

Resource Mobilization for Bangladesh's Smooth Graduation from the Group of LDCs: Issues, Challenges, and Way Forward

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I. Introduction

During the three decades immediately prior to the onset of the Covid-19 global pandemic, Bangladesh achieved commendable socio-economic development. Sustained economic growth—on average 5.6 per cent per annum since 1990 and 6.7 per cent during 2009-19—along with favourable policy support and various interventions by non-government organizations contributed to declining national headcount poverty incidence from more than 50 per cent in the 1990s to 20.5 per cent in 2019. Compared to many other countries at a similar stage of development, it achieved faster progress in various social and human development indicators such as health, demographic, and gender equality outcomes. In 2015, the country made an important transition from a low-income to a lower-middle income country as per the World Bank-defined classification of global economies. This was soon complemented by qualifying for graduation from the group of least developed countries (LDCs) for the first time in 2018. Even amid Covid-19 disruptions, Bangladesh maintained its resilience by posting—unlike most other global economies that experienced economic declines—a rather solid GDP growth of 3.6 per cent (in FY20) in the time of an unprecedented global crisis and securing LDC graduation qualification again earlier in this year to achieve the UN recommendation for leaving the ranks of the world's poorest countries (LDCs) by 2026.

The tremendous socio-economic progress in Bangladesh must be sustained and built upon further to achieve progressively higher development milestones, as specified in various national vision-setting documents such as the Perspective Plan 2021-41 to achieve the Sustainable Development Goals (SDGs) by 2030, become a higher-middle-income country by 2031 and a high-income one by 2041. The ongoing development transitions would require catering to the ever-rising demand for infrastructural facilities, energy, improved quality of health and education, etc. There is also no denying that the development gains achieved over many years are now being threatened by the pandemic with its far-reaching implications for deteriorating health situations, worsening poverty and inequality, weakened educational attainment prospects, uncertain labour market opportunities with potentially disproportionate consequences for the youth and women empowerment. Covid-19 has brought a reinvigorated attention to the need for much stronger health services and social protection, while the importance of investing into human resource development, major infrastructural projects and institutional building will continue to remain high-priority policy consideration to foster Bangladesh's economic progress. Therefore, mobilizing resources to deal with development priorities and challenges constitutes one of the most critical policy issues faced by the policymakers.

While the impending LDC graduation is an important development milestone, it would also bring in new challenges. The potential implications arising from lost trade preferences due to graduation, which attract a lot of discussion, would require preparing for navigating through the changed circumstances of the post-graduation trade regime for ensuring a smooth LDC graduation. Furthermore, foreign aid or overseas development assistance (ODA) i.e., grants or loans with concessionary terms, received both bilaterally and multilaterally, which has been an important source of development financing is already being offered at

less concessional terms because of the country's transition from the group of low-income to lower-middle-income countries. It is likely that the prospect for low-cost financing could shrink further along with the loss of LDC-specific preferential allocation of aid and concessional funding.

Against the rising need of public spending and unfavourable prospects for future concessional loans, the current state of domestic resource mobilization is a cause for concern. In comparison with many other comparator countries, Bangladesh's domestic revenue collection as proportion to GDP is amongst the lowest in the world. Therefore, dealing with Covid-19 consequences, steering a smooth graduation out of the group of LDCs, and achieving SDGs and other envisaged development milestones will critically hinge upon domestic resource mobilization (DRM).

In the above backdrop, the objective of this paper is to review the current state of resource mobilization in Bangladesh and, given the impending LDC graduation, the challenges Bangladesh faces in boosting its DRM efforts. It also provides a set of broad policy actions for improving the government revenue collection to mitigate the ensuing development challenges. The paper is organized as follows: after this introduction, section II provides a snapshot of Bangladesh's development trends, and the current state of government revenue collection. Section III discusses various challenges associated with domestic resource mobilization, while Section IV contains a set of policies for improving the situation. Finally, section V concludes.

II. Bangladesh's Development Trends and Resource Mobilization

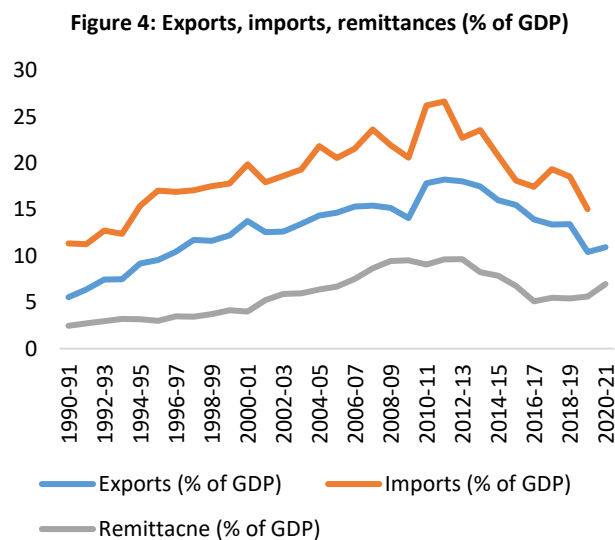
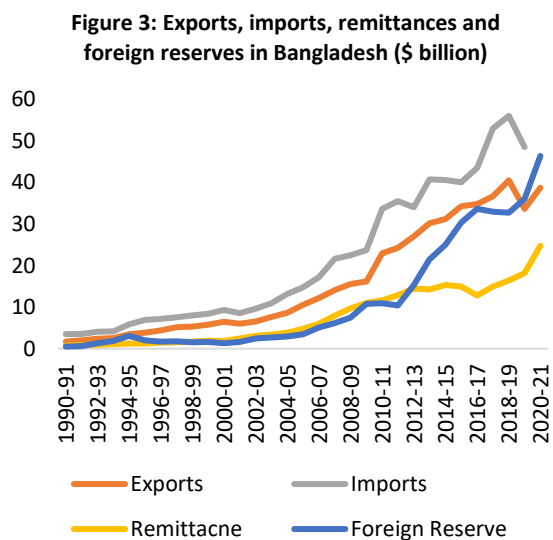
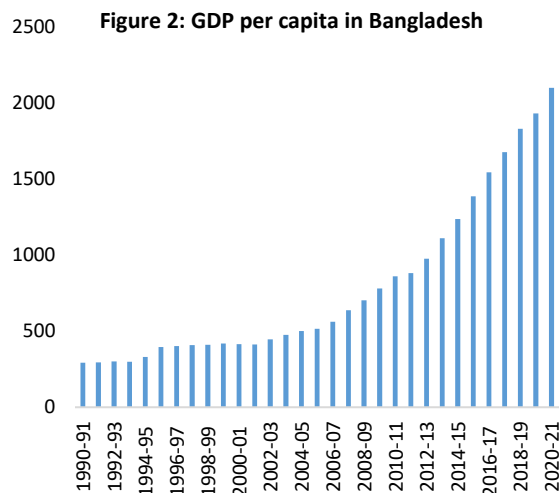
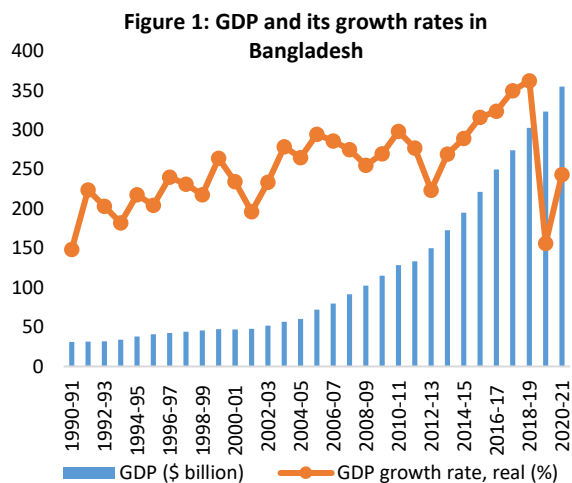
Bangladesh's development trends

Bangladesh's LDC graduation reflects the remarkable socio-economic progress that the country has made over the past decades. From a fragile socio-economic set up at independence and despite confronting numerous socio-economic challenges, it has emerged as a 'development surprise'. Sustained economic growth has helped a \$30 billion economy of the mid-1990s to grow to a sizeable one of more than \$350 billion in 2021 (Figure 1). The average annual GDP growth rate has been stable and on the rise from on average above 5 per cent in the 1990s, above 6 per cent in the 2000s and almost 7 per cent in the 2010s (Figure 2). Covid-19 has certainly dealt a blow to this impressive growth record, but still, in comparison with most other economies, Bangladesh has demonstrated a stellar performance during the pandemic-affected period.¹ As the economic growth always exceeded the rate of population growth, the per capita GDP registered a more than seven-fold rise from less than \$300 in 1991 to \$2097 in 2020-21 (Figure 2). The per capita gross national income (GNI) stood even higher at \$2227 – thanks to the inflow of remittances.

The impressive success story of Bangladesh has been hugely aided by the performance of its export sector. Merchandise exports expanded rapidly from less than \$2 billion in 1990 to a peak at \$40.5 billion in 2018–19—mostly driven by the apparel sector. Imports on the other hand stood at \$56.1 billion in 2018-19 (Figure 3). Merchandise trade increased to 32 per cent of GDP in 2018-19 from 17 per cent in 1990-91. Covid-19 induced economic disruptions then adversely affected Bangladesh's foreign trade, as reflected in falling exports and imports by 17 per cent and 13.4 per cent, respectively, in FY20. Since then, there has been a robust recovery although export earnings in FY21 remained lower than those of in FY19. It is worth

¹ GDP growth was 3.51 per cent in 2019-20 and 5.47 per cent in the following year.

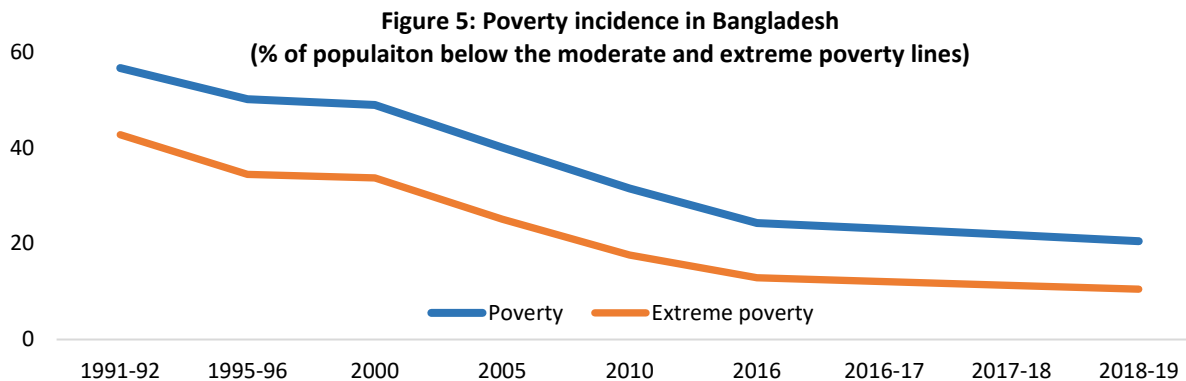
noting that exports and imports as proportion to GDP declined over in the past decade (Figure 4) depicting the strong growth in the domestic economy. Workers' remittances, experienced a boom during the pandemic, registering a growth of 36 per cent in the FY21 and about 11 per cent in 2019-20 (Figure 3). Bangladesh has always maintained a good size of foreign reserve, which—due to high inflow of remittances and declining import payments—grew further during the pandemic affected fiscal years of FY20 and FY21.



