). "Whither Privatization: Results of an Exploratory Survey of the Disinvested Industries in Bangladesh." Dhaka, Bangladesh: Ministry of Finance, Government of People's Republic of Bangladesh.

[*] Let tax revenue be tY where, t is the rate of tax, and Y is the level of activity. Therefore, $d(tY) = tdY + Ydt$. Suppose that the authorities hold the tax rate fixed, that is, $dt = 0$; hence, $d(tY) = tdY$. It is assumed here that Y is independent of the tax rate, that is, the tax rate has no effect on the level of activity.

Trade Liberalization and Import Taxes in Bangladesh: An Empirical Investigation

NASIRUDDIN AHMED*

This paper investigates the revenue implications of trade liberalization policies in Bangladesh during the period 1974-1996. The cointegration and error correction modeling approaches have been applied. The empirical results suggest that there exists a unique long-run relationship among import taxes, GDP and import payments. The short-run dynamic behaviour of import taxes has been investigated by estimating an error correction model in which the error correction term has been found to be correctly signed and statistically significant. GDP, import payments (lagged two quarters) and a dummy variable capturing the effect of trade liberalization policies on import taxes have all emerged as significant determinants of import taxes in Bangladesh. However, import taxes are found to be income-inelastic as well as import-inelastic. This study suggests the need for widening the tax base and strengthening compliance in the case of all taxes in order to increase the responsiveness of the tax revenue to GDP changes.

1. Introduction

Taxes on foreign trade constitute substantial sources of revenue for governments of many developing countries. The main type of trade tax has been the import tariff, but in addition, there are the export taxes and the profits of multiple exchange rate systems. Trade tax revenues such as tariffs, import surcharges, and export duties accounted for on average about 28 per cent of total tax revenue in 56 developing countries during the period 1975-89 (Zee,1996). Trade taxes are typically more important in low-income countries, where they often reach 8 per cent of GDP (UNCTAD,1989).

* The author a Deputy Secretary to the Government of Bangladesh. Currently he is working in the Economic Relations Division, Dhaka.

The high dependence on trade taxes may be explained in a number of ways. First, the dependence on import taxes has arisen out of the need to raise revenue, given the predominance of informal sector production in the economy and the consequent narrow domestic base of taxation in many developing countries, including Bangladesh. Secondly, the administrative ease with which trade taxes can be collected makes them an attractive alternative when administrative capabilities are scare. Thirdly, trade taxes, particularly import duties, have the added advantage of being quickly activated. However, domestic taxes and subsidies, not trade taxes, are the best way of correcting domestic distortions (Bhagwati and Ramaswami, 1963).

Empirical evidence from some developing countries (Philippines, India, Kenya, and Pakistan) shows that the marginal economic cost of raising revenue using trade taxes substantially exceeds that of indirect (or commodity) taxes, particularly with respect to the production of tradeable goods (Linn and Wetzel, 1990). For raising a given amount of revenue from commodity taxes on importables, import tariff is less preferable to a sales tax. This is because though both types of tax create distortions, an import tariff not only would add a production-distortion cost, but the consumption-distortion cost would be greater than a sales tax (Corden, 1974).

With the above background in mind, this paper seeks to examine the revenue implications of trade liberalization policies pursued in Bangladesh. Since import taxes contribute about 50 per cent of the government's tax revenue, this paper focuses on the discussion of import taxes in Bangladesh. As the available literature on this area is scanty, the present study will fill some gaps.

This study expresses scepticism about the validity of the results of most of the earlier empirical studies in this area. This scepticism is based on the now universal consensus that it is inappropriate to apply conventional econometric techniques to non-stationary time series.[1] This is because regression methodology appears to encounter spurious regression problems if the variables of interest are nonstationary.

[1] The empirical evidence provided by Nelson and Plosser (1982), Meese and Singleton (1983), DeJong and Whiteman (1991), and Senhadji (1998) has shown that in reality, aggregate economic time-series are not stationary in their levels and therefore contain variances that explode with time.

This study applies a cointegration-error correction modeling strategy. This is because this strategy provides a formal framework for investigating the existence of both long run and short-run relationships among economic time series, each of which is individually nonstationary. This framework helps identify the long-run relationships as well as the short-run dynamics between external sector variables and other macroeconomic variables for trade policy modelling.

2. Analytical Links Between Trade Liberalization and Import Taxes

The direction in which trade liberalization might push government revenues from import taxes is not predictable on *a priori* grounds. Obviously, much depends on the policy mix. Generally, trade policy reforms involve the following measures: (i) reducing tariff rate; (ii) simplifying import taxation; (iii) reducing tariff exemptions; (iv) liberalizing quantitative import restrictions; and (v) reducing impediments to exports (Greenaway and Milner, 1991). To this list is added real devaluation of domestic currency. This is because real devaluations raise the trade tax base by increasing domestic currency values of imports and exports. Let us discuss some of these points.

2.1 Reducing the Tariff Rate

It is argued that the reduction of the average tariff rate reduces tariff collections. For example, Yagci, Kamin and Rosenbaum (1985) agrue that the reduction of tariff reduces government revenue and increases imports, which in turn increases both the budget deficit and the balance of payments deficit. This is because trade liberalization by reducing tariff rates is likely to generate less import tax revenue, assuming a slow and price-elastic response on the part of import demand. A price elasticity that is below unity should generate a net revenue loss, as the decrease in imports demanded will lower the tax base. Empirical evidence shows that import tax revenue as a share of GDP fell in eight tariff reforming countries after tariff reforms[1] (Thomas, Nash and Associates, 1991).

Indeed, potential revenue loss is probably the single most important factor in creating resistance to tariff liberalization. But this does not automatically follow that tariff reduction leads to revenue depletion. In fact, lowering very high tariffs can reduce customs evasion by reducing

[1] The eight countries include Chile, Korea, Mexico, Morocco, Panama, the Philippines, Thailand and Turkey.

incentives to smuggling and other illegal activities, thereby broadening the tax base. Reductions in very high tariff rates (concertina cuts) can increase revenue under some conditions, while proportionate reductions in all tariffs (radial tariff reform) are likely to be revenue-reducing. With price elastic import demand, a fall in tariff rates would lead to a more than proportionate rise in imports and thus to an increase in revenue. The larger the share of imports with such high tariffs, the greater this positive impact.

2.2 Simplifying Import Taxation

Tariff reform attempts to simplify and consolidate a range of existing import specific-taxes into a single rate. For example, the introduction of single-rated value-added tax (VAT) in Bangladesh replaces a multiple rates of sales tax at the import stage and excise duty in the case of goods and services. Consolidation of multiple taxes into a single tax leads to greater transparency. And greater transparency is likely to reduce the scope for duty evasion through misrecording, thereby becoming revenue-enhancing.

2.3 Reducing Tariff Exemptions

Tariff structures in developing countries are characterised by the extent of exemptions provided to different organisations such as international bodies, expenditures financed by project aid, diplomatic groups and parastatal enterprises. Since exemptions are frequently discretionary, there is a tendency for their scope to widen through time. Elimination or reduction of the number of exemptions from import duties, which relate mainly to imported inputs, is unambiguously revenue enhancing. So is replacement of a ban by a nonprohibitive tariff, or a quota by an equivalent tariff. A lowering of very high duties can reduce customs evasion and thereby raise revenue by increasing the share of official transactions in total imports.

2.4 Removing Quantitative Restrictions (QRs) on Imports

Trade policy reform focuses not on the abolition of quotas *per se*, but on their replacement with equivalent tariffs. So long as the equivalent tariff is not prohibitive, this switching of instruments from QRs to tariff liberalization must enhance revenue collections. Moreover, as quantitative import restrictions are reduced, more is imported leading to an increase in trade tax revenues. Empirical evidence from seven quota reforming countries including Bangladesh[1] shows that import tax revenue as a share of GDP rose after import quota reform (Thomas, Nash and Associates, 1991).

2.5 Devaluing Domestic Currency

Real devaluation of the domestic currency raises the price of tradables relatives to that of nontradables. As a result, resources move out of nontradables into tradables sector. In this way real devaluation raises the trade tax base. Thus real devaluation generally has a positive valuation effect on the revenue bases of import taxes, except where the government is a net buyer of foreign exchange (Thomas, Nash and Associates,1991). The positive valuation effect of devaluation that accompanies trade liberalization program has been found useful in mitigating or avoiding revenue declines.

Based on the above analysis, it is difficult to say that trade liberalization undertaken in a country will always be revenue-enhancing or revenue-depleting. However, given the conditions that (i) lowering very high tariff rates[2] may reduce customs evasions by reducing incentives to illegal activities, including smuggling, (ii) consolidation of a range of import tariffs into a single tax (VAT), (iii) replacing quantitative import restrictions with equivalent tariffs, and (iv) real devaluation of domestic currency, trade liberalization is likely to enhance the government revenue from import taxes in Bangladesh. But it is to be pointed out that the increased import tax yields do not necessarily lead to an income-elastic import tax mainly because of narrow tax base in Bangladesh.

3. Import Taxes in Bangladesh

3.1 Structure of Import Taxes in Bangladesh

This study finds an increasing role for import tax in contributing to the government exchequer. Table 1 shows that the average share of import taxes in imports c.i.f., tax revenue and GDP. The average share of import taxes in total tax revenue increased from about 38 per cent during 1986-91 to about 48 per cent during 1992-97.

[1] The seven countries include Bangladesh, Colombia, Ghana, Jamaica, Madagascar, Mauritius and Pakistan.

[2] In Bangladesh the maximum tariff rate was reduced from a level of 350 per cent in 1992 to 42.5 per cent in 1998.

Table 1: Import Taxes in Bangladesh, 1986-97 (in million Taka)

Year	Import Tax (% of Import cif)	Import Tax (% of Tax Revenue)	Import Tax (% of GDP)
1986	17.11	40.61	2.88
1987	18.16	39.74	2.86
1988	16.96	38.84	2.77
1989	15.51	37.73	2.80
1990	16.94	37.30	2.90
1991	18.83	36.41	2.85
1992	24.87	45.91	4.03
1993	25.24	44.20	4.25
1994	23.55	45.72	4.27
1995	21.18	50.07	4.79
1996	21.97	51.15	4.72
1997	22.17	51.11	4.83
Periodic Averages (%)			
1986-91	17.25	38.44	2.84
1992-97	23.16	48.03	4.48

Source: Computed from NBR data.

We find a modest decline in the shares of primary and capital goods imports in total import taxes during the period 1992-97, while those of intermediate goods show an increase, and there were fluctuations in the import of final consumer goods (Table 2).

Table 2: Share of Import Categories in Import Taxes, 1992-97 (%)

Categories	1992	1993	1994	1995	1996	1997
Primary	21.41	24.74	24.71	20.98	18.04	17.90
Intermediate	47.94	46.21	46.14	51.69	54.78	53.73
Capital	18.43	16.36	13.98	13.91	13.96	14.87
Final consumer	12.21	12.69	15.18	13.43	13.22	13.50
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Author's computation based on NBR data.

3.2 Decomposition of Import Taxes

Bangladesh's import taxes are mainly decomposed into (i) customs duty, (ii) value-added tax on imports, and (iii) supplementary duty. The advantage of the system lies in avoiding input taxation and in making transparent the protective and revenue-raising objectives of indirect taxation.

3.2.1 Customs Duty

Customs duty in Bangladesh is designed to meet the dual objectives of raising revenue and providing protection to domestic industries. Historically, Bangladesh has maintained a highly protective tariff structure mainly to promote domestic industries. This has actually been counterproductive, helping in the setting up of inefficient industries. This has also led to improper allocation of resources and discouraged export industries (Hossain, 1996). The result of the reform in customs duty in Bangladesh is given in Table 3.

Table 3: Implementation of Customs Duty Reform in Bangladesh, 1992-97

Items	1992	1993	1994	1995	1996	1997
No. of CD rates	18	15	12	6	7	7
No. of HS codes with zero rate of CD	348	315	320	1256	1319	1417
Items with CD rate up to 25% range	25.01	23.68	21.00	20.48	26.63	26.50
Items with CD rate above 25% and not exceeding 50%	32.47	38.77	48.40	55.31	73.37	73.50
Items with CD rate above 50%	42.52	37.55	30.60	24.21	...	...

Note: ... indicates nil.
Source: Author's compilation based on NBR data.

It is evident from Table 3 that the number of *ad valorem* customs duty was reduced gradually from 18 in 1992 to 7 in 1997. The compression of CD rates is further evidenced by the reduction of the number of Harmonised System (HS) codes with CD rates of above 50 per cent over the period.

3.2.2 Value-Added Tax

The value-added tax (VAT) introduced in July 1991 at a uniform rate of 15 per cent has a wider tax base than that of the taxes it replaced, such as sales tax at the import stage and excise duty in the case of domestic goods and services. Unprocessed agricultural goods, forests, fisheries,

and livestock are exempt from VAT. Since VAT has a larger tax base than the taxes it has replaced, the elasticity of VAT is expected to be a little higher than that of sales tax and excise duty.

3.2.3 Supplementary Duty

Some more reforms in the tariff structure occurred with the removal of the development surcharge and the regulatory duty on imports at the beginning of FY 1991-92. A supplementary excise duty, which can be viewed as a trade-neutral consumption tax, was introduced to replace regulatory duties and surcharges on imports.

This study shows a sharp decline in trade-distorting customs duty from about 67 per cent in 1992 to about 54 per cent in 1997. On the other hand, we observe a modest increase in trade-neutral instruments like VAT collection from about 32 per cent in 1992 to about 39 per cent in 1997. Similarly, we find an increase in SD collection from about 2 per cent in 1992 to about 7 per cent in 1997 (Table 4).

Table 4: Decomposition of Import Taxes in Bangladesh, 1992-97 (%)

Categories	1992	1993	1994	1995	1996	1997
CD	66.68	62.69	61.64	59.81	55.68	54.42
VAT	31.73	36.79	37.02	36.95	38.58	39.03
SD	1.59	0.52	1.34	3.24	5.74	6.55
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Author's computation based on NBR data.

4. Modeling an Aggregate Import Tax Function for Bangladesh

Theoretically, revenue received from a particular tax is simply equal to the tax base multiplied by the tax rate. Tax rates are determined legislatively or by administrative fiat issued by the government. Thus to find tax yield only tax base has to be estimated (Sahota, 1975). However, a differentiated tax rate structure, various exemptions, extensive tax evasions and administrative inefficiency often make the relationship between tax yield and the tax base complex.

In this study a straightforward formulation of import tax as a function of its tax base is used. Following Jahan (1983), Hossain (1995) and Rahman and Shilpi (1996), import tax function is expressed in nominal terms on the following grounds. Firstly, on the basis of economic theory, the government revenue in nominal terms is taken to be functionally related to the level of current national income. Secondly, since customs duty on imports accounts for about 54 per cent of the total import taxes and since this duty is mainly *ad valorem* in nature, total imports in nominal terms should appear as a variable in the model. Thirdly, the import tax function has been specified in nominal terms because real taxes have less policy relevance (Rahman and Shilpi, 1996).

We know that in Bangladesh import taxes are decomposed into customs duty (CD), value-added tax (VAT) on imports and supplementary duty (SD). Both VAT and SD have no protective effect since they are imposed equally on imports and domestic production. So we take CD as the proxy for import taxes. Moreover, CD constitutes a major portion of import taxes in Bangladesh.

Per capita GDP and foreign trade (ratio of export plus import to GDP) are regarded as major explanatory variables of tax effort of developing countries (Greenaway,1984; and Gemmell, 1993) Increased economic growth leads to more imports. Obviously, the ability to pay taxes increases with prosperity as a consequence of economic growth. So GDP at current prices is an important determinant of import tax revenue. Since import tax revenue changes due to change in import payments, we incorporate imports c.i.f. as a variable determining import tax.

Finally, our intention is to see the impact of trade liberalization on import taxes. So we include an intercept dummy variable in the model to capture the effect of trade liberalization on import taxes in Bangladesh. We hypothesise that import tax effort in Bangladesh is positively related to economic growth, the size of the import trade and trade liberalization policies.

The long-run import tax function for Bangladesh, therefore, is specified as:

$$LCD_t = \alpha_0 + \alpha_1 \, LNGDP_t + \alpha_2 \, LNM_t + \alpha_3 \, D_t + u_t \qquad (1)$$

where CD = customs duty at current prices;

NGDP = GDP at current prices;

NM = the size of imports at current prices;

D = an intercept dummy variable with values 0 for 1974-91 and 1 for 1992-96 to capture the effect of trade liberalization on import taxes;

u = random disturbance term with its usual classical properties; and

L = natural logarithm.

It is expected that $(\alpha_1, \alpha_2, \alpha_3) > 0$.

If the time series variables of LCD_t, $LNGDP_t$ and LNM_t have unit roots, then we need to take the first difference of the variables (as in equation 2) in order to obtain stationary series:

$$\Delta LCD_t = \alpha_0 + \alpha_1 \Delta LNGDP_t + \alpha_2 \Delta LNM_t + \alpha_3 D_t + u_t \qquad (2)$$

Equation (2) ignores any reference to the long-run aspects of decision-making. That is, this procedure of differencing results in a loss of valuable "long-run information" in the data (Maddala, 1992). The theory of cointegration addresses this issue by introducing an error-correction (EC) term. The EC term lagged one period (*i.e.*, EC_{t-1}) integrates short-run dynamics in the long-run import tax function. This leads us to the specification of a general error correction model (ECM):

$$\Delta LCD_t = \beta_0 + \sum_{i=1}^{n} \beta_{1i} \Delta LCD_{t-i} + \sum_{i=0}^{n} \beta_{2i} \Delta LNGDP_{t-i} + \sum_{i=0}^{n} \beta_{3i} \Delta LNM_{t-i} + \beta_4 EC_{t-1} + \beta_5 D_t + \varepsilon_t \qquad (3)$$

where, EC_{t-1} = error-correction term lagged one period.

