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## **Fiscal Frontiers**

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### Editorial Note

The current- the sixth- issue of the Fiscal Frontiers, the journal of BCS (Customs and VAT) Association is being published after a long pause of about six years. The first issue of this journal was published in 1993 with a view to contributing to the understanding of issues like tax policy, development, globalization of international trade, revenue reforms. The Fiscal Frontiers aspired to become an intellectual platform for sharing knowledge and information that would help in professional development as well as the development of the country through internal resources mobilization and trade facilitation.

The function of a tax man has never been expressed more vividly than what the French Economist and Minister of Finance under King Luis XIV, Jean Baptiste Colbert, said, "The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing". But in a globalized economic situation of which we are an integral part, mastering the mere art of taxation i.e. acquiring professional skills is barely adequate to face the challenges that we as tax professionals face. For, our traditional role of revenue collector has been redefined as that of the trade facilitator. A comprehensive understanding of the dynamics and mechanism of international trade as well as those of fiscal issues with

relation to our socio-economic development is a must for each of us that has anything to do with tax, trade or development. This journal, right from its inception, despite its intermittent hibernation, aspires to contribute to that end. All the articles published in the current issue, we hope, will bear some testimony to our humble objective.

Opinions expressed in each of the article, however, are those of the contributor and are not necessarily shared by the Editorial Board.

I, on behalf the editorial Board, thank the Executive Committee of our Association for their kind support in publishing the journal. We hope that from now onwards, the publication of this journal will be a regular event of the Association. We earnestly look forward to the whole hearted support and cooperation of all concerned.

Ahmed Munirus Saleheen  
Editor

## CONTENTS

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Revenue Forecast by NBR <i>Faizul Latif Chowdhury</i>	7
Does trade liberalisation promote export and economic growth? Examining the Bangladesh case <i>Khairuzzaman Mozumder</i>	20
PICARD – the Benchmark for professional standards in Customs <i>Stephen Muller &amp; Buntha Hul</i>	36
Reforming the revenue administration <i>Mamun Rashid</i>	43
Value Added Tax: Theoretical and Bangladesh Perspectives <i>Md. Abdur Rouf</i>	46
Bangladesh Customs without PSI <i>Md. Rezaul Hoque</i>	66
Risk Management in Bangladesh Customs <i>Golam Md. Munir</i>	73
An overview of the Value-Added Tax in Bangladesh <i>Ahmed Munirus Saleheen</i>	83

# Revenue Forecast by NBR

Faizul Latif Chowdhury

*[Abstract: The National Board of Revenue makes a revenue forecast before the commencement of every fiscal year. This essay examines if a simple autoregressive forecast model based on time-series revenue data would produce reliable results. It is suggested that for a more accurate revenue projection, an economic model should be developed to take into consideration changes in the revenue base]*

## Introduction

Every year, in course of the preparation of the revenue budget, the National Board of Revenue (NBR) makes a forecast of tax revenue collection for the next fiscal year. This is, however, often referred to as 'revenue target'. Without a reasonably accurate forecast of tax revenue, it is difficult for the government to carry out its business with peace/without anxiety. A revenue forecast serves several important purposes.

First of all, it enables the government to prepare its expenditure budget in conformity with the projected revenue. However, this essentially requires that, before finalizing the expenditure budget, the Finance Division of the government, which is entrusted with the formulation of the expenditure budget, will ask for NBR's revenue forecast and tailor its budget accordingly. It follows that there should exist good level of co-ordination between NBR and the Finance Division so that the latter does not finalize the expenditure budget irrespective of NBR's projection of revenue. In practice, revenue forecast and expenditure budget are prepared almost concurrently in Bangladesh, and coordination, if any, takes place at a mature stage.

Secondly, the process of setting a revenue target for the upcoming fiscal year reveals the natural growth of revenue and, thereby, indicates the necessity of new tax measures for making up the gap, if any, between the level of natural growth and required revenue. This again asks for close co-ordination between the National Board of Revenue and the Finance Division, the latter being in a position to inform the former of government's demand for revenue.

Thirdly, a political government has limitations in introducing new tax measures and, so, boosting revenue often calls for enhancing

administrative measures. Such administrative measures includes plugging of leakages that occur through tax evasion and avoidance.

Last but not the least, formulating a target for the upcoming year allows an opportunity to analyze the errors, if any, that caused divergence between the forecast and actual collection in the current year. In fact, in Bangladesh 'revenue forecast', normally called 'revenue target', is used as a yardstick for performance evaluation.

The objective of this article is to develop a simple revenue forecast model and examine its reliability. First some light is thrown on the traditional method of revenue forecasting followed by NBR. Then the effectiveness of an autoregressive forecast model is examined. In the next section, factors that affect tax generating capacity of the economy is discussed. Based on these, the nature of an economic model for revenue projection is discussed.

#### The traditional method

At the NBR, the budgetary process is top-down in nature. The fiscal year runs from July to June and the budgetary process is normally initiated in March. A revenue forecast, often referred to as 'revenue target' is made in course of the budgetary process. It may be noted that there is no legal framework for such forecasting. Also, NBR lacks institutional set-up necessary for the purpose. Although NBR has a Research and Statistics wing, forecasting is normally carried out by the Policy and Regulation sections of different wings of NBR, namely Customs, VAT & Excises, and Income Tax. It may be noted that no input is received from the Ministry of Planning that deals with the macroeconomic development of the country. During the Five Years Planning regime, the country's growth model had no 'revenue sub-module'.

Traditionally, the National Board of Revenue (NBR) pursues a method which is essentially incremental in nature. Revenue potential of the upcoming year is assessed on the basis of the quantum of revenue collected in the current year. Current year's revenue is used as the base and a growth rate of 10, 15 or 20 percent is applied to this. Such an approach is legitimate except that the choice of the growth rate is arbitrary. In reality, the rate of growth of revenue is deduced to fit government's demand for revenue. So although no economic approach is in sight, NBR essentially follows a revenue projection model as captured by the equation below :

$$R_{t+1} = g_{t+1} \cdot R_t$$

Where  $R_t$  = revenue collected by NBR in the current year  $t$ .

$R_{t+1}$  = revenue target for the coming year ( $t + 1$ )

$g_{t+1}$  = expected rate of growth of revenue in the coming year

$t$  = current year

$t + 1$  = the upcoming year for which is forecast is made.

This is a simple model which is in use since long. It assumes that future generation of revenue ( $R_{t+1}$ ) depends primarily on past collection ( $R_t$ ). If a revenue shortfall is envisaged, NBR often makes two adjustments in the last quarter (April-June) of the fiscal year. First, it employs additional tax measures to prevent a short-fall. In the 1980s, the rate of Development surcharge (DSC)—an additional form of Customs duty—was often raised to meet the demand for revenue. Secondly, if such additional tax measures are not feasible or adequate, then the revenue target itself is adjusted downward. Also, if a shortfall is envisaged, the Department of Customs and Excise and the Department of Income Tax are asked to launch vigorous tax collection drive for staving off a possible short fall.

Although very simple and apparently unsophisticated, the model has no problem except that in applying it for revenue projection, the expected rate of growth of revenue in the upcoming year,  $g_{t+1}$ , is chosen arbitrarily and without appropriate consideration of the relevant economic factors including the growth of the tax base. This renders the model more qualitative in nature, dependent on subjective judgment of the future revenue potential of the economy. While a sophisticated model may not be difficult to develop, it may not be utilized for want of data. Also, any sophisticated model will require data examination and error correction techniques that may be beyond the competence of the tax officials working at the NBR. Such techniques are the business of duly trained and professional economists.

NBR may continue to use the simple model if it takes care in choosing the expected rate of revenue growth in the next year ( $g_{t+1}$ ). Better results will be obtained if NBR can estimate the revenue collection of the current year with accuracy ( $R_t$ ).

Nevertheless, in 1996, NBR went for an exception and formed a small committee to formulate a revenue projection model. The aim was to forecast revenue for the upcoming fiscal year 1996-97. The body comprised four NBR officials and was headed by NBR Chairman himself. It took an economic approach and deduced a regression model

that used time series macroeconomic data to capture the long run trend of growth in revenue bases. It would be interesting to learn if the revenue projection for 1996-97, based on a relatively sophisticated model, was any better in terms of accuracy than the traditional method normally applied by NBR.

#### A simple Revenue forecast model

A simple revenue forecast is an extension of the existing method traditionally employed by NBR. In the proposed model revenue ( $R$ ) in year  $t$  is estimated on the basis of revenue collected in year  $(t - 1)$ . In other words, it is an estimate of the future of an existing time series. The forecast model is a first order autoregressive model as captured by the following equation :

$$R_t = \beta_0 + \beta_1(R_{t-1}) \dots \dots \dots (1)$$

Where,  $R_t$  = forecast revenue for year  $t$

$R_{t-1}$  = actual revenue of year  $(t - 1)$

$\beta_1$  = parameter that captures the trend rate of growth of revenue over time.

$\beta_0$  = parameter that captures the jump in revenue for exogenous factors.

$\beta_0$  and  $\beta_1$  of equation (1) above can be estimated only if past revenue data ( $R_{t-1}$ ) are available. In estimating  $\beta_0$  and  $\beta_1$  for year  $t$ , we may use NBR's revenue data available from FY 1972-73. However, the tax structure underwent a radical transformation in 1991 when Excises were replaced with Value Added Tax (VAT). Because of this regime change it is logical to use data from FY 1991-92 for the sake of historical consistency. Our first step is to forecast revenue for FY 2001-02 based on the revenue collected during the previous ten years. Using ten years data from FY1991-92 to FY2000-01, the above equation yields estimate of  $\beta_0$  and  $\beta_1$  as noted below :

$$\beta_1 = 1.035459 \text{ and } \beta_0 = 703.5943$$

By substituting the above values in equation (1), the revenue forecast for FY 2001-02 is obtained to be Taka 16351.88 crore. Whether this model is a reliable one can be straight away assessed by comparing the forecast with the actual collection of revenue in FY 2001-02. In 2001-02, actual collection was Taka 16270.03 crore as against the forecast amount of Taka 16351.88 crore. The differential is a shortfall of only Taka 81.85 crore. The differential being obviously negligible (less than 0.05 percent) the forecast stood pretty good against the actual collection at least for FY 2001-02.

However, reliability of the model will demand a consistent performance over time. So we repeated the process in order to estimate forecast for a number of successive years, the results of which are compiled in Table-1 :

**Table-1 :Forecasting revenue from FY2001-02 to 2007-09 .**

Data Set period	Forecast year	Actual ( $R^A$ ) (in crore Taka)	Forecast ( $R^F$ ) (in crore Taka)	Forecast error (in crore Taka)
1991-2001	2001-2002	16270.03	16351.88	-81.85
1991-2002	2002-2003	19185.68	17506.75	1678.93
1991-2003	2004-2005	21192.62	21309.30	-166.60
1991-2004	2005-2006	24076.99	23467.39	609.60
1991-2005	2006-2007	26579.71	26910.73	-331.02
1991-2006	2007-2008	28169.27	29565.83	-1396.56

Even without applying statistical techniques, it can be seen that the forecast model has not performed consistently over time—not only by generating surplus as well as deficit, the magnitude of deviation from the forecast has widely varied from 0.50 percent in FY 2001-02 to 9.59 percent in FY 2007-08.

Data Set	Forecast for	Actual ( $R^A$ ) (in crore)	$\beta_0$	$\beta_1$	$R_{t-1}$	Forecast ( $R^F$ ) (in crore)
1991-2001	2001-2002	16270.03	703.5943	1.035459	15125.11	16351.88

$$R_t^F = \beta_0 + \beta_1(R_{t-1})$$

#### Assessing Revenue Potentiality

The revenue structure of Bangladesh remains pretty complicated notwithstanding continuous reforms and simplification since early 1990s. First of all, it comprises tax and non-tax revenue, with their share changing in the recent years.. NBR deals with only tax revenue. Tax revenue comprises both direct and indirect taxes. Direct taxes come from two sources, personal income tax and corporate income tax. On the other hand, three major components of indirect taxes are Customs duty, Value Added Tax and Excises. However, there are additional forms of Customs duty like Supplementary Duty and Development Surcharge (DSC) which are realized at the Customs points. The scenario is further complicated by advance collection of taxes. For example, a large chunk

of income tax is collected at the Customs point. Custom offers a very suitable handle that NBR has always used to its own advantage.

**Table-2 Revenue Structure of Bangladesh**  
(All figures in million Taka)

Sources	FY 2003-04	share	FY 2007-08	share
NBR taxes	261,937	77.17%	474,356	79.28%
Non-NBR taxes	12,370	3.64%	23,130	3.87%
Non-tax revenue	65,130	19.19%	100,860	16.85%
Total	339,437	100%	598,346	100%

Table-3 provides composition of NBR's collection of revenue. As it is seen NBR collects taxes at three stages. These are: (a) importation, (b) local production and (c) income and profits. Three major duties and taxes realized on imports are Customs duty, VAT on importation and Supplementary duties on imports. On local production too there are three types of taxes, namely, excises, Value Added Tax (VAT) and Supplementary duties (SD) on local production. Although not shown in Table-3, income taxes include personal income tax and taxes on business profits. A substantial portion of income taxes are realized at the Customs points.

**Table-3 Composition of NBR's Collection of taxes**  
(All figures in million Taka)

Sources	FY 2003-04	share	FY 2007-08	share
Customs duties	70875		96014	
VAT on imports	43978		84916	
Supplementary duties on imports	16857		17538	
Excise duties	1587		2143	
VAT on local production	43167		91848	
Supplementary duties on local production	35460		60013	
Income taxes	47073		117447	
Other duties and taxes	2938		4435	
	261935	100%	474354	100%

From the tax structure of Bangladesh briefly described above, three main sources of tax revenue can be identified. These are: (i) volume of international trade, (ii) national income and (iii) level of domestic production. So the tax base of the country is a composite of the three. The actual tax base of the country is narrower because of exemptions and administrative limitations that lead to non-coverage of the tax base.

The first feature being the tax base, the second feature of the tax structure is the rate of taxes. Here complexity emerges from different rates and exemptions. If the rate of Customs duties remain constant, total collection of by Customs will depend on at least three factors. First the physical quantum of international trade, secondly the price level at which international trade takes place and thirdly, the exchange rate of local currency. The relationship is positive in the first two cases and inverse in the third case because tax base is calculated in terms of local currency and a depreciation of Taka inflates the value of trade, and for that matter, base of Customs duty.

For Value Added Tax (VAT), the rate of is unique being 15 per cent *ad valorem*. In this case, the higher is the domestic production, the more will be the potential revenue as VAT. However, actual scenario is complicated because of exemptions, concessions and specificity for certain products.

The same applies to Income Tax. National income is straight away the base for levying income tax. Here too, exemptions and concessions cause non-linearity. Also, taxable income base is effectively narrow as many people remain outside the tax net.

All these factors deserve consideration in developing a meaningful model of revenue forecast. In addition, the contribution of new tax measures, withdrawal of existing exemptions and concessions and administrative measures for reducing evasion and avoidance need to be taken in to consideration.

In this regard it is important to underscore that many of the variables indicated above are matters of macro-economic forecast, a practice which is less or more absent for Bangladesh. If a revenue projection model is developed to incorporate all these elements NBR will have to rely on macro-economic projections carried out by agencies like the International Monetary Fund (IMF), the World Bank and the Asian Development Bank. The Finance Division carries out some exercises in macroeconomic projections which is hardly available for revenue projection.

It transpires from above that a good number of separate functional relationship exists between potential revenue and factors affecting the same. These functional relationships may be expressed in terms of equations. In the simplest case there may be only one form of tax with a determinate tax base with one tax rate. Assuming there is no other tax in the economy except tax on exports of petroleum at a flat rate, the revenue projection model would as simple as the following equation:

$$R_{t+1} = g \cdot X_{t+1}$$

where, R = revenue expected next year  
 g = rate of export tax on petroleum  
 X = value of exports of petroleum in local currency  
 t = current year and t + 1 = next year.

It may be noted that, X is product of export quantum and export price in local currency.  $X_{t+1}$  requires estimation of future export quantum and future exchange rate. One may assume a static exchange rate. However, the international price and quantum of exports may vary. Above equation can reduced as follows for the sake of estimation of  $R_{t+1}$  if it is assumed that value of exports of petroleum in local currency will remain unchanged.

$$R_{t+1} = g \cdot X_t$$

Here,  $X_t = Q \cdot P_x \cdot E_{t/\$}$   
 $Q \cdot P_x =$  value of exports in US dollar  
 $Q \cdot P_x \cdot E_{t/\$} =$  value of exports in in Taka

A similar model will stand for VAT with a flat rate if we can calculate the effective base for VAT. Effective base for VAT is  $GDP_{VAT}$  which is national GDP adjusted for exports, investment and non-VAT sectors of the economy. So, stands for revenue collected from as VAT, while stands for flat rate of VAT ad valorem, the the revenue forecast model will be as follows:

$$R_{t+1} = g \cdot GDP_{VAT} = GDP - (X - M) - I - G_w$$

where, R = revenue next year  
 GDP=(estimated) Gross Domestic Product of the country (at time t+1)  
 $GDP_{VAT}$  =base for VAT  
 g=rate of VAT ( single rate for all commodities)  
 X=(estimated) national exports (at time t+1)  
 M=(estimated) national imports (at time t+1)  
 I=(estimated) national investment (at time t+1)  
 $G_w$  =(estimated) government consumption (at time t+1)

### An economic model for revenue projection

In this section we propose a multiple regression model for forecasting tax revenue in Bangladesh which comprises Customs duty, VAT and Income Tax. The following notations are used:

$R_{t+1}$  =Estimated total revenue in year t+1  
 $C_{t+1}$  =Estimated Customs duty in year t+1  
 $V_{t+1}$  = Estimated VAT collection in year t+1  
 $I_{t+1}$  =Estimated income tax collection in year t+1

So, the Revenue equation is :  $R_{t+1} = C_{t+1} + V_{t+1} + I_{t+1}$   
 It future revenue depends on current revenue level, then the above equation can be re-written as:

$$R_{t+1} = g_c \cdot C_t + g_v \cdot V_t + g_i \cdot I_t + R_e$$

where,

$g_c$  = rate of growth of Customs duty in year t+1  
 $g_v$  = rate of growth of VAT collection in year t+1  
 $g_i$  = rate of growth of income tax in year t+1



$R_e$  = Growth in revenue for better tax-administrative efficiency leading to reduction in evasion and avoidance. (How to estimate this???)

While all of  $C_t$ ,  $V_t$  and  $I_t$  may be available, being revenue statistics of the current year, one has to estimate all three of  $g_c$ ,  $g_v$  and  $g_i$ . In order to do so we assume as follows.

**Expected rate of growth of Customs duty :** Duty structure remains unchanged over the year. We only consider Customs duty from Imports (M).  $g_c$  may be the trend for last 10, 20 or 30 years. (Fall in exchange rate will boost Custom duty collection)

**Expected rate of growth of VAT collection :** Duty structure remains unchanged over the year. VAT will grow at the same rate as of GDP, which is forecast by macroeconomist.

**Expected rate of growth of income tax :** Duty structure remains unchanged over the year.  $g_i$  may be the trend for last 10, 20 or 30 years.

#### Using a proxy

There are at least three major reasons why current year's actual collection may be replaced with better base for revenue forecast. First, estimation of three growth rates Secondly, data requirement Thirdly, complexity – as the revenue structure is not stable, undergoing reforms and alterations.

Therefore, it is suggested to reduce the number of independent variables. The simplest model would be to forecast national revenue as percentage of the country's GDP.

$$R_{t+1} = k \cdot GDP_{t+1}$$

where  $GDP_{t+1}$  is the forecast and  $k$  is the percentage. Here GDP is used as a proxy for the tax base.