Source: Authors' presentation using data from the Bangladesh Bureau of Statistics (BBS), Export Promotion Bureau (EPB) of Bangladesh, and Bangladesh Bank.

Bangladesh's robust economic growth has been accompanied by rapidly declining poverty incidence. The headcount ratio (HCR), measured as the proportion of the population living below the nationally defined poverty line income, declined from 56.6 per cent in the early 1990s to 20.5 per cent in 2018-19 (Figure 5)—a reduction of 36.1 percentage points. During the same time, the extreme poverty declined from 42.7 per cent to 10.5 per cent. However, the Covid-19 pandemic has caused widespread health and economic disruptions leading to loss of income and livelihood opportunities for many. Surveys and analyses

undertaken by various think tanks seem to suggest a significant rise in poverty, however, there are no official estimates available to provide a comprehensive and overtime comparable poverty incidence measures. Furthermore, it is also not clear if the rising poverty would be temporary in nature or would have a lasting impact.



Note: Poverty rates in 2017, 2018 and 2019 are based on BBS estimates.
Source: Based on Bangladesh Bureau of Statistics (BBS) data.

Bangladesh has also demonstrated notable achievements in improving other socio-economic indicators. In fact, it has been found that Bangladesh has achieved faster progress in various social and human development indicators such as health, nutrition, demographic and gender equality outcomes when compared with countries that have the similar level of per capita income (Asadullah et al., 2014). Along with robust economic growth, the average life expectancy increased from 58.2 years in 1990 to 72.6 years in 2019. The net educational enrolment and adult literacy depicted impressive progress. Achievements in reducing infant and maternal mortality have also been truly commendable. Some of the socio-economic development trends are summarised in Box 1. It is, however, a matter of concern if such progress has been hampered by health and economic disruptions triggered by the Covid-19 pandemic.

Box 1: Bangladesh – A summary of socio-economic progress over the past three decades

- Since FY1991, Bangladesh’s GDP has grown, on average, at an annual rate of 5.6 per cent. The comparable growth rate for the most recent past 10 years (of FY2010–FY2019) being more buoyant at 6.7 per cent.
- Sustained economic growth means a mere \$35 billion economy of the mid-1990s has grown to a sizeable one of almost \$330 billion.
- During the same period, the per capita gross national income has registered a more than seven-fold rise from just \$300 to above \$2,064.
- The headcount poverty declined fell from 58 percent in 1990 to about 20.5 percent in FY2019.
- The average life expectancy at birth registered a rise from 58.2 years in 1990 to 65.4 years in 2000, and then further increased to 72.6 years in 2019.
- Net enrolment in primary education stood at 97 per cent in 2019, up from 75 per cent in 1990; net secondary education enrolment increased to 66 per cent from less than 20 per cent.
- The adult literacy rate increased from just 35 per cent in 1990 to 74.7 per cent in 2019.
- The infant mortality rate declined from 99.6 per 1,000 live births in 1990 to 21 in 2019.
- The maternal mortality rate fell from 594 per 100,000 live births in 1990 to 165 in 2019.

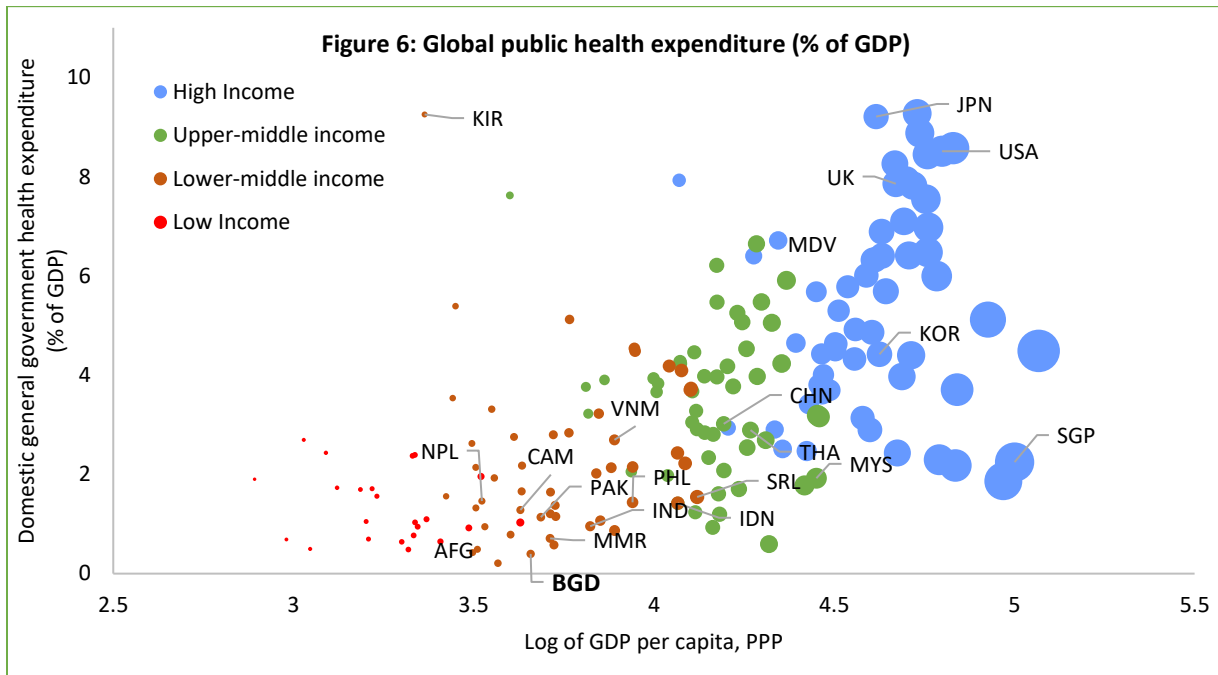
Source: Author's compilation from various publications of the Bangladesh Bureau of Statistics, the Bangladesh Bureau of Educational Information and Statistics (BANBEIS), and the World Development Indicators (WDI).

The impressive development progress has made it possible for Bangladesh to achieve two critical development transition—from low-income country to lower-middle-income country and graduation from the least developed countries (will be in effect from 2026). Because of the rising per capita income, the country in 2015 climbed up to the ranks of 'lower-middle-income' from the 'low-income' category, as classified by the World Bank. Earlier in this year (2021), Bangladesh, having met qualification criteria in two consecutive triennial reviews (in 2018 and 2021) has been recommended by the United Nations to leave the LDC group in 2026.² Buoyed by these achievements, the country now aspires to secure upper middle-income country (UMIC) status and eliminating extreme poverty by 2031 and aims to become a high-income country by 2041.

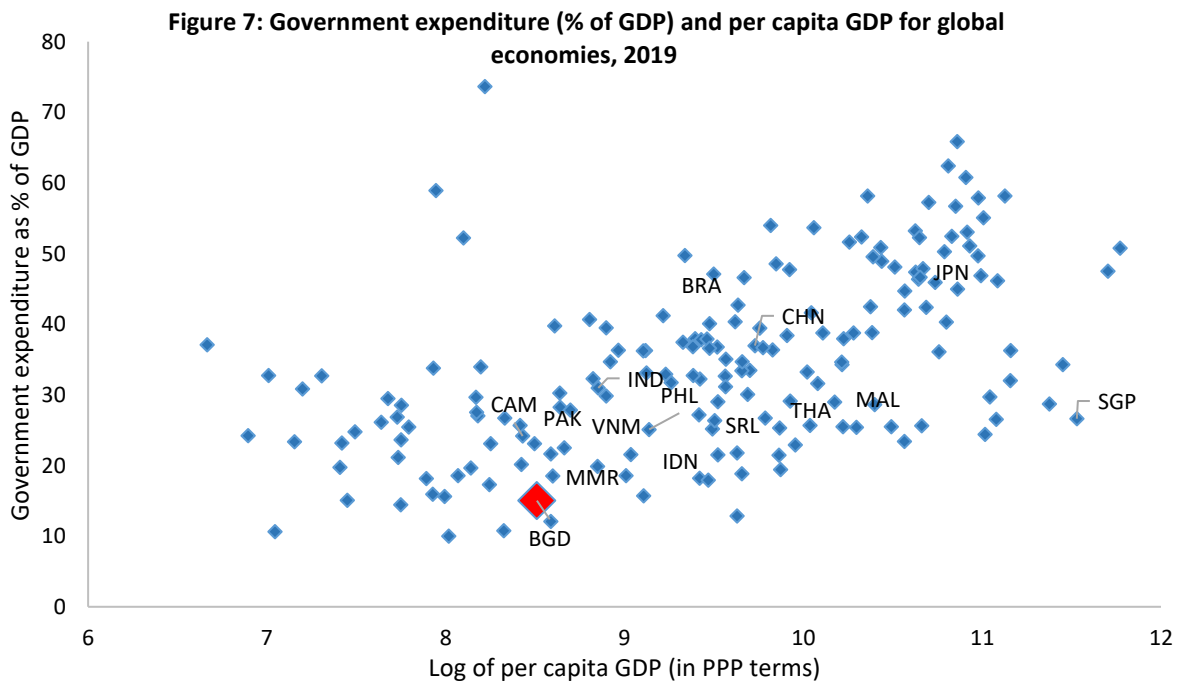
Both the development transitions can have implications for resource envelopes for overall economic development. The demand for public investment will continue to rise, while the prospects for getting external resources through the International Support Mechanisms (ISMs) for graduating LDCs will tend to shrink. To ensure a smooth LDC graduation, pursue the envisaged development targets, and attain the SDGs by 2030, Bangladesh will need huge public investment in many different areas: from infrastructural improvement to human resource development to social protection. Covid-19 has exposed the gross limitations of the current health and social protection systems while it also had a severe impact on education. These three sectors will need much more investment along with the demand for other public sector activities. Take the case of public health spending. Prior to Covid-19, Bangladesh's government health expenditure as per cent of GDP was lower than that of the countries at a similar stage of development as shown in Figure 6, which also depicts that upper-middle income and high-income countries, on average, have several times higher health spending. As Bangladesh aspires to become a high-income country over the next two decades or so, the cross-country evidence would suggest raising the health expenditure quite significantly.

It is in this backdrop that the role of public investment has become more prominent than ever, and with it comes the crucial issue of domestic resource mobilization. One major issue in this respect is the overall size of Bangladesh's public expenditure is quite small, as Figure 7 shows. Bangladesh's comparators, Cambodia, India, Indonesia, Myanmar, Pakistan, Vietnam, and many others have much higher government expenditure. This vividly illustrates the limited public spending capacity within which the Government of Bangladesh must manage the demand for resources from many competing sectors. This is largely due to weak revenue generating capacity.