The modeling strategy adopted in this study involves three steps:

(i) determining the order of integration of the variables by employing Augmented Dickey-Fuller (ADF) and Phillips-Perron unit-root tests;

(ii) if the variables are integrated of the same order, we test for cointegration by applying the Johansen -Juselius (1990) approach; and

(iii) if the variables are cointegrated, we can specify an error correction model and estimate it using standard methods and diagnostic tests.

5. Empirical Analysis

5.1 Summary Statistics

Data on CD, NGDP and NM for the 1974-1996 period are shown in Table 5 as are their means, standard deviations (SDEV), coefficients of variation (CV), and annual compound growth rate.

Table 5

Summary Statistics of the Variables

	Variables Description	Mean	SDEV	CV	Annual Compound Growth Rate (%)
CD	Customs duty at current prices	3506.1	2557.8	0.73	14.20
NGDP	GDP at current prices	126731.2	92453.6	0.73	12.98
NM	Imports at current prices	23219.5	18839.9	0.81	14.21

Note: Annual compound growth rates are trend values significant at 5 per cent level.
Source: Author's calculation based on IMF's *International Financial Statistics* (various issues).

5.2 Unit-Root Tests

The data used for investigating the aggregate import tax function for Bangladesh cover the period 1974:1 - 1996:4. Variable definitions and sources of data used are discussed in Appendix 1. We have conducted the Augmented Dickey-Fuller (ADF), and Phillips-Perron (PP) Unit-root tests. These unit-root tests are performed on the levels and the first differences of all the three variables.

The ADF tests (Table 6) show the existence of unit-roots, and therefore, non-stationarity, in the levels of the three variables, LCD, LNGDP and LNM. However, the first differences of these variables are stationary under the test. The Phillips-Perron (PP) unit-root test (Table 7) does confirm stationarity for all the three variables. Hence we conclude that these three variables are integrated of order 1.

Table 6

ADF Unit-Root Tests for Stationarity

Variables	Levels/First Differences	Optimum Lag Length	Without Trend	With Trend	Conclusion
LCD	Levels	2	-2.31	-3.99	I(1)
	First Differences	2	-10.01	-10.33	I(0)
LNGDP	Levels	2	-2.37	-2.55	I(1)
	First Differences	7	-9.79	-13.57	I(0)
LNM	Levels	1	-0.63	-2.91	I(1)
	First Differences	1	-8.89	-8.83	I(0)

Notes:

i. Unit-root tests were performed using Microfit 4.0.
ii. 95% critical values for ADF statistic (without trend) = -2.90
iii. 95% critical values for ADF statistic (with trend) = -3.46

Table 7

Phillips-Perron (PP) Unit-Root Tests for Stationarity

Variables	Levels/First Differences	Without Trend	With Trend	Conclusion
LCD	Levels	-2.61	-3.35	I(1)
	First Differences	-12.61	-13.50	I(0)
LNGDP	Levels	-1.80	-3.38	I(1)
	First Differences	-5.30	-5.37	I(0)
LNM	Levels	-1.33	-3.37	I(1)
	First Differences	-15.69	15.82	I(0)

Notes:

2. PP test was performed using SHAZAM 8.0
3. The critical values at 95 per cent level for constant and no trend, and constant and trend are -2.57 and -3.13 respectively.

5.3 Cointegration Tests

Before undertaking cointegration tests, let us first specify the relevant order of lags (p) of the Vector Autoregression (VAR) model. Given the quarterly nature of the data used, $\rho = 2$ seems to be a reasonable choice (Pesaran and Pesaran, 1997). On the basis of the above unit-root tests, we apply the Johansen (1988 and 1991) and Johansen and Juselius (JJ) (1990, 1992, 1994) test.

In Table 8 the results of both maximal eigenvalue and trace tests are reported. Both test results suggest r = 1. Therefore, we conclude that there is only one cointegrating relation among the three I(1) variables of LCD, LNGDP and LNM.

Table 8:
Johansen-Juselius Maximum Likelihood Cointegration Tests

Null	Alternative	Statistic	95 % Critical Value
		Maximal Eigenvalue Test	
r = 0	r = 1	43.08	21.12
r ≤ 1	r = 2	10.99	14.88
r ≤ 2	r = 3	1.98	8.07
		Trace Test	
r = 0	r ≥1	56.05	31.54
r ≤ 1	r ≥2	12.97	17.86
r ≤ 2	r ≥3	1.98	8.07

Notes: (i) The test was performed using Microfit 4.0.
(ii) r stands for the number of cointegrating vectors.

Estimates of long-run cointegrating vector are given in Table 9.

Table 9: Estimates of Long-Run Cointegrating Vectors (Linearised)

LCD	LNGDP	LNM
1.00	1.22 (0.16)	0.33 (1.14)

Notes: 1. The long-run equilibrium relation is
LCD = 1.22LNGDP + 0.33LNM
2. Figures in parentheses indicate standard errors.

5.4 Estimation of an Error-Correction Model

Once a cointegrating relationship is established, then an ECM can be estimated to determine the short-run dynamic behaviour of endogenous growth around its equilibrium level. Following Hendry's (1995) *general to specific modelling approach*, we first include 4 lags of the explanatory variables and of the error correction (EC) term, and then gradually eliminate the insignificant variables. After experimenting with the general form of ECM (equation 3), the ECM shown in Table10 is found to fit the data best.

Table 10: Estimated Error-Correction Model

Dependent Variable = ΔLCD			
Regressor	Parameter Estimate	T-Ratio	P-Values
Intercept	-0.49	4.88	.00
ΔLNGDP	0.61	1.78	.08*
ΔLNM(-2)	0.14	2.24	.03
D	0.05	-1.69	.09*
EC(-1)	-0.30	-5.43	.00

Adj $R^2 = 0.34$

D. W. = 2. 31

Serial Correlation = 7.15 (0.13)

RESET = 1.51 (.22)

Normality = 3.71 (.16)

HET = .01 (.91)

Notes: Figures in bracket indicate p-values.
* significant at 10 per cent level.

In the model, nominal GDP and import payments (lagged two quarters), and the dummy variable have all emerged as significant determinants of import revenue in Bangladesh. The income elasticity of import taxes is less than unity, implying the need for adopting discretionary budget measures to raise necessary revenue to meet the required public expenditure. The error correction coefficient, estimated at -0.30 is statistically significant at any level, has the correct sign, and suggests a moderate speed of convergence to equilibrium. The diagnostic test statistics show no evidence of misspecification of functional form, no serial correlation, nor any problem of heteroscedasticity and no problem of non-normality in the residuals. We have also checked the problem of multi-collinearity and found no such problem.

6. Major Findings and Conclusions

In our empirical investigation of the aggregate import tax function for Bangladesh, cointegration and error correction modeling approaches have been. We find a unique equilibrium relationship among import taxes, GDP at current prices and the size of imports at current prices. In order to determine the short-term dynamics around the equilibrium relationship, we estimated an error correction model (ECM).

The findings of the study show that import tax revenue is both income-inelastic and import-inelastic, even though the tax yields under import taxes have increased over the period under study. This implies that the rate of growth of import tax revenue tends to fall behind that of GDP and import respectively. The major factor behind inelastic import tax is an increasing degree of tax evasion in the form of mis-declared imports. The numerous measures for exemption designed as investment incentives provide the scope for loopholes in the system (Sobhan, 1993). The existing nominal tariff protection structure still exhibits considerable dispersion around the average rate, and there are numerous exemptions/concessions. These features, together with the use of discretionary tariff values for import valuation and multiple tariff slabs render Bangladesh's tariff system complex and less transparent, leaving considerable room for discretionary decisions and rent-seeking behaviour at the customs.

The policy implications are straightforward. In view of the inelastic nature of import taxes, the government has to take discretionary revenue-raising measures in the annual budget in order to keep the tax-GDP ratio at the same level. In order to increase the responsiveness of the tax revenue to GDP changes, it is thus necessary to widen the tax base and strengthen compliance in the case of all taxes. This apart, improving the quality of tax administration should be a major policy concern in revenue mobilisation.

References

Ahmed, Nasiruddin (2001), *Trade Liberalization in Bangladesh: An Investigation into Trends*. Dhaka: University Press Limited.

Alam, M. (1995), *Trade and Financial Liberalization in Bangladesh*. Dhaka: Desh Prakasan.

Bhagwati, J. N. and V. K. Ramaswamy (1963), "Domestic Distortions, Tariffs and the Theory of Optimum Subsidy," *Journal of Political Economy*, **71(1)**: 44-50.

Chowdhury, O. H. (1997), "A Review of the Fiscal Sector of Bangladesh in 1996", in Rehman Sobhan (ed.) *Growth or Stagnation? A Review of Bangladesh's Development 1996*. Dhaka: Centre for Policy Dialogue and University Press Limited: 99-113.

Corden, W. M. (1974), *Trade Policy and Economic Welfare*. Oxford: Clarendon Press.

Dickey, D. A. and W. A. Fuller (1981), "Likelihood Ratio Statistics for Autoregressive Time Series with a Unit Root," *Econometrica*, **49(4)**: 1057-1072.

Easterly, W. and S. Rebelo (1993), "Fiscal Policy and Economic Growth: An Empirical Investigation", *Journal of Monetary Economics*, **32(1993)**: 417-458.

Engle, R. F. and C. W. J. Granger (1987), "Cointegration and Error Correction: Representation, Estimation and Testing", *Econometrica*, 55: 251-76.

Gemmel, N. (1993), "Fiscal Dependence on Trade Taxes and Economic Development: Some New Evidence", *Scottish Journal of Political Economy*, 40(1): 56-68.

Gandolfo, G. (1981), *Qualitative Analysis and Econometric Estimation of Continuous Time Dynamic Models*. Amsterdam: North-Holland Publishing Company.

Greenaway, D. (1984), "A Statistical Analysis of Fiscal Dependence in Trade and Economic Development", *Public Finance*: XXXIX(1):70-89.

Greenaway, D. and C. Milner (1991), "Fiscal Dependence on Trade Taxes and Trade Policy Reform", *The Journal of Development Studies*, 27(3): 95-132.

Hendry, D. F. (1995), *Dynamic Econometrics*. Oxford: Oxford University Press.

Hossain, A. (1995), *Inflation, Economic Growth and the Balance of Payments in Bangladesh: A Macroeconomic Study*. Delhi: Oxford University Press.

----- (1996), *Macroeconomic Issues and Policies: The Case of Bangladesh*. New Delhi: Sage Publications.

Hossain, M. Z. (1997), "Domestic Resource Mobilization in the Public Sector", in M. G. Quibria (ed.), *The Bangladesh Economy in Transition*. Delhi: Oxford University Press.

International Monetary Fund, *International Financial Statistics* (various issues).

Jahan, S. (1983), "Money, Income and the Balance of Payments of Bangladesh: A Macroeconomic Model," (unpublished Ph.D. Dissertation), Department of Economics, McGill University, Canada.

Johansen, S. and K. Juselius (1990), "Maximum Likelihood Estimation and Inference on Cointegration with Applications to the Demand for Money", *Oxford Bulletin of Economics and Statistics*, 52: 169-210.

Linn, J. F. and D. L. Wètzel (1990), "Public Finance, Trade and Development: What Have We Learned?,", in Vito Tanzi (ed.), *Fiscal Policy in Open Developing Economies*. Washington, D.C.: IMF: 9-28.

Little, I. M. D., R. N. Cooper, W. M. Corden and S. Rajapatirana (1993), *Boom, Crisis and Adjustment: The Macroeconomic Experience of Developing Countries*. Oxford: Oxford University Press for the World Bank.

Maddala, G. S. (1992), *Introduction to Econometrics* (Second Edition). Englewood Cliffs, NJ: Prentice Hall, Inc.

Pesaran, M. H. and B. Pesaran (1997), *Working with Microfit 4.0: Interactive Econometric Analysis*. Oxford: Oxford University Press.

Phillips, P.C.B. and P. P. Perron (1988), "Testing for a Unit Root in Time Series Regression," *Biometrika*, 75: 335-46.

Rahman, S. H. and F. J. Shilpi (1996), A *Macroeconometric Model of the Bangladesh Economy: Model, Estimation, Validation and Policy Simulation.* Dhaka: Bangladesh Institute of Development Studies.

Sahota, G. S. (1975), *Brazilian Economic Policy, An Optimal Control Theory Analysis.* New York: Praeger Publishers.

Sobhan, R. (1993), *Bangladesh: Problems of Governance.* Dhaka: University Press Limited.

Thomas, V., J. Nash and Associates (1991), *Best Practices in Trade Policy Reform.* Oxford: Oxford University Press for the World Bank.

UNCTAD (1989), *Trade and Development Report 1989.*

World Bank (1989), *Bangladesh: An Agenda for Tax Reform.* Washington,

D. C.: The World Bank.

Yagci, F., S. Kamin and V. Rosenbaum (1985), "Structural Adjustment Lending: An Evaluation of Programme Design," *World Bank Staff Paper No. 735.* Washington, D. C.: The World Bank.

Zee, H. H. (1996), "Empirics of Crosscountry Tax Revenue Comparisons," *World Development,* 24(10): 1659-1671.

Appendix 1: Variable Definitions and Data Sources

In this paper we have used quarterly data for the period 1974 - 1996. Natural logarithms are taken on all variables.

CD: Customs duty at current prices.
Source: Government of the People's Republic of Bangladesh (1998), ETAC database, National Board of Revenue.

NGDP: Gross Domestic Product at current prices. Since the data are annual, we have made quarterly interpolation from annual observations using Gandolfo's (1981) methodology.
Source: IMF, *International Financial Statistics* (various issues).

NM: The size of imports at current prices.
Source: IMF, *International Financial Statistics* (various issues).

D = An intercept dummy variable with values 0 for 1974Q1-1991Q4 and 1 for 1992Q1-1996Q4 is taken to capture the effect of trade liberalization on import taxes.

Indo-Bangladesh Informal Border Trade: Reflections from an empirical study in selected areas[•]

ATIUR RAHMAN[▲]

1. Introduction

International trade does play a vital role in the growth and development of a country. The basis of international trade is the comparative advantage, which implies that flow of goods will take place from efficient low cost producers to inefficient high-cost producers. The theory of comparative advantage thus suggests that free trade would lead to the efficient allocation of resources across the trading countries and within their respective economies as well. That trade acts as an 'engine of growth' is well-established by now through the growth experience of the western economies and as well as the East Asian Countries. In fact, the growth rate of individual countries since the 1950's correlates better with export performance than any other single economic indicator (Thirlwall 1986). This trend further emphasizes the role of trade and outward-oriented strategy in the economic development of a country.

But the poor base of the industrial sector in the domestic economy and weak comparative advantage emanating from the inefficient operation of the industries had been constraining many developing countries in realizing the benefits of trade. In this backdrop, most of the poor countries adopted a policy of import substitution in order to promote their industrial development. Such policies required the restriction of foreign trade flows by deliberately adopting policies that include, *inter alia*, erecting tariff wall, maintaining overvalued exchange rate, direct controlling of import through quantitative restrictions on both import items and foreign exchange as well. However, the restrictive trade policies adopted under the protectionist regime have had a number of

[•] A paper presented at a seminar on "The Effect of Smuggling on Bangladesh Economy" organized by the National Board of Revenue, Dhaka on March 29, 2000. Paper is based on the original study by Atiur Rahman and Mohammed Abdur Razzaque, Informal Border Trade between Bangladesh and India (unpublished), BIDS, Jyly 1998.

[▲] The writer is a Senior Research Fellow at the Bangladesh Institute of Development Studies.

negative consequences in the economy as the high rate of protection breed inefficiency and more importantly act as a tax on exports by keeping costs and the exchange rate high. Having realized this the developing countries are now rapidly liberalizing their domestic economy although the infant industry argument for providing protection to particular set of industry for a limited period of time still remains valid.

Trade policies have historically been restr4ictive in Bangladesh and tariffs and non-tariff barriers such as quantitative restriction have been used to restrict free flow of imports into the domestic economy. Such restrictive policies tend to reflect the policy makers' concern about the need to raise revenue, reduce to pressure on balance of payments and offer protection to domestic industries to encourage import substitution. The cost of these policies to the national economy appears to be very high. The inevitable price distortions resulting from these policies are expected to channel resources to import competing industries because protection permits domestic industries to operate value added with higher than that of prevailing under free trade thereby providing incentives for the movement of resources into the protected industries. Incentives for import substitution and against exports market while getting the world price on export sales, although paying the same price for imported items.

However, it should be noted here that the persuasion of such a restrictive policy may result in widespread illegal trade activities within the protected economies. Such illegal trade restrictions could lead to rent seeking, tariff restrictions could lead to revenue seeking, both involving wastage. Whatever may be the sources and reasons for illegal trade it is for certain that such activities adversely affect the government's revenue effort and erode the protection given to the domestic industry?