So the problem boils down to estimating the trend of  $k$  over time. It may be clarified that. above,  $k$  is the elasticity of national revenue  $R$  with respect to nominal GDP.

Now the above expression may be made realistic by defining the tax base as accurately possible.  $R = C + V + Y$  as explained below :

Base for Customs Duties (C) = M (Value of imports in Taka)

Base for VAT (V) = GDP ( - (Agricultural GDP – value of exports X)

Base for Income Tax (Y) = (GDP – Agri GDP – govt. expenditure G – Investment I)

So we have got the following determinant variables :

GDP, M, X,  $GDP_{agri}$ , G, I (Any important variable missing???)

(How can we add rate of growth of GDP or  $g$  and rate of inflation  $p$ ???)

These are macroeconomic variables which are forecast by, say Finance Ministry.

#### Testing the model :

We shall test the model with data for 15 years from 1990-91 to project Revenue for the fiscal year 2006-7 and compare it with the actual collection of revenue for 2006-7. In doing so we shall take the following steps:

Step – 1 :

Step – 2 :

Step – 3 : etc.

#### Conclusion

The effectiveness of the model depends on its strength of predictability. The model may fail in two ways. Revenue forecast figured out using this model may result either in underestimation or in overestimation. Needless to point out that while underestimation may be interfere with governmental function, any overestimation will be a matter of concern for the government. Government has to overcome revenue shortfall either by curtailing its expenditure budget or by tinkering with the revenue structure. Nevertheless, even the model must be re-examined even in case of under-estimation leading to revenue surplus. The fiscal authority has to set out a tolerable limit for revenue surplus in a reasonable and any overshoot has to be analyzed for error correction. The fiscal authority may prefer underestimation leading to revenue surplus, which may be attributed to "better revenue administration than before", rather than underestimation of the independent macroeconomic variables. Particularly, persistent underestimation should be analyzed to find the sources of unexpected revenue.

Ideally, any forecast must be reviewed not only after the end of the fiscal year, but also a mid-term review will prove beneficial giving the fiscal authority an opportunity to go for correction, particularly so when overestimation is being indicated by a shortfall in revenue collection.

limitations of the proposed model

ways to develop a better but more complicated model

decomposition of errors

$$R_t^F = \beta_0 + \beta_1(R_{t-1})$$

	Data Set	Forecast for	Actual ( $R_t^A$ ) (in crore)	$\beta_0$	$\beta_1$	$R_{t-1}$	Forecast ( $R_t^F$ ) (in crore)
1.	1991-2001	2001-2002	16270.03	703.5943	1.035459	15125.11	16351.88
2.	1991-2002	2002-2003	19185.68	745.1585	1.030213	16270.03	17506.75
3.	1991-2003	2004-2005	21192.62	148.377	1.102954	19185.68	21309.30
4.	1991-2004	2005-2006	24076.99	187.9518	1.098469	21192.62	23467.39
5.	1991-2005	2006-2007	26579.71	17.59662	1.116964	24076.99	26910.73
6.	1991-2006	2007-2008	28169.27	98.95002	1.108623	26579.71	29565.83

#### Revenue projection using GDP data

	Data Set	Forecast for	Actual ( $R_t^A$ ) (in crore TK)	Forecast ( $R_t^F$ ) (in crore TK)	Forecast error (in crore TK)
1.	1991-2001	2001-2002	16270.03	14083.56	2186.47
2.	1991-2002	2002-2003	19185.68	17182.70	2002.98
3.	1991-2003	2004-2005	21192.62	20481.46	711.16
4.	1991-2004	2005-2006	24076.99	21903.15	2173.84
5.	1991-2005	2006-2007	26579.71	24856.35	1723.36
6.	1991-2006	2007-2008	28169.27	30172.75	-2003.48

Data source: (CIA World Factbook)

[http://www.indexmundi.com/bangladesh/gdp\\_\(purchasing\\_power\\_parity\).html](http://www.indexmundi.com/bangladesh/gdp_(purchasing_power_parity).html)  
[http://www.indexmundi.com/bangladesh/gdp\\_\(official\\_exchange\\_rate\).html](http://www.indexmundi.com/bangladesh/gdp_(official_exchange_rate).html)

Variable definition: This entry gives the gross domestic product (GDP) or value of all final goods and services produced within a nation in a given year. A nation's GDP at official exchange rates (OER) is the home-currency-denominated annual GDP figure divided by the bilateral average US exchange rate with that country in that year. The measure is simple to compute and gives a precise measure of the value of output. Many economists prefer this measure when gauging the economic power an economy maintains vis-à-vis its neighbors, judging that an exchange rate captures the purchasing power a nation enjoys in the international marketplace. Official exchange rates, however, can be artificially fixed and/or subject to manipulation - resulting in claims of the country having an under- or over-valued currency - and are not necessarily the equivalent of a market-determined exchange rate. Moreover, even if the official exchange rate is market-determined, market exchange rates are frequently established by a relatively small set of goods and services (the ones the country trades) and may not capture the value of the larger set of goods the country produces. Furthermore, OER-converted GDP is not well suited to comparing domestic GDP over time, since appreciation/depreciation from one year to the next will make the OER GDP value rise/fall regardless of whether home-currency-denominated GDP changed.

## **Does trade liberalisation promote export and economic growth?**

### **Examining the Bangladesh case**

**Khairuzzaman Mozumder**

The argument that exports stimulate economy or that continued robust performance of any country in exports leads to impressive growth in its overall economy has gained strong currency with the weakening of the appeal of the import substitution industrialisation and the adoption and growing popularity of export-oriented strategies by most of the developing nations since the latter part of the 20<sup>th</sup> century. The linkage has also been well established through empirical analyses by neo-liberal economists.

Similarly, the argument that trade liberalisation, in the form of removal or reduction of tariff and non-tariff barriers at the level of imports, stimulates exports, which in turn leads to economic growth, has also gained grounds among the economists who contend that import protection (tariff and non-tariff barriers) acts as an implicit tax to exports (Tokarick, 2006; Ken & Sjaastad, 1984). A study (Tokarick:3) of 26 developing countries showed that import tariffs were, on average, equivalent<sup>1</sup> to about a 12.5 percent tax on their exports, and that 7 countries had export-tax equivalents in excess of 16 percent, while 4 had export-tax equivalents in excess of 25 percent.

It has indeed been illustrated clearly in the cases of many developing countries during the last 20-30 years that liberalisation of import barriers and eradication of protectionist tendencies have led to higher performance of their export sectors, thereby making positive, rather than negative, effects on exports (Samen & Wang, 2006). The growth in exports in those countries in turn contributed to better performance of their overall economy.

The purpose of this paper is not to embark on any ambitious plan of providing an empirical proof of the theoretical linkages laid out above, or to set out with the challenging task of disproving them. It will instead focus on examining a single country case chronicling the experience of Bangladesh in liberalising its trade regimes throughout the last two decades, and the outcome of such efforts in terms of facilitating growth in exports and in the economy as a whole.

The paper will progress through a number of sections. The first will lay down the basis through outlining the theoretical underpinnings of dominant trade theories, theories of exports, and how exports are linked to economic growth. The second section will try to highlight the efforts made by Bangladesh to liberalise its tariff and non-tariff regimes. The third will analyse the impact of such efforts on its export performance and its economic growth. The concluding section will synthesise the arguments made in the paper and try to conclude through making specific recommendations with respect to Bangladesh trade policies.

#### **I. Trade theories of exports:**

Emphasis on the part of the policy makers and economists on enhancing exports is age old. Even in the mercantilist period, export growth strategies were vigorously pursued, whereby attempts were made by countries to induce trade surpluses by way of restricting imports and promoting exports. Later, the classical trade theorists (e.g. Adam Smith and David Ricardo) gained prominence with their focus on the theories of absolute and comparative advantages, whereby it was stressed that trade would occur between two countries as long as each of them had an advantage (either absolute or relative) over the other in producing something (Chacholiades, 1978:16-21). However, the problem with such free trade theories was that they, especially that of Heckscher and Ohlin, placed too much emphasis on relative resource or factor abundance to explain trade, exports, and their evolution. For that reason, they had only been able to explain the cases in those developing countries that were rich in natural or resource endowments, e.g. labour. Other major traditional trade theories of exports include Samuelsons's specific factors model (multiple factors with mobile labour), Linder's theorem based on demand and tastes, Vernon's product cycles model with phase of innovation, production, and exports, trade theories that emphasise technology (through its acquiring, adaptation and upgrading), role of externalities, and economics of scale trade models (Samen, 2006:11).

Protectionist theories came to dominate the international trade scene since the end of World War II. As outlined in ESCAP (2004:1), much of the theoretical basis of protectionism was provided by Prebisch and Singer, who advocated import substitution industrialisation and infant industry arguments as key strategies for success in industrialisation in the newly independent countries in the developing world. Influenced by such protectionist arguments, the developing countries embraced the import substitution industrialisation (ISI) strategy through which they tried to keep themselves shut off from the rest of world, with high tariff

and non-tariff barriers against imports and discouragement to exports in the name of autarky. The motive behind such policy adoption was that through pursuing this extreme protectionist posture, their newly emerging manufacturing sectors (especially the smaller ones) would receive some sort of temporary protection and import substitution in the process of their attempt to industrialise, and would benefit from that breathing space in their endeavour to catch up with the already industrialised developed nations.

The first phase of ISI was concerned with fostering industrialisation through the replacement of imports of nondurable consumer goods and their inputs by domestic production. The key industries were protected by high tariffs, overvalued exchange rates and other obstacles to foreign entry (Cumings, 1987:68). Once the first phase was over, these developing countries needed to oversee an efficient transformation into the second phase, that is, replacing imports of producer and consumer durables and intermediate products by domestic production (Balassa, 1988:282), or the upgradation of industrialisation into manufacturing of intermediate products and capital goods. But the countries failed to do so, for, with their small domestic market for nondurable consumer goods, they had no other option but to embark on their exportation. The emergence of a stalemate and the failure of the authority to solve this problem of industrial deepening resulted into a serious economic problem and a crisis of confidence on the efficacy of ISI strategies (O'Donnell, 1979). The resultant economic hardships paved the way for the emergence of military governments in these countries and contributed to the popularity of strong capitalist free market principles advocated by neo-liberal economists.

Such dismal performance of ISI in the developing world, such as Brazil, Argentina, and South Korea, led to the disillusionment with regard to the usefulness of protectionism, which in turn gave way to the resurgence of free trade principles through greater emphasis on export-oriented industrialisation (EOI) strategy, especially since the early 1980s. One after another, the developing nations gradually embraced the policies of facilitating growth of industries concentrating on export activities, providing incentives to industries having export potentials or demonstrating superior performance in exports, encouraging horizontal and vertical export diversification<sup>2</sup> in terms of both product mix and market bases or destinations.

EOI came to be associated with openness, trade liberalisation, and together they became popular policy prescriptions among economists and policy makers for achieving rapid economic growth (ESCAP,

2004:2). In some cases, countries, such as Bangladesh, were forced to pursue trade liberalisation and openness, as most bilateral and multilateral donor institutions insisted on these policies as a prerequisite in their aid packages for developing nations.

The argument put forward was that outward-oriented trade policies and trade opening would enhance exports. Removal of import barriers, such as tariff reductions, was viewed as 'an export promotion strategy', as it would reduce import restrictions thereby improving incentives to export (Tokarick:3). The proponents also contend that elimination of all tariffs by developing countries will increase their exports by about 20 percent, of which 'about 70 percent will come from eliminating tariffs against exports from other developing countries' (p.13). Such expansion in export is basically due to (a) a reduction in the cost of imported intermediate inputs used by exporters, and (b) an increase in access to other markets, namely other developing country markets, as a result of universal tariff reduction/elimination.

Again, the remarkable success of East Asian Tiger economies in promoting manufactured exports and witnessing high rates of growth in their GDPs, led to a growing consensus in economic literature that EOI 'combined with selective market friendly interventions' could help countries 'grow more and reap the benefits of trade liberalisation' (Samen:2). An ESCAP study (ESCAP, 2004:3-4) of data at the global level on gross domestic production (GDP) and total exports for aggregate global economies for all 49 LDC countries revealed that both GDP and exports grew simultaneously during the period between 1980 and 2000.

## **2. Trade policy reform measures adopted in Bangladesh:**

Like other developing countries (DCs) and least developed countries (LDCs), Bangladesh pursued the ISI strategy vigorously after it achieved independence in 1971. All the major industries were nationalised. Domestic industries were given excessive protection through the imposition of extremely high customs duty on imported products and the creation of numerous non-tariff barriers to imports by means of prohibitions and restrictions. However, the shortcomings of such strategy rapidly became evident as the country's economy struggled, and export growth stagnated due to inefficient allocation of economic resources in the absence of free-market mechanisms. Hence, the country has gradually shifted, since the mid-1980s, its focus towards the strategy of outward-oriented or export-led growth. This was accompanied by efforts aimed at liberalizing trade.

While the multilateral donor agencies, such as the World Bank and the International Monetary Fund, played an import role, through their policy prescriptions, in motivating the government to adopt such trade expansionary policies, the initial drive came from within. The dominance of liberal economists in economic policy planning within the government, the recognition of the growing force of the globalisation process, and an intense desire to catch up with those developing countries, such the Tiger economies, that have demonstrated a superior performance in achieving spectacular growth influenced Bangladeshi policy planners to pursue trade liberalisation measures. A brief description of trade reforms initiated by the Bangladesh government so far and its current trade policies is in order:

**Trade liberalisation:** As a founder member of the World Trade Organization (WTO), Bangladesh has been relentless in making her trade regime a pragmatic and liberal one in line with the WTO agenda. Being an active member, it abides by the rules and regulations devised by the WTO. For example, Bangladesh has implemented the Agreement on Customs Valuation that emphasizes the transaction value method. It closely follows developments made under the Agreements on Trade Related Intellectual Property Rights (TRIPS) and Trade Related Investments Measures (TRIMS), and the General Agreement on Trade in Services (GATS).

**Tariffs reductions:** Bangladesh, like other developing countries, has historically depended on import tariffs as the principal sources of its internal resource collection. Although revenue collected at the import stage is still the highest among various sources of government revenues, the country has initiated far-reaching reforms in its tariff structure over the last 15 years. In order to keep up with the pace of worldwide liberalization of tariff structures following the successful conclusion of the Uruguay Round of Trade Negotiations in 1994, and the eventual emergence of World Trade Organization in January 1995, Bangladesh has gradually reduced its import tariffs. While the highest customs duty slab has been lowered from 50 percent (in 1994) to 25 percent (as of today), the number of slabs has also been reduced from more than 10 in 1994 to only 3 (7 percent, 12 percent and 25 percent) in 2008-09, with only 212 items attracting 0 percent duty in 2007-08. On the other hand, the country does not charge any customs duty on the exportation of any goods. Export duty has been maintained at a nil rate for quite some time with a view to encouraging the export of domestic products.

During the early 1990s, Bangladesh's trade policy represented the highest protection level in South Asia, creating a significant anti-export

bias and acting as a barrier to its export competitiveness. However, the policy of gradual tariff reductions has changed the scenario over the last decade or so. Table 1 illustrates the position in Bangladesh in its unweighted total protection rate, which was reduced from a high 60.2 percent in 1991-1992 to 18.9 percent in 2006-07. It also reveals that conforming to the general trend in the world, the rate of reduction in Bangladesh, was much higher in the case of industrial products as compared to that of agricultural commodities.

**Table 1:**  
Average unweighted total protection rate (MFN rates adjusted for tariff exemptions/concessions)

Average rate	1991-92	1995-96	2003-04	2004-05	2005-06	2006-07
<b>Unweighted total protection rate:</b>	<b>60.2</b>	<b>25.1</b>	<b>23.7</b>	<b>21.4</b>	<b>20.7</b>	<b>18.9</b>
-Industrial Products	58.7	24.0	21.2	19.9	19.1	17.3
-Agricultural Products	73.6	31.6	38.9	31.4	31.6	30.5

Source: World Bank Report (2007:90).

Again, with the withdrawal of infrastructure development surcharge (IDSC) and the reduction of supplementary duty in 2007-08, the average tariff protection in Bangladesh has come down significantly. The average un-weighted tariff rate has come down to 13.44 percent in 2007-08 (source: National Board of Revenue statistics). The average protective tariff rate or the average nominal rate of protection came down to 20.4 percent in 2008-09 (Sattar, 2008).

**Elimination of non-tariff barriers:** Bangladesh has also tried to remove all types of para- and non-tariff barriers, and has sought to restrict the category of goods that carry various prohibitions and restrictions. For example, it eliminated the infrastructure development surcharge (4%) in this year's (FY 2007-08) budget that was previously applicable at a rate of 4% on all imported goods. The Import and Export Policies of the country have continuously been simplified by way of minimizing prohibitions and restrictions to the greatest possible extent so as to be in line with international efforts aimed at liberalization of trade. For example, the current 2007-2009 Import Policy Order has removed quantitative restrictions from all but 26 products, and retained complete restrictions on three items only, namely eggs, poultry, and salt, for which the country has received waiver from the WTO till 2009.

**Trade facilitation:** Bangladesh strictly adheres to the developments spearheaded by the World Trade Organization and World Customs Organization in relation to facilitation of international trade and

securing international supply chain management of goods. The customs clearance procedure in the country has undergone remarkable transformation following the Revised KYOTO Convention and other trade facilitation agenda of the WCO and WTO respectively. It is thus gradually improving its performance in terms of quick clearance of import consignments through simplification of trade documentation and procedures.

A number of steps taken by Bangladesh in that regard include full automation of customs clearance through ASYCUDA, direct traders input for allowing faster lodgement of declaration and quicker assessment, allowing containerized FCL cargo to get un-stuffing and delivery at the Private Inland Container Depots (outside the port area). The efficiency of the Chittagong Port, the biggest and busiest port in the country, has also seen significant improvement in terms of handling of ships and loading and unloading of cargo. Further, under the Chittagong Port Trade Facilitation Project, the customs authority has installed container scanners at the Chittagong Port. This will allow quick examination of both in- and out-bound cargoes thereby facilitating faster clearance of goods. Establishment of such non-intrusive modern inspection technology will also enable Bangladesh to submit advance electronic cargo information to customs administrations at export destinations, thereby satisfying an important clause of the SAFE Framework of Standards developed by the WCO. All these contribute to ensuring the adherence by Bangladesh to the concept of integrated supply chain management emphasized under the trade facilitation agenda of WCO and WTO.

With regard to clearance of export goods, the government gives high priority to boosting the volume of export of locally manufactured goods to international destinations. It, therefore, follows a fast-track assessment system with respect to export consignments, and about 100% of them are assessed and cleared for export within a day of the submission of Bills of Exports or shipping bills. The installation of container scanners, mentioned earlier, will also contribute in facilitating exchange of information of containerised cargoes and thereby expedite the process of entry of Bangladeshi export products through the customs stations in the United States, the top destination of Bangladeshi export products.

**Special import regimes to promote exports:** Emulating the formula adopted by many successful countries, and also following the prescriptions of multilateral donor agencies, such as the World Bank, Bangladesh has adopted a number of measures aimed at reducing the

impact of anti-export bias of existing tariffs and governmental regulations and enhancing the growth effects of trade openness. These special import regimes allow various duty free incentives to export-oriented firms for importing their manufacturing inputs<sup>3</sup>. An examination of the regimes created by the government in this regard is in order:

First, special bonded warehouse facilities are allowed by the Customs authority to the 100 percent export-oriented industries, under which they can import, duty free, all the inputs required to manufacture their export goods. Second, those industries that cater to both the domestic and foreign markets are offered duty draw back facilities by the Customs authority. Under this, they are allowed to get refund of duties and taxes they paid on the inputs, both domestic and foreign, used in the manufacture of only those products that are exported. Third, alternatively, the government offers cash incentives to those exporters who have not availed the benefits offered under either the bonded warehouse or the duty draw back scheme.