² Graduation from LDC status requires a country to meet development thresholds under at least two of the three pre-defined criteria (of per capita income, human asset and economic vulnerability) in two consecutive triennial reviews. It is to be noted that there is also a provision for the 'income-only' graduation rule under which, if the 3-year average per capita gross national income of an LDC rises to a level at least double the graduation threshold, the country could be eligible for graduation regardless of its situation under the other two criteria. In 2018, Bangladesh, for the first time, met the criteria for graduation from the group of least developed countries (LDCs), assessed at the triennial review conducted by the Committee for Development Policy (CDP) of the United Nations Economic and Social Council (ECOSOC). The country fulfilled all three graduation criteria for the second time in 2021 triennial review by United Nations Committee for Development Policy (UN CDP). The UNCDP recommended Bangladesh for graduation in 2026 (UNCDP, 2021).

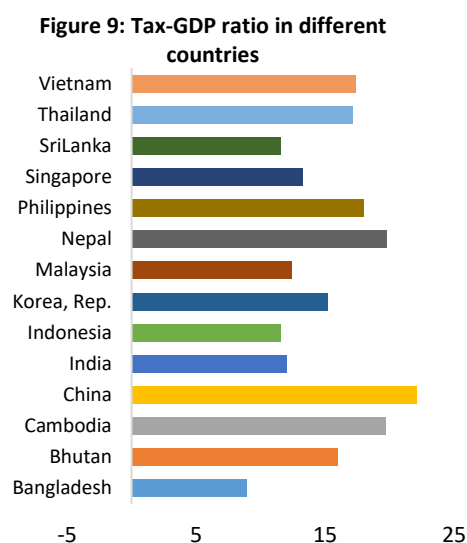
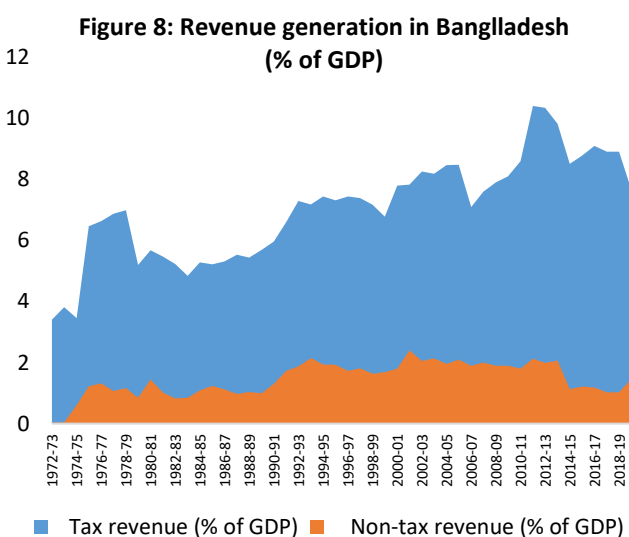


Note: Countries are indicated as AFG – Afghanistan, BGD – Bangladesh, CAM – Cambodia, CHN – China, IND – India, IDN – Indonesia, JPN – Japan, KOR – Republic of Korea, MDV – Maldives, MMR – Myanmar, MYS – Malaysia, PAK – Pakistan, PHL – the Philippines, SGP – Singapore, THA – Thailand, UK – the United Kingdom, USA – the United States of America, and VNM – Vietnam.
 Source: Authors' analysis based on World Development Indicators (WDI), World Bank.



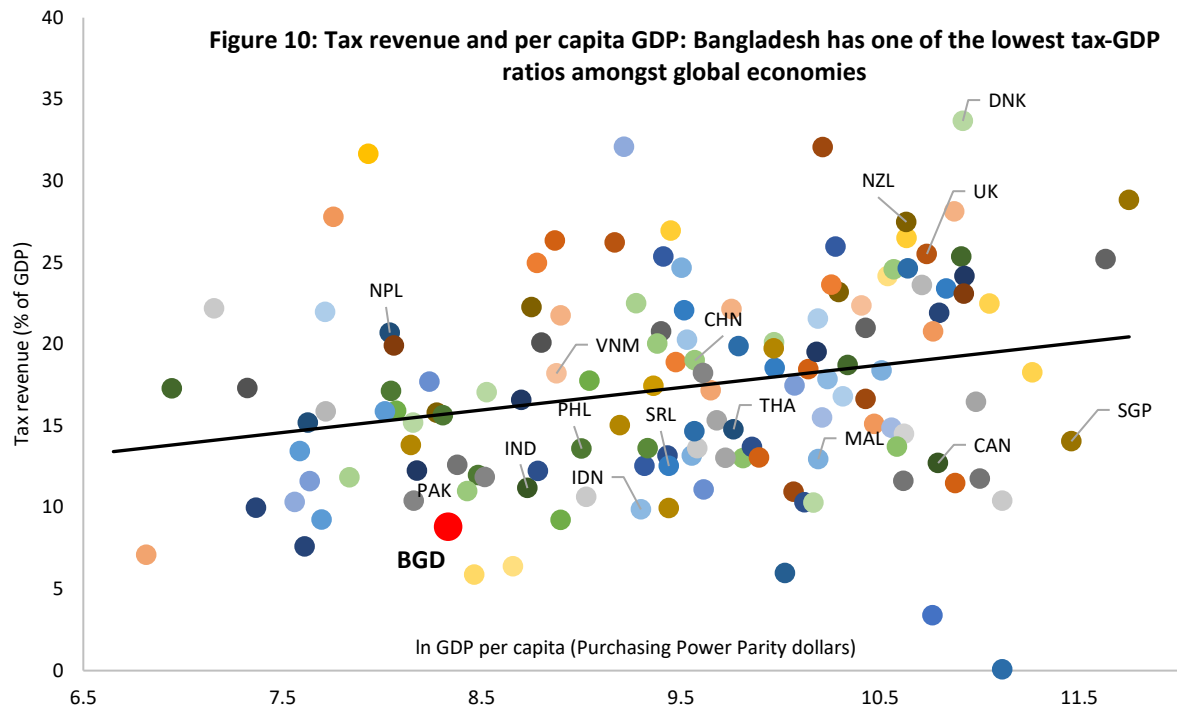
Resource mobilization in Bangladesh

The domestic revenue generation in Bangladesh has been historically low. The average revenue-GDP ratio has been just around 10 per cent (Figure 8) with the tax-GDP ratio remaining as one of the lowest amongst global economies—less than 9 per cent of GDP. As can be seen from Figures 9 and 10, there are only a few countries with a tax-GDP ratio lower than that of Bangladesh. All South Asian economies have considerably higher tax-GDP ratios. For instance, Nepal, which has a much lower per capita GDP than Bangladesh, collects as much as 21 per cent of GDP as tax revenue. The comparable figure is 19.7 per cent in Cambodia, 22.1 per cent in China, 12 per cent in India, 15 per cent in Republic of Korea, and 17.4 per cent in Vietnam (Figure 9). As per the macroeconomic framework of the government’s Perspective Plan 2041, Bangladesh will have to raise its tax-GDP ratio from the current level to more than 17 per cent by 2031. Since the mid-1990s, the tax-GDP ratio has risen by just 1–2 percentage points (Figure 8). Therefore, the target of doubling the tax-GDP ratio over the next decade should constitute an important endeavour. Only additional tax resources can increase the overall size of budgetary expenditure, which can then help expand public spending on such sectors as health, education, transport and communication and social protection.



Note: Data for Bhutan, China and India are for 2018.

Source: Authors’ analysis based on data from Ministry of Finance, Bangladesh; World Development Indicators (WDI); and OECD (2021).



Note: Countries are indicated as BGD – Bangladesh, CAN – Canada, CHN – China, DNK – Denmark, IND – India, IDN – Indonesia, MDV – Maldives, MYS – Malaysia, NZL – New Zealand, PAK – Pakistan, PHL – the Philippines, SGP – Singapore, THA – Thailand, UK – the United Kingdom, and VNM – Vietnam.
 Source: Authors’ analysis based on WDI data.

The National Board of Revenue (NBR) is the main tax authority in Bangladesh. Taxes collected by the NBR constitute around 96 per cent of all taxes and or 86 per cent of total revenues as of 2019-20. Taxes collected by it include income tax (IT), surcharge on wealth, value added tax (VAT), turnover tax (TT), supplementary duty (SD), customs duty (CD), regulatory duty (RD), excise duty (ED), income tax, foreign travel tax, and miscellaneous taxes. Other taxes—often referred to as ‘non-NBR portion’ of tax revenue – include narcotics duty³, land revenue⁴, non-judicial stamp⁵, registration fee⁶, and motor vehicle tax⁷. Since 2000-01, tax revenue collected by the NBR increased more than 11 times to reach Tk 21.8 trillion in 2019-20 (Figure 11). During this time, the average annual growth in NBR revenue was 14 per cent against the nominal GDP growth of 12.5 per cent.⁸ In recent years, the growth in tax revenue has been lower than that of nominal GDP (Figure 12). As a result, the share of NBR tax revenue as per cent of GDP declined from 10 per cent in 2010-11 to 8 per cent in 2019-20. It is important to note that the revenue collected by the NBR declined by 1.3 per cent in 2019-20. This is due to the disruptions caused by the pandemic as imports declined and economic activities of the corporate sector and individuals were affected.