Cross border informal trade has been the major characteristics of Bangladesh's trade with India. Generally foreign trade between two neighboring countries may occur and prosper on the basis of demand-supply ahd price factors of the traded goods. There is no debying the fact that if official trade is obstructed wither on economic or non-economic reasons informal or unofficial trade will take place. This is particularly so for the neighboring countries with long borders such as India and Bangladesh. It has been argued that besides Bangladesh's restrictive trade policies, the flourishing nature of smuggling flows from the differences in the level of development between India and Bangladesh (Chaudhari, 1995).

2. Methodology

The present report is based on the empirical survey of five border thanas in Bangladesh, namely, Daulatpur in Kushtia, Sharsa in Jessore, Comilla Sadar in Comilla, Kamalganj in Maulavibazar, and Shibganj in Chapai Nawabganj district. The broad objectives of the study are to analyze (i) the nature and extent of smuggling operation, (ii) volume and value of illegal trade of selected items through the surveyed ceentres (iii) price differentials of the commodities that are traded illegally (iv) the internal dynamics of illegal trade (i.e. structure of illegal trade, routes of smuggling operation and routes of distribution of smuggled goods, role of various intermediaries, etc.) (v) modes of financing and payments used in smuggling and (vi) the role of law enforcing agencies in combating illegal trade. One of the limitations of the study is that it did not consider the Southeastern Coastal belt and Chittagong in particular as its coverage.

Table 1

Occupational pattern of the respondents

Occupation	1 Shibganj, Nawabganj	2 Sharsha, Jessore	3 Daulatpur, Kushtia	4 Comilla Sadar, Comilla	5 Kamalganj, Moulavi Bazar	Total
Smuggling	9 (45.0)	11 (55.0)	12 (60.0)	10 (66.0)	6 (40.0)	48 (53.33)
Teacher	2 (10.0)	3 (15.0)	-	-	1 (6.7)	6 (6.7)
Small shopkeeper	4 (20.)	3 (15.0)	4 (20.0)	3 (20.0)	4 (26.7)	18 (20.0)
Service	3 (15.0)	2 (10.0)	1 (5.0)	1 (6.7)	1 (6.7)	8 (8.9)
Transport worker	1 (5.0)	1 (5.0)	2 (10.0)	1 (6..7)	1 (6..7)	6 (6..7)
Local journalist	1 (5.0)	-	1 (5.0)		1 (6..7)	
NGO worker	-	-	-	-	1 (6..7)	1 (1..1)
Total	20 (100.0)	20 (100.0)	20 (100.0)	15 (100.0)	15 (100.0)	90 (100.0)

Source: Field survey, 1998.

3. The Conceptual Issues:

Illegal trade can be define as the unofficial and unreported activities related to the use of either the illegal channels or the legal channels of trade which is accompanied by evasion of duties, secret transportation of 'banned' items, violation of rules and regulations. It derives sufficient incentives from restrictive trade policy regimes enough, enough border-price differentials for smuggling to be profitable, legal restrictions on the free flow of goods for which there exists such demand which is not to be mjet by the legal trade. It gains momentum in a situation where the methods of legal enforcement are faulty or ineffective to a large extent, the frontiers are many and large, and the rewards of illegal activity high relative to the returns from legal activity (Bhagwati 1973, p-1).

Connel (1992) states four assumptions that characterize the smuggling activity: (a) Smuggling services are produced by a combination of labour and factors of production specific to smuggling; (b) The cost of an additional unit of smuggling is a rising function of the total amount being smuggled; (c) In the domestic market for traded goods smuggling firms behave as price takers; and finally (d) The marginal cost of smuggling at the industry level rises so rapidly that legal trade is not driven out completely in equilibrium.

Igué (1976) conveys the nature of smuggling as (a) smuggling persists because it reflects ancient trade patterns that conflict with modern boundaries; (b) smuggling is well organized especially in the costal regions of the country; (c) the traditional markets are excellent break-of-bulk points where the smuggled goods are laundered and, (d) the goods are bought and sold at the border markets.

Deardorff and Stolper find two reasons for smuggling: i) official economies fail to make demanded goods available and ii) currencies are severely overvalued.

Bhagwati (1982) distinguishes two types of illegal trade triggered by tariffs and quantitative restrictions.

The first one may consist of bringing the goods through legal checkpoints by passing the control of the customs by simply bribing the customs offices or by concealing the importation in one form or another whilst the other form of smuggling may conducted through illegal check points.

The above formulation by Bhagwati points to a situation where legal import and smuggling can co-exist. The legal import may even take a

form, which can as well be smuggling in disguise. The case of zero-tariff can be a potential source of legal smuggling (e.g. other items with high tariff can flow in a box marked zero tariff). However, smuggling is more closely identified with exchange control regime.

The regime of comprehensive exchange control and import licensing – by their very nature, encourage underground economy to flourish. In this type of regime, exporters must surrender their export earnings to the authorities – as a response, under invoicing of the value of exports is triggered which diverts considerable amounts of export earning to the underground economy. Similarly, importers who receive an official allocation of foreign exchange – much lucrative due to usual under valuation of foreign exchange – often resort to over invoicing of imports and minimizing import duty payments by classifying the goods declared in import categories subject to lower rates.

Under such circumstances, preventing smuggling and protecting government revenues are not sound justifications for maintaining restrictive exchange control and import licensing regime. The picture goes all quite wrong if one considers the high level tariff and import licensing restrictions inducing more smuggling and reducing the government revenues to an insignificant level as an offshoot of smuggling. The inducement accrued to smuggling as a result of excessive high tariff regime also brings in the failure of other policy objectives such as curtailing consumption of "luxuries", providing protection and reducing trade deficits. In order to be effective, trade liberalization measures require tariff and exchange rate reforms that would minimize he incentive form smuggling.

The smuggling trade reduces the degree of protection for the domestic industries to levels below the levels implied by official tariff protection the moment the tariff level rises above the smuggling cost. This shows, excessive protection will lead to zero or marginal protection, if the smuggling is present in the economy as a possible substitute. Besides smuggling diverts resources to socially unproductive activities, namely, rent seeking generated by policy interventions and public efforts to enforce those policies.

Smuggling, however, is not always socially undesirable. It brings down he level of protection offered to the industries who enjoy this benefit against the rationale of cost minimization from the social point of view. It may, in some cases, increase welfare by increasing consumers' surplus, reducing high-cost inefficient production and restricting the government's interference with the consumers' sovereignty through the process of full or partial replacement of inefficient domestic production by inflow of smuggled goods. Again, as import licensing in a restrictive trade policy regime is effectively controlled by the few importers of big cities and not available to the small businessmen at the peripheries – smuggling is quite a welfare-improving instrument as it meets some import requirement of the people of remote border areas. Smuggling is also welfare improving in the sense that it limits the excessive profit margins of te big importers and the near-monopoly industrialists one generally finds in a country following restrictive trade policy regimes.

4. The findings:

The field survey found that a huge number of people of border areas are involved in informal trade. In the case of land border between India and Bangladesh the principal means of carrying goods are head loading, bicycle, rickshaw van etc. For border points demarcated with rivers small to large size boats are used in carrying the goods.

- **Operation in individual levels:**

  In most of the cases illegal traders operate on individual levels. Having purchased the good from Indian market these people sell them at local border markets. Then large business distributes these goods all over Bangladesh. However, in some cases a number of people involved in illegal trading were found to work as hired day labourers for some organized large businessmen. Such organized nature of smuggling was more evident in Sharsha thana of Jessore district. (Box 1)

- **Items involved:**

  As many as 70 items were reported to be illegally imported into the country while in the case of smuggled-out items the corresponding number is as low s 15 only. Cattle, textile items, cotton and silk saree, sugar, salt, bicycle, truck parts are the most important items of import while gold, high counts yarn (imported from other countries), copper, brass and bell metal are the main items of interest for illegal export. In 1994, a study showed a volume of Tk. 275 million worth of Phensydil smuggled into Bangladesh through 28 different points. In 1998, in the current study of 5 centres the volume is Tk. 241 million.

- **Tradable items change seasonally:**

  In terms of value by broad product group livestock, fisheries and poultry dominate the illegal import followed by textiles, agricultural products and process food. Cosmetic and toiletries and transport items also occupy some significant share. However, the list of the tradable items change seasonally.

Box – 1
Illegal Traders' 'Syndicate'

At the thana level the illegal traders are well-organized. This group of traders buy the products from the local markets and distribute those all over the country. This activity requires huge amount of capital to ensure high profit. A number of people float a 'firm' where they invest money according to their capacity and profit is distributed according to the share of the initial investment.

In each thana there are a number of firms and according to the size of their capital they 'specialize' in the 'business' of different products. The big firms involve in cattle and sugar trading while the relatively small firms are found to operate business of items such as agricultural products and other processed food items like salt. Small firms distribute the illegally, imported items mainly within the border thana and other short distant districts.

The firms of a particular thana have their own association which is known as 'syndicate'. All the firms are the members of the syndicate. The syndicate protects the interest of the smugglers and manages the law-enforcing agencies. Besides, it also determines the amount of subscription for the firm, which is needed to fulfill the demand of law-enforcing agencies and the 'mastans' as well. 'There is nothing political about forming the syndicate, we all, irrespective of our political affiliation, are united under this syndicate' – said a member of syndicate of Bheramara thana, under Kushtia district.

Source: Field Report by the Field Officers, February, 1998.

- **Trucks – new item added to the list:**

  The study finds that in recent times, a relatively new item, truck parts have become a major item of smuggling and import of this item was not found in the previous studies. The growing popularity of Indian trucks in the domestic economy has made the smuggling of its spare parts very attractive. Sharsha was the main route of ths illegal inflow. (Box-2)

- **Cattle corridor with positive impact:**

  The introduction of cattle corridor in some border areas has had its impact on the illegal import of cattle in the country. It was found that the import of cattle through the corridor has become a good source of govt. revenue although this system of 'legalization' of this import has one leakage.

Table 2

Yearly Inflow of Illegal Imports By Broad Product Group By Surveyed Thana

(Tk. Million)

Broad Product Group	Shibganj	Sharsha	Daulatpur	Comilla	Kamalganj	Total
Livestock, Fisheries and Poultry	1176.18 (69.72)	860.68 (22.3)	1166.13 (69.60)	146.98 (18.68)	62.77 (62.77)	3412.74 (41.01)
Agricultural Products	267.72 (15.87)	324.96 (8.41)	68.33 (4.10)	19.51 (2.48)	166.80 (53.77)	847.32 (10.18)
Processed Food	136.07 (8.10)	421.76 (10.92)	82.18 (4.94)	48.87 (6.21)	21.14 (6.81)	710.73 (8.54)
Textiles	44.3 (2.63)	1510.61 (39.10)	198.1 (11.81)	287.93 (36.60)	10.11 (3.26)	2051.05 (24.64)
Cosmetics and Toiletries	1.66 (0.09)	68.44 (1.77)	6.85 (0.4)	116.87 (14.85)	1.01 (0.3)	194.83 (2.34)
Cookeries and Utensils	- (-)	- (-)	- (-)	20.59 (2.62)	6.56 (2.11)	27.15 (0.3)
Electical Goods	12.44 (0.7)	- (-)	27.87 (1.67)	40.34 (5.13)	10.16 (3.27)	90.81 (1.09)
Transport Items	40.56 (2.40)	86.28 (2.23)	83.91 (5.01)	16.81 (2.14)	5.58 (1.77)	233.14 (2.80)
Other Consumers Goods	2.52 (0.1)	2.52 (0.06)	3.11 (0.21)	0.69 (0.08)	0.81 (0.2)	9.65 (0.1)
Miscellaneous Items	5.47 (0.3)	5.47 (0.1)	35.6 (2.12)	88.32 (11.22)	25.22 (8.13)	160.08 (1.92)
Total	1686.92 (100.0)	3862.92 (100.0)	1675.54 (100.0)	786.90 (100.0)	310.20 (100.0)	8322.48 (100.0)

Note: Figures in parenthesis gives the percentage of the column total.
Source: Field survey (1998)

- **Illegal import of Phensidyl increasing at an alarming rate**:

The incidence of illegal import of phensidyle has been increasing at an alarming rate since 1993/94. the BIDS 1994 study identified 28 centres of smuggling-in of phensidyle with an estimated value of Tk. 275 million while the current study estimates that import phensidyle was valued at Tk. 241 million from these five centres only.

- **Sharsha tops the list**:

Among the survey thanas Sharsha was found to be the main rout of

illegal import followed by Shibganj and Daupatpur. Yearly inflow of import through the Sharsha thana was estimated to be Tk. 3862 million while the total value of illegal import from all these centres was valued at Tk. 8322 million.

Box – 2

Twenty "Helicopters' Carry a Truck!

One does not expect to seed helicopters so often in a remote corner of Bangladesh. One dows not expect them to carry smuggled goods wither. But one dows find them in Sharsha. Bicycles, the very common two-wheeler, in known as 'helicopter' among the people of Sharsha thana. The smugglers in the locality make good use of this two-wheeler. These bicycles wait for their turn right inside the illegal border-entry points. Whenever the smuggled goods arrive, these helicopters start off. One finds nearly everything on it – from blades to trucks!

Interestingly enough, the carriers can even smuggle in a large truck simply on bicycles. This occurs mainly in the rainy season. This is a dull season for the transport business as long distance transportation becomes difficult. And as a result the truck owners prefer to complete all the repairing works during this season. This is the time to bring life back to the moribund giants. All sorts of truck parts are required – what better place to search than the trucks' motherland – India, and what better way to bring them home than smuggling. Now the helicopters are required – what better place search than the trucks' helicopters are required to perform their task. All truck parts are packed in lage jute bags; change hands a number of times; cross the border; are loaded onto the bicycles and are unloaded in the service centres.

It was informed that the trucks made in England as early as in the 1960s are now being rebuilt with the Indian parts. A bicycle paddler at Sharsha thana appositely mentioned 'it takes only 20 helicopters to carry a whole truck'.

Source: Field Report by the Field Officers, February 1998.

Table 3

Respondents' perception regarding the direction of change in Illegal Trade flows

Thana	Illegal Imports: No. of Respondents Reporting			Illegal Exports : No. of Respondents Reporting		
	Increase	Decrease	No change	Increase	Decrease	No change
Shibganj	16 (24.62)	2 (12.50)	2 (22.22)	5 (41.67)	10 (17.86)	5 (22.73)
Sharsha	15 (23.08)	5 (31.25)	-	3 (25.00)	15 (26.79)	2 (9.09)

Thana	Illegal Imports: No. of Respondents Reporting			Illegal Exports : No. of Respondents Reporting		
	Increase	Decrease	No change	Increase	Decrease	No change
Daulatpur	16 (24.62)	2 (12.50)	2 (22.22)	-	15 (26.79)	5 (22.73)
Comilla	8 (12.31)	5 (41.25)	2 (22.2)	2 (16.67)	11 (19.64)	2 (9.09)
Kamalganj	10 (15.38)	2 (12.50)	3 (33.33)	2 (16.67)	5 (8.9)	8 (36.36)
Total	65 (100.0)	16 (100.0)	9 (100.0)	12 (100.0)	56 (100.0)	22 (100.0)

Note: Figures in parenthesis give the percentage of total.
Source: Field survey (1998)

- **Inflow has increased significantly**:

Due to smaller size of sample a national estimate for total value of illegal import is not attempted. However, most of the respondents perceived that illegal import has increased significantly during the last three years. On the other hand, most of the respondent reported that illegal outflow of goods from Bangladesh to India has declined.

- **Price differential is declining**:

The current study finds that in most of the cases the ratio of border prices has been falling implying that the difference between prices of India and Bangladesh border is srinking. Smuggling on a massive scale rather than trade liberalization has been the main reason for this declining trend of price differentials. In fact, the large extent of illegal trade has created a free-trade situation in the border areas. Here it is also revealed that the differential rate of liberalization of import regimes of Bangladesh and India is most important element in Analyzing smuggling.

- **Means of settlement:**

The mechanism by which the huge illegal informal trade deficit is settled has also been analyzed in this study. It is found that Taka, India Rupee, gold and remittance has been the major means of settlement.