With a view to encouraging greater industrialisation in the export sector, the government has consistently maintained differential tariff structure in the case of imports of capital equipments. While the export-oriented industries have been allowed to import their capital goods at a tariff rate of 0 percent<sup>4</sup> since the mid-1990s, others (e.g. producer of home or non-tradable goods) were charged 7.5 percent until 2005, 6 percent in 2006, 5 percent in 2006-07 and 2007-08, and 3 percent in 2008-09 (source: NBR Statistics).

Further, to encourage both domestic and foreign investments in export-oriented activities, the government has provided Export Processing Zone facility. Such EPZs have been established in a number of places throughout the country, with the biggest concentration in Dhaka and Chittagong. The enterprises that are allowed to set up industries in the EPZs enjoy duty free facility not only for the import of capital equipments but also for the import of all raw materials and inputs needed to manufacture their finished products. Within these EPZs, exporters obtain a secure power source, retain foreign currency earnings, operate in a less-hostile labour market, and enjoy tax (income tax) holidays for the first 10 years of operation.

### **3. Analysing export and economic growth in Bangladesh:**

Examination of export performance of Bangladesh over the last decade reveals that the trade reforms and liberalisation measures undertaken in

Bangladesh have contributed to an expansion in exports. Table 2 shows huge growth Bangladesh has been able to register in its export volume (in terms of value) from FY 1995-96 to FY 2006-07. It also reflects growing contribution of exports relative to imports in the country's overall Gross Domestic Product. The contribution of exports as a percentage of national GDP was 9.5 percent in 1995-96, 13.7 percent in 2000-01, 16.8 percent in 2005-06 and 22.9 percent in 2006-07. Table 2 also reflects that while the contribution of imports to GDP, compared to that of exports, was much higher in 1995-96, due to slower growth over the next decade, it gradually declined and finally fell below that of exports by 2006-07.

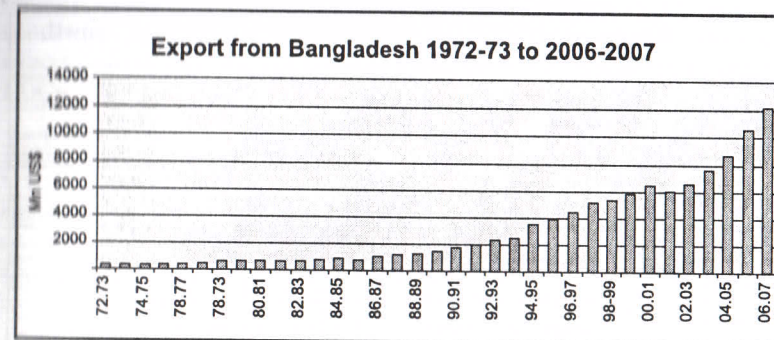
**Table 2:**

	1995-96		2000-01		2005-06		2006-07	
	Value in billion Tk.	(%)	Value in billion Tk.	(%)	Value in billion Tk.	(%)	Value in billion Tk.	(%)
<b>GDP</b>	1663.20		2535.50		4157.30		4675.00	
<b>Exports</b>	158.50	9.5	348.60	13.7	699.10	16.8	1070.80	22.9
<b>Imports</b>	281.00	16.9	503.70	19.9	892.20	21.5	841.00	18.0

Source: (a) Bangladesh Economic Review 2007,  
(b) Trade Policy Review, 2006 (World Trade Organization)

Except 2001-2002, Bangladesh exports have grown continuously since the late 1980s, when it embraced the policies of EOI and trade liberalisation. Export earnings have increased from a mere \$348.42 million in 1972-73 to \$14.12 billion in 2007-2008. Graph 1 illustrates that as a consequence of its reliance on the ISI and an excessively protective trade regime, exports growth remained stagnant throughout the 1970s and the early 1980s. On the other hand, with the adoption of the EOI and liberalization of trade in the mid-1980s, the situation started improving, and the country's exports actually began posting growth from 1989-90. However, the process of exports growth gained momentum from 1994-95 when Bangladesh began undertaking gradual but meaningful reduction of its protective tariff and non-tariff barriers, as demonstrated in Graph 1.

**Graph 1:**



Source: Export Promotion Bureau, Bangladesh.

Table 3 attempts to provide data on real historical Gross Domestic Product (GDP) and its growth rate in Bangladesh during 1972-2008. It reveals that in the early 1970s, the heyday of ISI and protectionist autarkic strategies, Bangladesh's annual GDP experienced wide fluctuations ranging from -13.97 percent in 1972 to + 9.59 percent in 1974, and from - 4.09 percent in 1975 to + 5.66 percent in 1976. It took long for Bangladesh to recover from that dismal condition, as its economy continued to limp on an average growth rate of 3.5% during 1977-1989. But pursuance of policies of EOI and openness since the late 1980s ultimately began to pay off. Since 1990, Bangladesh has experienced a respectable annual economic growth of around 5 to 6 percent, with the rate being the highest in 2006 (6.63 percent). With its current GNP per capita at \$599, it's now anyone's conclusion that Bangladesh will soon be out of the LDCs club and elevated to the position of a developing country. A recent World Bank report (2007:15) predicted that if per-capita growth could accelerate to 6 percent, implying a GDP growth rate of 7.5 percent, Bangladesh could become a Middle Income Country (MIC) by 2016. The impressive rise in per capita GNP from \$470 in 2005 to \$590 in 2008 bears testimony to that.

Table 3:

Year	GDP (in billions of 2005 dollars)	Annual Growth Rate
1972	13.46	- 13.97
1973	13.91	3.33
1974	15.29	9.59
1975	14.62	- 4.09
1976	15.45	5.66
1977	15.86	2.67
1978	16.98	7.07
1979	17.80	4.80
1980	17.95	0.82
1981	18.63	3.80
1982	19.07	2.38
1983	19.89	4.02
1984	20.86	5.18
1985	21.54	3.22
1986	22.45	4.25
1987	23.29	3.73
1988	23.79	2.16
1989	24.41	2.61
1990	25.86	5.94
1991	26.73	3.34
1992	28.08	5.04
1993	29.36	4.57
1994	30.56	4.08
1995	32.06	4.93
1996	33.55	4.62
1997	35.35	5.39
1998	37.20	5.23
1999	39.01	4.87
2000	41.33	5.94
2001	43.51	5.27
2002	45.43	4.42
2003	47.82	5.26
2004	50.82	6.27
2005	53.55	5.38
2006	57.10	6.63
2007 (projected)	60.82	6.51
2008 (projected)	64.59	6.20

Source: Compiled from (a) World Development Indicators, World Bank,  
 (b) International Financial Statistics, International Monetary Fund,  
 (c) Oxford Economic Forecasting, University of Oxford.

Above analysis validates the proposition that continued increase in the country's export performance has allowed it to achieve an acceptable economic growth rate since the mid-1990s. Surely in terms of overall export performance, Bangladesh has done very well compared to other LDCs.

Again, trade liberalisation is often considered a double-edged sword. While it contributes in aggravating, in the short term, the poverty situation, it actually helps alleviate overall poverty in the long run. The success of trade reforms in Bangladesh in improving the poverty situation is visible in the sense that since 1990, its poverty incidence has been reduced every year by at least a percentage point (Rahman:1). There has also been very little evidence to suggest that such liberalisation efforts have produced a negative impact on the poor. The sector which has been the hardest hit from the removal of tariff protection was the manufacturing, as the unproductive and overly protected industrial enterprises in manufacturing and consumer durables had to give in to the cheaper imported goods. However, the resultant redundancies did not have that much of a significant impact on the labour force, as the retrenched workers from those industries found alternative sources of jobs, especially in the garments and textile sectors, which saw a huge boom in the aftermath of the adoption of trade liberalisation policies by the country. The massive expansion in exports, even though limited to a handful of product categories<sup>5</sup>, bears testimony to the argument that reduction of tariff protection and removal of non-tariff barriers actually reduce disincentives to exports and enhances competitiveness of export products, thereby leading to increased volume of exports.

As the Bangladesh economy has expanded as a result of continued growth in exports, we can safely conclude that trade liberalisation might have helped the poor. The evidence could well be found in the Garments industry. The contribution of the garments industry in terms of empowering the poor female population in the country is extraordinarily remarkable in this regard. The astonishing growth in the export-oriented readymade garments industry in the country has enabled hundreds of thousands of female workers, who had previously been confined to the destitute and poorest sections in the society, to shed the yoke of poverty by dint of getting jobs in the RMG industry. Such empowerment of the womenfolk in the garments sector, both knitwear and woven, has allowed them to have greater say in family matters as they have emerged equal partners, along with their spouses, in family life, enhanced their position in society, and in many cases, given them much needed economic security.



#### 4. Conclusions:

It has been amply clear from the above discussion that trade liberalisation measures undertaken in Bangladesh since the early 1990s made significant contribution in reducing the disincentives to exports and ensuring efficient allocation of resources. Tariff rationalisation not only reduced the anti-export bias, but also encouraged both backward and forward linkages related to the export sector. The resultant gain in international competitiveness of the country's export sectors led to a robust growth in its export. The huge expansion in labour intensive industries in the export sector created greater income generating opportunities for the blue collar workers, especially among the women, which in turn made a positive contribution in alleviating poverty in the country, and uplifting the status of the women folk. Success in exports in Bangladesh, as demonstrated also in the cases of Asian Tigers and other developing countries pursuing similar strategies, was thus translated into a steady growth in its GDP at an average rate of 5 to 6 percent since 1990.

The question that would inevitably arise at this stage is how far Bangladesh could go in terms of trade reform measures, or, whether it should continue with trade reforms at all, and if so, at what pace. Apart from the protectionist arguments made by those who either favour import substitution or form the lobby group for industries that produce non-tradable or home market products, there is another important concern, often raised by government officials whose views on reform measures is only lukewarm. They may argue that in the absence of a tax compliant culture in the country, collection of direct taxes (e.g. income tax) and effort-based indirect taxes (e.g. value added tax) is still very low, and for that reason, the government depends heavily on the collection of revenue at the import stage, since it is easier to administer and chances of leakage are slim. Therefore, according to them, further reduction in tariffs will contribute to reducing the ability of the government to generate revenue.

These are indeed powerful arguments in the context of Bangladesh. One can not deny the immense contribution the customs revenue has made over the years and still continues to make in terms of internal resources collection for financing the country's expenditure. While sharing the concerns of this group, this paper would like to humbly argue that gradual tariff reduction does not necessarily hamper revenue collection. The experience in Bangladesh of the last decade or so will bear ample proof of that position. The revenue earning scenario at National Board of Revenue clearly demonstrates that even though the government has

continued with deep and meaningful tariff cuts since the mid-1990s, customs revenue has always shown a consistent pattern of impressive growth<sup>6</sup> throughout the period.

Considering the success of tariff reduction and rationalisation measures in promoting both export and economic growth, as illustrated in this paper, Bangladesh should continue with its current emphasis on gradually reducing its trade barriers. This policy of gradualism is particularly important in the sense that the government also needs to consider the possible adverse economic, personal and social costs that tariff reduction measures and restructuring of the economy usually entail. These costs, such as decline of some industries and rise of others, complete elimination of some sectors, relocation of employment, family disruption, devastation of some regions, and loss of some declining industry skills (Samen & Wang:7), have the potential of destabilising the gains achieved through trade reforms. A gradual approach will enable Bangladesh to adopt various compensatory or complementary policies, as and when required, with a view to adequately addressing these costs, thereby maximising the gains from trade liberalisation.

#### End Notes:

1. The logic behind 'export tax equivalent' is that even though there is no export duty on a product, the import duty on its imported inputs or raw materials will create a disincentive (e.g. in the form of hidden export tax) to export by directly raising the domestic price of imports relative to exports, or equivalently, by reducing the price of exports relative to imports. Hence, any import duty on the imported inputs of an export product has an effect, termed as export tax equivalent, on that export product. For the formula to calculate export tax equivalents, please see Tokarick (p.18-19).
2. Horizontal export diversification takes place within the same sector (primary/ secondary/tertiary), and entails adjustment in the country's export basket by adding new products within the same sector. Examples include addition of more primary products (e.g. rice, cotton, raw fish etc.) in the export basket of primary products along with the existing products (e.g. rice, onion, pulse etc.). Vertical export diversification, on the other hand, involves a shift from the primary to the secondary or tertiary sector, and entails adjustment in the export mix by means of adding value added products through processing, marketing or other services. Examples include a movement from the export of wheat to that of flour, or from the export of raw shrimp to that of processed or semi-cooked shrimp etc.

For more in-depth analysis of various types of export diversification, please see Samen (p. 3-4).

3. For more information on various special import regimes and other selective government intervention employed by developing countries, please see, Lall (2000).
4. This year (FY 2008-09), the Government of Bangladesh has decided to impose a nominal duty of 1% on imports of capital machinery by export-oriented industries.
5. Bangladesh's problem of export diversification is not within the purview of this paper, and will, therefore, be taken up later in another work.
6. This paper does not delve into the economic argument of how tariff reduction generates economic activity and consumption practices, and thus enhances revenue from both the domestic and import stages. This might be taken up in a future paper.

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## PICARD – the Benchmark for professional standards in Customs

Stephen Muller & Buntha Hul

Historically, Customs has been a regulatory agency. However, during the early 21<sup>st</sup> century, the global trading environment was subject a great deal of changes that required Customs to realign its role from being a regulatory agency to that of being a service provider both to the local community and the international community. Further, increasing international trade volumes, trade liberalization, new trade rules, new logistic and supply chain models, emergence of transitional crime and terrorism, proliferation of trade agreements coupled with the use of information and communication technology have created a huge impact on the existing role played by all Customs Administrations at the border. In this context, Customs had to facilitate trade on the one hand and enforce revenue and trade related laws on the other hand. This unique situation evolved to a level of sophistication that demanded highly knowledgeable and competent Customs staff to play a multifaceted role.

It is in this backdrop that the World Customs Organization (WCO) has developed initiatives on capacity building to assist its members in their human resource development programs. The initiatives of the WCO include E-learning modules, the Columbus Program, the Partnerships in Customs Academic Research and Development (PICARD), and the establishment of Regional Training Centers. This article discusses PICARD as the best benchmark for Customs to improve its competency for the new challenges.

### Background of PICARD Professional Standards

PICARD is a pathway to develop competencies in the *Customs Profession*. Work on the PICARD framework commenced in 2006 with the strong support by delegates of the High Level Work Group of the WCO, partner Universities and the private sector. As a result, a Memoranda of Understanding (MOU) between the WCO and seven Universities involved in Customs related education and the International Network of Customs Universities (INCU) was signed to provide the world class customs training, education and research in customs related fields.

To date, three PICARD conferences have been conducted. Two were convened in WCO headquarters from 1<sup>st</sup> to 3<sup>rd</sup> March 2006 and 27<sup>th</sup> to

28<sup>th</sup> March 2007 and the last conference was held in Shanghai Customs College from 14<sup>th</sup> to 16<sup>th</sup> May 2008. PICARD Professional Standards (PICARD) were drafted at the first conference and finalized at the second. It was a result of full cooperation between the capacity building Directorate of WCO and INCU. In their preparatory work, proponents of PICARD acknowledged and worked on the fact that the responsibility of Customs in maintaining the economic stability and safety of local community against organized crime and terrorism was greater than ever.

### The need for competencies and a benchmark

From a Customs perspective PICARD serves as a guideline in developing training modules and educational programs at Bachelor and Master degree levels; as a benchmark in establishing specific in-house training programs and recruitment strategies for Customs Administrations; a professional standard in competencies for the Customs profession and provides academic research and development tools to assist Customs personnel in their academic pursuits.

The general knowledge, technical knowledge, skills and expertise required for Customs staff vary with the level of function within the organization. Howard and Hekala explain that Customs staff should have knowledge on international trade, finance, human resource management, new and emerging technology, border control procedures, risk management and intelligence methodology to their current competencies in order to deal with a number of new challenges. In addition, they identify six pillars of Customs activities that are required in Customs competencies in the following areas: international trade and commerce, classification and valuation of traded goods, duty and tax collection, border control services, investigation and combating smuggling, human and financial resources management.

From the international perspective, the World Bank acknowledges the unique role of Customs among other government agencies at the border. Customs is viewed as neither a domestic agency nor an international border agency. Being the government agency responsible for the maintenance of consistency and conformity of the policies and standards related to international trading agreements, laws and regulations Customs need to be equipped with staff, who possess relevant knowledge, skills and expertise that match that role. Also Customs plays the role as a domestic agency that works closely with other Government Agencies (OGA) in initiating and communicating trade policies for the benefit of the nation to attain two goals: national security and economic prosperity. At the operational level, most of Customs posts are usually

located at the international borders. Customs facilitates the moving of goods and people across the border as a border enforcement agency at these posts.

Whether at the central office working in relations to policies or at the border dealing with enforcement, the skill set required by a Customs officer is certainly unique. While he/she must have an understanding of the policies behind what he/she is implementing or enforcing, he/she must also have the competencies to ensure that the policies are complied with, the clients are provided with equal treatment, trade flow is not hindered for the sake of enforcement, ensure that follow up action is prompt in case of infringements and organizational goals are met appropriately. The toughest task is to be able to enforce and facilitate at the same time. One could argue that this is impossible. However, PICARD makes an endeavor to achieve this nearly impossible task by identifying the multifaceted skill sets required by the Customs Profession at different levels in different roles. PICARD identifies roles in Customs, then defines the roles and explains the scope of each role and finally lists out the competency attributes for each role under different competency headings.

#### **PICARD composition**

PICARD determines two levels in the Customs Profession;

- The strategic level designed to provide knowledge, skill and experiences at the leadership level (Strategic Managers) who function at the top and middle level of the organization who take responsibility for developing trade policies.
- The operational level designed to widen the knowledge and technical skills of the operational staff who take responsibility in managing everyday work, implementing headquarter policies and managing the borders

Additionally, PICARD includes three main overall requirements of Customs professionals in the two core levels;

- Knowledge
- Skills
- Attitudes

A good illustration of the versatility of PICARD can be derived by perusing the overall knowledge requirements, overall skill requirements and overall behavioral/attitudinal requirements for a *Strategic Manager/Leader* for which the following different areas have been listed.

#### **Strategic Manager/Leader**

##### **Overall knowledge requirements**

National and international policy/politics, Customs role in government and interaction with other Government departments, the customs business, aspects of judicial and legal systems relevant to Customs, micro and macro economics, strategic planning, policy development and implementation, financial management, human resource/capital management, risk management, information /knowledge management, the international supply chain, trade practices, modern technological approaches to customs and business, public and media relations and communication, principles of ethics, good governance & integrity, customer management

##### **Overall skill requirements**

Leadership, capacity to motivate, visioning, inspiration, intelligence assessment, analytical ability, decision making, problem solving, communication, self evaluation skills, political skills, networking internal/external customers, negotiation skills, drafting skills, change management, program/project management, basic computer skills, research methodology decipher/interpretation / structure, creativity,

##### **Overall behavioural/attitudinal requirements**

Role model, ethics, empathy awareness and objectivity, confidence, motivation, customer orientation,

For the Operational level, PICARD has listed the following overall knowledge requirements, overall skill requirements and overall behavioral/attitudinal requirements.

## Operational Manager/Leader

### Overall knowledge requirements

Interaction with other government departments, know the role of customs and its usual partners, knowledge of the administration, role and responsibilities of managers within customs organization, budget planning and human resources, information management, information and communication technology (ICT), the customs business, judicial and legal systems, micro economics, financial and resource management, risk management, the international supply chain, public relations and communication, principles of ethics, good governance and good service, technical and it knowledge appropriate to a specialization.