³ Collected by the Department of Narcotics Control, Ministry of Home Affairs

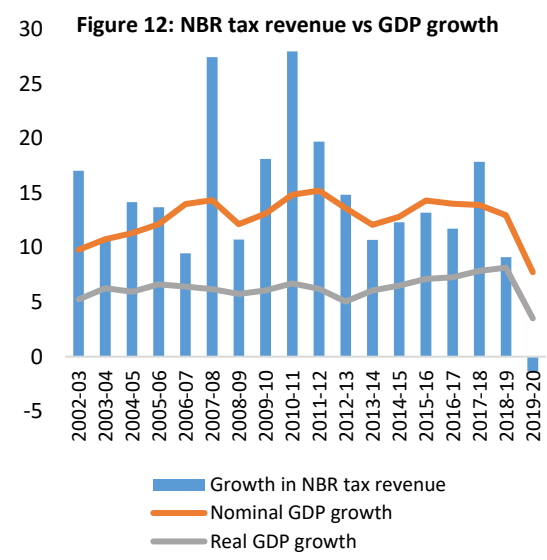
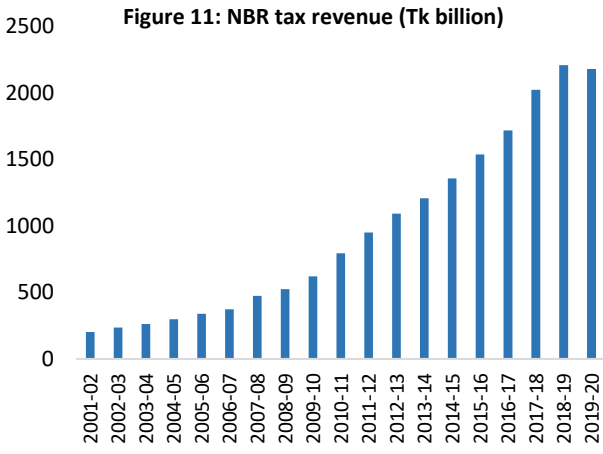
⁴ Administered by the Ministry of Land and collected at local Tahsil offices

⁵ Collected under the Ministry of Finance

⁶ Collected by the Registration Directorate of the Ministry of Law, Justice and Parliamentary Affairs

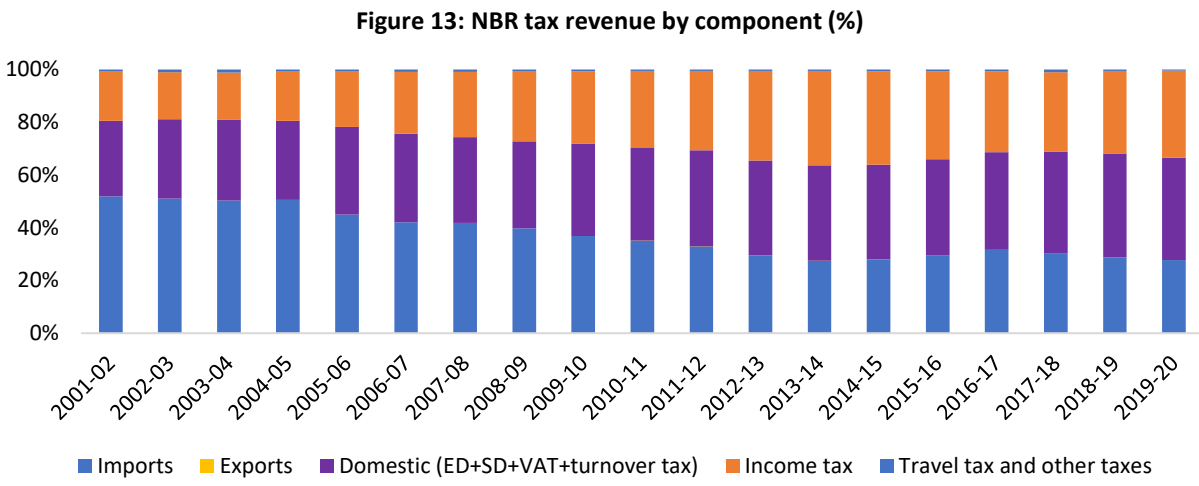
⁷ Collected under the Ministry of Communication

⁸ Average annual GDP growth in real terms was 6.1 per cent during this time.



Source: Authors' presentation using NBR and BBS data.

Major components of NBR revenue come from trade taxes, domestic duties (such as excise tax, VAT, supplementary duty and turnover tax) and individual and corporate income taxes. As Figure 13 shows, the structure of taxation in Bangladesh has improved significantly over the past years with the share of income and domestic production/consumption taxation increasing while the reliance on international trade taxation declining. Currently, one-third of all NBR tax revenue is due to income taxes, almost 39 per cent comes from domestic production and consumption, and the remaining 28 per cent is collected from international trade transactions (almost entire from imports).⁹ In the 10 years immediately prior to the onset of covid-19, import revenue grew annually at 12 per cent on average. The comparable figure was 17.2 per cent for income tax, and 16.8 per cent for domestic duties. The annual growth of different components of NBR revenue is given in Table 1.



Note: ED – excise duty, SD – supplementary duty, VAT – value-added tax
 Source: Authors' presentation using NBR data.

⁹ The share of import revenue in total NBR revenue has declined from 52 per cent in 2001-02 to 27.8 per cent in 2019-20.

Table 1: Growth in NBR revenue by different components, FY2011-FY2020 (%)

	2010- 11	2011- 12	2012- 13	2013- 14	2014- 15	2015- 16	2016- 17	2017- 18	2018- 19	2019- 20
1. Import revenue	22.2	12.1	3.1	2.9	15.3	17.9	20.2	12.9	3.4	-4.4
1.1 Customs duty	28.7	13.6	0.8	2.4	13.1	17.3	17.0	15.4	-0.2	-2.9
1.2 VAT (imports)	16.0	11.6	7.4	3.2	15.7	16.4	24.2	13.6	8.1	-4.4
1.3 Supplementary duty (imports)	24.8	9.3	-3.7	3.1	21.1	24.9	16.3	3.2	-2.6	-9.0
2. Exports	--	35.7	-14.1	25.4	-3.2	-2.2	-42.9	58.1	54.0	-98.1
3. Domestic tax revenue (other than income tax and travel tax)	28.8	23.4	13.2	11.8	12.1	14.4	13.3	23.8	10.8	-3.0
3.1 Excise tax (domestic level)	39.9	35.8	17.0	6.5	16.8	64.7	13.2	15.8	14.5	-4.0
3.2 VAT (domestic level)	29.1	23.3	19.9	10.9	10.4	8.0	9.8	22.0	19.8	0.3
3.3 Supplementary duty (domestic level)	27.8	22.9	0.5	13.9	15.5	24.6	19.6	27.3	-3.6	-11.6
3.4 Turnover tax (domestic level)	-22.3	-6.6	8.6	28.3	-0.2	3.0	-49.5	-10.6	847.0	3004.4
4. Income tax	35.0	24.5	29.6	16.4	12.3	5.8	2.8	15.9	13.0	3.9
5. Travel tax and other taxes	6.7	16.8	22.6	8.7	35.4	17.3	3.8	88.8	-43.6	-17.4
Total	28.0	19.7	14.8	10.7	12.3	13.2	11.7	17.9	9.1	-1.3

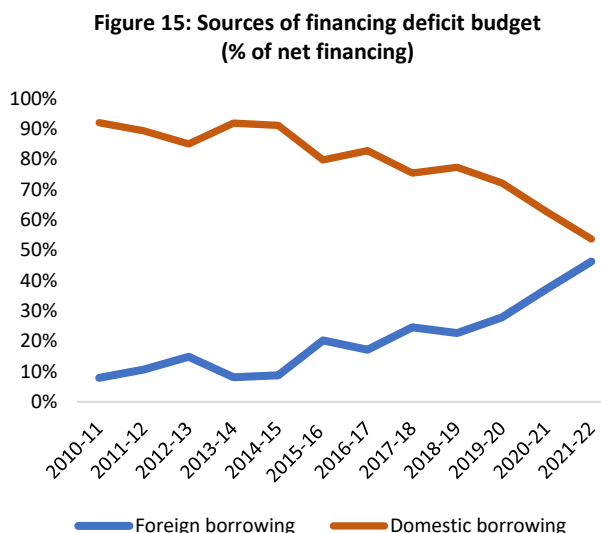
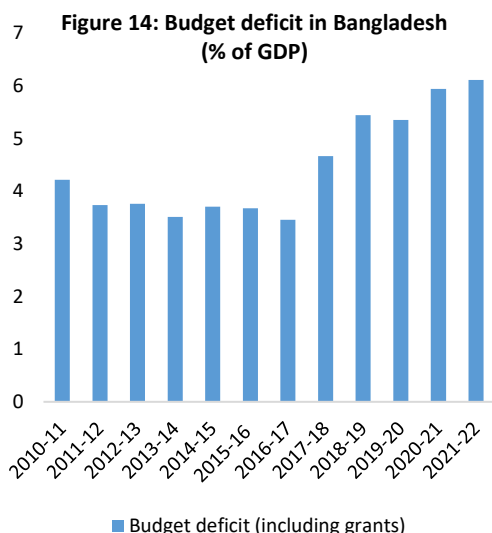
Source: Authors' presentation based on NBR data.

While the revenue generating capacity is the most important determinant of the overall size of public expenditure, governments can run budget deficits to boost current spending. Bangladesh is known for its prudent macroeconomic management, maintaining relatively low budget deficits of around 3-4 per cent of GDP. However, over the past few years, a rising trend of budget deficit is observed (Figure 14).¹⁰ The projected budget deficit for FY22 is 6.2 per cent, of which only 0.1 per cent will come from grants while the rest will be financed through borrowing from domestic and external sources. During the past several years, Bangladesh's dependence on foreign aid/external resources in deficit financing has risen as domestic tax revenue continues to expand at a much slower pace than targeted. Since 2010-11, the share of external financing in budget deficit has increased from less than 10 per cent to 46 per cent in 2021-22 (Figure 15). While domestic borrowing is already expensive, costs associated with the funding from external sources as part of the annual development programme (ADP) spending are going to rise significantly in the future, as discussed later in the paper.

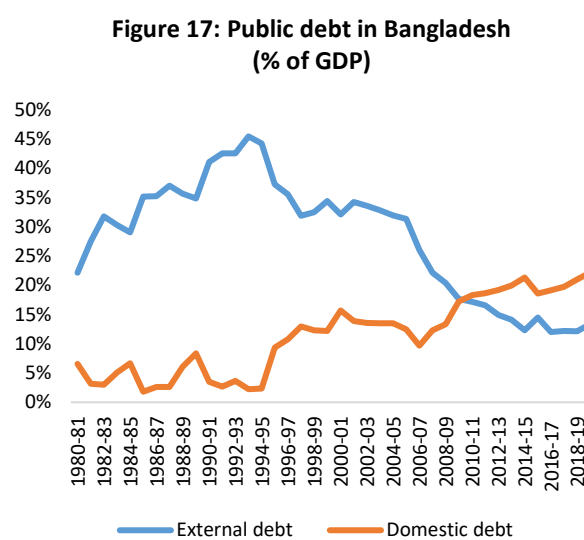
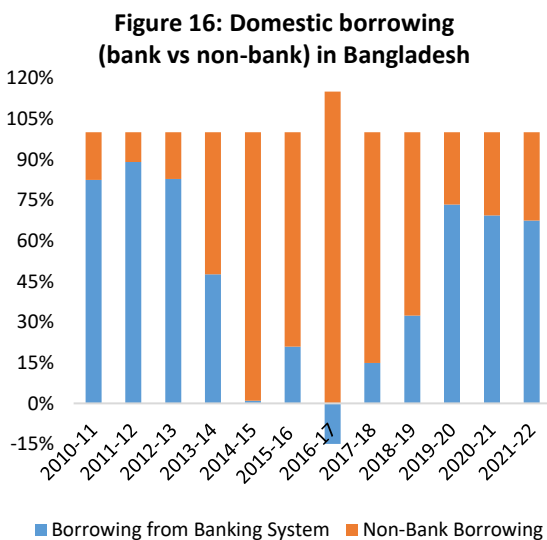
In 2021-22, borrowing from domestic sources is set at 3.3 per cent of GDP. Two-thirds of it is projected to come from the banking system and the remaining from non-bank sources including from the sale of national saving certificates, bonds, etc. The dependence on the banking system for deficit financing is increasing (Figure 16), giving rise to the concern about the crowding-out of the private sector. Borrowing leads to public debt and the resultant external debt to GDP ratio has declined significantly from more than 40 per cent in the mid-1990s to just 13 per cent in 2019 (Figure 17). This mainly reflects the falling significance of official development assistance (ODA) as the economy continued to grow rapidly (Figure 18). What is however quite striking is the escalating pace of domestic debt as the government increasingly

¹⁰ Covid-19 puts pressure on the revenue generation. Economic activities have slowed while at the same time tax relief measures are provided by increasing the base of tax-free income slab, reducing personal and corporate tax rates, etc. On the other hand, public spending on health, social protection, and income generating activities, along with stimulus for economic recovery has increased.

relied on internal sources for budget financing. Domestic debt increased from just about 2 per cent of the mid-1990s to 22 per cent in 2019.