Table 4

Price Ratio of Smuggled-in Items, 1990, 1994 and 1998

Item	Unit	Border Price Ratio 1990	Border Price Ratio 1994	Border Price Ratio 1998	Ratio of Dhaka market price to Calcutta Price 1990	Ratio of Bangladesh market price to Indian Border Price 1998
Cow (Big)	No.	1.84	1.47	1.29	2.01-2.95	1.39
Cow (Medium)	No.	-	-	1.20	-	1.52
Cow (Small)	No.	-	-	1.29	-	1.92
Buffaloes	No.	N/A	1.69	1.20	2.6	1.56
Ruhi fish	Kg.	1.35	1.24	1.38	N/A	1.62
Egg	Dozen	N/A	1.36	1.08	N/A	1.29
Apple	Kg.	1.68	1.43	1.35	2.42	1.62
Mango	Kg.	2.27	1.37	1.84	4.76	2.12
Grapes	Kg.	1.46	1.36	1.82	3.47	2.69
Orange	Dozen	1.85	1.50	1.09	3.78	1.90
Rice	Kg.	2.27	1.25	1.20	1.48	1.35
Potato	Kg.	1.79	1.45	1.19	2.15	1.44
Pulses	Kg.	1.54	1.18	1.14	1.86	1.33
Onion	Kg.	2.28	1.41	1.17	3.36	1.44
Garlic	Kg.	1.51	1.32	1.12	1.81	1.25
Turmeric	Kg.	1.60	1.23	1.08	3.72	1.34
Cumin seed	Kg.	1.45	1.27	1.20	4.30	1.54
Black pepper	Kg.	1.69	1.44	1.10	3.32	1.30
Bamboo	Piece	N/A	N/A	N/A	2.35	2.49
Wood	Cft.	N/A	1.35	2.20	N/A	3.33
Salt	Kg.	2.78	1.43	1.38	4.37	1.86
Sugar	Kg.	1.48	1.11	1.17	1.87	1.40
Powder Milk	Kg.	N/A	1.24	1.19	N/A	2.03
Bidi	Piece	1.58	1.48	1.31	1.25	2.15
Cotton saree	No.	1.86	1.32	1.11	1.74-2.21	1.37
Silk saree	No.	N/A	1.45	1.13	-	1.32
Bed sheet	No.	N/A	1.25	1.22	N/A	1.43
Towel	No.	N/A	1.13	1.23	N/A	1.39
Lungi	No.	N/A	1.20	1.36	N/A	1.60
Than cloth	Metre	N/A	1.23	1.26	N/A	1.44
Shwal	No.	N/A	1.30	1.10	N/A	1.60
Facial cream	Piece	1.55	1.28	1.08	1.88	1.21

Item	Unit	Border Price Ratio 1990	Border Price Ratio 1994	Border Price Ratio 1998	Ratio of Dhaka market price to Calcutta Price 1990	Ratio of Bangladesh market price to Indian Border Price 1998
Shaving cream	Piece	N/A	1.18	1.22	2.55-2.89	1.47
Tooth paste	Piece	1.38	1.38	1.14	1.29	1.50
Perfume	No.	1.37	1.37	1.06	N/A	1.23
Hair oil	Bottle	1.80	1.14	1.10	2.35-3.84	1.40
Glass	Piece	N/A	1.37	1.18	N/A	1.44
Ceiling fan	Piece	2.35	1.20	1.16	1.43	1.34
Table fan	Piece	1.85	1.19	1.17	1.43	1.34
Bicycle	Piece	1.38	1.21	1.15	1.98-2.09	1.41
Bicycle tire	Piece	1.47	1.41	1.16	2.49-2.68	1.30
Bicycle tube	Piece	1.65	1.25	1.30	1.77-2.57	1.52
Razor blades	Piece	1.76	1.69	1.21	1.79-2.33	1.54
Phensidyle	Bottle	3.01	1.28	1.25	N/A	1.6

Source: BIDS 1990, BIDS 1994 & Field survey 1998

Informal remittance is much higher than normally perceived:

Having reviewed a recent study (Islam, 1997) the present report indicates that the amount remittance channeled through the informal channel can be much higher than the generally perceived figure (which is about 20 percent of total remittance sent through the official network). This concern calls for policy intervention immediately.

Table 5

Border Price Ratio of Illegal Export to India

Product	Unit	Border price ratio 1990	Border price ratio 1994	Border price ratio 1998
Gold	11.663 gm	-	1.26	1.30
Silver	11.663 gm	-	-	1.67
Yarn	Kg	-	-	1.36
Betal nut	Kg	-	-	1.34
Copper, brass, bell metal	M.Ton	1.15	-	1.34
Electronics	-	-	-	1.23
Gas cylinder	No.	-	-	1.68
VCP/VCR	No.	1.13	1.41-1.47	1.19
Used cloth	-	-	-	2.00
Hilsha fish	Kg.	1.48	-	1.42
Jamdanee saree	No.	-	-	1.41
Camera	No.	-	-	1.37
Dry fish	Kg.	-	-	1.56
Coin	No.	-	-	1.25
Nuts & bolts	Kg.	-	-	1.46

Note: '-' means not available

Source: BIDS 1990 & 1994 and Field survey 1998.

- **The role of law enforcing agencies**:

The role of law enforcing agencies was originally evaluated in this study. From all the surveyed centres it was informed that the police and BDR were in volved in making money out of the smuggling activities.

Such corruption makes it almost impossible to put an effective control on informal trading between India and Bangladesh (Box-3)

Box – 3
The 'Cashiers' of Thana

The word 'cashier' implies the persons who distribute money among the clients usually in the commercial banks to meet the claims made by them through cheques. Since the Police stations or the Thanas do not have functions like Banks they are also not supposed to have any post of 'cashier'. However, during our field visit we came to know from the knowledgeable persons that there are 'cashiers' in the Police stations!

The cashier of a Thana is usually a constable who is in charge of distributing coupons/tokens among the illegal traders and collecting money from them. He is the most influential person of the Thana and is usually nominated by the Circle Officer of the respective Thanas. The performance of a cashier depends on how much money can accumulate to be distributed among all the members of Thana although not equally.

The cashiers regularly maintain a register where the names of all the 'smugglers' are mentioned. The amount of money received from these traders is also written in this register. The cashiers appoint the 'linemen' in order to get the information related to smuggling that would increase the Thana's income.

A bad cashier is one who is unable to accumulate a good amount of money. Consecutive bad performance over a few months causes a change in the cashier's position. When the money is distributed the cashier gets a large share of it, which is, of course, much higher than what a police officer of his position gets. The lion's share of collected money however, is distributed among the police officers lying on the top segments of job hierarchy. Our field investigation found that even a constable in the Thanas A, B and C received 50 to 100percent of his official salary from the source of illegal money accumulated by the cashiers of their respective Thanas.

(Field findings by the field officers), February 1998.

- **Liberalization fuels smuggling:**

Bangladesh introduced a policy of liberalization, decontrol, and deregulation in the late 1980s and the successive governments have extended their efforts to make the economy more outward oriented. Despite these reforms, the incentive for smuggling still exists in the structure of current rates of import duty. The operative tariff rates on some of the selected items show that for most of the commodities of illegal import, the import duty is as high as 42.5 percent. Besides there are VAT (rice is exempt) and other duties like development surcharge and advance income tax on some of the commodities. This high tariff structure is thus providing enough incentive for smuggling.

Table 6

Respondents' Perception Regarding Involvement of Police and BDR in Smuggling

Persons Involved	Centre A	Centre B	Centre C	Centre D	Centre E	Total
Police	5 (25)	-	-	-	-	5 (6)
BDR	-	-	-	-	-	-
Both Police and BDR	15 (75)	20 (100)	20 (100)	15 (100)	15 (100)	85 (94)
None of BDR & Police	-	-	-	-	-	-
Total	**20 (100)**	**20 (100)**	**20 (100)**	**15 (100)**	**15 (100)**	**90 (100)**

Note: '-' means nil. Figures in parenthesis give the percentage of column total.
Source: Field Survey, 1998

Table 7

Pattern of Involvement of Police and BDR

Involvement pattern	Centre A	Centre B	Centre C	Centre D	Centre E	Total
Through dalals (middlemen)	4 (14)	-	5 (20)	6 (40)	4 (27)	19 (19)
Direct intervention	20 (69)	20 (67)	15 (60)	5 (33)	10 (66)	70 (61)
Prior agreement	5 (17)	10 (33)	5 (20)	-	-	20 (18)
Unknown	-	-	-	4 (27)	1 (7)	5 (4)
Total	29 (100)	30 (100)	25 (100)	15 (100)	15 (100)	114 (100)

Note: '-' means nil. Figures in parenthesis give the percentage of column total. In some cases multiple responses were recorded.
Source: Field Survey, 1998

Table 8

Respondents' perception regarding the amount of illegal income earned by the law-enforcing agencies

(Figures in Million Taka)

	Centre A	Centre B	Centre C	Centre D	Centre E
Monthly income of Thana	1.0 (95.0)*	2.0 (95.0)*	0.95 (90.0)*	0.175 (100.0)	0.244 (96.7)*
Yearly income of Thana	12.0	24	11.4	2.1	2.93
Monthly income of BDR	1.5 (75.0)*	4.5 (65.0)*	2.25 (65.0)*	0.280 (37.0)*	0.45 (80.0)
Yearly income of BDR	18.0	54	27	3.36	5.4
Yearly income of Thana & BDR	30.0	78.0	38.4	5.46	8.33

Note: ()* - means the percentage of respondents answering to this particular question.

Source: Field Survey, 1998

- **High tariff values and price differentials for agricultural goods and food items**:

Besides, the government has set tariff values that are to be used in place of the invoice price declared by the importer in assessing the imort value of some imports. In many cases the specified tariff values are much higher than the world prices and thus these values are quite unrealistic. In the case of import from India, the tariff value becomes a major problem because the Indian prices of the majority of the goods differ substantially from other international prices. Specially for agricultural goods and food items the existing tariff values are much higher than the prices existing in India. In fct, it would be quite realistic to have different set of prices for goods that are being imported from India. Price differentials also arise because of arbitrary and ad hoc nature of policy making regarding tariff, tariff value and taxes.

- **Non-tariff barriers discourage legal import**:

Bangladesh's tariff liberalization has been taking place without a major breakthrough in administrative reforms. As a result, there exist a lot of administrative hassle, which discourage legal import of commodities.

- **Bangladesh's illegal import from India is on the rise and the reverse is declining**:

A major contrasting factor between Bangladesh and India is that whilst despite trade reforms Bangladesh's illegal import form India is on the rise, the reverse flow of goods is actually declining. This is particularly true for the goods that are legally imported into Bangladesh and illegally exported to India.

Table 9

Sources of Imports to Bangladesh by Major Countries

(Percent)

Major Countries	1985-86	1989-90	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97
India	4.1	5.8	8.1	10.3	12.3	14.7	16.1	21.1	17.0
China	5.0	5.1	5.8	5.3	5.8	7.8	9.6	12.3	10.3
Hong Kong	3.2	6.3	8.4	11.0	11.0	11.8	9.6	7.5	7.5
Korea	405	5.1	7.5	8.1	9.5	10.1	8.0	7.0	6.6
Japan	12.3	10.2	7.8	7.2	6.7	6.6	6.0	5.3	5.9
Taiwan	-	-	-	-	-	-	-	4.1	5.5
Singapore	14.5	13.0	15.3	12.2	7.8	7.2	6.4	8.6	5.5
USA	3.7	4.4	3.6	4.2	5.2	3.6	5.0	5.3	5.0
Malaysia	1.9	-	1.5	1.8	2.0	-	-	1.3	3.6
UK	3.9	2.7	2.8	2.3	2.3	2.7	2.7	2.7	3.0
Australia	-	3.0	2.4	2.3	-	-	-	1.8	2.8
Germany	3.6	2.9	2.7	2.3	2.7	2.5	3.0	2.6	2.5
Indonesia	-	2.7	-	-	2.2	-	-	1.4	2.4
Saudi Arabia	-	1.7	2.4	2.4	2.6	-	-	1.4	1.5
Thailand	-	4.4	-	-	-	1.5	2.0	1.2	1.4
Russia/USSR	2.0	-	-	-	-	1.8	2.0	1.3	1.3
Pakistan	-	-	2.1	3.0	3.5	2.9	3.1	2.2	1.2
Kuwait	3.4	-	-	-	-	-	-	-	-
Switzerland	2.7	2.6	-	-	-	-	-	-	-
Netherlands	9.9	3.4	3.7	2.2	1.9	-	-	-	-
UAE	-	4.2	4.6	4.7	2.9	-	-	-	-
Brazil	25.3	-	-	-	-	1.0	2.8	1.3	-
Others	100.0	22.5	21.3	20.7	21.3	25.8	24.0	13.6	17.0
Total	4314.6	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total imports in Crore Tk.	-	8181.8	7793.4	8582.4	10617.9	11224.5	17188.9	21274.2	23165.4

Note: Total imports defined here as Imports under Cash, Barter and Wage earners fund. Figures for 1996-97 are provisional.

Source: Annual Import Payments, various years. Statistics Division, Bangladesh Bank.

- **The bilateral balance of trade between Bangladesh and India is widening fast:**

The bilateral balance of trade between India and Bangladesh has traditionally been in deficit for the home country and in recent times this deficit has been increasing very rapidly. Table 16 presents the bilateral trade figures between Bangladesh and India for the period 1992-97. it is evident that Bangladesh's trade deficit with India is widening very fast. Considering the trend growth rate of export to and import from India one would not find much difference but in making comparison it should be taken into cognizance that the initial export base was very low for Bangladesh in contrast to very high import base from India. The share of Bangladesh's export to import from India has shown a negative trend during the same time period implying the fact that export share is declining.

Table 10

Bilateral official trade between Bangladesh and India

Year	Bangladesh's export to India	Bangladesh's Import from India	Trade deficit for Bangladesh	Bangladesh's Export as % of import
1991-92	292.1	8823.7	8531.6	3.31%
1992-93	296.6	13384.7	13088.1	2.22%
1993-94	855.0	16579.5	15724.5	5.16%
1994-95	1150.4	27679.4	26529.0	4.16%
1995-96	998.1	44925.9	4392.78	2.22%
1996-97	1195.9	39359.0	38163.1	3.04%
Change in absolute amount	197.68	7382.85	7185.17	-
Trend Growth rate	31.38%	33.20%	33.27%	-1.8%

Table 11

Indices of Import and Export Intensities (Bangladesh and India)

Year	Import Intensity Indices		Export Intensity Indices	
	Bangladesh	India	Bangladesh	India
1986	4.78	1.17	1.17	9.94
1987	5.88	1.73	1.47	11.82
1988	6.04	1.72	0.97	11.80
1989	6.11	0.22	1.29	9.16
1990	8.74	1.24	1.83	15.63
1991	10.68	0.61	2.47	18.88

Year	Import Intensity Indices		Export Intensity Indices	
	Bangladesh	India	Bangladesh	India
1992	13.56	0.71	0.33	17.59
1993	17.35	0.98	1.00	19.86
1994	17.87	2.07	1.50	20.13
1995	2538	3.69	0.17	24.17
1996	25.34	1.63	0.80	20.01

- **X-M intensity indices show a complete opposite picture:**

By estimating the import and export indices of Bangladesh and India it is found that Bangladesh's export intensity indices is on the decline and India is having much stronger export indices although fluctuating around 20 points. The import intensity indices, however, show a complete opposite picture.

- **Smuggled-in inputs go to export-oriented industries:**

The widening trade gap with India has now become a major concern for Bangladesh. However, such concern seem to conceal the fact that a significant part of import from India go to export oriented industries as inputs and as result the country can maintain appositive balance of trade with other partner countries such as the USA. For example in 1996-97 raw cotton, cotton yarn, and cotton fabrics constituted more than 36 percent of total import from India thus have undoubtedly helped promote export growth rate of RMG sector in Bangladesh.

- **Appreciated Taka helps expand trade imbalance:**

Several studies found that the Taka was about 30 percent appreciated (as on July 1988) compared to Rupee and this have partly contributed to the expanding trade imbalance. But they disagreed with the opinion that an appreciated take lies at the root of Bangladesh's trade imbalance rather some structural factors like larger size, diversity and technological maturity of Indian economy should be regarded as major reasons.

- **Enough scope to rationalize tariff structure:**

It is very difficult to understand the rationale for keeping high tariff on the items of illegal trade. If this is for making revenues it is tobe noted that most of these items are being imported illegally and hence the government is deprived of such revenues. The information on the imported items either through legal or illegal channels shows that there exists hardly any similarity between the goods that are officially imported and illegally brought into the country. If the high import duty is meant for providing protection to the domestic industry it should be taken into cognizance that the price differentials are much lower than the specified rate of duty which would imply that due to widespread informal trade a significant portion of the protection is eroded. In fact, the comparison of border price differentials and duty structure amply suggest that there is a lot of scope to rationalize the tariff structure. It should be mentioned here that the extent to which protection can be given to domestic industries is limited by the cost of the smuggling. Moreover, since the cost of smuggling is not prohibitive the attempt of providing absolute protection through import ban of a particular item would hardly work. This only diverts the import of the item to the smuggling trade, with the price of the item in the domestic market going up to cover the cost of smuggling. A tariff equivalent to the cost of smuggling would provide the same protective effect. This point should be considered in rationalizing the tariffs structure in general, and liberalizing the banned items (except for non-trade reasons) in particular.

- **High and unrealistic tariff values discourage the official import:**

  High and unrealistic tariff values discourage the official import. There are reasons to believe that for a number of items the production cost and hence the price of commodities of Indian origin may be lower compared to other countries. Thus the possibility of setting a different tariff values for goods imported from India may be considered. For that matter it may be required to monitor the border price and gather other price information on a regular basis.

- **Hundis as means of informal trade settlement:**

  A large proportion of remittance earned by the Bangladeshis working abroad are being channeled through the informal mechanisms and these are being used as a means of settlement of the informal trade. No doubt, this may be a great cause of concern for Bangladesh.

- **Policy measures for reducing trade deficit:**

  Trade dependence on Indian economy has been increasing and since 1993-94 India has become the major source of Bangladesh's import. Besides, if the case of informal import were considered India would dominate very strongly among the list of the countries as our m major source of import. There is no gainsaying the fact that imports from India help increase or sustain growth rates of some important exportable sectors of the economy. Yet, it may be an important objective to reduce the bilateral trade deficit between Bangladesh and India. Although the pace of reforms in the Indian economy has been lower than that of Bangladesh various policy measures both at the domestic and regional level may be launched in order to mitigate this problem of huge deficit at least in the medium to long term.

5. Conclusions & Recommendations:

Illegal trade flourishes in a situation where import restrictions (both tariff and non-tariff barriers) are put in the way of free flow of goods between two countries in the name of providing protection to the domestic industries or for some other reasons such as gathering government's revenues, discouraging luxurious consumption, and limiting imports on the grounds of improving the balance of payments situation. There is no denying the fact that illegal trade with India is widespread and its extent has been colossal. Indian economy exerts considerable influence on Bangladesh's economy, which is reflected in the official trade figures. Besides, there is now sufficient information to establish that the cross-border illegal trade on a massive scale between these two countries is going on and in the recent times the trend is on the rise.