### Overall skill requirements

Leadership, motivation, inspiration, information gathering and processing, analytical ability, decision making, problem solving, communication of information and ideas, social skills to interact with all levels, self evaluation skills, negotiation skills, drafting skills, functional computer skills, ensure regulatory integrity, time management, coping with stress and pressure, manage performance, managing staff, appropriate foreign languages and technical skills, conflict containment.

### Overall behavioral/attitudinal requirements

Ethics, role model, empathy awareness and objectivity, confidence, customer oriented,

## Conclusion

In the current environment, it is quite evident that Customs staff require a high level of competency to cope with the many changes at border and the head quarters. Each Customs administration should have a good management team that can engage in developing national trade policies at the strategic level as well as implementing government policies at the operational level. This team should be equipped with sufficient knowledge, skills and expertise to perform as Customs professionals. In this connection, PICARD is the benchmark for the world academic institutions and customs administrations in providing the right training for the rank and file to acquire the competencies in Customs matters. Also, PICARD is a benchmark for capacity building and modernization aimed at assisting Customs academic institutions or Customs administrations in their training or educational programs on Customs professionals. Furthermore, the international community has recognized PICARD as an internationally accepted standard for Customs capacity building.

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## Reforming the Revenue Administration

Mamun Rashid

Bangladesh is expected to be a Middle Income Country (MIC) by 2021, if not earlier. The country is also so far on track to achieving millennium development goals (MDGS) by 2015 which aims to reduce poverty and improve human development indicators. While we all are thinking of growing bigger and taking measures for developing our country, have we given a hard look on financing aspect of the growth? How will we be able to finance the growth? What are the ways of financing the growth? .

Along with ensuring enough depth in the financial sector, corporate governance, discipline in public expenditures and broadening the tax net , enhancing country's tax-GDP ratio can be the most prudent way of financing our country's growth. We have to reallocate the wealth from the surplus streams to the hungry streams of the economy and need to create a sustainable model which will ensure the strong momentum of tax revenue collection. If we cannot accumulate required financing from the surplus streams through direct taxation then is there really any other viable alternatives left?

In fiscal 2008 National Board of Revenue (NBR) earned Taka 21 billion more in tax revenue than its targeted amount. This was a unique performance on the part of the tax collectors since our independence. However, given their performance level until the recent past, it is hard to give full credit to the tax people for this 'excellence'. The fear factor that originated from a massive and anti-tax dodging drives under the ongoing emergency rule, no doubt, played an important role in collection of larger tax revenues, especially income taxes. The less-than-expected collection of income tax revenue from normal taxpayers as well as holders of untaxed legal money until September this fiscal supports that finding. With relaxation of emergency rules and national election, the fear factor is found to be less intense then in the past.

There is no denying that a sustained increase in the number of taxpayers and tax earnings can only be ensured under an efficient tax administration. Unfortunately, Bangladesh is yet to achieve that objective, despite some sporadic attempts made to beef up the efficiency

level of the tax collectors at the initiatives of the development partners. In 2002 a reform project called Reforms in the Revenue Administration (RIRA) was introduced with the aim of building a transparent, efficient and effective tax administration. Financed by the UK government the RIRA project has been assisting the NBR and works mainly with the Large Taxpayer's Units and the Central Intelligence Cell (CIC). On the other hand, the World Bank (WB), back in 2004 came up with over Taka 4.5 billion project, styled Revenue Administration Modernization Project (RAMP), with the objectives of bringing about major structural changes in the tax administration, simplifying revenue collection procedures and developing human resources. But the last political regime government dragged its feet and postponed a final decision on the project. The interim administration, for reasons best known to them, had also displayed a sort of lukewarm attitude towards the project. Media report said the launching of the project is likely to be further delayed since the authorities concerned wanted to examine the contents of the project more closely.

In Bangladesh, the tax-GDP ratio is one of the lowest among the emerging economies. However, we have to admit that during last twelve years there has been significant improvement in revenue collection. In fiscal '96 total tax revenue of the government was only Taka 20 billion, which has improved to Taka 473 billion in fiscal '08. The key driver of the tax revenue is indirect taxes such as value added taxes (VAT) and customs duty, which constitutes around seventy five percent of total tax revenue. In fiscal '09 revenue budget, government targets to collect Taka 545 billion as tax revenue, out of which around Taka 225 billion will be from customs duty and Taka 184 billion from VAT. Of the rest Taka 136 billion, Taka 130.5 billion will come from income taxes, which is only 24 percent of the total tax revenue and the rest Taka 5.55 billion from other taxes.

There is still much 'opportunity space' available to improve the collection of income taxes. We have already seen improvements in tax collection in the last fiscal. In fiscal '08, the total collection of income tax was Taka 120 billion. This large improvement, as mentioned, resulted primarily from the robust anti-corruption drive of the care taker government and the scope of regularizing undeclared income by paying penal taxes. Recently, NBR Chairman Mr. Abdul Mazid said that in Bangladesh about 15 million people have the ability to submit their tax

returns, of which at least 10 million people are capable of paying taxes. According to Bangladesh Bureau of Statistics (BBS) at least 10 million people in Bangladesh earn more than the tax exemption limit. The number of people submitting tax returns is still less than 1 million. A huge number of people were exempted from paying taxes for last several years, mainly because of structural weakness of the tax department, poor infrastructure and technological expertise, lack of systematic data collection and more precisely manpower shortage in tax administration with no resource management process in place.

We have to admit that there is no alternative to reform the tax administration if we want to broaden the tax net. This is an imperative for generating more revenue domestically, particularly when the global aid climate is becoming increasingly tight and would be tighter in the face of the global financial crisis. There was an apprehension that the momentum of the tax revenue growth may dry up after transition into political regime. Hence, it is crucial to have political commitment to augment the tax collection. For example, during the care taker government Bangladesh first observed "National Tax Day" on September 15th. The new political government similarly needs to create a "tax-payer friendly" atmosphere and make the people aware of the importance of paying taxes. More importantly, they have to withdraw all barriers and take all out actions for timely collection of taxes.

## Value Added Tax: Theoretical and Bangladesh Perspectives

Md. Abdur Rouf

*[Abstract: This article examines the system of Value Added Tax (VAT) from its both theoretical and Bangladesh perspectives. In this context the article seeks to know how VAT has developed as a modern taxation system with some new features – the most prominent of which being the credit mechanism. The article is divided into three parts. Part-I elaborates the theory of taxation as well as that of VAT – an indirect tax of consumption type. It also probes taxation systems in the pre-VAT era, the emergence of VAT as a new system of taxation, and then describes how it quickly expanded worldwide since its adoption in France in the middle of the 20<sup>th</sup> century. Part-II includes a comprehensive study in a bid to compare the VAT system with other taxation systems. This part also includes an examination of VAT's pros and cons to ascertain how this system has accommodated all modern features to fit itself as a modern system of taxation. The typology of VAT has as well been discussed in this part to find that keeping other varieties far behind, the invoice-based VAT has gained ground almost all over the world in a short span of time. The basic features of the VAT system of Bangladesh have been identified and discussed in Part-III. Some of the distortions of the system prevalent in Bangladesh are also identified and discussed in this part. The article concludes with the observation that since its adoption in July 1991, the VAT has made tremendous growth in the realization of revenue outpacing the rate of national economic growth and therefore, in concluding remarks, the VAT system of Bangladesh is termed a success].*

### Introduction

The present international system is composed of nation-states. A specific territory, population, government and sovereignty are the elements of a state. The government is bestowed with the responsibility of running the affairs of state which calls for huge amount of revenue. Governmental revenue can at first be divided into two categories as tax revenue and non-tax revenue. A tax is “a compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the tax payer in return” (Dalton, 1978: 23), such as Customs Duty, Supplementary Duty, Income Tax etc. but non-tax revenue is collected in exchange of some direct benefits such as license fees, registration fees etc. Tax can again be divided into two categories as direct tax and indirect tax. When the burden of tax can not be shifted by the person paying tax, it is called direct tax. Income Tax, Wealth Tax, Gift Tax etc. have been examples of direct taxes. On the other hand, when the burden of tax can be forward shifted, it is called indirect tax. Customs Duty, Supplementary Duty, VAT are the examples of indirect taxes. VAT is imposed on the provision of goods and rendition of services. Whenever, a supplier of goods or renderer of service delivers goods or renders service, VAT is imposed on them. But the supplier of goods or renderer of service forward shifts the burden of

VAT on the consumers i.e. the ultimate consumers are required to pay VAT. The VAT has been an innovative phenomenon in the history of taxation. Since its adoption in France in 1936 on limited scale, it has quickly spread over Europe and then throughout the world. This calls for an exploration of the principles inherent in the VAT system and the process through which the system developed and emerged as a popular revenue collection mechanism worldwide.

### Part-I The Theory and History of VAT

#### (A) The Theories of Taxation

Governments require huge amount of revenue to run the affairs of states. From various sources, governments realize the required revenue that can be divided into various categories from different points of view. From the perspectives of tax stages and incidence, tax can be of several types as follows.

#### Single vs. Multiple Tax

On the basis of number of taxes, a taxation system can be called single or multiple taxation system. When a country has only one tax, it is called single taxation system but when a country has more than one tax, it is called a multiple taxation system. There have been enough discussions on the comparative advantages of single vs. multiple tax. There are various types of single tax system on the basis of tax-base. According to the Physiocrats, a single tax on the economic rent of land is a good taxation system, since this is where all taxes ultimately fall (Dalton, 1978: 29). But there are two grave objections to a single tax of this sort. Firstly, in modern communities based on trade, commerce and technology, this kind of tax would not generate enough revenue. Secondly, it would result in a bad distribution of the burden of tax, since a millionaire who owns no land pays no tax; but a poor man who has nothing but a small piece of land pays tax. There are points for the application of single tax on income. Again, there are objections to exclusive reliance on income tax. Firstly, such a tax imposed on small incomes is relatively difficult and expensive to administer. Secondly, it secures no special contribution from inheritors of wealth – a preeminently taxable class. Thirdly, it tends to check saving more than most other taxes do (Dalton, 1978: 30). However, with the development of science and technology and with crisscross of economic activities,



single tax is increasingly losing relevance. Multiple tax system with proper management to keep evasion within endurable limit fits the complex economic activities of today. Arthur Young said, "if I were to define a good system of taxation, it should be that of bearing lightly on an infinite number of points, heavily on none" (quoted by Dalton, 1978: 32). It is wise to rely on a few substantial taxes for the bulk of the tax revenue.

#### *Proportional, Progressive and Regressive Tax*

On the basis of structure of tax rates, a taxation system may be called proportional, progressive or regressive. Under a taxation system, if the tax increases or decreases at a constant rate with the increase or decrease in tax-base, it is called *proportional tax*. If the tax increases at a higher rate than the rate of increase in the tax-base, and if the tax decreases at a lower rate than the rate of decrease in tax base, it is called *progressive tax*. If the tax increases at a lower rate than the rate of increase in tax-base and if the tax decreases at a higher rate than the rate of decrease in tax base, it is called regressive tax.

#### *Direct vs. Indirect Tax*

On the basis of impact and incidence of taxes, a tax may be called direct or indirect tax. When both the impact and incidence of tax fall on same person or entity, it is called direct tax. Income Tax, Wealth Tax, Gift Tax, inheritance tax etc. have been examples of direct taxes. Direct tax is usually progressive, revenue-productive, anti-inflationary and thus ensures economic stability. It is easier to determine impact and incidence of tax and it generates a feeling of economic consciousness in the minds of people. The criticisms of a direct tax system include: disincentive effect against motivation; encouraging tax-evasion and avoidance; discouraging investment; high collection cost; narrowness of scope and ultimately unpopularity of the tax. When the impact and incidence of tax fall on different persons or entities, it is called indirect tax. Here, the incidence can be shifted from the payer to the ultimate consumer of the goods or services. Customs Duty, Supplementary Duty, VAT are the examples of indirect taxes. Indirect tax system is advantageous since its scope and coverage is comprehensive, voluntary, does not make any harm to work-effort and initiative and is flexible to administer. However, an indirect tax is regressive and hence all the problems of a regressive tax are associated with this. It penalizes certain consumption and thus does harm to concerned industry. It increases price and hence may be the cause of inflation. It is difficult to determine the impact and incidence thus people outside the target may be adversely affected.

#### **(B) The Pre-VAT Taxation System**

John Fitzgerald Due, in his book *Indirect Taxation in Developing Economics* (Due, 1970: 1) has used the term *indirect tax* to refer to three categories of taxes: Customs Duty, Excise Duty, and Sales Tax. Customs Duty has been mentioned by Due (1970: 27) as one of the oldest form of taxation imposed upon the importation of goods, whereas Excise Duties have been stated as taxes traditionally 'applied only to domestically produced goods' (op. cit.: 59), and Sales Taxes as imposed at different stages of production and distribution systems (op. cit.: 79). Prof. Richard E. Wagner (1983) has classified taxes on consumption into four types: Excise Tax, General Sales Tax, Turnover Tax, and Value Added Tax. According to him, an Excise Tax is one 'which is applied to specific item with different rates applicable to different items' (Wagner, 1983: 264) and 'a General Sales Tax is applied at a common rate to a broad range of transactions. In principle, a Sales Tax may be levied against any of several links in the chain of transactions from the initial manufacture of items to their ultimate sale to consumer' (op. cit.); 'a Turnover Tax is one in which the gross value of the merchandise sold is taxed at each transaction' (op. cit.: 269); and 'the assessment of tax only against the value added at each stage in the process of production and distribution is referred to as the Value Added Tax' (op. cit.: 270).

Alan A. Tait (1988) has enumerated taxes in the pre-VAT regime, which were replaced totally or the scope of which was substantially reduced. According to him, unsatisfactory Sales Taxes were mainly replaced by VAT. The unsatisfactory Sales Taxes were grouped into three major types as follows: (i) *the cascade tax* – the simplest Sales Tax that takes a straightforward percentage on all business turnover; (ii) *manufacturer and wholesales taxes* – a single-stage tax levied on manufacturers, wholesalers and retailers; and (iii) *retail sales tax* – a single-stage tax on retail sales only. Most of the countries adopting VAT (including Germany, France, Chile, Israel, Spain, Peru, Nicaragua) have replaced the cascade Sales Tax, the defects of which are numerous such as cumulative and unknowable tax liabilities, different tax liabilities depending on the degree of industrial vertical integration, difficulty in assessing the amount of cascade tax to be rebated on exports or imposed on imports, and so on. Australia, Austria, Belgium, Canada, Luxembourg, Mexico, Morocco, the Netherlands, New Zealand and the United Kingdom have replaced manufacturer and wholesales taxes to implement VAT. Iceland, Norway, South Africa, Sweden, and Zimbabwe have replaced retail Sales Tax to introduce VAT (Tait, 1988: 9-19).

### (C) Emergence of VAT in European Countries

Although the popularity of VAT is of comparatively recent, it started being discussed in certain European countries and in the United States of America after the World War I (Musgrave and Musgrave, 1989: 399). Back in 1918, the well-known German industrialist F. Von Siemens advocated the replacement of Turnover Tax with VAT. In the USA, in 1921, T. S. Adams suggested the use of this tax and VAT was included in an amendment to the Revenue Act of 1921 by Senator Reed Smoot (Vaish and Agarwal, 1992: 141). In 1936, one-stage VAT was first adopted in France which was limited only in production stage. Subsequently, in France VAT was extended to wholesale level in 1954 and in 1966 to retail level (Mia, 1991: 17). While it was adopted in France replacing more numerous taxes (Sandford and others, 1984: 16), it became popular among the members of the European Economic Community (EEC) as an effective instrument of harmonizing the members' tax systems and of encouraging intra-EEC trade. To increase trade among its members, the Council of the EEC made first attempt issuing a directive on April 01, 1967 asking all member countries to establish a VAT system by January 01, 1970 (Vaish and Agarwal, 1992: 141). VAT came into effect in the United Kingdom on 1 April 1973. When these countries succeeded in more domestic resource mobilization introducing VAT, the other European countries followed suit. Article 99 of the EEC Treaty urged to consider how the legislation of the Member States concerning various taxes can be harmonized in the interest of a common market. In 1980, three working groups had been formed to study the matter. In the same year, a Fiscal and Financial Committee had also been established to study the extent to which the tax systems of the Member States were in conflict with the interest of a common market. These committees gave detailed reports which came into being as the following Directives:

**The First Directive:** This aims at the establishment of a common market whose characteristics are similar to the characteristics of a domestic market. It emphasized upon harmonization of taxes of the EEC countries and adoption of VAT.

**The Second Directive:** This Directive establishes the form of VAT as a tax-credit method that depends on invoices for records and calculation of tax. It provides definitions to some basic terms for instance: taxable persons, supply of goods etc.

**The Third Directive:** This Directive extended the deadline for implementation of the First and Second Directives until 1972.

**The Fourth and Fifth Directives:** These two directives were necessary to extend time limits for Italy. The VAT was eventually introduced in Italy in 1973.

**The Sixth Directive:** This Directive was promulgated to cover most of the areas that needed precise definition to achieve harmonization of national VAT laws including the aspects like territorial application, taxable transactions, chargeable events, rates and exemptions etc.

### (D) Expansion in Other Countries of the World

Seeing the growing success in the EEC countries, the developing countries became interested in the adoption of VAT. The system rapidly spread and today, over 141 (Owens, 2007:12) countries worldwide including many developing countries have introduced the VAT system in either form. In general, all manufacturing and trading activities with the exception of primary agricultural products have been brought under the VAT system. For the enterprises excluded from the VAT network, a flat Turnover Tax at a low rate (generally 2 to 4 percent) or a fixed lump sum tax is maintained. Now VAT is levied on almost all business transactions in over 141 countries all over the world including many developing countries (Report of Bangladesh Tax Mission, 1990). IMF took the lead to introduce VAT in many developing countries.

## Part II

### Basic Features of VAT

#### (A) What is VAT?

Value Added Tax (VAT) refers to the tax applied on value added (Stout, 1973: 412). In the production and distribution process, a firm buys materials from other firms. These materials may include principal raw materials, auxiliary raw materials, chemical, electricity and capital goods such as machinery, equipment, buildings, furniture, vehicles etc. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production such as labor, land, capital etc. The increase of the value of output over inputs is the *value added* by the firm (Khadka, 1997: 1-2). Carl S. Shoup (1990: 3) has defined VAT as "a tax on the value added by a business firm, through its own activity, to the goods and services it buys from other business firms". As per the definition given by Bannock and Peacock (1989: 158), "VAT is a tax on final consumption which is collected at every stage of production and distribution rather than at the retail stage alone". According to the Canadian Royal Commission on Taxation (CRCT), "A tax on value-added might best be described as a sophisticated Turnover Tax, where the cumulative tax factor is removed by taxing each transaction only in respect of the addition to sale value which has occurred in the stage immediately prior to the transaction in question" (CRCT, 1967: 244). To maintain the multiple tax points and also to avoid 'tax on tax', VAT is an innovative tax phenomenon. Alan A. Tait, the VAT expert of the IMF who worked for long on the possibilities and problems of VAT in many countries, commented that "VAT may be thought as the Mata Hari of the tax world – many are tempted, many succumb, some tremble on the brink, while other leave only to return, eventually the attraction appears irresistible" (Tait, 1988: 3). The VAT has not been a new form of taxation but a Sales Tax administered in different ways (Bird and Oldman, 1975: 317-322). Some economists are in the opinion that a properly implemented VAT is equivalent to a corresponding single-stage tax (Bannock and Peacock, 1989: 158).