Source: Authors' presentation using data from the Ministry of Finance, Bangladesh.

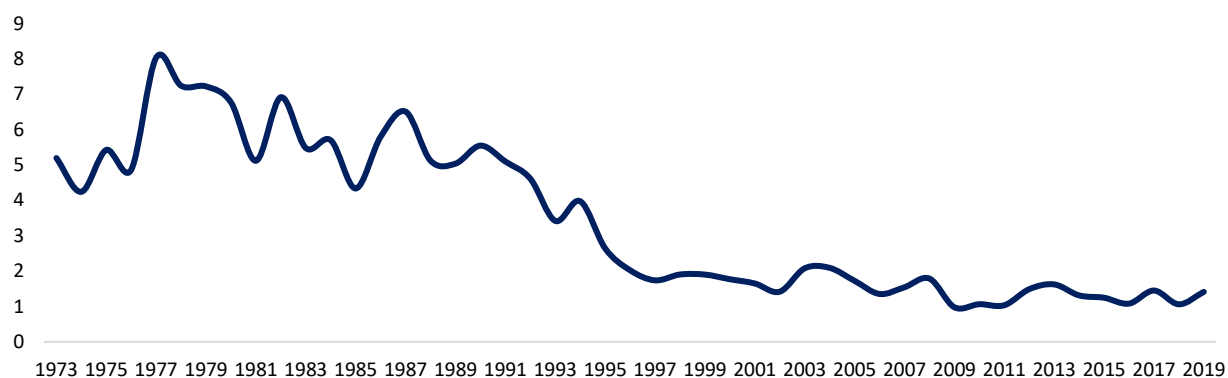


Source: Authors' presentation using data from the Ministry of Finance, Bangladesh.

Official development assistance (ODA) constitutes an important part of resource mobilization efforts. With sustained economic growth over the past three decades, the relative significance of ODA has fallen from around 8 per cent of GDP to 1.4 per cent in 2019 (Figure 18). Despite the dwindling relative significance, the overall inflow of ODA and concessional loans in recent years has increased in absolute

terms. Between FY12–FY19, new aid commitments received by Bangladesh was about \$71.9 billion while the actual disbursement was recorded at \$30.7 billion (Razzaque et al., 2020). The share of grants has fallen from as much as half of all ODA received in the early 1980s to only 4.12 per cent in FY19 suggesting that Bangladesh has become a credible borrower over the years. Currently, less than one-third of aid commitments come from bilateral donors, while the rest is from multilateral sources.

Figure 18: Net ODA received (% of GNI)



Source: Authors' analysis based on WDI data.

III. Resource Mobilization Challenges for Bangladesh

For a rapidly growing economy like Bangladesh, a lower tax-GDP ratio compromises the governments' ability in allocating the desired level of resources to many sectors. There are certain expenses that must be met as part of the regular spending portfolio and thus one critical problem of a low tax effort is the constrained fiscal space. It has been estimated that after meeting regular and fixed obligations like civil service salaries, interest payments of the public debt, defence spending, office supplies and materials, and transfers (subsidies, pensions, local government grants, and transfers to state-owned enterprises), the government is left with just 10-14 per cent of the revenue collected that can be used for development spending (Ahmed, 2020). This situation has deteriorated further as in the current fiscal year (F22), almost the entire spending for the ADP could be sourced from deficit financing. The cost of borrowing from domestic sources, which is the principal component of deficit financing, is very high and about 14 per cent of total public spending in FY20 was due to interest payments (to both domestic and foreign borrowing). To put things into perspective, the interest payment obligations amounted to more than three times the allocation for the health sector.

The challenge of resource mobilization has drawn a lot of attention in Bangladesh. Successive development plans have highlighted the underlying problems and offered strategic directions to strengthen resource mobilization. However, implementation of these strategies has proven to be a formidable task as the tax-GDP ratio remains largely unchanged. This section summarises some of the current and emerging challenges in this respect.

Corporate and personal income taxation

Taxes on different forms of person and corporate income generating around one-third of government revenue are administered under the Income Tax Ordinance 1984. There are several income tax instruments including personal and corporate taxes, surcharges on wealth as percentage of income tax payable in any tax year, additional taxes for public limited companies not paying a 15 per cent dividend to shareholders, taxes on the income of non-Bangladeshi citizens employed without the prior approval of the Board of Investment, and taxes on excess profit by the banks.

Although the revenue from income taxation has increased in absolute terms, it is rather striking that the income tax revenue-GDP ratio has declined considerably from a peak of 3.22 per cent in 2012-13 to 2.67 per cent in FY 2020 (Table 2). This is even though Bangladesh has amongst the highest levels of corporate and income tax rates in the region (Mansur, 2020). Tax rates on the profits of banks, insurance and other financial institutions are as high as 40 per cent if not listed in stock exchanges and 37.5 per cent if listed. Telecommunications and tobacco companies are taxed at even at a higher of 45 per cent (Table 3). Corporate taxes on listed and non-listed companies are respectively 22.5 per cent and 30 per cent, respectively as discussed above.

Table 2: NBR tax revenue by different components as per cent of GDP

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
1. Import revenue	3.51	2.97	2.69	2.47	2.53	2.61	2.75	2.72	2.49	2.21
1.1 Customs duty	1.45	1.25	1.11	1.01	1.01	1.04	1.07	1.08	0.95	0.86
1.2 VAT (imports)	1.55	1.31	1.24	1.14	1.17	1.19	1.29	1.29	1.24	1.10
1.3 Supplementary duty (imports)	0.50	0.41	0.35	0.32	0.35	0.38	0.39	0.35	0.30	0.25
2. Exports	0.004	0.004	0.003	0.003	0.003	0.002	0.001	0.002	0.002	0.000
3. Domestic tax revenue (other than income tax and travel tax)	3.52	3.28	3.26	3.25	3.23	3.24	3.22	3.50	3.43	3.09
3.1 Excise tax (local level)	0.06	0.06	0.06	0.06	0.06	0.09	0.09	0.09	0.09	0.08
3.2 VAT (local level)	2.24	2.08	2.20	2.18	2.13	2.01	1.94	2.08	2.20	2.05
3.3 Supplementary duty (local level)	1.22	1.13	1.00	1.02	1.04	1.13	1.19	1.33	1.13	0.93
3.4 Turnover tax (local level)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.02
4. Income tax	2.89	2.72	3.10	3.22	3.20	2.96	2.67	2.72	2.72	2.62
5. Travel tax and other taxes	0.05	0.05	0.05	0.05	0.06	0.06	0.05	0.09	0.04	0.03
Total	9.97	9.01	9.10	8.99	8.95	8.87	8.69	8.99	8.68	7.95

Source: Authors' presentation using NBR and BBS data.

Various tax cuts and exemptions granted for individuals and enterprises, particularly during the economic downturn inflicted by covid-19, could be argued as a reason for falling significance of income taxes.¹¹

¹¹ Bangladesh has introduced certain tax exemption measures as response to Covid-19. Personal income tax rates have been revised downward and the tax-free income slab has been expanded to TK 3 lakh with a reduced rate at 5 per cent for the next one lakh of taxable income. The income tax rate for highest income group, the taxpayers with an annual income over TK 47.5 lakh, has been reduced to 25 per cent from 30 per cent for higher income group having annual income above BDT 47.5 Lakh. The tax rate for publicly traded companies has been reduced to 22.5 per cent in FY2021-22, while the corresponding rate for non-publicly traded companies has come down to 30 per cent in FY 2021-22.

However, the declining trend has been present even before the pandemic (Table 2). Since 2013-14, the annual average growth in income tax revenues was 10 per cent against the corresponding GDP growth of 12.5 per cent (both at nominal prices). This is also quite striking that the revenue growth could not keep pace with the growth in the overall economy.

Table 3: Taxes levied on income of companies and other entities as of FY2021-22

Companies of entities	Income tax rate
Publicly traded companies	22.5%
Non-listed companies	30%
Banks, insurance, and other financial institute (except merchant banks), if not publicly listed	40%
Banks, insurance, and other financial institute (except merchant banks), if publicly listed	37.5%
Merchant Banks	37.5%
Cigarette, dried tobacco (zarda), bidi, gul and any other tobacco product manufacturing companies irrespective of listing status	45%
Mobile phone operator companies, if not publicly listed	45%
Mobile phone operator companies that covert themselves into publicly traded company by transfer of at least 10% shares through stock exchange, of which minimum 5% may be through pre-initial public offering placement	40%

Source: Finance Acts of various years

As despite high tax rates and sustained economic growth, revenue collection remains very low, tax efficiency in direct tax administration would be called into question (Mansur, 2020). It has been argued that low compliance rate, tax exemptions for many sectors, and high level of informality associated with various economic activities, etc. are major reasons for low revenue collection (Mansur, 2020; Ahmed, 2020). Of the 84,435 registered companies in 2018-19, around one-third failed to submit their tax returns. Although the number of registered companies increased between 2016-17 and 2018-19, the proportion of companies submitting returns declined from 29,215 to 27,680. Furthermore, the estimated corporate tax yield since 2013-14 has largely been on a declining trend, which is in sharp contrast to buoyant economic activities resulting in annual GDP growth in the range 6-8 per cent during the period (as shown in Figure 1 above).¹²

Table 4: Corporate taxpayers and the average yield

	Number of Registered Company	Number of Companies Submitted returns	Tax Collection (million TK)	Average yield (million TK) (revenue per taxpayer)
FY2013-14	59,581	21,799	313,340	5.3
FY2014-15	65,979	23,011	349,210	5.3
FY2015-16	68,887	21,839	259,490	3.8
FY2016-17	75,144	29,215	318,350	4.2
FY2017-18	79,870	27,286	360,580	4.5
FY2018-19	84,435	27,680	336,180	4.0

Source: Based on NBR data.

¹² Revenue collection per taxpayer (company) declined from Tk 5.3 million in 2013-14 to Tk 4 million in FY2018-19.