It is for almost certain that the large portion of illegal trade creates a free trade situation in the border areas and the magnitude and importance of such trade is no less significant than the official bilateral trade. It goes without saying that Bangladesh suffers from a trade deficit not only in its official trade but also in the informal trade.

The police and BDR are usually responsible to inhibit the illegal trading activities. However, the present study finds that the law enforcing agencies are deeply involved in the operation of such illegal activities and this, in fact, generates a huge amount of illegal income for them. Given the extent of their involvement probably it would be very unrealistic to presume that these two law agencies can curb smuggling by any significant scale.

The price analysis suggests that although border price ratios for the smuggled items over the years have fallen the very nature of smuggling operation makes such venture still feasible and profitable. There is a valid reason to argue that probably it is not the trade and tariff liberalization rather the scale of smuggling operation that has reduced the price differentials between two neighbors, Bangladesh and India.

It was very difficult to understand the rationale for keeping high tariffs on the items of illegal trade. It his is for making revenues it is to be noted that most of these items are being imported illegally and hence the government is deprived of such revenues. The information on the imported items either through legal or illegal channels show that there exists hardly any similarity between the goods that are officially imported and illegally brought into the country. If the high import duty is meant for providing protection to the domestic industry it should be taken into cognizance that the price differentials are much lower than the specified rate of duty, which would imply that due to widespread informal trade, a significant portion of the protection is eroded. In fact, the comparison of border price differentials and duty structure amply suggest that there is a lot of scope to rationalize the tariff structure. It should be mentioned here that the extent to which protection can be given to domestic industries is limited by the cost of the smuggling. Moreover, since the cost of smuggling is not prohibitive the attempt of providing absolute protection can be given to domestic industries is limited by the cost of the smuggling. Moreover, since the cost of smuggling is not prohibitive the attempt of providing absolute protection through import ban of particular item would hardly work. This only diverts the I m of the item to the smuggling trade, with the price of the item in the domestic market going up to cover the cost of smuggling. A tariff equivalent to the cost of smuggling would provide the same protective effect. This point should be considered in rationalizing the tariffs structure in general, and liberalizing the banned items (except for non-trade reasons) in particular.

It is also to be pointed out that high and unrealistic tariff values discourage the official import. There are reasons to believe that for a number of items the production cost and hence the rice of commodities of Indian origin may be lower compared to other countries. This finding, however, deserve to be further researched. Thus the possibility of setting a different tariff values for goods imported from India may be considered. For that matter it may be required to monitor the border price and gather other price information on regular basis.

It is indicated that a large proportion of remittance earned by the Bangladeshis working abroad are being channeled through the informal mechanisms and these are being used as a means of settlement of the informal trade. No doubt, this may be a great cause of concern for Bangladesh. In the present report we have mentioned about the findings of recent study on this particular issue. It is felt that there exists sufficient scope to intervene in this arena so that a huge amount of foreign exchange can be made available for the purpose of the domestic economy. Indeed Bangladeshi Banks should be encouraged to open branches/subsidiaries abroad to cater to this demand.

Trade dependence on Indian economy has been increasing and since 1993-94 India has become the major source of Bangladesh's import. Besides, if the case of informal import is considered India would dominate very strongly among the list of the countries as our major

source of import. There is no gainsaying the fact that imports from India help increase or sustain growth rates of some important exportable sectors of the economy. Yet, it may be an important objective to reduce the bilateral trade deficit between Bangladesh and India. Although the pace of reforms in the Indian economy has been lower than that of Bangladesh various policy measures both at the domestic and regional level may be launched in order to m mitigate this problem of huge deficit at least in medium to long term.

Again the threat of imposing economic sanction on India by the international community following India's nuclear testing may change the price-differentials of the goods covered by Indo-Bangla informal trade. This may also have serious implications on our internal price dynamics, and export potentials. Some of these emerging problems/issues need to be kept in mind while developing policy responses to the growing trade imbalances both in the formal and informal sector between India and Bangladesh.

Some policy suggestions:

i. Regular monitoring of the content and pace of policy reforms related to India economy.

ii. Regular monitoring of the prices of Indian goods and setting up of separate tariff values for them.

iii. Rationalization of the tariff structure through mutual discussion. A tariff equivalent to the cost of smuggling would provide the same protective effect. This point should be considered in rationalizing the tariffs structure in general, and liberalizing the banned items (except for non-trade reasons) in particular.

iv. More dialogue between the two governments on trade policy issues involving all the stakeholders for correcting trade policy related distortions.

v. Conscious move to mitigate the problem of huge trade deficit.

vi. Close cooperation for greater flow of daily necessities at times of crisis (e.g. rice).

vii. Reducing the price of production of agricultural products through both infrastructural and price supports.

viii. In order to make the local manufacturing of goods more competitive, the cost of finding should be reduced & adequate fund must be made available on easy terms.

ix. Remove barriers from the official flow of remittance so that 'hundis' do not overwhelm the currency settlement process.

x. Wage Earners Bond deposits should be allowed higher rate of interests so that NBRs are tempted to remit their money through official channel.

xi. Branches of scheduled Banks of Bangladesh should be opened at strategic places of abroad for collecting remittances of the NBRs so that they find easy way to make remittances.

xii. Adjust exchange rates with the currencies of the neighbouring countries through appropriate devaluation so that inflation does not steal benefits of adjustment.

xiii. Rethink the role of law enforcing agencies – though the industrialization of corruption and the economics of rent seeking makes it almost impossible to eradicate smuggling through law enforcing agencies. So economic policy-making remains the only effective mechanism to counter smuggling.

xiv. Keep an eye on the impact of economic sanction on the Indian economy and its likely effect on IBT.

xv. Greater coordination of regional macroeconomic policies including exchange rate, foreign direct investment, infrastructure development, etc.

xvi. Create job facilities to people living in border areas through investment in agriculture – in agro-based industries and/or other cottage industries. Encourage NGOs to set up targeted programmes so that poverty is alleviated and poor people do not feel hard pressed to participate in this risky income-earning activities provide m ore public investment for developing infrastructure (e.g. electricity, roads) so that opportunities for legal income earning expand.

xvii. Finally, the issue of illegal border trade that has been taking place between those two countries should be discussed and resolved through intensive bilateral discussions, if possible, with the South Asian Association for Regional Cooperation (SAARC) framework and spirit.

Reference:

A. H. M. Nuruddin, 'Smuggling and Domestic Economic Policies in Developing Countries', ADB, Report No. 36, October 1986.

Alam, N. and Forrert Cookron (1995), 'Cross Border Trade with India'.

Bakht (1996), Cross Border Illegal Trade in Bangladesh: Composition, Trends and Policy Issues BIDS.

Bangladesh Bank, Economic Trends, Various Years.

Bangladesh Bank, Import Payments, Various Years.

Centre for Policy Dialogue (1995), Experience with Economic Reforms: A Review of Bangladesh's Development, 1995, UPL, Dhaka.

Centre for Policy Dialogue (1997): Growth or Stagnation? A Review of Bangladesh's Development 1996, UPL, Dhaka.

Centre for Policy Dialogue (1998): Crisis in Governance: A Review of

Bangladesh's Development 1997, CPD & UPL.

Chaudhari, K.S. (1995), Cross-Border Trade Between India and Bangladesh, NCAER, New Delhi, India.

Chowdhury, N. (1986), Smuggling and Domestic Economic Policies in Developing Countries, Asian Development Bank, Economics Office Report Series, Report No. 36.

Connolly, M., John Devereux, and Mariluz Cortes (1995), 'The Transhipment Problem: Smuggling and Welfare in Paraguay', World Development, Vol. 23, No. 6.

Deardorff Alan V. and Stolper Wolfgang F. 'Effects of Smuggling under African conditions: A Factual, Institutional and Analytic Discussion, Review of World Economics, Weltwirtschaftliches Archiv, 1990, Vol. 1 26(1), page-116-141.

Ghafur, A, Muinul Islam and Naushad Faiz (1990), Illegal International Trade in Bangladesh: Impact on the Domestic Economy, Phase-I, BIDS.

Ghafur, A, Muinul Islam and Naushad Faiz (1991), Illegal International Trade in Bangladesh: Impact on the Domestic Economy, Phase-II, BIDS, 1991.

Hossain, Akhter (1996), Real Exchange Rate Behavious and Policy in Bangladesh: 1972-1995.

Igue Ogunsola Hohn (1976a): Evolution due commerce clandestine entre le Dahome et le Nigeria depuis la guerre du 'Biafra', CanadianJournal of African Studies, Vol. 10, 1976, P-235-258.

Islam, Muinul (1997), Externalities, Market Failures and P olicy Failures in Migration: A Study of Bangladeshi Migrants in Singapore, ISAS, Singapore.

J. Bhagawati and Hansen (1973), "A Theoretical Analysis of Smuggling", Quarterly Journal of Economics, Lxxxvii, May 1973, pp. 172-387.

Khan, F.C, (1994), 'Import Liberalization in a Developing Country with Import Intensive Industry: The Case of Bangladesh, International Economic Journal.

Mahmood, M. (1997), 'Trade Policy Reform and Trade Performance in Bangladesh'.

Rahman, M (1996), 'Regional Trade Cooperation in the SAARC: Issues of Transition from SAPTA to SAFTA, Paper presented at the Regional Seminar on South Asian Free Trade Area, Organiaed by SCCI/FBCCI, December, 1996.

Stephen, A. O' Connell, Uniform Commercial P olicy, Illegal trade, and the Real Exchange Rate: A Theoretical Analysis, World Bank Economic Review, 1992 Vol. 6, No. 3, p.465.

Vinod R. (1997), Report of the Study Team on Final Act of Uruguay Round of Multilateral Trade Negotiations.

World Bank (1996), Trade Policy Reform for Improving the Incentive Regime, Report no. 15900-BD.

Tax Policy Making In Bangladesh: 1985-2000

MOHAMMAD ALAM
FAIZUL LATIF CHOWDHURY

This is a descriptive article that intends to document how tax policies have been enforced in Bangladesh through the annual budgets during a period from 1985 to year 2000. Starting with an overview of the tax structure and the policy making process, it puts together main tax measures adopted by the governments from year to year. Analysis of consecutive budgets would possibly show interesting cases of policy reversal and inconsistencies. Deeper investigation could also reveal the role that the *interest groups* have played in the enactment of desired policies. Even without going into such analysis and investigations, it may be observed that, while many socio-economic goals are pursued, tax policy consists merely of a number tax measures that do not have any underpinning of a set of coherent strategies, or a pre-set objective

The tax structure

Historically, taxes are the major source of government revenue in Bangladesh. National Board of Revenue (NBR) is the principal agency for collection of taxes. For more than two decades, NBR's contribution to government's tax revenue has remained over 90 percent. It was as high as 92.47 percent in FY1985-86, 93.40 percent in FY1991-92 and 93.30 percent in FY1997-98. In FY2000-01, the total NBR collection stood at Taka 18,808 crore.

Various taxes collected by NBR include Customs Duty, Value Added Tax (VAT), Excise Duty, Income tax, Supplementary duty (SD), Infrastructure Development Surcharge (IDCS), Income Tax, Travel Tax and Wealth tax. Taxes collected outside NBR include land revenue, agricultural cess, Stamp duty, Motor Vehicle tax and duty on liquor. In addition, there are several categories of taxes and levies collected by local governments.

Important non-tax government receipts include profits of the nationalized banks and financial institutions, interest from government bonds, registration fees of different types including passport and visa-fee, earnings of the state owned enterprises (SOEs), tolls on road, bridge and ferry, rent from local resources, and income from telephone, telegraph and postal departments. Fines and penalties also fall into this category. In FY1998-99, the total non-tax revenue of the government stood at a puny of Taka 3055 crore against a tax revenue of Taka 15750 crore.

Customs offers a very suitable handle for collecting taxes. So, it is found that in addition to customs duty, various taxes and fees are also realized at the customs points. Of these Value Added Tax on importation is most important, followed by supplementary duty (SD). SD collected at the stage of importation is nothing but an additional form of customs duty. In the year 2000-01, collection of SD on imports was Taka 1271 crore while the total collection of Customs duty stood at Taka 5080 crore. Infrastructure Development Surcharge (IDCS) is another form customs duty. Regulatory duty, which is levied selectively on few items every year, also falls within this category. Customs offers such a good handle that even income tax is realized from the importers on the basis of import value which has come to be known as Advance Income Tax (AIT). License fee relating to international trade, which is levied by Ministry of Commerce, is realized at the stage of importation too. In this situation, it may be observed that much of governmental efforts at resource mobilization pivot largely around customs sources.

Policy making process

It is clear from the brief discussion above that government administers a range of duties and taxes for meeting its revenue needs. However, it is also clear that majority of the taxes and duties are levied and enforced through the National Board of Revenue (NBR). As a result, NBR is the single largest source of tax policies in the country.

In formulating tax policies, while NBR acts on the directives of the political government, it also considers proposals received from its stakeholders from time to time. Then it also invites opinion from its own officials engaged in the implementation process. However, it transpires that NBR primarily follows an incremental approach as a result of which a new tax measure is often built upon an earlier one. A drastic departure from a previous policy is not frequently seen.

That said, it must be pointed out that many of the fundamental policy changes have been adopted by the government at the behest of the international agencies like IMF and World Bank. From time to time, foreign aid donors have periodically reviewed tax policies and suggested changes to modernization and optimization.

It should be noted here that since its independence in 1971, Bangladesh has followed a planned approach in controlling its economic activities. Fundamental elements of Government's overall economic philosophy is documented in what is known as Five Year Plan. However, it cannot be claimed that such Five Year Plans have provided any effective guideline for tax policy makers.

Tax policies in Bangladesh are characterized by continuous change and alterations. Annual Budget is the main instrument for documenting and enforcing tax policies. However, extra-budget policy making continues throughout the year in the form of government *rules* that bring about change in effective rates of taxes and duties and revision of the tax base (often known as tariff value).

This paper is basically a descriptive article that intends to document how tax policies and procedures have been changed over time through the annual budgets. Analysis of consecutive budgets would possibly show interesting cases of policy reversal and inconsistencies that deserve thorough investigation. Deeper investigation could also show the role that the interest groups have played in the enactment of their target policies. However, given the space constraint, such investigation and analysis have not been undertaken here.

Annual Budget and Tax Measures

Fiscal year (FY) in Bangladesh runs from July 1 to June 30 of the following year. Every year the Finance Minister in the Parliament announces the national budget some time prior to the commencement of the fiscal year. The *budget speech* of the Finance Minister consists of two parts: Part-I focuses on the overall principles of economics administration, development strategies and statement of the governmental income and expenditure for the fiscal year; Part-II, on the other hand, contains the tax proposals including change in tax laws and regulation.

To be specific, budgetary tax proposals include changes in the tariff structures, withdrawal of old taxes and imposition of new taxes, increase or decrease of effective tax rates, granting and withdrawal of concessions, exemptions and tax holidays, and also, changes in the tax collection procedures. Tariff values are also altered in course of the budget. In addition, the *budget* sets the revenue targets for the fiscal year, showing loss of revenue from exemptions and gain in revenue from rate enhancement and new taxes.

Clearly, all major and fundamental changes in tax policy and procedures

are effected through annual budget. It should be noted here that, while the speech of the Finance Minister (Part-II) gives an overview of the tax proposals, they are placed before the parliament in the form of a Finance Bill. Proposals are enacted when approved by the members of the Parliament.

Post budgetary tax measures

In the post-budget period, government, and for that matter NBR, can revise the tax structure in the public interest, to respond to certain contingencies. Government makes such changes issuing notifications published in the official gazette, popularly known as SRO. However, it is seen that NBR is moving more and more away from adopting post-budget fiscal measures. In fact, in order to avoid litigation and judicial intervention, NBR now pursues a policy of minimal post-budgetary change.

Post-budgetary measures are normally necessitated by special circumstances. In many cases, demand for such changes is raised the trade and industry. For example, the Federation of Chamber of Commerce and Industries (FBCCI) and such other bodies approach government for special treatment of certain cases, mainly on grounds of competitiveness. General consumer interest is also involved in many cases. Some practical examples may be useful.

Partial or total duty exemption of customs duty is allowed if there is sudden scarcity of certain essential consumable. It is believed that reduction of duty will encourage importation and enhance market supply and remove scarcity thereby. Then, during the Islamic holy month of *Ramadan*, temporary duty reduction is allowed on dates, onion, ginger, chic peas and prunes for the sake of Muslims. In times of electricity crisis, tax exemption period for generating set was extended up to the end of year 2000. Similarly, in the context of bumper production of rice, customs duty at the rate of 5 percent was imposed on rice to discourage rice importation. Finally, industry- or even firm-specific duty and tax exemptions are allowed from time to time by the government for the sake of competitiveness, for reducing cost of production of export items, and on religious as well as social welfare grounds.

Basis for making tax policies

The prime objective of any tax policy is to collect revenue for the government for meeting its expenditure needs. However, taxes are a powerful instrument for addressing many other socio-economic issues.