#### (B) Advantages of VAT

(1) VAT promotes horizontal expansion of economic activities as against Excise Tax that promotes vertical integration of economic activities. Since in the Excise Tax system, there is no credit mechanism and tax is applied on total sale, so to avoid paying tax on raw material

purchases and on different stages after production, firms tend to go for backward and forward linkage firms. Thus, economic activities get vertically integrated that goes against even growth of all sectors of an economy. But in the VAT system, with credit mechanism since incidence of tax falls upon the ultimate consumer, there develops a trend of horizontal expansion of economic activities, which ensures greater division of labor and investment in all sectors of the economy.

(2) The most important advantage of VAT is credit mechanism. The credit mechanism works as follows: For example, importer has imported an item at pre-VAT price of Taka 1,000 at import-stage and he has sold it to a producer at a price of Taka 1,200; the producer has sold the same to a wholesaler at a price of Taka 2,000, and the wholesaler has sold it to a retailer at a price of Taka 2,500, and finally, the retailer has sold the item to a consumer at a price of Taka 2,500. At the rate of 15 percent, output-VAT will be Taka 150, Taka 180, Taka 300, Taka 360, and Taka 375. But allowing the input tax credit, net VAT liability will be Taka 180 for importer (first Taka 150 and then Taka 30), Taka 120 for producer, Taka 60 for wholesaler, and Taka 15 for retailer. But total VAT will be Taka 375. This credit mechanism encourages industrial diversity against vertical integration which causes economic inefficiency and other distortions in the economy.

(3) The most alluring feature of the VAT for both the fiscal authority and the VAT payers is the self-clearance [or self-policing] system. As stated earlier, the credit mechanism is a system of allowing the preceding-stage input-VAT as credit against the succeeding-stage output-VAT. Documentation plays important role in the functioning of the credit mechanism and only documentation can ensure forward shifting of VAT. The self-clearance system works for all the parties in the production and distribution system [except the final consumer] through deduction of input-VAT from the output-VAT by himself. Thus, the allowance of input tax credit and the motivation for it automatically safeguard the confirmation of payment of earlier-stage VAT and the issuance and maintenance of related tax invoices for documented claim. Consequently, the input tax credit system in the VAT mechanism works as a self-policing system on assesses. The motivation of forward shifting of the VAT incidence also inherently influences assesses not to break the chain of the production and distribution process across the VAT registered persons.

(4) A significant advantage of VAT is the cross-audit feature except at the final sale. Tax paid by one firm is reported as a deduction by the firms buying from other firm. The firms require keeping all purchase

and sell records that help tax officials to go for cross-audit across the VAT registered persons.

(5) A further merit is significant when a country is a member of a common market. The yield of VAT on each commodity is automatically distributed among the various countries on the basis of the value added in each country if there is no rebate on exports within the common market.

(6) Somewhat incidental advantage of VAT is the provision of statistics of sales by sector and by individual commodity to aid in the preparation of input-output tables and significant economic planning in developing countries (Due, 1972: 318-20).

(7) The popularity of VAT with authorities is mainly due to its administrative advantages. It is much easier to assess tax liability of a firm by using the credit method. There is also a greater scope of crosschecking the returns submitted by firms. It is argued that for various reasons, some goods should enjoy a tax exemption (zero tax rate) while the remaining ones need not be subjected to a uniform tax rate. In practice, it has been found possible to incorporate these features in VAT. Multiple (including zero) rates are now commonly found in VAT systems. All these impart a great deal of administrative flexibility to VAT so that its exact contents can be modified to suit different policy objectives of the authorities (Bhatia, 1999: 155-156).

(8) VAT is neutral between factor costs because it taxes all value added. As against this, the corporation taxation discourages the use of equity capital and punishes profit earning. VAT does not hinder adoption of advanced technology, which may be capital intensive.

(9) A very important advantage quoted in favor of VAT is that of lesser tax evasion. *Firstly*, this happens because the tax is divided into parts and therefore the incentive to evade tax by any one firm is reduced. *Secondly*, it is in the interest of a firm to account for the taxes paid by earlier firms through which the inputs have appeared. Otherwise, this firm pays the tax itself. If any firm, therefore, understates its output, it will be caught by the disclosures of the firms buying inputs from it. This type of cross auditing enables the authorities to plug the tax leakages in the VAT system.

(10) The use of VAT helps a country to promote its exports. In order to get a competitive edge over others, a country may refund the taxes paid on the exportable goods. It is easier to separate the tax from the cost of

production in case of VAT but not so in case of other taxes, which get mixed up with the cost of production since they are levied at gross value in each stage.

(11) The VAT is needed to mesh with the growing international character of production and since many countries of the world have adopted VAT in any form, it is better to adopt VAT to facilitate coordination of economic activities.

(12) It is argued that VAT avoids cost-cascading effect. A conventional Sales Tax leads to compounding of tax liability, while VAT system allows credit of VAT paid in the earlier stage.

(13) An implied advantage of VAT is its neutrality with regard to resource allocation. It exerts no effect on the resource allocation among various sectors of the economy. The VAT is an economically neutral tax and therefore will improve economic efficiency. It is neutral in its treatment of efficient and inefficient businesses; partnerships, proprietorships and corporations; equity and debt financing; labor and capital-intensive businesses; and new and old capital (Tax Executive Institute, 1992: 2). VAT can help increase national savings since it is neutral between the decision to save or consume, and therefore encourages capital formation.

### (C) Disadvantages of VAT

(1) VAT is a complicated system and needs honest and efficient government machinery to do the crosschecking and link up various production activities. It is, therefore, necessary that the country adopting VAT should be sufficiently advanced in its financial and economic structure and the firms should be in the habit of keeping proper accounts.

(2) VAT system depends a lot upon the cooperation of taxpayers. Each firm itself calculates its tax liability and also finds out the taxes paid by the earlier firms. Once, the sellers realize that the administrative machinery of the government is ill-equipped to do the necessary cross-checking they will resort to the creation of false purchase invoices showing taxes paid by others.

(3) The rate of VAT is required to be high to generate more revenue as against the collection from Sales Tax regimes. In Sales Tax since there

remains multiple rates, there could exist high and low rates but in VAT system since there is only one rate, it needs to be on the high edge.

(4) Even if the taxpayers are fully honest, VAT system forces them to maintain elaborate and costly accounts. This becomes uneconomical, especially for the smaller firms. The VAT is expensive in terms of administration and compliance costs. Record keeping, auditing requires more manpower at both tax-payers and tax-collectors end. The difficulties of maintaining accounts, cross-checking and preventing tax evasion increase if the system contains some exemptions (such as for food items) and differential rates of taxations (luxuries are likely to be taxed at higher rates than necessities).

(5) Critics of VAT doubt that it induces efficiency. They claim that in a shortage economy like ours speculative hoarding, non-competitive price rise and similar practices are quite common. In a seller's market, producers and sellers have no incentive to increase their efficiency and reduce costs since goods will be sold irrespective of their inferior quality and high prices.

(6) It would be naive to assume that a modern government would like to have a tax system which is claimed to be 'neutral' in its allocative and distributive effects. The realities of non-competitive markets, income and wealth inequalities, and (in underdeveloped countries) the need for quickening the pace of capital formation can not be ignored. VAT has to be selective in coverage and with differential rates. And once the authorities decide to adopt a selective pattern, vested interests develop and exert pressures for exemptions and concessions. In such circumstances actual decisions may not remain fully objective.

(7) Some scholars are in the opinion that VAT is a regressive tax and it promotes inflation in the economy. The base of VAT widely covers almost all economic activities but revenue collection does not increase proportionate to the expansion of the VAT base.

(8) The VAT will encroach upon state and local revenue bases in a federal system of government (Tax Executives Institute, 1992: 2).

#### **(D) Different Forms of VAT**

The VAT can be segregated into three different types: gross product or gross receipts, income, and consumption. The basic difference among the three types of VAT is their treatment of capital expenditures.

#### *Gross-Product VAT*

To calculate tax under a gross-product VAT, each firm in the production and distribution process deducts its raw material purchases, but not capital equipment purchases, from its total sales and applies the tax rate to this base. Because capital is effectively taxed in each stage of the production and distribution process, this form of VAT tends to discriminate against capital-intensive industries, discourages savings, and causes firms to postpone the modernization of plant and equipment in an attempt to minimize capital expenditures. This type of VAT was extensively used throughout Europe in the 1950s but was considered economically destructive and thus has been replaced with other forms.

#### *Income-Type VAT*

The calculation of tax under an income type VAT is basically the same as a gross-product VAT except that depreciation on capital goods is deducted from total sales. Although this deduction corrects the problem of 'pyramiding' taxes, the income-type VAT has many of the same complexities and biases as of the other type of VAT.

#### *Consumption-Style VAT*

Under a consumption-style VAT, all business purchases are deductible. Under a consumption-style VAT, there are three different ways to calculate tax liability. The first of these is generally known as the *addition method*. Under this method, a firm calculates its tax liability by adding together its wages paid, rent and interest expenses, and profit, and then applying the tax rate to this sum. A second method of calculating a consumption-style VAT liability is the *sales-subtractive method*. To calculate the tax base under this method, a firm adds together all sales and subtracts all purchases including capital equipment. The last and most common method of calculating VAT is the *credit-subtractive method*. Under this method, a firm calculates its tax liability by applying the tax rate to each individual sale and subtracting all taxes previously paid on purchases. Most of the countries including us are on this method.

A VAT can be based on either a 'destination principle' or an 'origin principle'. Under the destination principle, a good or service is taxed where sold or consumed. With this principle, the VAT is imposed on imports but not on exports. Contrarily, under the origin principle, a good or service is taxed in the jurisdiction where value is added. With this principle, exports are taxed but not imports. VAT can be calculated on either a 'tax-inclusive basis' or a 'tax-exclusive basis'. A tax-inclusive

VAT will apply the tax rate to the base price plus the tax itself, whereas a tax-exclusive VAT applies the rate to the base price only. A VAT system may be either 'accounts-based' or 'invoice-based'. An accounts-based VAT is one where the taxpayer calculates his tax liability from his books of account. An accounts-based tax will calculate liability on a tax-year or period basis. With an invoice-based VAT, the taxpayer will calculate tax liability from tax shown on the invoices he receives from his purchases (input tax) and the invoices he issues for his sales (output tax). VAT system becomes more confusing with the realization that the credit method and the subtraction method can either be (1) invoice-based or accounts-based, (2) tax-exclusive or tax-inclusive, (3) based on the origin principle or the destination principle, and (4) in theory at least, characterized by exemptions, zero-rating, or multiple rates (Tax Executive Institute, 1992: 1-10).

#### (E) Exemptions, Zero-Rating and Multiple Rates

The simplest and most direct way to institute a VAT is to apply one rate on all goods and services. In practice, this is never done. Each country has adopted unique ways to adapt the tax to its political, economic, and social milieus. The three most common adjustments are exemptions, zero-rating, and multiple rates. The VAT system was introduced to eliminate multiple rates, which plagued the pre-VAT taxation system. But in reality, the VAT system could not eliminate multiple rates. In the name of exemptions, zero rating and reduced rates, in fact multiple rates remain in operation. The principle of one rate and widest possible tax base remain a distant possibility.

### Part III VAT in Bangladesh

#### (A) Introduction of VAT in Bangladesh

As a fiscal instrument alternative of Sales Tax, the concept of VAT was first discussed in Bangladesh in April 1979 by the Taxation Enquiry Commission formed by the then Government. In October 1989, a World Bank Mission recommended the introduction of VAT in Bangladesh within *three* years (i.e. within October 1992). But the Government of Bangladesh adopted it in July 1991 i.e. earlier than the recommended World Bank deadline. The Draft VAT Act was prepared sometimes before June 1990 but it was promulgated as an Ordinance (the *VAT Ordinance, 1991*) on 31 May 1991 with a given preparatory period of

only one month. The legal effective date for VAT registration and also for reorganization of the tax administration for VAT purposes was 2 June, 1991 and the tax collection was made effective from 1 July 1991, although the *VAT Act* was passed in the Parliament on 10 July 1991. In the budget speech of FY 1991-92 (on 12 June, 1991), the then Finance and Planning Minister M. Saifur Rahman mentioned: "... the Value Added Tax (VAT) which is in existence in many developed and developing countries, is going to be introduced in Bangladesh from 1<sup>st</sup> of July, 1991. It is a modern and progressive tax system. This will expand the tax base, simplify the tax collection procedure and will help in curbing the tax evasion."

#### (B) Tax Coverage

According to the provisions of section 3 of the VAT Act 1991, VAT is imposed on the following goods and services:

- (a) all goods imported in Bangladesh except those goods mentioned in the First Schedule of the VAT Act;
- (b) all goods supplied except those goods mentioned in the First Schedule of the VAT Act;
- (c) all services provided in Bangladesh except those services mentioned in the Second Schedule of the VAT Act.

#### (C) Tax-Base

Value Added Tax is a tax on 'value added.' Hence, the tax-base of VAT is 'value added'. Section 5 of the VAT Act specifies the provision of determining the value on which 'output tax' is imposed. A VAT payer is liable to pay VAT as the excess of 'output tax' over 'input tax'. The difference between the 'value for imposing output tax' and the 'value on which input tax has been paid' is the 'value added'. In the VAT Act, the 'value for imposing output tax' has been specified in Section 5, which can be stated as the foundation for tax-base of VAT.

#### (D) Tax Points

Under the VAT system, tax points depend on the stage of production and distribution as follows:

- (1) For goods imported, VAT is to be paid at the time of paying import duty [under Section 6(1) of the VAT Act].
- (2) For goods produced or manufactured or imported, purchased, acquired, or otherwise gathered by registered persons [under Section 6(2) of the VAT Act 1991], VAT is to be paid at the time of one of the following activities whichever occurs first:

- (a) When the goods are delivered or supplied;
  - (b) When an invoice relating to the supply of goods is given;
  - (c) When any goods are used personally or given for use to another person;
  - (d) When the price is received in part or full.
- (3) For services rendered by registered persons [under Section 6(3) of the VAT Act 1991], VAT is to be paid at the time of one of the following activities whichever occurs first:
- (a) When the service is rendered;
  - (b) When an invoice relating to the rendering of service is given;
  - (c) When the price is received in part or full.

#### (E) Tax-Rate

The VAT introduced in Bangladesh is a consumption tax payable ultimately by the consumers of taxable goods and services with a standard tax rate of 15 percent. Under Section 8 and Rule 4, if the annual turnover of any supplier of taxable goods or any provider of taxable services is below Taka 24 lakh, then (s)he has to pay Turnover Tax @ 4 percent. Cottage industry benefit i. e. no tax is allowed to industrial enterprises which produces goods prescribed through an SRO with certain conditions. To ensure further justice and equity, luxurious goods and other goods and services, which are not very essential and are socially undesirable, are subject to Supplementary Duty at different tax rates under Section 7. There have been some special treatments of tax calculation for selected service providers and traders, which is the use of a truncated value-base on which the rate is applied but here input tax credit is not allowed. Tariff Value is made where ascertaining of value is difficult.

#### (F) Exemptions/Exclusions

As stated earlier, a large number of goods and services are exempted from imposition of VAT (the First and Second Schedules). Outside those, there is another type of exemption through cottage industry benefit to selective industrial enterprises producing prescribed goods subject to a number of conditions. There is also provision of zero-rate to be applied for exports and goods or things provided in a country-leaving conveyance for consumption outside Bangladesh. The exempted item producers can not claim credit/drawback. However, for zero-rated items, the output-VAT is zero against which the input-VAT can be credited or can be refunded as drawback.

#### (G) The Credit Mechanism

VAT is a multi-stage tax collection system over the whole production and distribution process allowing the credit of input tax paid at preceding stage. But in some cases in Bangladesh, the input tax credit system has been made arbitrary probably for avoiding hassle with the taxpayers (such as 80 percent of VAT paid on insurance, gas and electricity distributors; and 60 percent of the VAT paid on telephone, fax, teleprinter, internet, freight forwards, clearing and forwarding agent, WASA, insurance, audit and accounting firm, procurement provider, security services, legal advisor, transport contractor, banking service and electricity distributor).

#### (H) Accounting

Accounting is very important in VAT because VAT is a documents-based tax. In our country, the invoice-based credit system presupposes the use of formal accounting. Usually, VAT accounting encompasses *inter alia* (1) the recording of VAT-related transactions, (2) maintenance of statutory VAT books of accounts and other documents, (3) deposit of money into the Treasury towards the payment of "output tax" and maintenance of copy of Treasury Chalan, and (4) preparation of the VAT return and submission thereof. To facilitate VAT accounting the NBR has prescribed the books of accounts and records to be maintained by various parties having legal interaction with the VAT law.

#### (I) Auditing

VAT is a document-based modern taxation system. The importance of audit under the VAT system is unbounded in consideration of revenue protection and transparency. Examination, verification and ensuring of the following matters are the main aims and objectives of audit function:

- (1) Maintenance of proper documents;
- (2) Whether there is any devaluation in price declaration;
- (3) Whether the goods supplied for export have really been exported;
- (4) Whether the selling price is kept undisclosed or disclosed at a lower rate;
- (5) Whether credit taken on inputs or drawback claimed against export has been proper;
- (6) Whether the supply/provision of "zero-rated", "taxable" and "exempted" goods or services is properly done;
- (7) Whether tax payment or submission of return has properly and timely been done;

- (9) Whether the inputs have been utilized duly and the amount of wastage has been proper; and
- (10) Whether secret events of purchase of inputs, manufacturing/production or release have been occurred.

#### (J) Return Submission

Under Rule 24(1), the registered persons are required to file two copies of return in prescribed form [Form VAT-19]. The return is to be filed generally within 10 working days of each "tax period" (the English month following the "tax period"), except for insurance company, for which the return is to be submitted within 20 days of the month following the "tax period". "Tax period" is usually one month, but in some cases it is a period of 3 months (e.g., brick manufacturers or for indenting firms) or 6 months (e.g., hundred percent export-oriented firm and consultancy firm).

#### (K) Distortions in the VAT System of Bangladesh

VAT is to be imposed on the actual value added. The value addition is a matter of business practice that can not be ascertained by government directives. But in Bangladesh, value of goods including value addition requires to be declared by the VAT registered persons and approved by the VAT authorities, which is a prominent shift from the standard practice of VAT. In case of a number of goods and services, government has ascertained tariff value; in few cases the actual value base has been curtailed with truncated value base and in few other cases, there are fixed value additions. All these go against the spirit of the VAT system. Trade VAT has to be collected from the traders – that is the proper stage but in many cases it is being collected at import stage in advance. Although VAT is to be imposed on actual value addition, yet in few cases fixed/lump sum VAT has been introduced going against the spirit and standard practice of VAT. VAT is to be paid at the place of the delivery of goods and rendition of services. But huge amount of VAT in Bangladesh is being collected at source. Although eighteen years have been passed VAT has been introduced in Bangladesh, but it has not yet been extended to all stages covering all VAT-able goods and services. A standard VAT system requires to cover all stages of import, production and distribution because VAT is a multi-stage tax and VAT collected in all stages is equal to the tax amount collected through a single-stage excise tax.