Many entities/companies remain outside the tax net due to a large informal economy and low administrative capacity. Most of the micro, small and medium enterprises operate outside the formal sector, often lacking any credible and effective accounting practices. On the other hand, many large businesses in the formal sector enjoy tax benefits granted under different policies. These include textile industries; garments exporters; jute industries; cooperative societies; public universities; medical and dental colleges; engineering colleges; companies engaged in the production of poultry feed, feed for fish, shrimps, and cattle; cattle firming; horticulture; floriculture; sericulture; poultry, shrimp and fish production; etc. The corporate tax rate on the country's largest manufacturing sector, the readymade garment (RMG) sector, is just 12 per cent in comparison with 30 per cent for non-listed companies. Even then, most of the RMG firms do not pay this. The government thus has imposed a minimum of 0.3 per cent turnover tax on exporting products (Mansur, 2020). Furthermore, newly established industries both in and outside specialized zones enjoy tax holidays for certain periods at different rates (Table 5). Various other specified 'thrust sectors' such as electronic products; fruit and vegetable processing; milk and milk products; baby food; light engineering products; household goods; training institutes providing degrees or certificates in specified areas; hospitals located outside Dhaka, Narayanganj, Gazipur and Chittagong; etc. are also exempted from corporate income taxes for 10 years.

Table 5: Tax holidays enjoyed by industries in different industrial zones

Year	Rate of Tax exemption					
	Dhaka and Chittagong	Rest of the country	Export Processing Zones		Special Economic Zone and Hi-Tech Park	
			Dhaka, Chittagong, Comilla, Adamjee and Karpaphuli	Uttara, Ishwardi and Mongla	Developer	Investor
1 st year	100%	100%	100%	100%	100%	100%
2 nd year	100%	100%	100%	100%	100%	100%
3 rd year	60%	70%	50%	100%	100%	100%
4 th year	40%	55%	50%	50%	100%	80%
5 th year	25%	40%	25%	50%	100%	70%
6 th year	-	25%	-	50%	100%	60%
7 th year	-	10%	-	25%	100%	50%
8 th year	-	-	-	-	100%	40%
9 th year	-	-	-	-	100%	30%
10 th year	-	-	-	-	100%	20%
11 th year	-	-	-	-	70%	-
12 th year	-	-	-	-	30%	-

Source: Information obtained from BIDA.

Revenues from personal income taxation are also low—just 1 per cent of GDP in 2018-19, declining from the peak of 1.46 per cent of GDP in 2015-16 (Figure 19). This is lower than the average of Asia-Pacific countries (3.6%), and African economies (3.1%) (OECD, 2021). Between 2012-13 and 2018-19, while per capita income almost doubled, tax revenue per taxpayer declined (Figure 20). Bangladesh has thus failed to benefit from the existing progressive income taxation structure and the rapid growth of the economy.

Figure 19: Personal income tax (% of GDP)

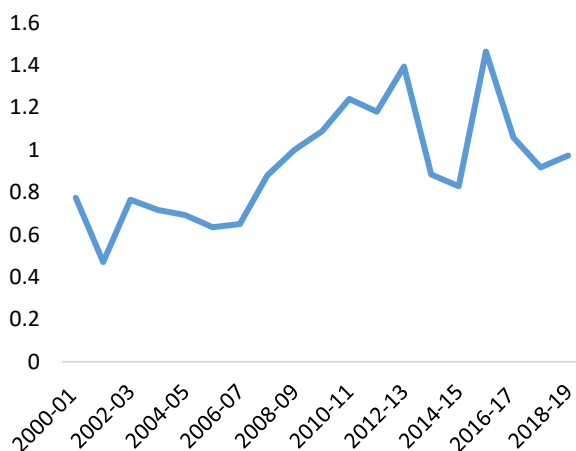
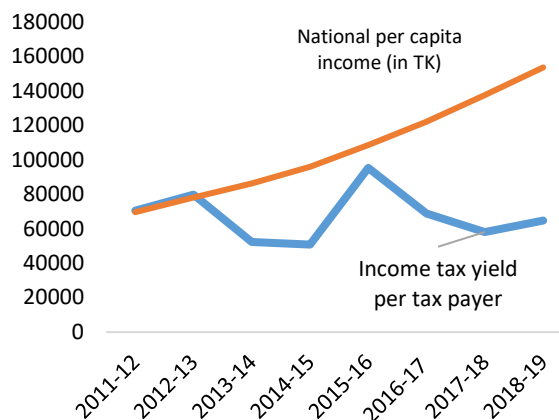


Figure 20: Personal income tax yield and per capita GDP (Tk)



Source: Computed based on NBR and BBS data.

With tax rates ranging from 10-30 per cent plus (when wealth tax is included), generating such relatively small revenue depicts inefficiency in administering income taxation. One major challenge in this respect is the relatively narrow tax net. In a country of over 160 million population, only 5 million have taxpayers identification number (TIN). This is just about 4.5 per cent of the working-age population and 8.2 per cent of the employed population). Of the people with TIN, less than 40 per cent or 1.9 million individuals submitted their tax returns in 2018-19. In other words, while the total number of individual taxpayers with TIN was 2.3 per cent of the population in 2018-19, while the people who submitted their returns comprised just 1.14 per cent. The comparable figures of tax return submission are 4.45 per cent of population in India. The registered taxpayers in Indonesia and Vietnam are respectively 9 per cent and 18.3 per cent of population.

The extremely low coverage of people within the tax net becomes obvious when the national income distribution over various income percentile groups is analysed and as presented in Ahmed (2020). According to the Household Income and Expenditure Survey of 2016, the latest currently available, the income share of the top 10% in total national income is just above 38 per cent. If this group of people is subject to an income tax rate of just 10 per cent, the income tax-GDP ratio should reach 3.8 per cent. A 15-per cent tax rate for the same group would raise the same ratio to 5.7 per cent (Ahmed, 2020). Therefore, even with a conservative assumption that the top 10 per cent household can pay only 10 to 15 per cent of their income as taxes, only about 17 to 26 per cent of tax potential is currently utilized.

Low personal income tax base and high tax evasion are the result of multiple factors including, not limited to, legal tax exemptions and loopholes, political connections, corrupt practices, complexities of tax assessment and collection, inefficient tax audits, and the presence of a large informal economy. Around 85 per cent employment is the informal sector and almost all of it is outside the tax net. There is no mechanism to bring the informal sector workers within the tax net. Besides, there is a tendency of underreporting income among the taxpayers through informal arrangements involving a section of income tax practitioners (ITP) and tax collectors.¹³ Lack of automation, improper and irregular scrutiny,

¹³ Information obtained from key informants' interviews (KIIs).

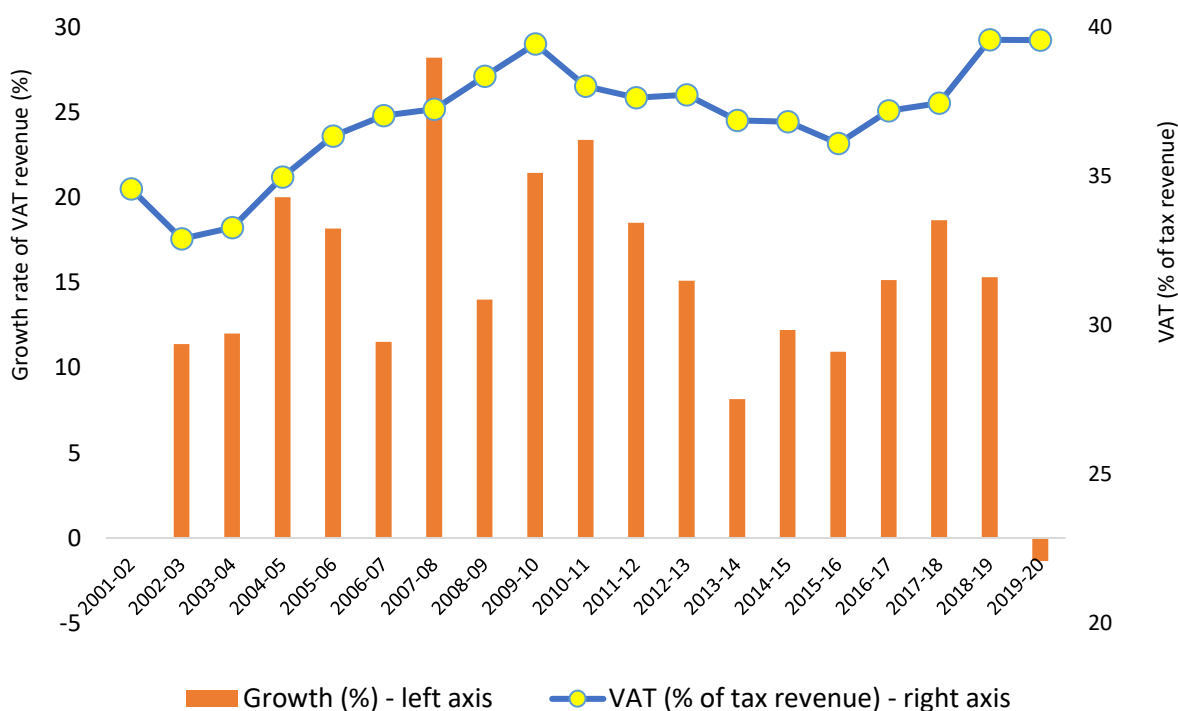
and corrupt practices also undermine the tax effort. Lengthy time requirement for manual tax filing, lack of knowledge, and fear of harassment after tax filing also discourage people from submitting tax returns.

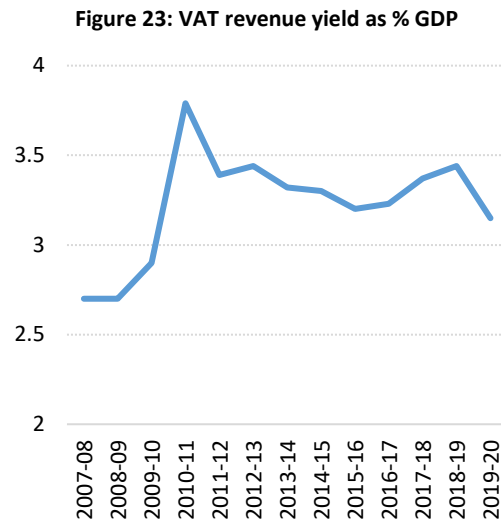
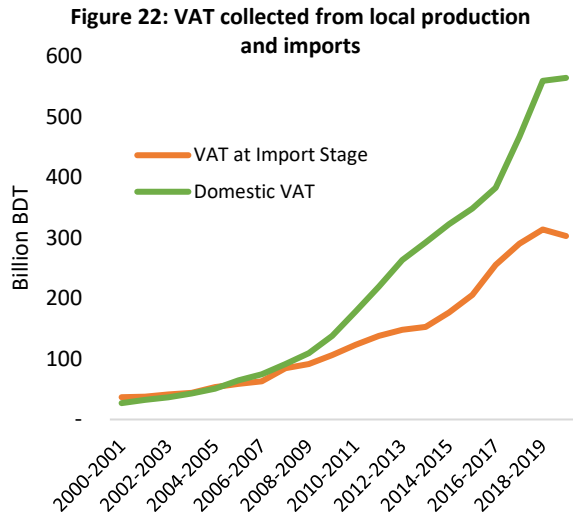
Value Added Tax (VAT)

The value added tax (VAT) is the largest source of government revenue in Bangladesh. It contributed to 40 per cent of the tax revenue in 2019-20—up from 33 per cent in 2002-03 (Figure 21). The average growth in VAT collection during the same period has been a staggering 16.1 per cent. It however suffered a major setback due to Covid-19 with the revenue collection in 2019-20 declining by 1.4 per cent.