From a study of budget speeches of different years one can note a number of socio-economic goals that have been pursued by Bangladesh government over the two decades. Some of them are (a) protection to local industries against unfair competitions from the foreign imports, (b) discouragement to use of luxury goods, (c) exemption to raw materials for encouraging local production. (d) exemption to capital machinery for encouraging domestic investment, (e) encouragement to investment in the less developed areas, (f) encouragement to assembly industry, (g) lowering of tax incidence for essential consumer goods to help the low income people, (h) bolstering the import-capacity by encouraging the establishment of export based industries, (i) discouragement to consumption of alcoholic beverages, (i) concessionary rates for the goods imported for use in agriculture or poultry, (k) income tax exemption for low income groups. However, pursuance of such policies is not coherent, and does not emanate from any pre-determined principles to be applicable in all similar cases. This occurs due to absence of tax planning and for want of committed taxation principles.

The National Board of Revenue plays a major role in preparing the tax proposals and for that matter the Finance Bill. In doing so, it consults trade and industrial bodies while in many cases it receives instructive advice from higher levels of the political government. However, while government pursues many socio-economic objectives through tax policy, it does not seem to strive for obtaining an *ideal* or *optimal* tax system in the country. There is no government document that binds NBR to obtain an economically optimal tax system. In this situation, NBR enjoys a huge freedom in formulation of tax measures, the bottom line being the achievement of revenue target. Yet NBR's pattern of working is highly *reactive* in nature. While it carries out governmental directives and responds to the needs of the clientele, it is not very frequent that it reviews its own policies with the aim of modernization and optimization.

Not only that NBR is reactive, its approach is also incremental in nature. This point is brought out if tax measures of consecutive budgets are compared. The justification for the tax proposals is briefly offered in the budget speech. Fuller explanation is available with NBR that prepares tax proposals in the form of *broad sheet* for discussion at different levels of the government before they are approved for placement before the parliament. Such records are neither properly maintained nor they are easily accessible for a researcher.

In this circumstance, it will be useful to discuss the underlying principles and strategy of our tax policy and different tax measures, as described in

only the budget speech. In this paper, a period from 1985 to year 2000 is covered. Mid-1980s is a good starting point because since then need for tax reform has been voiced and efforts have been made at modernization, simplification and rationalization of our tax and tariff regime in line with the global and regional trends. The discussion will inform the reader of the trend of tax policy making in Bangladesh for a good period of time, the areas of priority considerations and the objectives that are sought to be met through budgetary measures. It will also educate us on the nature of rationale that is used for proposing change in the tax policy and measures.

It will give us a good opportunity to look into the perspective of our fiscal policy related to tax measures undertaken during the last fifteen years or so. It will also give us an idea of the efficiency of our tax department as to the fulfillment of the revenue targets assigned to them during the noted period.

Tax Measures for FY 1985-86

This year M. Syeduzzaman, a retired bureaucrat and the then Financial Advisor to the government of General H.M. Ershad placed the budget before the Parliament. The budget laid greater emphasis on direct taxes and local production taxes as a source of internal revenue collection that indicated a shift of emphasis from import duties. Traditionally, imports appear to be a very convenient tax handle to the policy makers.

The basis of import tax measures was to use import tax not only as a means of revenue collection but also as a tool for industrialization and export growth. The concessionary rate of duty on capital machinery and equipment of 2.5 percent for under-developed areas and 15 percent for developed areas was replaced by a tax rate of 2.5 percent for under developed areas, 10 percent for less-developed areas and 20 percent for developed areas. Customs Duty on a large number of items and raw materials considered essential for industrialization was reduced by various extents and duties on a number of finished goods were also enhanced with a view to protecting the domestic industries. Regulatory duty at a rate of 25 percent of the statutory rate of customs duty was imposed for the items which, previously banned, were now made importable in course of liberalization of the Import Policy. Tariff values for the purpose of customs assessment were fixed for a number of new items and a few existing Tariff values were abolished. Export duty on wet blue leather was unified to 5 per cent from three former rates, namely, 2.5, 5 and 10 percent.

A major procedural change was brought in the realm of excises. A regime of self-assessment and self-clearance was introduced in Bangladesh with effect from 1st January 1985. This ended the century long regime of physical control of goods by the excise inspectors installed at the factory premises. The price of natural gas, an item with Excise duty, was increased by 20 percent with the objective of increasing Excise Duty collection from the gas sector. Rate of Excise duty on Biri (a type of handmade cigarette) was enhanced. The rate of capacity taxes for collection of Excise duty on Cinema was enhanced from 5 per cent to 10 per cent for sub-urban areas and from 10 per cent to 20 per cent in case of the district headquarters. Regulatory duty of 2 per cent imposed in FY 1984-85 on 18 types of excisable goods and services was extended for this financial year also. Notably, regulatory duty is leviable only for a fiscal year. Also sheet glass was brought under purview of 2 percent Regulatory duty. The highest limit of capital investment allowable for Cottage industries was raised from Taka 50,000.00 to Taka 100,000.00. The restriction on the maximum number of employees was also raised from 10 to 15.

In the realm of Income Tax, the limit of exemption limit for individual assessee was raised from Taka 20,000.00 to Taka 30,000.00. The number of tax slabs in the same category was reduced from 9 to 5. For registered firms the highest rate of Income Tax was reduced from 30 per cent to 25 per cent. The limit for compulsory submission of statement of assessment and liabilities with the Income Tax return was enhanced from Taka 50,000.00 to Taka 80,000.00. The tax holidays for new industries scheduled to end on 30th June 1985 was extended for a further period of 5 years up to 30th June 1990. A 10 percent AIT was imposed on the interest earnings of fixed deposit bank accounts with capital in excess of Taka 40,000.00.

Gift Tax law was abolished in this fiscal year. For the determination of net wealth for Wealth tax calculation, the exemption limit for value of agricultural land was raised from Taka 100,000.00 (fixed in 1969) to Taka 300,000.00.

In this financial year, NBR's revenue target was Taka 2995.00 crore while the actual collection rose to as high as Taka 3054.13 crore. The actual collection exceeded the target by a margin of 1.97 percent and previous year's collection by 12.10 percent.

Tax Measures for FY 1986-87

This year the budget was placed by the Adviser in charge of Finance M. Syeduzzaman. The basic objective of this year's policy were additional protection to domestic industries, control of smuggling and tax evasion, encouragement to investment, exportation and employment creation, simplification of tax collection procedure and strengthening of the tax administration.

Customs duty and sales tax on a large number of items used as raw materials were reduced, relating to important industries, including textiles and steel and engineering. Customs duty and sales tax on a large number of items were enhanced to protect a range of domestic industries. Duty rates were also raised to protect revenue earning following a fall in international prices of major items like Crude Petrolium Oil (CPO) and crude and refined Soybean oil. Regulatory duty imposed on some items like duplicating ink, G.I. pipe, TV (black and white) and ballpoint pen in FY 1985-86 was discontiued this year. Tariff values for a number of items were revised and coverage of the same was further expanded to in order to remove valuation problems at the entry point. Concessions allowed to passengers under the Baggage rules were elaborated. A salient feature of such concessionary measures was the exemption of customs duties on personal computer of a maximum value of Taka 60,000.00 in excess of 20 percent of the normal rate.

In case of *ad valorem* Excise duty the highest rate was reduced from 30 percent to 25 percent. The price of natural gas, 85 of which is appropriated as Excise duty, was enhanced by 20 percent. Rate of Capacity tax on Cinema halls was also enhanced.

Various amendments were made in the Income Tax laws and rules with a view to simplifying the calculation and collection procedures. Tax rebate at the rate of 2.5 percent and 5 percent respectively were allowed to small and cottage industries for rise in production by more than 15 percent and 25 percent respectively over the preceding year. The rate of interest allowable to assessees on account of delay in payment of refund was revised from 12 percent to 15 percent. New 'High-tech' industries in the EPZ were allowed tax holiday for 10 years with the facility of accelerated depreciation of 100 percent of the actual cost of machinery and plant. Dividend income of non-resident shareholders was made tax exempted during the tax holiday period. Aggregate income and wealth tax fixed at a maximum of 60 percent in 1981 was reduced to 50 percent. Unmovable properties transfer tax was enhanced from 1 percent (fixed in 1981) to 2 percent. A new air ticket tax on domestic and international travel was imposed and the existing rates of foreign travel tax (for land and sea) were enhanced. Turnover tax at a rate of 2 percent on the commission was levied on indenting firms.

In this financial year, NBR's revenue target was Taka 3576.00 crore while the actual collection was Taka 3576.20 crore. Actual collection was 17.09% higher than previous year's collection; it exceeded the target by a small margin of 0.01 percent.

Tax Measures for FY 1987-88

IN FY 1987-88, the budget was placed in the Parliament by the technocrat Finance Minister of the ruling Jatiya Party government M. Syeduzzaman. In this budget customs duties and sales tax on industrial raw materials were reduced to help rapid industrialization and the same on a number of finished products was also reduced for maintaining price stability and checking smuggling. Major sectors benefited in this regard were steel an engineering industry, textile industry, chemical industry and road transports sector. The rate of Development Surcharge (DSC) on all dutiable goods was raised from existing 2 per cent to 5 per cent. The highest duty rate of 400 percent in the tariff schedule was abolished. As a result, the highest statutory rate of customs duty stood at 300/350 percent.

In case of Excise duty the limit of investment in machinery for exempted Cottage industry was raised from Taka 100,000.00 to Taka 300,000.00 and all other conditionality relating to the nature of the company and the number of employees were withdrawn. Specific Excise Duty rates on a number of items was revised upward. At the same time, Regulatory duty(RD) of 2 per cent on some excisable items was withdrawn.

In case of Income tax, the exemption limit for individual assessees was raised from Taka 30,000.00 to Taka 36,000.00. The limit for compulsory submission of statement of assets, liabilities and expenses was raised from Taka 80,000.00 to Taka 100,000.00. The list of items on which a 2 percent AIT was applicable at the stage of importation was further expanded. Provision was made for acceptance without questions by tax authority of the return of income by an assessee, other than a company, for income from *other sources*, by paying 20 percent higher tax than the previous year. Corporate Tax rates for publicly traded company, non-publicly traded company, and banks and other companies were reduced from 45, 50, and 60 per cent to 40, 45, and 55 percent respectively. All exemptions in Foreign Travel tax were withdrawn.

In FY 1987-88, NBR's revenue target was Taka 4028.00 crore while the actual collection stood at Taka 4068.71 crore. Actual collection exceeded the target marginally by 0.01 percent although it corssed previous year's target by 13.77 percent.

Tax Measures for FY 1988-89

General Abdul Munim, the Minister for Finance, presented the budget FY 1988-89. This year, the policy emphasis was on increasing collection of consumption tax on domestically produced goods and Income Tax to lessen dependence on import duty as a source of government revenue. Customs duty on raw materials of many industries notably, steels and engineering, chemicals, textiles, and transport sector were drastically reduced. However, presumably in a bid to compensate for the revenue loss, the rate of DSC was further enhanced this year from the existing 5 percent to 6 percent. Classification and assessment of imported goods based on the Harmonized system of Nomenclature (Harmonized commodity description and coding System, or HS Code system for short) for Customs Tariff was introduced in Bangladesh, replacing the former CCC Nomenclature with effect from the 16th June 1988.

In addition to the revision of Excise duty on a number of items, the capacity-based Excise duty on Cinema houses, introduced in 1983, was abolished and the Excise Stamp on cinema ticket system was introduced. A Regulatory duty of 10 percent and 5 percent of the livable Excise duty was imposed on cigarettes and services rendered by hotels and restaurants.

In case of Income Tax, a Surcharge of 10 percent of the Income tax payable was imposed. The scope of deducting Income Tax at source was expanded to include house rent paid by government, sector corporations, and public limited companies to the landlords; manpower exporters; travel agencies, and filmmaking. The initial capital investment in 'self assessment procedure' was raised from Taka 150,000.00 to Taka 200,000.00. The amount of Air Ticket tax for international routes was increased from Taka 100 to Taka 150 per ticket. Notably, a new tax called Insurance Premium tax at the rate of 5 percent of the premium paid on general insurance policy was imposed this year.

In FY 1988-89, NBR's revenue target was Taka .4557.70 crore while the actual collection was Taka 4490.99 crore. The actual collection exceeded last year's collection by a good margin of 10.38 percent, but amounted to 98.54 percent of the target.

Tax Measures for FY 1989-90

It turned out to be the last annual budget of Jatiya Party government headed by General Ershad. The budget was placed before the lawmakers in the parliament by Professor Wahidul Haque, a renowned economist and the Finance Minister. Broadly speaking, tax measures for this fiscal year was based on the fiscal policy of encouraging personal and corporate savings, investment, creation of employment and alleviation of poverty.

In case of customs duty, high duty rate of 150 and 100 per cent chargeable on many imported items were lowered to 100, 50, 20 and 10 percent depending on the economic nature and public importance of the goods. At the same time Sales tax on these items were lowered from 20 per cent to 10 and 0 per cent. Existing 6 per cent Development Surcharge was again enhanced to 8 per cent. It may be mentioned here that DSC was chargeable on all commodities irrespective of concessions and exemptions of other forms duties and taxes. For the purpose of easier customs assessment, Tariff values for 115 classes of goods were revised.

Excise duties (*ad valorem*, specific rate and capacity duty) on a number of items including important excisable items like cigarettes and Biri (manually made cigarettes) were also revised.

In case of Income tax, the existing surcharge of 10 percent of the income tax payable was raised to 15 percent. The list of items for collection of AIT at the stage of importation was further expanded. Clearly, imports provided an easy handle to the policy makers for collection of income tax.

Foreign travel tax was enhanced from the existing 5 per cent to 12.5 per cent and Air Ticket Tax on international travel was abolished while the rate of domestic Air Ticket Tax was enhanced.

Electricity duty was raised from the existing Taka 0.06 per unit to Taka 0.10 per unit. Also, the Shop Tax, based on floor space and introduced in 1983, was abolished in course of this budget.

This year, NBR's revenue target was Taka 5352.36 crore. However, actual collection was as much as Taka 5292.01 crore. This year also the actual collection exceeded the previous year's collection by a margin of 17.84 percent; it could reach 98.87 percent of the target.

Tax Measures for FY 90-91

Tax measures of this year were almost identical to those of FY 1989-90.

No change in number of duty slabs, VAT rate and Income Tax rates and exemption limits. Actual collection in this year was Taka 6152.35 crore exceeding the target of Taka 6011.10 crore by a small margin of 2.35 percent and previous year's collection by 16.25 percent.

Tax Measures for FY 91-92

In formulating the tax proposals for the FY 1991-92, special attention was given to the introduction of new and advanced techniques for revenue collection, simplification of payment methods and procedures, which included elimination and adjustment of distorted tax system of surcharge, plugging of loopholes, broadening of tax base, introduction of a more reliable method for the valuation of imported commodities and enhancement of the efficiency of the tax collecting machinery.

In case of Income tax, the provision of acceptance of the income tax returns filed by the public limited companies, sector corporations and nationalized banking, industrial and business enterprises as correct and complete subject to fulfillment of certain conditions was introduced. To encourage investment in housing capital gains arising from transfer of vacant residential lands were exempted from tax provided the gain was invested in the acquisition of new residential housing property within two years of income tax chargeable on income. The existing surcharge chargeable at the rate of 15 per cent on income was withdrawn. To recoup the consequent revenue loss, at least partly, the existing corporate tax rats of 40 and 45 per cent respectively applicable in the case of "publicly traded" industrial companies and "not publicly traded" industrial companies were enhanced to 45 per cent 50 per cent. The highest rate of individual income tax was lowered from existing 50 per cent to 45 percent.

The income ceiling for the purpose of levying income tax was raised to Taka 1,00,000 (one lac). The provision of compulsory filing of statement of assets and liabilities for an individual having an income exceeding was Taka forty thousand was relaxed.

The existing provision of an industrial company enjoying tax-holiday having to invest 50 per cent of its exempted profit for the purchase of Government bond was lowered to 20 per cent. The existing ceiling for investment allowance was re-fixed at one-third of the total income or Taka two hundred thousand, whichever was less. In the interest of mobilizing domestic resources, the ceiling of investment allowance was lowered to 30 per cent of total income or Taka 1,00,000 whichever was less.

So far public limited companies was entirely exempt and dividend up to Taka 15,000 issued by private limited companies was also exempt. To encourage savings, investment and the capital market dividend up to Taka 30,000.00, issued by the public limited companies except inter-corporate dividends was exempted, to deduct tax on dividends at source at the rate of 10 per cent in the case of recipients other than companies and at the rate of 10 per cent in the case of companies the existing partial exemption of dividends issued by private limited companies was withdrawn. The duration of tax-holiday scheme earlier extended up to 2000 by the Finance Act, 1989 was curtailed to expire by the end of 1995. The existing provision of tax exemption of donations to sports federations and clubs up to five hundred thousand Taka was made to restrict to the case of sponsors of first class national and international games and sports only.

The existing Wealth Tax exempted value –limit of Taka 25,000,00 for a house where the owner himself lives was raised to Taka 50,00,000.

The current rate of travel tax for Bangladeshies traveling abroad (other than SAARC countries for which a fixed tax of Taka 500 was charged) by air at the rate of 12.5% of the fare subject to a minimum of Taka 250 and maximum of Taka 2000 and, was lowered to 10% of the fare subject to a minimum of Taka 250 and maximum of Taka 1500 and Similarly, for foreign travel by land this tax was lowered to Taka 150 from Taka 250 per traveler and for travel by sea to Taka 500 in place of the existing Taka 800 .