#### (L) Concluding Remarks

In Bangladesh, the VAT system has seen eighteen years. The VAT system has contributed to the realization of increasingly more amount of revenue. In FY 1972-73, tax-GDP ratio of Bangladesh stood at 3.67 percent and in FY 1990-91 (preceding year of the introduction of VAT), it has reached to 5.96 percent. In FY 1991-92 (i.e. in the year of the introduction of VAT), it has reached to 6.61 percent. With the maintenance of same pace of increase, in the FY 2000-2001 it has reached to 7.86 percent (NBR, 2003: 56) and in the FY 2006-07, the tax-GDP ratio of Bangladesh has reached to 10.56 percent (NBR, 2008: 3). This has been a significant achievement in our revenue collection. However, the tax-GDP ratio in few regional countries has been much higher than the ratio of Bangladesh. For instance, tax-GDP ratio is around 13 percent in Pakistan, 16 percent in Sri Lanka, and 18 percent in Maldives (UNDP, 1999). However, data suggests continuous increase in the collection of VAT revenue in Bangladesh since its adoption in FY 1991-92 (NBR, 2008: 42). The rate of growth is quite substantial. From FY 1991-92 to FY 2006-07, VAT revenue has been increased from Taka 1,735 crore to Taka 13,782 crore, thus the annual compound growth rate is around 14 percent. It is much higher than the annual growth rate of GDP. Admittedly, there is evasion in the VAT system. In fact, no system can be made full-proof. The efficiency of a system lies in the reduced rate of system loss. In the VAT system of Bangladesh, there is a substantially increasing growth trend that has been possible much because of the efficiency and effectiveness of the VAT system.

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# Bangladesh Customs without PSI

Md. Rezaul Hoque

*Abstract : Pre-shipment Inspection system was introduced to help the customs authority of developing countries which do not have sufficient technical and technological skill for performing customs assessment work for a limited period of time. Serious allegations are coming both from the businessmen and customs officers that these PSI agencies certify false declarations in H.S. code and value which causes revenue leakage and harassment of importers. Government of Bangladesh has decided to discontinue the PSI system after 2009. Institutional and infrastructural development and skilled manpower are essential to cope up with the changed situation when there will be no PSI agencies.*

Customs is an authority or agency in a country responsible for collecting and safeguarding customs duties and for controlling the flow of goods including animals, personal effects and hazardous items in and out of a country. In most countries, Customs is the oldest public institution. The responsibilities of customs administrations vary from country to country, and are often the subject of regular review and modification to ensure their ongoing relevance in a constantly changing world. Traditionally, however, Customs has been responsible for implementing a wide range of government policies, spanning areas as diverse as revenue collection, trade compliance and facilitation, interdiction of prohibited substances, protection of cultural heritage and enforcement of intellectual property laws. This breadth of responsibility reflects the fact that customs authorities have long been entrusted with administering matters for which other government ministries and agencies have policy responsibility, such as health, agriculture, environment, trade statistics and in some cases, immigration.

## Functions of Customs:

While primary responsibilities of Customs offices have not changed significantly throughout the years, their focus and importance have changed dramatically during the past decade. The principal functions done by customs authority are summarized below:

- Collector of Revenue including customs duty, supplementary duty and duties and taxes of other agencies / department (value added tax, advance income tax, trade VAT, travel tax etc)
- Providing source of National Trade Data of import and export.
- Guarantor of a 'level playing field' for Trade and Commerce
- Front Line Protector of Society
- Facilitator of Legitimate Trade
- Cornerstone for Civil Society and Good Governance
- Protection of financial and economic Community interests
- Trade facilitation and co-operation

- Overall strategic and general support
- Strengthening security and safety
- Role against business fraud and counterfeit and protecting Intellectual Property Rights (IPR).

## Bangladesh Customs and PSI:

The functions of customs are very much technical. So, extra ordinary knowledge and skill in law, regulations and know-how about technology and new inventions of world and a clear conception of international trade are necessary for a good customs officer. But, direct recruitment of inspectors, who are regarded as the basic officers of assessment, in Bangladesh customs got stalled since 1981. The blank posts are filled by promoting lower level staffs and 'Mujibnagar Karmochari' many of whose professional skill and educational level are not up to the mark for performing the tasks of customs officers. Moreover, there is a shortage of infrastructure and computer facilities.

Following areas of concern are identified by WTO for Bangladesh and developing nations:

- excessive government documentation requirements
- lack of automation and insignificant use of information-technology
- lack of transparency; unclear and unspecified import and export requirements
- inadequate customs procedures; particularly audit-based controls and risk-assessment techniques
- lack of co-operation and modernisation amongst customs and other government agencies, which impedes efforts to deal effectively with increased trade flows.

As a result of this condition and as Bangladesh is a signatory of WTO, we started optional PSI (Pre-shipment Inspection) in the middle of 90s and later on mandatory PSI in 1999.

## Pre-shipment Inspection:

Pre shipment inspection activities are all activities relating to the verification of the quality, the quantity, the price, including currency exchange rate and financial terms, and/or the customs classification of goods to be exported to the territory of the user Member. Pre-shipment inspection is offered to exporters and importers and comprises a detailed inspection of equipment or materials after manufacture, but prior to shipment. The scope includes Quality & Quantity, Packing & Marking and Supervision of Loading. A Certificate of Inspection is provided

against a Letter of Credit which is known CRF (Clean Report of Findings).

At present, about 32 countries of the world take the help of PSI agencies for customs assessment.

Governments impose pre-shipment inspections to ensure that the price charged by the exporter reflects the true value of the goods, prevent substandard goods from entering their country, and mitigate attempts to avoid the payment of customs duties. Under SRO 255-Law 2002/1973/Customs dated 19/09/2002 of the Government of the Peoples' Republic of Bangladesh, the scopes of PSI agencies are:

- Physical Inspection
- Valuation
- HS Classification
- Import Eligibility
- FCL Sealing
- Labelling of non-FCL and sampled packages.

The key benefits of PSI are supposed to be:

- facilitate and promote transparency in trading activities
- improve the collection of customs duties and taxes
- identify dumping and subsidies
- ensure that goods conform to contract specifications
- provide authorities with effective means of overseeing and controlling foreign trade through accurate statistics
- compliance with WTO Agreement on Customs Valuation.
- Trade facilitation by necessary physical and documentary inspections.
- Help customs authority to build up data base for customs assessment.

#### **Allegations against PSI agencies:**

The above key benefits of PSI agencies are not always available and businessmen and customs officials have valid reasons to believe that PSI companies harass importers and commit gross malpractice in valuation of imported goods.

- The credibility and performance of the PSI organisation have been put in question due to detection of large numbers of false declarations from among the on-the-spot checks carried out on only 5-6 percent of items.

- Lots of false declarations in CRFs are found in every month by custom houses or stations either in value or H.S. code. When PSI companies certify lower value or H.S. code with lower tax rate in stead of the original what it should be, it is loss of government revenue. On the other hand, if the companies certify excessive price or H.S. code with higher tax rate, it is harassment for the businessmen.
- It is alleged that some staffs of PSI agencies are involved in bribery and malpractice. It is supported by the fact that PSI sometimes certify different values for the same quality of goods of same country of origin.
- PSI was introduced as a short / medium term measure pending reform of the Customs authority. But the PSI companies have not provided serious training and other services to Customs to restore it to a position where it could resume normal operations. For the most part, however, little or nothing has been done to enhance the efficiency, effectiveness or integrity of the national Customs services. The capacity of Customs Valuation Department is not up to the mark yet.
- A PSI agency will typically charge a fee of 1 per cent of the value of the goods shipped. This fee must be paid in hard currency. This increase the cost of goods.
- Often PSI requires excessive time as there is shortage of technical and skilled manpower of these companies. Thus, importers suffer when they badly need some consignments.
- There have been numerous instances where Customs authority has found that the contents of PSI verified shipments did not correspond to the findings of the PSI agencies. The instances of getting luxurious car in stead of scrap metal and soil in stead of metal can be cited.

### Discontinuation of the PSI

In the light of the above allegations and findings, NBR has decided to discontinue the PSI system after December, 2009. The government has also recently cancelled the operating license of the Cotecna Inspection, a PSI firm, after it detected a series of irregularities in the inspection and customs evaluation processes of imported goods by the PSI company concerned.

So, we have only 9 months time to prepare for an environment where the customs officials will do the assessment (valuation and classification) individually without the help of CRFs issued by PSI agencies indicating the description of goods, quantity, value and H.S. code. Do we have sufficient preparation to tackle such a challenging situation and handle the immense tension and work volume?

Customs administrations now using PSI would like to see the return to their traditional responsibilities under the right conditions. Creating these right conditions is, however, a major challenge. The question that arises is: is there enough preparation to take this major challenge?. It is a matter of regret that this fundamental issue is not also getting much attention in media and also in the discussion of the leading economists of the country.

- The first thing which is necessary is to make Customs Valuation Commissionerate effective and strong. There is a strong reason to believe that after its introduction in 2002, this office has not got chance to become fully equipped and effective and perform the job fully for which it was established.
- The recent database of PSI agencies and all custom houses and stations can build up a good database for valuation commissionerate which should be modified regularly. This office should be paid subscriber all leading price related internet sites and magazines.
- Having a good database is not all. Most import is its availability to field offices. It is not possible for the field offices to write letter or phone to valuation commissionerate and wait for their written answer for few days for all consignments as it will create deadlock of goods. The valuation commissionerate office should have networked with all field custom offices and officers of the rank of inspectors / appraisers must have direct access to this database so that they can use it when they required.
- About 90% of goods imported in Bangladesh come from a limited countries (China, India, Taiwan, Thailand, Japan, Germany, UK, USA). Two or more customs cadre officers (as per requirement) can be deputed in this country who will collect the value of different goods imported to Bangladesh and also send required information as per the requirement of field offices and NBR.

- Customs office lacks educated, experienced and efficient manpower, which is essential for operating in this highly technology-dependent environment. Many officials working in Custom Houses cannot verify import-export documents without the direct assistance of C&F agents and cannot operate computers by running ASYCUDA++ software. So adequate number of computers as well as computer-literate customs officers are essential for the department to thrive in the changing scenario..
- Technology is changing fast and new inventions are coming to market everyday. But there is no systematic approach to train the customs officers at home and abroad in order for them to face the situation. Regular trainings should be arranged for officers particularly in the field of telecommunication equipment, machinery, chemical and fabrics so that the officers can determine actual H.S. code after visual inspection and analysing documents.
- A nominal service charge can be taken (say 0.10% of assessable value) to create a fund for maintenance and modernization of customs authority and make it capable for taking the challenge of new era. This fund will be solely used for purchasing technological equipment, build infrastructure and training of customs officers. It is expected that the importers will not hesitate to spend such negligible amount as they are now giving 1% of assessable value as PSI service charge.

## Conclusion:

The long term interests of the countries concerned lie not with contracting overseas operators to carry out critical revenue assessment functions but in rebuilding and reforming the indigenous institutions to carry out these tasks. A critical success factor will undoubtedly be the cooperation and commitment of Customs officials at all levels within the administration to ensure efficiency and ethical behaviour. Returning to the original system leaving behind the PSI regime will require a major effort to dislodge the practice of using PSI and to rejuvenate Customs services. We should not hesitate to spend the money in this regard as every year we pay 3-4 billion foreign currency to PSI companies as service charges. It must be noted that although customs duty rate has reduced considerably over the last few years, revenue in import stage is still the single most source of revenue (more than 33%). An intelligent organization should be proactive not reactive. It must foresee what problems can arise in future and take necessary action in stead of taking action after some events occur. It is good that Customs is getting back to its original function – assessment of imported goods individually without the help of other but we should remember that to return duty assessment responsibilities to an administration that are not thoroughly prepared would simply make a bad situation worse. And for this preparation we have only 11 months is hand. So, there is no time to waste.

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## Risk Management in Bangladesh Customs

Golam Md. Munir

*[Abstract: This paper endeavours to study the level of risk and challenges that Customs and VAT authorities face and the strengths and weaknesses that they have to take into consideration in managing those risks. This paper also summarizes the structural, managerial and financial measures that can be considered in order to facilitate trade and investment and prevent loss of revenue as well.]*

### Introduction

The process of globalization has played a significant role in the tremendous increase in international flow of people, goods, capital and information. The world has experienced a fabulous growth in international trade (88%) over the global GDP growth (25%) in the last decade of twentieth century.

Bangladesh has also experienced more growth in terms of both the indicators. In last five years, we enjoyed 130% growth in import consignments, 85% in containers imported and exported, 29% in number of ships and 44% in the number of importers. On the other hand, we have recorded only 12% growth in tax-GDP ratio.

This growth in international trade & commerce has changed the priorities of many governments in the world towards reform and modernization of Customs. Governments have to change priorities continuously, because globalization creates a highly competitive environment where most of the international trade and investment will flow toward trade-friendly locations.

Customs authority should not put the prosperity of the nation at risk by driving away business and investment. Rather, they should contribute to domestic national priorities while facilitate trade, and address complex international issues at the same time. In this new situation, Customs administration must balance between protecting government revenue and encouraging economic growth. Finding a trade off between these apparently contradictory objectives involves Trade Compliance and Risk Management Process.

Bangladesh Customs & VAT, however, witness a conflict between revenue collection (enhancing tax-GDP ratio) and trade facilitation. The conflict raises dilemma between priorities to modernize customs administration, managing risks and deploying available scarce

resources. Finding a suitable mix in these priorities may delay implementation of modern risk management tools both in Customs and VAT if they cannot recognize the challenges, uncertainties and risks inherent to globalization and the reforms that they need to face those challenges.

#### **Emerging Trend of risks that every developing country encounters:**

With development of global trade, national and transnational economic crimes including commercial or business frauds continue to evolve and increase in its complexity and sophistication. These crimes pose ample threats to businesses, the economy, and the society and to government organizations like NBR. Therefore, managing these risks requires tracking and analysis of predictive knowledge of high volumes of transactions, and building collaborative culture of sharing knowledge or information.

#### **Why managing risk is so important? – NBRs' Challenge:**

NBR nowadays faces challenges to ensure speedy clearance of goods for home consumption at the customs stations and ensure that only highly risky imports are audited or checked by a single team of government officials. Moreover, NBR faces challenge to facilitate trade without losing control on import consignments or domestic business transactions for national interest. A better control, while facilitating trade in traditional paper-based way, is no longer possible because of a few distinct reasons. First, the ratio of Trade volume and the number of Customs/VAT officers has been decreasing. Secondly, the pressure from domestic and global trade regime to facilitate trade has been increasing. And, finally, the complexities of organized economic crime have been continuously increasing and changing their modalities.

This situation resets the priorities of NBR to modernize itself through intensive, proactive and well-thought restructuring and reform programmes by implementing automated risk management process among others.

In this process, NBR has to examine and focus on the importance of risk management in a handful of areas. First, a shift in global trade and investments to developing parts of the world creates huge opportunities and as well as challenges and risks. The demand for trade facilitation has been rapidly increasing as a result of increasing globalization, new International trade regime & agreement, more lenient regulations concerning movement of goods, people, capital & information across the border, and changes in production-procurement status (for example,

e-commerce, etc) of countries concerned. The needs for facilitation and opening economy thus open the door for risky trades.

Secondly, fierce competition in domestic markets compels businesses and traders to become more efficient in eliminating unproductive costs and resource slacks. Domestic trades and commerce are becoming fully competitive as we are globalizing in terms of economy, trade and market. As economy globalizes, domestic trade and businesses are getting momentum and bargaining power to demand more lenient, hassle-free and trade friendly regulations to conduct businesses is ever increasing. For example, businesses want that only the risky businesses are audited and audited by a single team of officials. Businesses do not want separate audits by CRAD, Customs, VAT and Income tax officials that increases the cost of business and compliance. In addition, businesses no longer can afford multiple audits on the same transaction or an audit that they think is unnecessary.

These wants and needs of international domestic trade pose huge challenges to Customs authorities to modernize in order to facilitate trade, manage risks that are inherent to lenient regulations while having far better control over insignificant number of unscrupulous trade and businesses. Therefore, Customs administration is striving for an answer that facilitates trade, protects economy through better control while making the task of customs officers effective and efficient. Risk management with modernization of NBR (Customs & VAT) can help at this end.

Perceptibly, modernization has many dimensions. Do we need to modernize to manage risks? The answer is a simple and straight-forward YES. Because, as mentioned earlier, the ratio of the trade volume and the number of Customs-VAT personnel has been decreasing rapidly. At present, only 7586 employees are engaged in dealing with more than six hundred thousand of businesses and trading firms! So, finding risks in high and ever increasing volume of businesses manually now a day appears to be finding a lost needle in bushes! To find those needles or risks to avoid pricks or penalty, we need microscopes or tools in addition to skills for applying those tools. Therefore, full automation for virtual information sharing to combat risks and their consequences appears to be the need of time.

### **Sources of risks and their modalities in Bangladesh:**

Sources of risks to customs are embedded in the internal environment or the management process that they have at present and in external environment in which they work.

A presence of regulatory vacuum instigates non-compliance and bona fide errors in revenue collection process. Businesses may commit these errors because, at times, they find fiscal laws, policies, and procedures inadequate, confusing or uncertain, full of gray areas or complexities. For these reasons, businesses often cannot assess right amount of tax. Failure to assess tax properly increases possibilities of non-compliance. Moreover, misuse and abuse of exemptions and discretion also impedes collection of duty and taxes, distorts the market structure and increases non-compliance in the form of revenue risks.

Inefficient entrepreneurship and market failure can also give rise to non-compliant taxpayers and risks to customs. Taxpayers may choose to avoid assessing or paying the right amount of tax deliberately when they cannot afford unproductive costs, or when they face uneven competition in the market and/or industry. Moreover, development of international trade and commerce also creates numerous challenges and risks to customs. Significant increase in volume and pace of global trade enhances incentives & financial advantage for perpetrators to commit interconnected and organized transnational economic crime. These syndicated crimes invade every vulnerable economy like Bangladesh in the form of international terrorism, money laundering, commercial fraud, trafficking drugs, nuclear materials and waste, chemical and lethal weapons of mass destruction, human body organs, pornography, works of art and antiques, etc. These syndicated crimes however, pose sufficient risks and bandwagon impact on the economy like Bangladesh. As a result, the economy has to bear stiff penalty if we cannot find and treat those risks in time while facilitating trade. However, it is more cost-effective to prevent all these risks rather than to investigate and treat them after the events take place.

### **Cost of not managing risks efficiently:**

What cost the nation has to bear if we do not find a trade-off between managing risk and facilitating trade? Serious impact/consequences of international/Transnational organized crime in Bangladesh are as follows:

- Commercial and business frauds help evade taxes that make government unable to finance fiscal and social development program;

- Money laundering and pornography trafficking pose threat to social security and culture
- Commercial frauds distort the market that generates monopoly/oligopoly or syndication. Syndication affects consumer welfare. In this situation, consumer surplus decreases and poverty increases. As, a result government passes through financial hardship to ensure food and energy security.
- Weapon, dangerous species and waste trafficking threatens national security.

### **Benefits of Risk Management in Customs:**

There are many benefits of managing risks that are specific to businesses and organizations. Benefits unique to NBR situation can be summarized as follows:

- Managing risks efficiently prevents wastage of resources in operation. Prioritizing human, structural and financial resources to high risk areas results in resource gain that eliminates resource slack in customs operation and as well as in businesses.
- For example, risk management helps organize human resource efficiently to obtain highest possible qualitative outcome. Risk-based import clearance or VAT audits free staff from laborious work in physical and documentary checks, audit and investigations that generate less effective results. Risk management, on the other hand, enables them to take care of risky tasks. Moreover, focusing on deploying limited human resources rationally to deal with the highest risks makes more cost-effective use of existing capabilities, skills and experience that ensures better results.
- Further, managing risks helps reduce clearance time and improve customs' image to the global trade community. With deploying risk management tools, vast majority of shipments can be released immediately after clearance application or even before arrival of consignments and only risky shipments can be targeted and examined.
- In addition, these tools lower cost of doing business. Risk management techniques can release 80-90 percent of the shipments within a few hours of arrival. Thus, managing risks saves significant overhead costs and protects businesses and traders from unnecessary checks, audits and investigations.
- Risk management improves the quality of customs controls, information and accountability. At present, 90% of the

consignments are checked at import level on the basis of inadequate information or just on assumption or educated guess. Using information database and deploying risk e-profiles in post clearance audit is almost absent. Educated guesses and assumptions make management process unaccountable. Unaccountable management dissatisfies business community through increasing cost of businesses.