After its introduction in 1991, revenue collected from value added tax imposed on imports was initially higher than that collected from domestic sources. Since FY 2005-06, as a positive and desired development, domestic sources have become more important for VAT collection than imports (Figure 22). However, given the statutory rate of 15 per cent, the VAT yield—estimated between 3 and 3.5 per cent for most years (Figure 23) is quite low.

Figure 21: Value-added tax revenue and its growth





Source: NBR data.

To modernize the VAT legislation and to broaden its scope, the government adopted the *VAT and Supplementary Duty Act 2012*. Some salient features of the Act include, a simplified and modernised VAT system, major improvements in VAT administration, including a shift from manual to electronic filing, a voluntary approach to tax compliance, a single registration for each taxpayer, the use of the invoice credit method for tax assessment, etc. (Ahmed, 2013). However, the implementation delayed due to the preparatory work. The government attempted to launch the new act in FY2018, however failed due to the strong opposition from retail trading communities and politically well-organised federations (Ahmed, 2020). In July 2019, a variant of VAT Law 2012, with some revised provisions, were enacted. It has introduced an online VAT registration system, considered using input-output coefficients instead of price declaration, and provided greater scope for obtaining input VAT credit or refunds. It has removed the maintenance of current accounts, which has eliminated the requirement of maintaining positive balance in current account. Thus, it is claimed that the new VAT Act will be easier to follow and will not require making any advance payments (of VAT). The registered companies will have to pay the net VAT, if any, before 15th day of the next month at the time of submitting the return. The new Act continues to maintain the so-called truncated VAT system. The truncated rates are set at 5 per cent, 7.5 per cent and 10 per cent or fixed annual lump-sum amounts for retail shops that met certain criteria. Besides, VAT on medicines, petroleum and land development are respectively 2.4 per cent, 2 per cent and 3 per cent. The truncated rates are fixed based on the assumption on the value-added content. For example, a 5 per cent truncated VAT rate means that value added in those sectors is 33.33 per cent. If an industry pays truncated VAT rates, it will not be able to claim any rebate for payment of VAT on inputs. Alternatively, it may still pay VAT at 15 per cent with claim of rebate or adjustment for VAT paid on inputs.

The continuation of truncated rates in the new enacted law is a significant departure from the original VAT Law. The level of truncation is mostly ad-hoc without following any specific method. Besides, due to inefficient VAT administration, many companies are out of the VAT net and do not pay the minimum truncated VAT. There is no proper accounting system to track value addition and sales. Currently, the National Board of Revenue is distributing Electronic Fiscal Devices (EFDs) to businesses as part of the VAT automation process. However, till July 2021, only 3,393 shops are using the EFD system as against of

350,000 that are currently VAT-registered all over the country.¹⁴ The NBR expected to distribute 10,000 EFDs by June 2021 but could not succeed in doing so. There are concerns that distortionary measures in the new VAT law did not yield any positive results and improvements in tax collection from VAT at the retail and wholesale levels remained marginal (Mansur, 2020).

Issues with customs

Trade based taxes in Bangladesh is better administrated and more organized in comparison with other two main components of revenue. Bangladesh adopted the Automated System for Customs Data (ASYCUDA) of the United Nations Conference on Trade and Development (UNCTAD). Besides, Authorised Economic Operator programme, National Single Window, National Enquiry Point, Advance Ruling System E-payment etc. have either been initiated or being set up to simplify customs clearance. Notwithstanding, the efficiency of customs clearance remains low compared to other such comparators as China, India, Indonesia, Vietnam, etc. (Figure 24). Time required for customs clearance and inspections by customs authorities for exports and imports remain at 96 and 120 hours, respectively, according to World Bank Doing Business Indicators 2020 (Figure 25). This is in comparison with 6 and 4 hours in China (Shanghai) respectively for exports and imports, 10 and 12 hours in India (Mumbai), 5 and 16 hours in Vietnam. Customs clearance cost is also higher in Bangladesh.

Bangladesh has made some progress in the customs valuation process. Exports and imports are assessed based on the criteria against 8-digit HS codes. However, there is no mechanism for inspecting and assessing overvaluation of traded items. Thus, trade-based money laundering is thought to be one major problem. Besides, there are issues about inappropriate reporting of HS codes by the importers to escape customs and other duties. One important challenge of tax evasion has been reported as, e.g., in Ahmed (2020), the collusive behaviour between importers and the customs staff.

¹⁴ <https://www.newagebd.net/article/145975/nbr-misses-deadline-for-installing-10000-efds-amid-covid-outbreak>

Figure 24: Logistics performance index: Efficiency of customs clearance process (1=low to 5=high), 2018

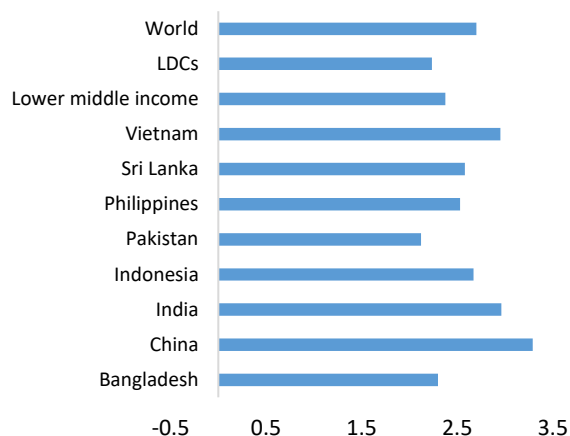
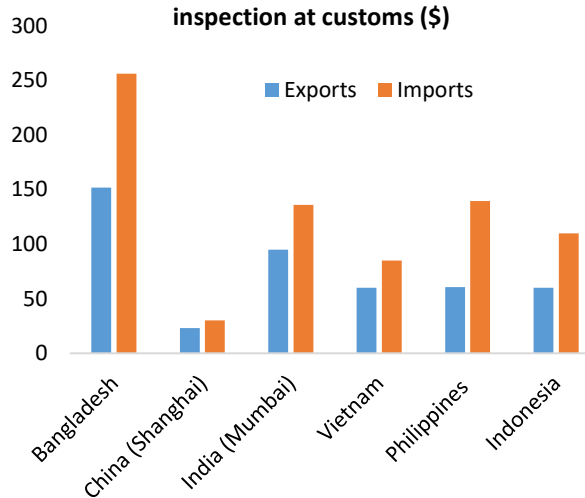


Figure 25: Associated cost of clearance and inspection at customs (\$)



Source: World Development Indicators (WDI), World Bank.

Bangladesh maintains two types of border measures: one for imported goods to be used for the exporting firms in the Export Processing Zones (EPZs) and export-oriented industries having bonded warehouse facilities, and the other one for imported goods for home consumption. While imports by EPZ firms and export-oriented industries having bonded warehouse facilities are exempt from payment of any duties, imports for home consumption are subject to customs and other duties and taxes. Duty-free imports are also allowed for packaging materials used for deemed exports and for imports of inputs/raw materials used by industries located in EPZs.¹⁵ According to recent statistics, slightly more than a quarter of imports were duty-free – coming through bonded warehouse facilities or EPZ imports (Razzaque, 2021). Imports for home consumption also receive lots of concession and exemptions from tariffs and other trade taxes and most of the exemptions and special treatments related to trade taxes (particularly for supplementary duties) are ad-hoc and unpredictable, determined during the budget making process. Many of these special treatments are determined by strong political lobbies by the beneficiary groups and are not based on proper assessments.

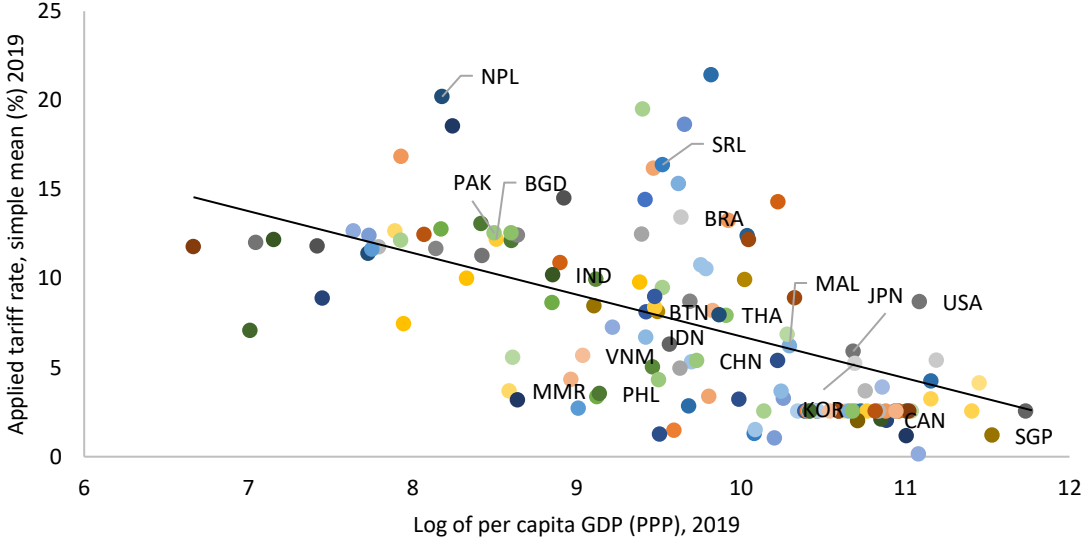
Trade taxes for revenue generation

Compared to many other comparator countries, Bangladesh has maintained higher import tariffs. For instance, the average applied tariff rate in the country is higher than that of India, Vietnam, China, Thailand, Malaysia, etc (Figure 26). Along with customs duty, the tariff regime in Bangladesh is characterized by supplementary duty, regulatory duty, advance income tax, and VAT. As mentioned earlier, currently about 30 per cent of government revenue is sourced from international trade, mainly taxing imports. This level of dependence for revenue makes it very difficult to use trade policy in improving

¹⁵ A deemed export is defined as exporting of goods embedded into other products like buttons, hangers used in the readymade garments sector, packaging materials/cartons, labels, polybags, etc. used in virtually all other industries.

incentives for exporters. It has been argued that maintaining high tariffs (using custom duties as well as various other para-tariffs) makes investments in import-competing sectors more lucrative than in the export industry, causing a disincentive for the latter. Exporters do receive certain policy support, however, compared with the magnitude of tariff-based protection, export incentives (e.g., cash assistance and interest rate subsidies) are small. When tariff protection and export incentives are used to compute the effective exchange rate for import-competing and export sectors separately, the relative incentive—as measured by the ratio of effective exchange rate for exports to the same for import-competing sectors—for exporters is estimated to be 33 per cent less than the firms that make sales targeting domestic consumers alone (Sattar, 2020). This policy-induced anti-export bias is regarded as one important reason for Bangladesh’s not being able to replicate the export success of the RMG industry. Therefore, there have been calls for tariff rationalization to improve export incentives. Furthermore, given the upcoming LDC graduation, which would result in the loss of unilateral trade preferences, Bangladesh will have to look for bilateral and regional trade agreements that will require undertaking tariff cuts as part of reciprocity-based trade negotiations.