The principles followed in formulating budgetary proposals for FY 91-92 whereas follow: simplification of the import duty structure; reduction of duty on some items of common use; assistance to post-cyclone and post-flood rehabilitation and reconstruction efforts; improvement of communication systems of the country; rationalization of import duty structure by removing anomalies; protection of the legitimate interests of domestic industries; encouragement to education, research and health services; and augmentation of revenue and prevention of misuse of foreign exchange. Based on these principles customs duty on a large number of industrial raw materials used by the domestic industries and a number of finished goods of common use and used for education, medical services and scientific research were reduced at different rates. At the same time to augment government revenue and to discourage consumption and investment in a few sectors customs duty on a number of items were increased by various percentage. In many cases customs duty rates were unified to a single rate to remove anomalies in the

customs duty rates. Import of gold bullion up to 200 grams of payment of a duty of 10 percent *ad valorem* were allowed to the incoming Bangladeshi passengers.

Introduction of Value Added Tax (VAT) from 1st of July, 1991, in this fiscal year represented a land mark in the history of Tax Policy of Bangladesh. VAT replaced Sales Tax at the import level and Excise Duty on all local products with the exception of a few commodities, such as, tobacco products, natural gas, petroleum products, and also a few services. At the local level VAT was initially limited to manufacturing stage. This threshold A flat rate of 15 per cent Vat was payable by a business unit with an annual turnover exceeding Taka 15,00,000.00 and those with a turnover below this threshold paying a 2 per cent Turnover tax (excepting those enjoying Cottage industry benefit).

Excise Duty on natural gas used in the production of fertilizer and power was raised by 5 percent and in other cases, by 10 percent of the existing rates. Excise Duty at the rate of Taka 120.00 per account per year on bank accounts with a balance of Taka 5,000.00 – Taka 1,00,000.00 at any time in a year and Taka 200.00 per account with a balance exceeding Taka 1,00,000.00 was levied.

Development Surcharge (DSC) at the rate of 10 percent of the excised duty on most of the excisable goods and services was withdrawn.

In this financial year, NBR's revenue target was Taka 7260.00 crore while the actual collection rose to Taka 4347.72 crore. The actual collection exceeded the target by a small margin of 1.21 percent, although it was 19.43 percent higher than the previous year's collection.

Tax Measures for FY 92-93

This year the main objective of fiscal reforms was to raise the revenue-GDP ratio through enhancing the growth rate of revenue by rationalizing fiscal laws and structures, improving fiscal management and expanding computerization. In the face of poor performance of the Import Substitution strategy pursued during the last decade and also based on the experience of developing countries like Bangladesh, the thrust/emphasis of government tax policy shifted to the Export-led Growth strategy, liberal competitive economy and minimization of bureaucratic control by the government. The main objectives to reform the existing anachronistic and weak Income tax system were reduction of high rates of tax; minimization of multifarious exemptions and their rates; simplification of return submission and tax-payment procedures and reduction of discretionary powers of the tax officials.

In case of Income tax *Filing Threshold system* was replaced by the *Conventional Exemption Limit* system. To explain a little more, under the existing system the maximum limit of income not liable to tax was Tk 40,000 for assesses other than companies and non-residents. For income exceeding this limit, tax was levied on the entire taxable income determined after deduction of admissible allowances on a straight -line method? Under the changed system, tax will be charged on the residual amount of income after deduction of Tk 40,000 from total income. To take an example: under the Filing Threshold system a person with a total annual income of Tk 41,000 will be taxed on the entire amount after deduction of admissible allowances. But under the Conventional Exemption limit system Tk 40,000 will be deducted and tax will be imposed on the balance of Tk1000 only. This year highest personal income tax rate was reduced to 30% from 40%. The maximum limit of taxing annual income in excess of Tk 40,000 was reduced to one fourth of such income from previous one third. The Corporate tax rate on publicly traded and non-publicly traded companies were reduced to 40% and 45% respectively from 45% and 50 % respectively.

On the other hand, measures were taken to adopt a special programme to rationalize the Customs tariff structure through reducing high duty rates and their numbers, limiting the scope of exemptions and their rates, and simplifying valuation and duty collection procedures.

In case of Customs tariff, the number of duty rates were reduced from the existing 11 to only 7, namely, 100%, 75%, 60%, 40%, 30%, 15% and 7.5%

In FY 92-93 the revenue target for NBR was Tk. 8450.00 Crore and the actual collection was Tk. 8537.78 Crore. It means that the actual collection was 1.04% more than the target fixed.

VAT was introduced in Bangladesh in the budget of FY 91-92. This year, budget decisions extended VAT to a number of items and services including natural gas, cigarettes, insurance, courier services and advertising agencies. To simplify tax collection, only 5 effective rates of supplementary duty, namely, 32.50%, 47.50%, 50%, 53% and 56% were introduced in place of existing 29. Excise duty rates.

In this financial year, NBR's revenue target was Taka 8450.00 crore while the actual collection rose to Taka 8537.78 crore. The actual collection exceeded the last year's collection by a good margin of 16.20 percent; the target was exceeded by a margin of 1.04 percent.

Tax Measures for FY 1993-94

Tax measures of FY93-94 were a continuation of the policies pursued during the last two years of BNP government rule. The Income Tax Ordinance was thoroughly amended to make the low simple and modernize the tax administration. The existing exemption limit of income tax for individual assesses was raised from Taka 40,000.00 (forty thousand) to Taka 50,000.00 (fifty thousand) and at the same time highest tax rate for individuals was reduced from 30 percent to 25 percent. The corporate tax rate for banks, financial institutions and non-industrial companies was reduced from 55 percent to 50 percent. The system of computing income from self-occupied houses of the owners was discontinued and exemption limit for income from housing was raised from Taka 20,000.00 (twenty thousand) to Taka 30,000.00 (thirty thousand). The rate of deduction of income tax at source for contractions was reduced from 3 percent to 2.5 percent and raised from 6.25 percent to 10 percent for manpower export. The system of computation of Capital gains on the basis of market price of the property at the time the current owner inherited it was reduced in place of calculation on the actual cost of acquisition to immediate previous owner.

Measures for Customs Duty was aimed at supplementing the broad economic policy of open and competitive economy – a clear departure from a projectionist policy characterized by high tariff walls aimed at existing Customs Duty rates for protection to local industries ranged from 72 percent to 118 percent protecting the domestic industries. However to protect the economy from unfair trade practices by the foreign producers provision for Anti-dumping and countervailing duty was introduced in the Customs Act, 1969. In this budget Customs Duty on 2870 items out of a total dutiable 12800 items were reduced to various extent. In view of increase in food grain production a 7.5 percent Customs Duty was imposed on import of rice and duty on wheat was raised from 7.5 percent to 15 percent.

The turnover tax limit of Taka 5,00,000.00 (five hundred thousand) was raised to Taka 7,50,000 (seven hundred and fifty thousand) VAT was withdrawn from cattle and poultry feed, milk products, all kinds of insecticides and jute cuttings. Foreign travel tax rate was enhanced.

In FY 93-94 the revenue target for NBR was Tk 9200.00 crore and the actual collection was Tk 8995.51 Crore. The total revenue collection in FY 93 – 94 was Tk.8995.51 crore as against a target of Taka 9,200.00 – i.e. revenue collection fill short by 2.20 peak of the target fixed by 97.78% of the target was achieved.

It is worth nothing that there has been a systematic reduction in customs duty rates during the 1991-94 period as evidenced from the fact that number of commodities with a duty rate of 100 percent or more came down to on 56 in FY 93-94 as against 2734 in FY 90-91.

In this financial year, NBR's revenue target was Taka 9200.00 crore while the actual collection stood at Taka 8995.51 crore. Although this year's actual collection exceeded the last year's collection by a good margin of 5.36 percent, it fell short of target by 2.22 percent.

Tax Measures for FY 1994-95

In this budget the rate of Income tax for publicly traded companies and non-publicly traded companies were reduced to 37.5 percent and 42.5 percent respectively from 40 percent and 45 percent respectively. Exemption limit of individual income was raised from Taka 50000.00(fifty thousand) to Taka(fifty five thousand) and the minimum tax for individual income tax assesses was fixed at Taka 1200.00 (twelve hundred). Minimum tax for self-assessment was increased from Taka 1500.00 to Taka 1800.00. The existing limit of allowable prerequisites was raised from Taka 60000.00 to Taka 72000.00. The provision was introduced so that no Wealth-tax would be payable on one house/flat/apartment regardless of its value if occupied by the owner himself.

The highest rate of customs duty was reduced to 60 percent and customs duties in case of 3116 H.S. Codes of goods were lowered. Voluntary Pre-shipment inspection (PSI) system was introduced for imported goods in Bangladesh.

VAT applied so far to import and manufacturing stages was extended to allow the wholesalers and retailers on a voluntary basis [94-95 Page 20 'Ka']. Supplementary Duty (SD) was withdrawn from 34.1 items ranging from 10 percent to 350 percent out of a total of 426 items of manufactured on which SD were applicable. An additional travel tax of Tk 50.00 on the existing rates of travel tax for all classes of passengers was levied.

This year all surcharges and levies for Jamuna Bridge, introduced in 1985, were withdrawn.

In FY95-96 the revenue target for NBR was Tk 11,300.00 Crore and the actual collection was Tk 11,370.06 crore, which was 8.05 percent higher than the last year's collection but only 0.62 percent higher than the target.

Tax Measures for FY 1995-96

This was the last budget of NBR government, which assumed power for five years in 1990. Substantial amendment was made in the Income Tax Ordinance to make the collection system easier and simple through reduction of discretionary power of the Income Tax Officials. As far as tax rates are concerned corporate tax rate for publicly traded companies was reduced from 37.5 percent to 35 percent for non-publicly traded companies from 42.5 to 40 percent and for banks and financial institutions from 50 percent to 47.5 percent. Tax holiday facility was extended for a further period of five years and the facility was extended to physical infrastructure facilities and extraction of mineral resources run on a commercial basis. To stimulate capital market all transfer of shares except bonus shares were exempt from tax on capital gains. The exemption limit of Tk. 30,000 allowed on income of house property was raised to Tk. 36,000 and extended for a further period of five years. Income Tax on insurance, commission receipts of less than T. 25,000 was abolished. Most notable change in customs duty was lowering of highest rate of Customs Duty to 50 percent from existing 60 percent. Customs duty on low lift pumps, shallow and deep tube wells, diesel engines (up to 45 HP), oil cakes were abolished. Customs duty on various items was reduced to various extents. These items include vitamins for poultry industry, some 1028 items of intermediate raw materials, transformers, glass lenses, television, fridge, sewing machines, life-saving surgical and eye surgery instrument, iron oxide, potassium chlorate, adhesive and duplex outer shells were reduced to a substantial extent.

This year NBR's revenue target was Taka 11,300.00 crore and the actual collection amounted to Tk 11,370.06 crore implying an excess of 0.62 percent over the target and 8.05 percent over last year's collection

Tax Measures for FY 1996-97

In this FY the highest rate of Customs duty was reduced from 50% to 45%. In case of Income tax the annual limit of tax-free amount was raised from Tk 55,000 to Tk 60,000. In order to encourage exports of the Income tax deductible at source from the exporters was reduced from 0.50% to 0.25%. Capital profit arising generated from transfer of stocks and shares of Public Limited companies were made tax-free.

In FY 96-97 the revenue target for NBR was Tk 13,040 Crore and the actual collection was Tk 12.503.25 Crore. This year's collection exceeded last year's collection by 9.97 percent although it fell short of the target by 4.12 percent.

Tax Measures for FY 97-98

Major tax measures for this FY included lowering of highest effective rate of Customs duty from 45% to 42.5%.In order to protect the local industries from unfair competition from foreign goods Safe guard Duty was introduced in the Customs Act,1969.To reduce smuggling of gold and precious metals and encourage legal imports of the same provision to allow a Bangladeshi passenger coming home from abroad to import in his/her baggage up to 5KG gold and 15KG silver on payment of tax at a very nominal rate and import of gold ornaments up to 200 Grams per passenger free of customs duty was introduced. In case of Income tax to reduce tax burden of the taxpayers the lowest personal income tax rate was lowered from 15% to 10% Income tax rate for banks, insurance companies, investment companies and foreign companies was also reduced from 45% to 40%.

In this financial year, NBR's revenue target was Taka 14100.00 crore while the actual collection stood at Taka 13801.79 crore. The actual collection exceeded the previous year's collection by a margin of 10.39 percent, by failed to achieve the target by 2.11 percent.

Tax Measures for FY 1998-99

Important tax measures fro this FY were: Number of tax slabs for Customs duty was reduced from 6 to 5 (7.5%,15%, 25%, 30% and 40%) . The highest rate of effective Customs duty was lowered from 42.5% to 40%, which resulted in the lowering of the customs duty rates on goods of 2325 H.S. code. In respect of Income tax the highest limit for tax exemption for investment was raised from Tk 1,00,000 to Tk 1,50,000.

In FY98-99 the revenue target for NBR was Tk 14,850 Crore and the actual collection was Tk 14,862, which was 7.73 percent higher than the last year's collection and only 0.13 percent higher than the target.

Tax Measures for FY 1999-2000

Tax policy of FY 99-2000 was A was to encourage and support the local industries; simplify the tax system and reduce the tax burden of the citizens; contain smuggling and increase revenue through rationalization of the tax system.

In line with the principles of tariff rationalization and simplification the number of tax rates was reduced from 5 (2.5% 7.5%, 15%, 25% and 40%) to

4 (5%,15%, 25% and 37.5%) only. The highest rate of Customs duty was lowered from 40% to 37.5%. Mandatory Pre- Shipment Inspection (PSI) system was introduced from February 15, 2000 for all imported consignments (initially PSI was to apply to all consignments the individual CIF value of which exceeds US$5,000 and later this limit was abolished) with some exemptions including government imports and Zero-rated goods as notified by the GOB. Under the new system 95 percent of total imported consignments are being released by customs authority on the basis of Clean Report of Findings (CRF) without any physical examination. For customs valuation of imported goods in place of long existing Brussels valuation Method the Transaction Value Method based on GATT Valuation Agreement was introduced from 23rd February,2000. Consequently, Tariff values for about 2200 items of imports were abolished. However, SD ranging from 5 per cent to 10 per cent were imposed on imports of goods for which tariff Values were abolished.

In VAT the annual threshold limit of Turnover tax was raised from Tk 1.5 million to Tk 2 million .As a result business units with an annual turnover of Tk 2 million or more will be subject to pay VAT as compared to those with an annual turnover of Tk 1.5 million-the threshold limit that existed for VAT since the introduction of VAT in July, 1991.

For personal Income tax the exemption annual limit was raised from Tk 60,000 to Tk 75,000.Tax holiday were granted to the hospitals established between July 1, 1999 to June, 2000.Advance Income tax at source at the rate of 0.2.5 percent for export business was abolished. Spot assessment system for small business units and shops was introduced. Wealth Tax collected under the Wealth tax Act, 1963 was abolished and replaced by a surcharge at a rate of 3 per cent y on the amount of Income tax in case of net wealth at acquisition cost exceeds Tk I million.

In FY 99-2000 total revenue target for NBR was Tk 16,000.00 crore and the collection was Taka 15,115.02 crore implying that 94.47 per cent of the target was achieved, although it marginally exceeded last year's collection by 1.65 percent.

Tax Measures for FY 2000-2001

Major objective of this year's tax policy was to maximize the benefits of globalization process while protecting our domestic industries unfair and uneven competition from abroad. In Income tax changes were made to reduce tax burden of the lower income group, widen the tax base, check tax evasion, continue incentives for industrial investments, encourage declaration of proper income and reduce the complexities of tax Law. The exemption limit for individual assesses was raised from Tk. 75,000.00 to Tk. 1,00,000.00.

Currently The rate of surcharge for individual assesses whose net wealth at cost exceeds Taka 30,00,000.00 was raised from 10 percent to 15 per cent of the payable income tax by supplementing the existing provision of 10 per cent surcharge for assesses whose net wealth at cost exceeds Taka 10,00,000.00. The provision for granting tax holiday to new industrial undertakings scheduled to end on 30th June 2000 was extended up to 30th June 2002. Special provision was made allowing declaration of untaxed/undisclosed income by any person up to 30th June, 2001, on payment of tax at the rate of 10 percent which was be accepted by the Income tax authority without any question.

In the interest of industrialization and for providing reasonable protection to the local industries, duty rates were to be kept at 5 percent for basic raw materials, 15 and 25 percent for intermediate raw materials and semi-finished goods and 37.5 percent for finished goods.. To encourage legal import of gold and export of gold ornaments made in Bangladesh, the import quota of gold per person under the Baggage Rules was enhanced from 5 kg to 10 Kg and the duty rate reduced from Taka 300.00 to Tk. 200.00 per tola (grms) and the import quota of silver from 15 to 20 Kg per person.

In VAT the concept of "trade service" was abolished and VAT at a uniform rate of 2 per cent was imposed on all sales of goods covered by VAT. Facilities of no audit and inspection by VAT officials extended in FY 99-2000 to the manufacturers paying a minimum of 20% additional VAT over previous year's payment was withdrawn this year due to widespread misuse of the same by the business units.

Existing supplementary duty structure on motorcars at import stage was restructured by reducing the tax range from 12.5 -152.5 percent to 12.5 - 120 percent. This year total collectin reached Taka 18,807.88 crore exceeding target of Taka 18,000.00 crore by 4.49 percent and exceeding previous year's collection by a huge margin of 24.43 percent.