- Risk Management improves voluntary compliance rate in businesses and trade. These tools improve efficiency in Customs and VAT. This efficiency increases traders' incentive to get faster clearance through the green channel that ensures better voluntary compliance from traders. Moreover, better compliance ensures reliable and accurate trade statistics that has a bandwagon positive impact on risk management.
- Managing risk by customs builds trust-worthy private-public sector partnership and collaborative culture. Faster clearance and better compliance further grows trustworthy and sustainable relationship between customs and honest traders that gives further control on risky trades and businesses.
- Risk Management facilitates trade. It lessens cost of businesses through accurately and quickly tracking high risk trades and business that bear severe impacts on revenue. Automated customs and VAT risk profiles are able to process VAT returns, and customs declarations, to exempt honest taxpayers from being audited, and to lessen physical interaction and thus corruption. Moreover, it brings about greater openness and transparency in operational decision-making that makes customs management processes accountable to trade. In this way also this tool facilitates trade.
- It maximizes revenue and economic growth. Managing risks ensures prevents revenue evasion and increases voluntary compliance. Reduced physical check at import points and unnecessary audits in businesses improves efficiency and professionalism. On the other hand by improving customs resources this tool effectively prevents evasion of duty and taxes. Improved efficiency in turn, ensures trustworthy relation and partnership with business community. A trusting relation finally, increases voluntary compliance and the size of tax-GDP ratio and hence growth.

### **Cost of introducing risk management process:**

Global economy and businesses have been witnessing accelerated changes over the last two decades. Like businesses, adopting accelerating change has become the necessity for governments because; recent global economic crisis has created rampant uncertainties. Risks are inherent to uncertainties. It becomes true as the role of the state in market is no longer considered controversial.. Acting upon calculated risks requires continuous updating and modification of management to adopt changes and keep the economy viable. Significant Infrastructural modification for gathering intelligence is costly in terms of human resource and ICT. It needs adequate training, coaching and mentoring. Moreover, resistance from people in fear of losing job adds legal & administrative cost to reform process. New staffing costs also add.

### **What to do?**

Many scholars regard risk management as 'managing future rather than administering past events' as integral part of business planning. Further, it is the main tool for modernization of Customs. UNCTAD considers this tool as a logical and systematic approach of identifying, analyzing, treating and monitoring the risks involved in any activity or process by considering opportunity cost of allocating managerial, structural and financial resources.

Therefore, we need to deploy scarce resources rationally to facilitate trade while monitoring cargo, providing security of the international trade supply-chain and ensuring better revenue from domestic trade. Efficient monitoring while preventing wastage of resources needs modern risk management tools and techniques. Frequently-used techniques include modernization and automation of Customs-VAT and virtual networking with all stakeholders that hold useful information of risks by using ICT backbone.

We must consider that risk management has three dimensions in its application. First, in strategic or long-term dimension, it focuses on preventing regulatory vacuum that leaves incentives for non-compliance and arbitration. To save cost of all stakeholders, facilitate trade and avoid many grievous consequences and probabilities of high risk businesses, Customs has to focus on bringing in transparent fiscal policy, regulations, and efficient, effective organizational routines, practicing best practices, building on appropriate knowledge and skills.. Secondly, in operational or mid-term dimension, we need to focus on treating high risk areas on immediate basis and leave the low



risk or no risk areas considering the opportunity cost of allocating resources. Risk management tool at operational level, if used for considerable span, can bring about efficiency of human resources. It frees them from unproductive laborious work and engages them in upgrading their skill. Thirdly, in tactical or short term dimension, it focuses on building efficient human resources.

Therefore, to deal with uncertain future and risks inherent to it, we must focus on the following actions:

- Enact and strengthen legislation (Customs act, VAT act and rules made thereunder, etc.), rationalize exemptions and Customs tariff codes and reduce gap between tariff slabs and remove distortions. All these initiatives will reduce the incentives for perpetrators to commit organized crime and avoid many, if not all, severe risks to economy and businesses.
- Continuously monitor the global economic and business trends, changing international and domestic industry standards, and evaluate current management procedures/routines and skill gap to identify potential strengths and weaknesses in management process for adopting these accelerating trends. Weaknesses in management process generate high to moderate degree of internal risks. Rejuvenating the management process through redesigning HR policy, procedures, processes and routines helps avoid/mitigate these risks. Process improvements remove huge unproductive costs and losses inherent to these management risks. These improvements also prevent corruption and loss of revenue and strengthen internal control and management standards.
- Consider and monitor the adequacy of the existing competence and strengths of NBR in terms of resources and capabilities and opportunity cost of acquiring and deploying them to combat risks. In doing so, consider the trade-off between national objectives and demand of open economy. This creates a context for acting upon with risk management tool. If we do not understand the context in which risks are created, we cannot identify all facets of these risks and obviously, may fail to treat them appropriately.
- Create 'knowledge center for excellence' and build 'collaborative culture' of sharing knowledge of risks. We must focus on building collaborative culture across multiple systems or stakeholders to exchange information on risks in order to protect against economic crimes in the form of commercial or business fraud that poses high risks. It is impossible to get a

full picture of future risks that we are prone to unless we share information of risks that lie with different stakeholders in different form. For example, ACC taskforce involving all stakeholders and Attorney Generals' office provides deeper insights into the level of awareness of economic crime-the risks, its impact, cost and preventive measures being taken to combat it. Therefore, all stakeholders, for example, Customs, Income tax, Treasury, Banks, Police, Anti Corruption Commission, Bangladesh Rifles, etc., should move towards the same direction to collaborate and share information on all economic crime. In addition, for the purpose of creating collaborative culture, we have to focus on few painfully clear steps. Step one - establishing a legal basis for "collaborative information and intelligence exchanges between all law-enforcement agencies". A strategic alliance between ACC, Police, BB and NBR, treasury, related ministries for example, finance division and commerce ministry, and law enforcing agencies may appear very important to comply with Johannesburg Convention of WCO. Step two - prepare to enter into agreements for the exchange of information and improve capacity across borders and stakeholders. Step three - build partnership with business community and all stakeholders to detect commercial fraud more effectively. Step four - use web based communication to detect under-invoicing and other commercial or money frauds. We, for example, can use Reuter value database, e-partner with international stakeholders like shipping lines, banks, traders-businesses, WCO, RILO, etc. Finally - leverage this collaborative culture to collect cross border Customs information in order for identifying illegal consignments. These Information could be on people/suppliers/companies, country of origin of consignment; destinations; routings/transit places; means of transport; methods of concealment, the demand for prohibited goods, such as drugs, pornography, traffic in CITES wildlife, etc. Implement Risk Management practices that correctly recognize and rationally rank the risks. For this purpose, research existing databases and past records of business - trade transaction, build risk profile and target the risks that we can treat cost efficiently and effectively. Enforce risk-based audit-controls and post clearance audit to Comply with Revised Kyoto Convention; Use WCO's tool "Guidelines on the development and use of a national valuation data base as a risk assessment tool";

- Modernize with web-based automation to develop better border and inland controls. Nonetheless, automated risk management applications validates information for accuracy and reliability; evaluates all commercial information consistently and comprehensively to detect possible fraud; delivers both high-level alerts and detailed information from multiple sources in a simple and cost-effective manner; allows further automation to simplify management process while mitigates costly commercial fraud/risk;

#### The bottom line:

Nevertheless, modernization has its own ache manifested by resistance from within and the consideration of limited resources. We have to find visionary, transformational and transactional leader in NBR equipped with skills and positive mindset to modernize Customs that includes reaping benefits of ICT component as the key factor. These champions can act as 'Thought Leaders' or 'The Change Agents' to sustain the benefits of risk management tools. For the leaders to motivate employees, to manage risks efficiently and cost-effectively, finding a trade-off between opportunity cost of deploying scarce resources and resources gain through risk management is a key issue.

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## An overview of the Value-Added Tax in Bangladesh

Ahmed Munirus Saleheen

Personal income tax, generally considered to be the most effective means of taxing the rich, is relatively unimportant in most developing countries. In the absence of a tradition of voluntary compliance and appropriate accounting procedures, an income tax, as Richard Bird notes, is “neither global in coverage (since many forms of income escape effective taxation) nor (for that reason) progressive nor, indeed, really on personal income. The often more adequate administration of indirect taxes, the frequent rate differentiation for various goods and the widely different consumption patterns of different subgroups of the tax paying population have resulted in a progressive incidence pattern for the indirect taxes in many countries.” This is very much true of a developing country like Bangladesh. The implication, therefore, is that “generalizations about taxes in developed countries, where direct taxes are found to be progressive (up to a certain level) and indirect taxes proportional or regressive, are thus not relevant for analyzing most developing countries, where these results are, most commonly reversed.” The rise and the economic importance of a consumption tax like value added tax owes much to this economic pattern of taxation.

Most of the countries that adopted VAT have accepted the consumption tax system of the value added tax primarily because of its universality and general uniformity, its great revenue raising potential for financing increased governmental services and benefits, and the efficiency with which it may be imposed on imports and removed from exports.

As with other countries, the major reason for substituting the VAT in Bangladesh for excise duty on most domestically produced goods and the sales tax at the import stage was the belief that VAT has a higher capacity of generating revenues at low costs.

The Value Added Tax was introduced in Bangladesh in 1991 by partially replacing the time-honoured Excise Duty in most of the domestically produced goods and some services and wholly the sales tax at the importation stage. During its inception some economically important domestic products like cigarettes, natural gas, petroleum products, textiles and hand-made cigarettes popularly known as 'bidi' were kept outside the purview of value added tax network. Later all these products except hand-made cigarettes and textiles were phased in into the VAT roll.

### *Excise*

Before the introduction of VAT in 1991, Bangladesh had a long and enduring legacy of excise taxes that date back to 1950s. But as opposed to excise taxes defined or described as the selective taxes on goods and services in many developed countries like UK or USA, Bangladesh and the then Pakistan practiced an extended excise tax which was meant to be a kind of sales tax with a lot of exemptions rather than a selective tax on goods and services. In fact the excise system in Indian subcontinent was much broader in scope than the sales taxes in some other countries.

The choice between excise and sales taxation cannot be validly poised. Each fulfils a different role: the sales tax is primarily a revenue raiser and excises, in addition, fulfil regulatory functions. The two roles have combined in the Supplementary Duty which is equivalent to the western excise tax; this tax is applicable to a large number of goods both at import and manufacturing stages and to a few domestic services.

Differentiated sales tax rates or separate excises at the retail stage are difficult to administer, because of the diversity of the products handled, the small size of many outlets and the lack of adequate records.

The administration of excise taxes in Bangladesh used to be similar to customs operations, with the difference that instead of crossing international boundaries, goods used to enter the domestic market from the factory premises closely guarded by the excise staff. The role of excise officer was similar to that of a customs officer: both canalize the flow of goods, verify and examine contents, classify, appraise values, undertake laboratory test if necessary, check quantities and values against accompanying records and did not release without payment of duty or until a bond has been provided. The problems of the custom houses- misclassification, improper valuation, underreporting of magnitudes- were frequently also those of an excise administration.

### *Presumptive Taxation*

So far as the practices and difficulties encountered in the extended excise system of taxation that covered virtually the whole range of industrial activity in Bangladesh are concerned, the conventional system relied on physical controls of compliance.

Before the introduction of self-clearance which was the precursor of value added tax in Bangladesh, a form of excise taxation based on the

output "presumed" to arise in manufacturing from one or more production factors. One presumptive method that had been used in olden days and still is being used in textile factories relates to excise liability to the number of machines in operation.

Producers discharge their excise tax liability by paying a specified amount monthly for each of machine installed. Textile mill owners are obliged to obtain a record of the number of machines in operation which forms the basis for the excise assessment. Compliance control is limited to occasional visits by excise staff to verify that the number of machines does not exceed the number declared by the owner.

Presumptive excise taxation was often thought to represent an incentive to increase production, since it provides a reward for entrepreneurs whose output exceeds presumptive output. The penalty implicit in producing below the capacity acts as the powerful incentive to increase production up to the point where production equals presumptive output.

A presumptive excise obviated to some extent the need for the sometimes cumbersome production controls effect under the conventional excise system. These controls, governed by complex provisions prescribing such matters as the design of buildings in which excisable commodities are produced or stored, and the movement of goods and personnel on factory premises, require the continuous presence of excise staff during working hours.

The method of taxing small manufacturing units on the basis of presumption, developed in India during the fifties, was also adopted in the erstwhile East and West Pakistan where a more comprehensive version was designed in the sixties based on factory production capacity. Taxing the capacity rather than the actual production was warranted not only to ease the tax administration but there was also a belief that decline in average tax rates as production expanded would stimulate output. But the more consideration was that administrative procedures would be simplified to benefit both the tax collectors and taxpayers. Because the presumptive method did not require production control and excise personnel could be withdrawn from factories, which would also remove a potential source of collusion and tax evasion.

However effective and rewarding it might be for an entrepreneur, capacity based excise taxation failed to tax the potential revenue base. Service providers like cinema halls had been taxed on the basis of capacity until the introduction of VAT in 1991. Due to the prevailing

socio-economic reality of developing countries, the remnants of the excise system still pervade in many economic sectors. Especially for services like sweetmeat seller or cinema hall, the capacity-based taxation still looms large under the camouflage of a value added tax.

The consumption taxation system that preceded the introduction of value added tax- excise duty at the domestic level and sales tax at the import stage- in Bangladesh was not only relatively complicated, but also narrow-based, personalized and discretionary for the tax collectors. They failed to provide the domestic resources required for the macro-economic goal of the country. The system's heavy dependence on the taxation of imported goods ultimately resulted in the taxation of raw materials and intermediate goods. The import- based taxation system performed two related functions. It helped raise revenue as well as give protection to domestic industry. The structure of protection was not justified on economic grounds. It thus led to inefficiencies in production and created an overwhelmingly anti export bias. Since sixty percent of the total tax revenue is collected from the import based taxation, revenue collection in Bangladesh became a hostage to the balance of payment situation. The excise system of taxation was also characterized by narrow base, cascading, too many rates and exemptions.

In this chapter I will briefly discuss salient features of the VAT system in Bangladesh. The critical study of those features will be made in the following chapters.

#### *Adoption of VAT*

Unlike many other countries that have adopted VAT, Bangladesh introduced VAT without much prior preparations.<sup>1</sup>

<sup>1</sup> Nepal, for example, introduced VAT in 1996. But the preparations for the introduction of VAT commenced in 1993. For this purpose a steering committee and a task force were formed. The financial assistance for the preparations was provided by USAID and the technical assistance by the Harvard Institute for International Development. Discussions on draft VAT Act were held with various stakeholders. A number of seminars, symposia, training programs were conducted as part of taxpayer's education. Massive advertisements on various aspects were done through print and electronic media. As for Singapore, the preparations for introducing the VAT were even more minute and exhaustive. As Dr. Rup Khadka noted in his article published in the book commemorating the fourth anniversary of the introduction of VAT in Nepal, "In 1993, a White paper was issued to implement this tax system. Then on 26 February 1993, a Bill for tax on goods and services was presented at the parliament. A Select Committee of the parliament was formed to discuss on this. On 7 September 1993, the committee presented its report to the parliament. The parliament then passed the VAT Act on 12 October 1993. On 29 October, a gazette was published stating that the Act would commence from 26 November 1993 and that the registration and tax collection would commence from 1 April 1994.

The Value Added Tax was adopted in July 1991 vide a Presidential Promulgation of 1991. Later the promulgation with some changes and modifications was adopted as the মূল্য সংযোজন কর আইন, ১৯৯১ (The Value Added Tax Act, 1991)

Of different types of VAT, Bangladesh has adopted the invoice-based credit method of the consumption type VAT. This is by far the most prevalent type of VAT in use throughout the world.

#### *Taxable goods and services*

All goods except those mentioned in the First schedule to the VAT Act and all goods except those mentioned in the 2nd schedule are taxable goods and services respectively (Appendix 1,2). Only primary and unprocessed agricultural products like cattle, crops, fruits, seeds and basic essential services like education, social welfare services and charitable medical care are exempt as per the VAT Act.

The number of VAT-able services so far identified and scope explained by the National Board of Revenue stands at 73 now. They are:

#### *Exemptions*

In addition to the exemptions in the First and Second schedules of the VAT Act a number of goods and services have been kept outside the purview of VAT at different stages of transaction by an executive notification.<sup>2</sup> This notification is usually revised every year at the time of fiscal budget.

Though the substantial threshold for small businesses keeps many potential taxpayers out of the VAT roll, there are hosts of other kind of exemptions, which can be classified into three groups:

- Statutory exemption of goods mentioned in the First schedule of the Value -Added Tax Act and of services NOT mentioned in the Second schedule.
- General exemption by notification in the official gazette
- Cottage Industry exemptions

The mass media was used widely. Wide publicity campaigns were carried out through the radio, television advertisement, discussion programs, stories and cartoons in various newspapers, magazines, posters etc.

<sup>2</sup> Notification SRO 131-law/2006/459-VAT, June 8, 2007

All goods except those mentioned in another notification<sup>3</sup> may qualify for VAT exemption at the manufacturing level upon fulfilling certain conditions of cottage industry. In order for a product to qualify for VAT exemption as cottage industry at the manufacturing stage, the conditions to be fulfilled are:

- It is not one of the goods mentioned in the notification
- the concerned business is not a joint stock company
- the investment in its plant, machinery and equipment does not exceed Taka 1500,000 at any time of the year
- the annual turnover of the business does not exceed 4 million Taka

As opposed to general exemption, the VAT exemption benefit for cottage industry is granted by the concerned Commissioner upon receiving application from the business fulfilling the conditions and the subsequent verification of such application.

- Special and periodical exemptions by statutory rules and orders

#### *VAT threshold*

The VAT threshold has been mentioned in the Value-Added Tax Rules, 1991.<sup>4</sup>

The standard rule for VAT registration is that any business or person dealing in any taxable goods or services and having an annual turnover of taka 4 million (equivalent to approx.US\$56,500 as of 2007) or more must take VAT registration from the concerned VAT divisional office. But, businesses of most of the identified taxable services and few goods irrespective of their annual turnover are required to take mandatory VAT registration.

A business whose annual turnover<sup>5</sup> is less than the VAT threshold and is not one those listed in the mandatory VAT registration scheme can pay a turnover tax @4% of declared and approved annual turnover with no opportunity to claim input tax credit.

<sup>3</sup> Notification SRO 168-law/2003/376-VAT, June 12, 2003

<sup>4</sup> Rule 9, Value-Added Tax Rules,1991

<sup>5</sup> 'Turnover' is defined in the law as all money received or receivable by any person from supply of taxable goods produced or manufactured by him or rendering of taxable services for a particular period

#### *Rate of VAT*

Bangladesh has two VAT rates- 15% and 0%; 15% for all taxable goods imported and supplied within the country and all taxable services provided within the territory of the country. And 0% rate for all goods and services to be exported and deemed-exported from the country.

Though the law stipulates a single rate of VAT at 15%, the assessment of VAT on truncated base or on the basis of the rate of value addition has in fact given birth to multifarious rates details of which have been discussed later.

#### *Value for assessment of VAT*

The Value Added Tax Act categorically stipulates the value on which VAT is charged at different stages.

- *value of goods at importation*

At the importation stage, the value on which VAT is charged is the value which is arrived at by adding all duties\* and charges to the assessable value ascertained/determined under section 25 or 25a of the Customs Act,1969.

- *value of goods manufactured or supplied<sup>6</sup>*

At the stage of supply, the value for imposition of VAT is the total due to seller from the buyer. This is also the price paid or payable by a buyer. This value includes seller's profit the cost of input, all charges and commission incidental to the supply and all duties and taxes except VAT and t. It is noteworthy that profit has been made an integral part of the value which restricts a person to lose in his/her business!

For a few items which are specified by the government notification there is a provision<sup>7</sup> of charging VAT on the maximum retail price (MRP) printed on the body or the pack of a product at manufacturing stage. Cigarette is one of those few items. According to this provision, the VAT payable at different stages of business transaction is collected at the manufacturing stage and no VAT is leviable at other stages. For example, if the printed price of a pack of cigarette is Taka 10, then the VAT@15% chargeable thereon is Taka1.50. Details of this system,

<sup>6</sup> Section 5(2) of Value-Added Tax Act,1991

<sup>7</sup> Section 5(3) of Value-Added Tax Act,1991

however, have been discussed in another chapter.

A range of goods are assessed at the manufacturing stage on the basis of tariff value. The National Board of Revenue has been empowered to determine tariff value

- a notional value taking the value addition into consideration – for the imposition of VAT on any taxable goods or services by an order published in the official gazette.

Tariff value is a value only purpose of VAT assessment. This is a kind of truncated value for some listed goods and services suppliers of which are not entitled to claim input tax credit.

#### *Value for taxable services*

For taxable services, the assessable for imposition of VAT is “total receipt”. Total receipt is defined in the legislation as total amount of money, including commission or charge except VAT or Advance Income Tax (AIT) received or receivable by the provider of the services. But for a number of items the VAT authority has fixed a notional base commonly known as truncated base which can be opted by the relevant service providers.

The difference between a tariff value and truncated value-base is while a tariff value is mandatory (a person supplying goods or providing services on which tariff value has been fixed has no option but to pay VAT on that value), a truncated value base is rather optional. The concerned business may also elect to pay VAT on normal value.

#### *Tax liability*

In the Bangladesh VAT legislation, the tax liability rests on the taxable person. The term ‘person’ means both natural and legal persons. In this context it means sole proprietors, partnerships, limited companies, clubs and other unincorporated associations and any other group of individuals combining for the purpose of carrying out business activities.

#### *Payment Time of VAT*

In case of taxable imported goods, VAT is payable at the same time as any customs duties, prior to the clearance of the goods.

The time for payment of VAT against any supply of goods meant for home consumption is the time when whichever of the following activities takes place first:

- when goods or services are delivered or supplied;
- when invoice as regards supply of goods/services is issued;
- when goods/services are personally consumed or delivered for other’s consumption;
- when full or part payment is received.

#### *Method of payment of VAT*

There is more than one method of depositing the VAT collected by a taxable enterprise to the government treasury. All the manufacturers of taxable goods have maintain a register known as Account Current<sup>8</sup> Register in a prescribed form (Mushak-18) in which all their input taxes are credited and they clear their goods from the business premises until the credited amount of input tax is exhausted. In case the balance in the account current is not sufficient for any amount of tax payable on the supply of goods at any time, they are required to credit an amount of money in the government treasury before the supply of taxable goods takes place. By this way of crediting the input taxes and periodic deposit in the treasury, the taxpayer needs to keep the balance sufficient enough to pay the tax due on any supply at a given period of time. This method is good for the government since it gets taxes before they are due to it. But numerous complaints are heard from the business sector about this advance payment of taxes which, they say, block no mean amount of their capital.

In this system of making payment of the tax collected, submission of returns means giving a statement of how much VAT is collected, how much input tax is credited, how much of refund has been drawn and so and so forth.

On the other hand, the service providers, with the exception of Cinema Halls, are entitled to paying the taxes they have collected through Returns.

<sup>8</sup> The idea of account current would be better understood if we take the analogy of post-paid and pre-paid method of payment into consideration. The account current method can easily be compared with the pre-paid method of payment where tax is paid to the government exchequer well before the sale of goods or services.

### *Input Tax*

According to the VAT legislation, the VAT paid on the input at the prior stage is immediately deductible or refundable if it has been directly invoiced to a taxable person and the latter uses the commodities in his / her business. "Input" has been defined in the legislation as –

- “(a) Except land, labour, building, office equipment and transport, all sorts of raw materials, any gas, any material used as fuel, packaging material, service, machinery and parts;  
(b) in case of trading, -goods imported, purchased, acquired or otherwise procured in way of sale, exchange, or to transfer in any manner.”<sup>9</sup>

The above definition underlies that some generally recognized input viz. building, office equipment and transport have been kept outside the purview of the definition and hence, any VAT paid on the purchase of these items cannot be deducted. Needless to say, any duty or tax other than VAT paid on the input cannot be taken as input tax credit.

A registered taxpayer has to fulfil certain conditions in order to be eligible for input tax credit:

- Input tax can be deducted only against taxable supplies
- the taxpayer must possess a valid Bill of Entry or VAT invoice in his/her own name in support of his/her purchase and the goods involved must be received in business premises
- Input tax must be deducted within 30 days of the goods in question being received in the business premises
- Businesses paying VAT on truncated base or on the basis of tariff value cannot deduct input tax

Despite purchased for business purposes and contributing solely to the making of taxable supplies, the deduction input tax on certain items is not allowed:

- VAT paid on such goods services as are related to the construction, renovation and repair of any building or structure or establishment
- VAT paid on the purchase or repair of all kinds of furniture, stationary, air conditioner, fan, lighting equipment, generator etc.
- VAT paid on expenditure related to travel, entertainment,

<sup>9</sup> Section 2(c), Valued Added Tax, 1991

and staff welfare and development activity.

While only 80% of the VAT paid on gas and electricity supplies is deductible, only 60% of the VAT paid on telecommunication and internet usage, water and sewerage charges, audit and accountancy services, security services, clearing and forwarding and transport charges can be deducted.

### *Registration for VAT*

Importers, Exporters and suppliers (manufacturers, distributors, wholesalers, retailers) of all taxable goods and services having a threshold of annual turnover of taka 4 million and above are required to be registered under Bangladesh VAT

While getting registered is mandatory for all taxable businesses having a threshold of annual turnover of taka 4 millions and above is mandatory, other businesses not having a turnover of VAT threshold or exempt from VAT may elect to get registered under optional VAT registration. A number of taxable of services, however, are liable to mandatory VAT registration irrespective of their annual turnover.

A VAT registration certificate with business registration number should be issued within two working days of the submission of application. This certificate must be prominently displayed at the business premises.

### **Some special operational schemes**

#### *Withholding*

There are some 26 services in which case the VAT payable by the service providers is withheld at the source by the service receivers.

Deduction and deposit of VAT payable on those services is mandatory for the persons authorised to deduct. The withholding authority is supposed to issue a certificate of deduction in favour of the service renderer. In case of failure to deduct or deposit, the VAT payable is realized from the deduction authority with an interest of 2% per month. As per the VAT Act the delinquent deducting authority will be dealt with as if the authority is a service renderer. Penalty not exceeding Tk 25,000/- to be imposed by the Commissioner in case of failure

Though withholding of taxes by the person that receive the service or supply does not relieve the taxable person of submitting a return, in

most cases the concerned registered person thinks that his obligation is over as soon as the tax has been deducted from his bill. Thus this system of withholding of tax accounts for a great deal of non-submission of tax returns.

#### *Turnover tax*

A taxable supplier whose annual turnover is below the registration limit has to enlist himself as a turnover tax (TT) unit and pay TT at the rate of 4% on his annual turnover declared by him at the time of enlistment with no credit for input; purchase from turnover tax paying business does not qualify for input credit as well.

#### *Supplementary Duty*

In conjunction with the VAT, Bangladesh imposes a luxury tax on an extensive list of goods, including, for example, alcoholic beverages, motor vehicles, cosmetics. Supplementary Duty (SD), functionally equivalent to selective excises, as the name suggests, is a duty that is meant to be imposed in addition to VAT on "luxury goods, such good and services as are not essential and socially undesirable."<sup>10</sup> Goods and services mentioned in the Third Schedule of the VAT Act are subject to SD at various rates ranging from 2.5% for powdered milk to 250% for imported cigarettes: but, by dint of exemption notifications, some items are being subjected to SD at the importation stage while others face it at the domestic level. The principle of trade neutrality in applying SD to all stages of transaction seem to have been sacrificed mainly to have it perform the combined role of a revenue raiser and fulfilling regulatory functions.

It is important to mention here that supplementary duty paid at the prior stage cannot be claimed back as input credit; on the other hand, SD is added to the base for the determination of VAT.

Many VAT adopting countries, like, for example, Indonesia, impose this kind of selective excise taxes.

<sup>10</sup> Sec 7, Value-Added Act, 1991; "luxury goods, non-essential and socially undesirable goods and other goods and services specified in the Third Schedule on which imposition of supplementary duty is justified in the public interest, supplementary duty at the rate specified in the said schedule shall be imposed  
On such goods and services supplied, imported or rendered in Bangladesh.

#### *Trade sector*

The original version of the VAT Act did not envisage the inclusion of the trade sector in the value added tax net. Originally, the supply of goods and delivery of certain services were brought under VAT net. Initially, "supply" meant supply by a manufacturer or an importer or an exporter. Later in 1996, the term "supply" was re-defined to include the supply by a trader as taxable. But initially only thirteen of the items traded at the retail and whole sale levels were brought under the VAT purview. The number of items to be liable to VAT at the retail and wholesale levels have been increased by phases in the following years. At present all items traded at retail or whole sale levels are subject to VAT.

Most of the retailers have difficulty in accounting for VAT on each transaction in the usual way. This is because they engage in a large number of transactions of multifarious unit value, do not normally issue invoice with every sale. Special schemes have therefore been devised in VAT adopting countries to enable the retailers to determine their output tax. This is not uncommon even in some developed countries like Great Britain which has devised nine schemes for enabling the retailer to pay their taxes

While the partial inclusion of the trade sector has substantially increased the tax base of VAT, it could not achieve the goal that a comprehensive VAT would have achieved; inclusion of the trade sector was supposed to automatically resolve a number of administrative problems that have resulted from exemption. The sales by the exempt trade sector to domestic manufacturers used to create the problem of cascading. But, adoption of some methods for calculating the VAT liability as an alternative to credit method has nipped the potential of having a somewhat comprehensive VAT in the bud.

For the items subject to value added tax at the retail and wholesale levels, there are practically three methods of determining VAT including the appropriate VAT procedure:

Credit method VAT which is practiced by a handful of retailers and wholesalers;

VAT calculated on the basis of the rate of value added: the rate of value added has been fixed by the National Board of Revenue at 10%;

VAT determined by what has been described as a participatory system is akin to the French forfait system.



### *Forfait system*

The provision of assessment of lump sum VAT by a committee comprising VAT officials and business representatives has been incorporated in the VAT law in 1998.

This system seems to be modelled on the French Forfait system aimed at easing tax payer compliance. The French VAT utilizes four rates and has numerous exemptions. This type of tax requires extensive bookkeeping since each transaction, sale and purchase must be itemized to record to claim tax liability and tax credits. The French record keeping system was sufficiently severe to lead to a revolt by small taxpayers which resulted in the forfait system in 1955. The forfait system - restricted to the small taxpayers - still requires some bookkeeping but simplifies this matter by relying upon estimates rather than detailed accounts for determining tax liability. The small tax payer in France is required to self assess his annual taxable receipts, annual purchases, total wages and number of workers.

Though it bears on the gross tax corresponding to the taxable turnover, the Forfait system is really only a negotiated tax payment and would be contrary to the ideals of VAT. The lump sum system is not compulsory; enterprises may elect to be subjected to other available methods of paying tax liability.

Because of poor accounting system, most of the traders prefer paying VAT on a lump sum basis to paying it on the basis of credit method of value added tax. The Achilles' heel for the retailers and most of the wholesalers lies not in the fact that they do not maintain their account but in the fact that they do not want any government agency to have access to their accounts, which they apprehend would complicate their income tax related matters.

### *Administration of VAT in Bangladesh*

The Value -Added Tax in Bangladesh is administered by the Customs and Excise Department which was re-christened after the introduction of VAT as " Customs, Excise and VAT" department. The operational activities of VAT administration are performed by 112 circle offices which are defined in the value added tax law and rules as the local offices; they are pivotal to the collection of taxes. Each of the circle offices is headed by a Superintendent having the status of a class- I gazetted officer. The Circle offices are monitored by 30 Division offices which in turn are supervised by 6 Commissionerates. Though

traditionally each circle office was divided into some geographical locations i.e. some blocks/areas/ranges, of late there has been an attempt to replace the territorial jurisdiction by a jurisdiction based on job description. According to the new division, a circle should consist of the following units:

Data Processing Unit  
Implementation Unit  
Enforcement and Audit unit  
Information Unit

With the exception of the Large Taxpayers Unit- VAT, the territorial system of monitoring is in force with much emphasis on physical control. VAT-LTU, however, has its expressed motto of following the functional type of administration.

### *Invoice*

It is appreciated that the whole basis of the VAT system depends upon the giving of the invoices. Although the invoice will be issued at the time of supply, the supply will only normally evidenced by the invoice and the invoice is therefore of paramount importance to the system. In practice, the taxable person obtains his information as to VAT charged to his customers from his invoices and is allowed to deduct input tax on invoices received from other taxable suppliers. Though in most of the VAT adopting countries rules stipulate what particulars are to be specified in an invoice, Bangladesh has a format for invoice that contains the following particulars:

- The supplier's invoice number
- The supplier's registration number
- The supplier's name and address
- The customer's name and address
- The date of supply
- Mode of Transportation
- A description of the supply to identify it
- The quantity supplied
- The tax exclusive price
- The amount VAT, or, VAT &SD, if applicable, paid

At the introductory stage of VAT there was a provision to get each of the invoices authenticated by the proper VAT official, which practice had to be abandoned /discarded later in face of dismay from the business community. But according to one NBR standing order\*, a Commissioner still has the power to require taxable persons to get their

invoices authenticated by the proper VAT officers. Although after the rescinding of authentication system it has never been practiced in any commissionerates, there is a strong lobby among the tax collectors in favour of re-introducing the authentication system in order for them to handle the problem of evasion more effectively.

#### *Credit and payment of VAT*

In the ideal VAT system, as in the British system for example, if the VAT payable on inputs exceeds the VAT receivable by him he can claim a credit from H.M. customs who will pay it.

But in Bangladesh, as in France among other countries, there is no provision to repayment except in the case of exports and credits must be carried forward. This is known as "buffer rule" which is naturally unpopular. It is quite possible to have large credit because of bulk purchase of imports; situation would have worsened for the trader had the capital machinery not been exempted.

In addition to not allowing the repayment of excess input tax, the traders are in fact required to pay VAT payable on outputs in advance before the supply actually takes place. Much of the Excise accounting procedures have been adapted in the administration of VAT in Bangladesh. Maintaining account current to adjust the payment of VAT payable on the supply of taxable goods is an example. Business units registered under VAT are required to deposit an amount of money with the treasury so that the sum of the deposit and input credit is sufficient enough to pay the output tax payable on goods at the time supply. This method of depositing VAT and supplementary duty, if any, however, has been viewed by the business community as advance payment of tax rather than "collect and pay".

#### *Tax compliance*

##### *Submission of Returns*

Tax compliance is ensured through the submission of periodical returns. In Bangladesh VAT, the submission of a return in tax period by a registered person is mandatory under section 35 of the VAT Act. This Return is submitted in FORM-MUSAK 19.

Tax periods are of varying lengths- Standard tax period is one calendar month. For some specific areas of business, it is three months and six months. VAT Act empowers the government to determine different tax periods of different duration.

#### *Submission of Return*

VAT Return is to be submitted in FORM -MUSAK 19 in duplicate to the local VAT office within 10 working days of the following month.

In case of insurance company return is to be submitted within 20 working days of the following month.

The VAT law requires the following the documents to be submitted along with a Return:

In case of supply and export of goods-

- a. Original copy of account current (where applicable)
- b. Purchase documents like BoE, VAT Invoices <sup>11</sup>
- c. Any other documents as demanded by the Commissioner

In case of providing and export of services -

- a. Original and duplicate copies of Treasury chalan (where applicable)
- b. Purchase documents like BoE, VAT Invoices <sup>12</sup>
- c. Any other documents as demanded by the Commissioner

#### *Penalty for non-filing*

If a registered person fails to file a Return within stipulated time, then the Inspector in-charge will have to file a departmental case under section 37 of the VAT Act to the Divisional Officer through the circle Superintendent within 7 days of the expiry of Return filing date.

There is an office order from NBR to check certain percentage of returns at divisional and headquarters levels in addition to circle office. But that order is hardly followed.

There is no denying the fact that with the introduction of VAT, a significant growth of domestic revenue has been experienced. But given the socio-economic reality coupled with the existing tax culture, to what extent VAT is a suitable tool for taxing consumption in Bangladesh is still a valid question. The following chapters will show how the VAT regime in this country has been interpolated with a lot of ingenious elements drawing heavily from the excise and turnover tax system.

<sup>11</sup> This requirement has been done away with in the budgetary measures of FY 2007-2008

<sup>12</sup> *ibid*

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## Contents of past issues

### **Fiscal Frontiers, January 1993**

Editor: Saiful Islam Khan

Faizul Latif Chowdhury  
*Some Thoughts on Tax Reforms in Bangladesh*

Dr. M. Zahid Hossain  
*VAT in Bangladesh*

Saiful Islam Khan  
*Duty Drawback Systems: International Perspective and Bangladesh Context*

Dr. Omar Haider Chowdhury  
*Role of Taxation in Economic Development: the case of Bangladesh*

*A profile of the Customs Co-operation Council.*

*A profile of National Board of Revenue in relation to the Customs Administration.*

### **Fiscal Frontiers, December 1994**

Editor: Saiful Islam Khan

Faizul Latif Chowdhury  
*An Estimate of Underinvoicing in relation Bangladesh's Import from Seven Asian Countries*

Mohammad Alam  
*Trade and Financial Liberalization in Bangladesh*

Dr. Md. Rafiqul Islam  
*Application of Modern Technology in Indirect Tax Administration*

Dr. M. Zahid Hossain  
*Recent Reforms of Indirect Taxes in Bangladesh*

Dr. Zaidi Sattar  
*Economic Liberalization in South Asia: Return to Fundamentals*

Mobarak Ali Molla  
*Export-led growth: Duty-drawback to Exporters*

Saiful Islam Khan  
*The Value Added Tax: Bangladesh Experience*

### **Fiscal Frontiers, August 1997**

Editor: Saiful Islam Khan

Dr. Md. Rafiqul Islam  
*Value Added Tax Administration and its Potential in Bangladesh*

Ghulam Hussain  
*Automation of Customs Clearance Procedure in Bangladesh*

Dr. M. Zahid Hossain  
*Uruguay Round Agreements and Bangladesh*

Saiful Islam Khan  
*Value Added Tax in Operation: A Bangladesh Perspective*

### **Fiscal Frontiers, September 1999**

Editor: Saiful Islam Khan

Abdul Latif Sikder  
*GATT Valuation Code: Introducing Transaction Value for Customs Purposes*

Dr. Ali Ahmed Rushdi  
*Introducing the Goods and Services Tax (GST) in Australia*

Saiful Islam Khan  
*Transnational Organised Crime: Role of Customs in controlling International Money Laundering*

Dr. M. Fouzul Kabir Khan  
*Incentives and Agency: Pre-shipment Inspection Scheme in Bangladesh*

Dr. M. Zahid Hossain  
*Macroeconomic Management: Relevant Policy Issues*

Faizul Latif Chowdhury  
*An Economic Model of Customs Evasion*

Tanweer Akram  
*Tax Registration of Privatized Firms in Bangladesh: Results of an Empirical Investigation*

Md. Nasir Uddin  
*Drug Trafficking: Means of Concealment*

Ahmed Munirus Saleheen  
*The Value-Added Tax in Bangladesh: Some Aspects of Adaptation*

**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 and 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*