Major trends in tax policymaking during 1985-2000

We have so far briefly discussed the principles and major objectives of our tax policy as depicted in the annual budget for the last decade and a half beginning from the fiscal year FY 85-86. We have also put forward annual revenue statistics and noted NBR's overall tax revenue targets

and collection from year to year. It is to be noted that the total period of our analysis covers the ruling periods of three major political party governments of Bangladesh, almost 5 years each, of Jatiya Party (JP) headed by General H.M. Ershad (1985-90), of Bangladesh Nationalist Party (BNP) under the leadership of Begum Khaleda Zia (1991-96) and the Awami League (AL) government led by Sheikh Hasina (1996-2000). Such a unique and almost equal period of governance by three political parties certainly offers us a good opportunity for a comparative analysis of our tax policies during the last one and a half decade.

During the entire period under analysis the major objectives and principles behind our tax policies remained more or less similar, namely, promotion of investment, industrialization, export growth; maximization of revenue collection, protecting domestic industry from unfair foreign competition, reforming the tax structure through systematic procedural simplification, reduction, rationalization and unification of tax rates, removal of distortive exemptions and achieving accelerated economic growth, and attainment of social equity and justice.

In case of Income Tax for individual assessees the highest rates has systematically been reduced from the range of 60% in mid-1980s to 24 in 2000 along with reduction in the number of tax slabs in this category. In line with the price escalation with the reduction in tax rates, the limit of exemption for income tax for individual assesses has been enhanced from Taka 30000 in 1985 to Taka 100,000 in 2000. Exemption limits in other cases have also been revised upward to keep conformity with the impact of annual inflationary trends of price indices. Surcharge leviable on the amount of income tax paid, as a source of additional tax revenue, has been a common feature of our direct tax. The DSC rate during our period of analysis has varied in the range of 2 percent to 8 percent. Income tax procedure has been simplified to a great extent in the form of facilities allowing filling of returns by Bangladesh abroad through embassies abolition of wealth tax and merging it with IT. Like self assessment and rebate for the tax payers, and provision of deduction at source, and spot assessment with the process of income tax simplification the discretionary power of the tax officials has been curtailed substantially during the last one decade and a half. Examples are: acceptance of loss on tax returns, opportunity for declaring untaxed income on payment of a nominal tax rate of 10/5 percent were allowed twice- once in FY 1997 and finally in FY 2000-2001 with the result of a declaration of untaxed or black money as we may call it of a total amount falling far short of the projected yield. This has been mainly due to lack of predictability, credibility and stability of our tax policy during all our previous and present government as well as existence of scope of evasion of tax through non-declaration and under-statement of taxable income for the taxpayers. It is undeniably true that when our tax policy changes too frequently instilling an element of uncertainty in the system and when tax dozers go unpunished in many cases, honest tax payers get discouraged to pay tax regularly and correctly.

As a part of the rationalization measures, maximum tariff rate was reduced from a level of 350% in 1991-92- to in 1995-96 and then further down to 42.5% in 1997-98 and 37.5% in FY 1999-2000. Simultaneously with the reduction in the magnitude of customs duty rate the number of slabs of the same has declined. Prior to 1986, the tariff code had 24 tariff slabs. The number of *ad valorem* custom duty rates has been reduced gradually which stood at 12 FY 93-94 and 6 in FY 96-97, 5 in FY 98-99 and 4 in FY 99-2000.

The duty rate varied, not only among different industries, but also between products in the same industry depending upon the type of importer, end use of the product, geographical location of the firm, or the size category of the industry. As a result of these divergent nominal rates, effective rates of protection also varied widely and in a somewhat unsystematic manner. For many products, basic raw materials received higher protection than intermediate output, while these in turn were protected more than final products.

Capital machineries and industrial raw materials have always been attracting lower rates of duty during the entire period starting from 1985. The rate has varied between 2.5 per cent to 7.5 per cent. During the late 1990s and at present as a matter of general principle the custom duty rates for basic raw materials stand at 0 to 5 per cent, intermediate and semi-finishes products at 15 to 25 per cent and 37.5 per cent for finished products.

Substantial changes and amendment of the Customs Act, 1969 has taken place during our period of analysis resulting in the modernization and simplification of customs procedures. Examples of such reforms and changes are numerous. Few of these are: unification of multiple customs duty rates, abolition of user specific rates, introduction of Harmonized System of Tariff Coding, abolition of Tariff values for customs assessment, introduction of duty-free special Bonded Warehouse, system for exporters, substantial expansion of Flat Rates for Duty Drawback system, use of Voluntary and presently Mandatory PSI System in Customs clearance of imported goods, Green Channel for import of raw materials related to exports in the Customs Parts and for passengers in

the International Airports, liberalization of Baggage Rules, introduction of Transaction Value Method for customs valuation based on GATT valuation principles have also been enacted.

During the period of our analysis the discretionary powers of the customs officials have been greatly reduced by removing discretion from the provision of Customs Act. A very important and recent example could be the use of CRF for customs assessment. For imported goods under PSI System, 95 percent of the consignments are released by the customs authority without any physical examination on the basis of CRF certificates containing description, quantity, value, H.S. Code and ITC aspect of the imported consignment issued by the government employed PSI agencies. This has reduced hassles for the importers and reduced average clearance time for imported goods. It is important to note that liberalization of Tariff regime and simplification of customs procedures has been greatly facilitated and supplemented by simultaneous liberalization of our import and export policy in the form of substantial reduction in the number of banned and restricted importable items, abolition of import quota and licensing system, abolition of export taxes, incentives for exports and removal of a large number of conditions for import and export trade. Financial liberalization, especially relaxation of exchange restrictions and modernization of banking system have also helped liberalization of Tariff regimes of our country.

There has been significant decline in the unweighted tariff rate from 57.3% in 1991-92 to 22.3 in 1995-96 and then further down to 20.8% in 1997-98 although the fall in the import weighted tariff rate has been less substantial.

Because of overall tariff rationalization, import weighted mean level of nominal protection came down from 42% in 1990-91 to 21% in 1995-96.

While discussing the changes in nominal rates of customs duty it will be useful for our analysis to briefly discuss about Effective Rate of Protection (ERP) which measures protection to net value added in Bangladesh during the contemporary period of our analysis. Although the manufacturing sector enjoyed an unweighted nominal protection equal to that for the overall economy, the effective rate of protection (ERP) indicates that the domestic sale component of the sector was highly protected in 1992-93 with ERP recorded at 82%. In 1995-96, the estimated ERP in this component of manufacturing came down to 67%.

The comparative picture with regard to tariff reform in south Asia is shown in Table 3. As can be seen from the Table, both with regard to the maximum tariff and the unweighted average tariff, Pakistan had highest rates in 1995 in South Asia followed by India.

Table: 1

Country	Year	Maximum Tariff	Unweighted average	Coefficient of variation	Import weighted average
Bangladesh	1995	50	25	73	21
India	1995	50	41	61	19
Nepal	1994	100	20	n.a	10
Pakistan	1995	65	49	27	n.a.
Sri Lanka	1995	35	n.a.	n.a.	10

Source: World Bank, *Bangladesh; Trade Policy Reform for Higher Export Growth.* (Zaid Bakth)

An analysis of the trends in tax yields in Bangladesh suggest that the tax system in Bangladesh is income inelastic, so the rate of growth of tax revenue tends to fall behind that of GDP unless discretionary measures are taken for enhancing the rate structure and (0r) expanding the tax base. A large and increasing degree of tax evasion is alleged to be the major factor behind this tax in-elasticity, see Task Forces (1991), volume 1, Chapter on Macroeconomic Polices.

Statistics of trade taxes collection in Bangladesh from FY72-23 to FY 97-98 are given in Table below:

Table 2

In Crore Taka

Fiscal Year	Import Duty	Total taxes	Import Duty as % of Total Taxes	Average
1972-73	69.96	166.30	42.0686	
1973-74	125.57	278.08	45.1561	41.89
1974-75	150.62	410.29	36.7106	
1975-76	281.66	673.63	41.8123	
1976-77	277.60	726.07	38.2332	

Fiscal Year	Import Duty	Total taxes	Import Duty as % of Total Taxes	Average
1977-78	398.37	939.66	42.3951	
1978-79	497.29	1146.78	45.3771	
1979-80	625.36	1378.14	43.3889	
1980-81	747.50	1722.79	42.2246	
1981-82	782.65	1853.54	43.6569	
1982-83	869.96	1992.72	41.8534	41.05
1983-84	933.87	2231.29	43.5864	
1984-85	1183.10	2714.38	43.8478	
1985-86	1339.17	3054.13	43.115	
1986-87	1541.88	3576.20	40.6618	
1987-88	1654.41	4068.71	41.0852	
1988-89	1845.13	4490.99	40.385	
1989-90	2137.18	5292.01	38.589	
1990-91	2374.13	6152.35	33.6823	
1991-92	2746.02	7347.72	37.3724	37.75
1992-93	2875.72	8537.78	33.6823	
1993-94	2983.58	8995.51	33.1674	
1994-95	3676.94	10522.56	34.9434	
1995-96	3772.58	11370.06	34.9434	
1996-97	4013.05	12503.25	32.0961	
1997-98	4539.46	13801.79	32.89	

From the above revenue data it is observed that the average share of the trade taxes in the total tax revenue during the 1970s was around 42%, 41% during the 1980s and it came down to 38% during the first 8 years of the 1990s. In other words, there has been a slow but systematic decrease in the contribution of the trade taxes as a source of revenue in Bangladesh.

Regulatory duty has sometimes been used for collection of import duties with its varying range. DSC rates have also declined from usual 10 percent in the late 1980s and early 1990s to current 2.5 percent. In addition to customs duty the application of supplementary duty (SD) as a source of additional revenue has been rampant since early 1990s. The rates of SD applying equally to import and domestic production has varied between highest 270 percent and 2.5 percent. The rate of VAT at the import level, which replaced sales tax in 1991, has remained unchanged at 15 percent since its inception. But the basis of VAT collection has changed. Initially VAT for customs assessment purpose was based on the customs duty paid value (=C & F Value + CD). From FY 97-99 the law was changed to include SD in addition to C&F value in the calculation of import VAT resulting in higher incidence of the latter than the statutory rate of 15 percent.

The SD was initially applicable to items of socially undesirable, luxuries, and health hazards nature. The law was amended in FY 1999-2000 to include any item of revenue need of the country in the net of SD.

The rate of SD during our period of analysis has varied between the lowest 2.5 per cent to the highest 350 per cent (On manufactured tobacco cigarettes). The intermediate rates being 5, 7.5, 10, 12.5, 15, 20, 22.5, 25, 30, 32.5, 35, 40, 45, 50, 55, 57.560, 75, 93.5, 100, 112.5, 125, 152.5.

The rate of AIT collected by the customs authority at import source was enhanced from 2.5 percent prior to 1997, which was increased to 3 percent in 1997. However, License fee of 2.5 percent, also collected at the import level by the customs authority, has not changed during the period under discussion.

Policy reversal

While the trend is receding, the tax authorities have always engaged in tinkering with the rates of duties and taxes. Sometimes, changes made on one ground has been reversed referring to a different reason. Taxes withdrawn once have been re-introduced under a new name. Introduction of IDSC in 1997 in fact constitutes the re-introduction of 'development surcharge', which was withdrawn in 1991, 'under a different name. Concessions given showing one causing have been withdrawn showing another cause. Study of budget speeches will produce many examples of such policy reversals.

Conclusion

As we had noted earlier, NBR played the major role in formulation of the tax policy of the country during the period under consideration. The role of the Planning Commission which is the highest economic body of the country was nil or negligible. However, the Tariff Commission and some ministries of the government as well as private sector trade bodies had some contribution in suggesting tax measures. One can also observe that even the role of the Parliament in shaping the budgetary measures have not been significant. Tax policy making has largely been bureaucratic in nature.

While NBR played the major role in formulating the tax policy of the country, the role of external forces needs to be noted. For example, major reformative efforts like the introduction of self-clearance system in Excise in 1985, introduction of VAT in 1991, introduction of pre-shipment inspection system in Customs first in 1992 and then in 2000, all emanated from sources like foreign aid donors. In this regard, the role of IMF and the World Bank has been substantial in bringing about epoch making changes. NBR's role has largely been reactive in nature.

It cannot be said that a steady tax policy is in place in Bangladesh. Tax measures undergo significant changes from year to year depending on revenue prospect. Emphasis on meeting revenue target is prime, and often vertically inconsistent tax measures are introduced and implemented in order to meet ambitious revenue targets. Also, post budgetary adhoc measures are pursued to achieve targets. Consequently, attempts at simplification and modernization of the tax system have proceeded in a non-committal fashion. It appears that NBR needs to undertake a project for strengthening its tax planning capabilities so that it can develop and follow some fundamental tax principles. Formation of a tax-planning cell at the NBR, with adequate power, may be a useful proposition in this regard.

Notes on the Authors

AHMED MUNIRUS SALEHEEN is currently pursuing academic studies and professional development activities in the area of public policy analysis and tax administration in the Pennsylvania State University U. S. A under the Hubert H. Humphery Fellowship Program. He joined the Customs and Excise department in 1991as Assistant Commissioner, and was later promoted to the rank of Joint Commissioner. Until then he served as a Deputy Commissioner in the Chittagong Customs, Excise and VAT commissionerate. Earlier, he worked as Second Secretary of VAT Policy and Budget at the National Board of Revenue. Mr. Saleheen studied English for his Bachelor and Masters degree and expects to research further for a Ph. D. in near future. He is a writer and translator. He has published two titles to his credit including translation of *Sand and Foam* by Kahlil Zibran.

TANWEER AKRAM Tanweer Akram is an Economist at Global Business Policy Council of A.T. Kearney, an international management-consulting firm. He has worked for Economist Intelligence Unit, International Monetary Fund, and The World Bank. He has taught at Barnard College, Columbia University, and North South University. He was Visiting Research Fellow at the Centre for Policy Dialogue. He was educated at Grinnell College, London School of Economics and Columbia University. His papers and reviews have appeared in various peer-reviewed academic journals, including Applied Economics, Applied Economics Letters, Journal of Bangladesh Studies, Journal of Third Third_World Studies, Kyklos, Savings and Development, and Third World Quarterly. His articles have appeared in Counterpunch.org, Dawn, Holiday, pressaction.com, and Z Magazine. He is the author of Peace for Palestine. He lives in Arlington, Virginia.

Nasir Uddin Ahmed holds a Ph. D. degree in Economics from the University of Sydney, Australia. A career civil servant, Dr. Ahmed is currently working as a Director in the Prime Minister's Office in Bangladesh. He has authored a number of papers on macroeconomic policy issues of the Bangladesh economy, which have been published in international journals like Applied Economics, Public Administration and Development and Indian Economic Review. His areas of interest include macroeconomic policy reforms, child and women development, sustainable poverty alleviation programmes and development management. He is a Joint secretary of Bangladesh Government. Recently he published a book titled "Trade Liberalization in Bangladesh: An Investigation into Trends".

Atiur Rahman, a renowned economist of the country, Dr Atiur Rahman was born in 1951 in the district of Jamalpur. He studied Economics at the University of Dhaka (1976) and the University of London (1979). He obtained his Ph.D. from the University of London in 1983. His dissertation was titled "A Study in Differentiation of Peasantry". Currently he is working as a Senior Research Fellow in the Bangladesh Institute of Development Studies. He has published a number of books in Bangla and English including three on the language movement of 1952. His titles also include Rural Power Structure (1981), The Political Economy of SARC (1985), Peasants and Classes (1986), Demand and Marketing Aspects of Grameen Bank (1986). In addition to economic writing, he regularly writes in the newspapers on popular political, cultural and sociological issues.

Mohammad Alam, joined Bangladesh Civil Service customs & Excise Cadre in 1981. He has worked in a number of responsible positions in the Department of Customs, Excise and VAT and is currently working as the Commissioner at the Dhaka Custom House. A Master of Science in Economics from the Williams College, Mr. Alam is engaged in economic research especially in the fields of fiscal and trade policy.

Faizul Latif Chowdhury joined the Bangladesh Civil Service in the Customs and Excise cadre in 1983. He studied Economics at the Dhaka University (1977-1983) and Public management & public policy at the London School of Economic (1996-97). He also studied at the Monash University (1990-92) for his MBA. He is a literary critic and has so far published 17 books to his credit, in addition to numerous newspaper articles. His book *Corrupt Bureaucracy and Privatization of Tax Enforcement* is due to be published early next year. He was recruited as a Deputy Secretary to the Government of Bangladesh in year 2001. Currently he is working Director (Finance and Planning) in the Prime Minister's Office. Earlier, he was promoted as an Additional Commissioner of Customs and Excise and placed as the Implementation Manager of the Customs Administration Modernization project. E-mail: flc@bdmail.net

Contents of 5 issues

Fiscal Frontiers, January 1993
Editor: Saiful Islam Khan

Fiscal Frontiers, December 1994
Editor: Saiful Islam Khan

Fiscal Frontiers, August 1997
Editor: Saiful Islam Khan

Fiscal Frontiers, September 1999
Editor: Saiful Islam Khan

Fiscal Frontiers, January 2003

Editor: Mohammad Alam

AHMED MUNIRUS SALEHEEN
Input Tax Credit System in Bangladesh VAT

TANWEER AKRAM
Tax Compliance Record Of Privatized Firms Results of an Empirical Inquiry

NASIR UDDIN AHMED
Tax Imports

ATIUR RAHMAN
INDO-BANGLADESH Informal Border Trade

MOHAMMAD ALAM
FAIZUL LATIF CHOWDHURY
Tax Policy Making In Bangladesh: 1985-2000