Figure 26: Average applied tariff rate and per capita income of global economies



There are suggestions that the need for tariff rationalization has long been overlooked because of the NBR’s concern about potential import revenue loss. Many trade liberalization measures of the 1990s have somewhat been reversed by imposing para tariffs—such as supplementary and regulatory duties—that ideally should have no protective intent but actually have conveniently targeted imports for revenue generation purposes. Customs duty accounts for just 29 per cent of all import revenue while supplementary and regulatory duties together contribute to 14 per cent.

Table 6: Import revenue by different duties (%)

	2016-17	2017-18	2018-19
Customs duty	28.8	30.2	28.7
Regulatory duty	3.2	2.8	2.2
Supplementary duty	14.4	12.8	11.8
Value Added Tax	36.2	36.3	37.1
Advance Income Tax	10.8	11.4	11.7
Advance Trade VAT	6.6	6.4	7.7
Other duties	0.0	0.1	0.7
Total import revenue	100	100	100

Source: Razzaque et al (2021).

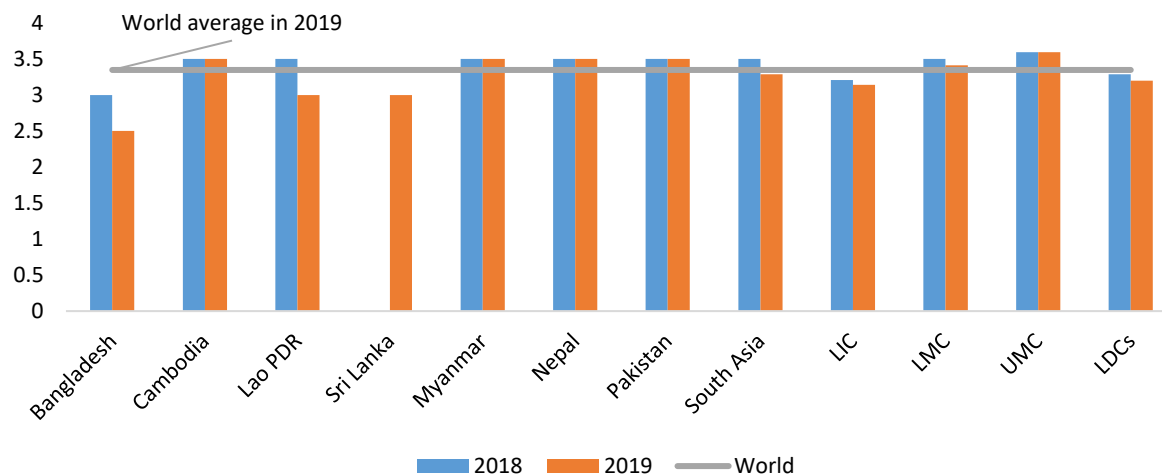
It is worth pointing out that the relationship between tariff cuts and import revenue is ambiguous. The impact on revenue depends on the price elasticity of import demand and the elasticity of substitution for imported goods. If either of the elasticities is sufficiently high, import revenue should increase because of lowering of tariffs (Ebrill et al. 1999 and Agbeyegbe et al. 2006). Besides, when imports expand in response to tariff adjustments, VAT revenue (due to imports) should increase offsetting at least some of the downward pressure on the revenue due to customs duty. Another important aspect of tariff rationalization is that the inflow of imports, especially of raw materials and capital goods, at a lower cost would help expand domestic production base, contributing to overall economic activities thereby helping widen the domestic tax base. Furthermore, as mentioned above, there has already been a considerable decline in the significance of import revenue, and it is only natural that as an economy grows and develop, such dependence should fall. Therefore, the role of import revenue needs to be given careful consideration so it does not unnecessarily compromise other policy options and flexibilities that Bangladesh will need to exercise to promote export expansion and diversification and explore new trading opportunities through free trade agreements particularly as LDC graduation is fast approaching.

Tax administration

Tax administration in Bangladesh is considered inefficient by the standard of comparator countries. It has one of the lowest revenue mobilization efficiency scores¹⁶ – much lower than the averages of low-income countries and LDCs (Figure 26). Several factors influence the tax administration efficiency including, amongst others, lack of centralization, little capacity of tax policy analysis, insufficient capacity to implement tax policy reforms, lack of separation of tax policy and tax collection, lack of coordination between NBR and the Ministry of Finance, weak and improper tax auditing and inspection, lack of automation, and shortage of human resources.

¹⁶ Efficiency of revenue mobilization assesses the overall pattern of revenue mobilization, not only the de facto tax structure, but also revenue from all sources as actually collected. The CPIA efficiency scores are prepared based on 16 criteria. All these criteria are rated on a scale of 1 (low) to 6 (high). The scores depend on the level of performance in a given year assessed against the criteria, rather than on changes in performance compared with the previous year. The World Bank evaluates a country's performance on each of the criteria and assigns a rating. The ratings reflect a variety of indicators, observations, and judgments based on country knowledge and on relevant publicly available indicators.

Figure 26: CPIA efficiency of revenue mobilization rating (1=low to 6=high)



Note: CIPA - Country Policy and Institutional Assessment (CPIA)

Source: World Bank Group, CPIA database.

There is no centralized database and information sharing among the three wings of NBR – income tax, VAT, and customs.¹⁷ This results in a fragmentation of tax administration and missing information, leading to improper counting and low compliance, tax evasion and avoidance. Besides, the separation of two tax cadres—customs and VAT, and direct tax—and the rivalry between them undermines coordination and revenue mobilization efforts. Bangladesh’s tax administration is not linked to the central bank and commercial banks verification processes, which makes proper accounting and monitoring difficult. This ends up with many individuals and firms’ not filing for tax returns or their underreporting of incomes.

The current tax administration system continues to be paper-based, manual system rather than a computerized and automated one that many developing countries use. This results in a high level of discretion at every stage. Automation and digitalization can greatly enhance revenue potential by bringing clarities and giving confidence to taxpayers that they would not be harassed thereby encouraging individuals and businesses to submit tax returns. Because of extensive discretionary practices, the perception about the overall system is generally unfavourable. The NBR has recently introduced online income tax return submission, however, it falls far short in terms of implementation. Both paper-based and online return filing require remain an arduous task compelling most taxpayers to seek assistance from third parties, who are most often not adequately trained and can have different perceptions about dealing with the procedures. It is quite common to find that taxpayers guided by the advice received from third parties file their statements and documents only to find anomalies being picked up later on, compelling them to look for extra-legal solutions. Besides, there are no centralized and automated mechanisms of auditing with no systematic rules and criteria established for selection of audit cases. This improper audit system creates the scope of corruption.

Lack of separation between tax policy and tax collection is another challenge for fiscal reform. Reforms and challenges needed for improved functioning of the system should be determined independent of interferences from tax administration. The lack of policy work means various decisions are taken in an

¹⁷ Information obtained from KIIs.

uninformed nature based on the experience of the current practices that are flawed and have inherent inertias for embracing the changes required. There was an attempt to establish a tax policy division under the ministry of Finance, but that could not make progress. The NBR established three separate tax policy units under its three wings – VAT, direct tax, and customs. However, these policy units are not free from interference as the senior positions are held by tax administrators.

Institutional capacity constraints facing the NBR also seriously limit the revenue-generation potential and developing a modern system while keeping pace with the development that is taking place in the country. It lacks, for instance, in terms of tax policy analysis capacity. Undertaking formal surveys and analyses of emerging growth centres and potential taxpayers, assessing the relationship between various tax rates and revenue productivity, analysis of the nature of the taxation system (e.g., if the system is progressive or not), etc. do not get the required attention in developing workplans and policy directions. The Bangladesh BCS Tax Academy is the relevant apex training centre for the officials, but its capacity is limited in tutoring policy analysis. Besides, the NBR has a huge shortage of human resources for administering taxation policies, auditing, monitoring, and inspections. The absence of automation/digitalization makes these tasks even more difficult, undermining the revenue mobilization efforts.

Despite all these challenges there are some recent developments in tax administration. During the period between 2010 and 2020, the National Board of Revenue undertook various initiatives with a view to modernizing and reforming tax administration. In the area of income taxation, such initiatives include establishment of tax information and service centers; online submission of return, application of appeal and alternative dispute settlement; issuance of system-generated orders; etc. In the area of VAT administration, an online registration system has been introduced. Besides, help desks have been established for providing services to taxpayers. A countrywide survey is being conducted for expanding the VAT coverage, and electronic fiscal devices (EDF) are being distributed among the traders and businesses. Under its VAT online project, an Integrated VAT Administration System (iVAS) has been established and initiatives are underway to link it with Bangladesh Bank, ASYCUDA, and Bangladesh Income Tax System (BiTAX). These reform initiatives resulted some positive impact including an absolute increase in the number of individual taxpayers and expansion of the domestic VAT net.

As part of customs modernisation, ASYCUDA World has been Introduced in all customs stations and an E-payment system has been activated. Initiatives have been undertaken to integrate ASYCUDA with BSTI, Plant Quarantine Wing, BEZA, BEPZA, and BRTA. Besides, with a view to modernizing and reforming customs “Customs Modernization Strategic Action plan 2019-2022 has been adopted. A post clearance audit system has been introduced for rapid clearance of goods at the port.

Political economy factors in reforming tax policy and tax administration

One issue that has especially been highlighted in the context of the reforms needed for tax policy and administration is political economy factors (e.g., see Ahmed, 2020; Mansur, 2020, Hassan and Prichard, 2014). Political economy analysis sheds light on incentives, relationships, and distribution and contestation of power between different groups and individuals. It has been argued that “The stakes are particularly high with tax reforms because substantial amounts of money are involved. The beneficiaries of the present tax system in Bangladesh (political elites, big business, the NBR administration) are happy with the status quo” (Ahmed, 2020, p.16). Again, others are of the view that, “the current system delivers

low and predictable tax rates to businesses, provides extensive discretion and opportunities for corruption to the tax administration, and acts as an important vehicle for political elites to raise funds and distribute patronage and economic rents” (Hassan and Prichard, 2014, p.v). Furthermore, it is also suggested that, “[R]eform initiatives at the NBR have mostly failed in recent decades because of lack of ownership and resistance at the level of field offices and unholy alliances between field officials and business entities (Mansur, 2020).

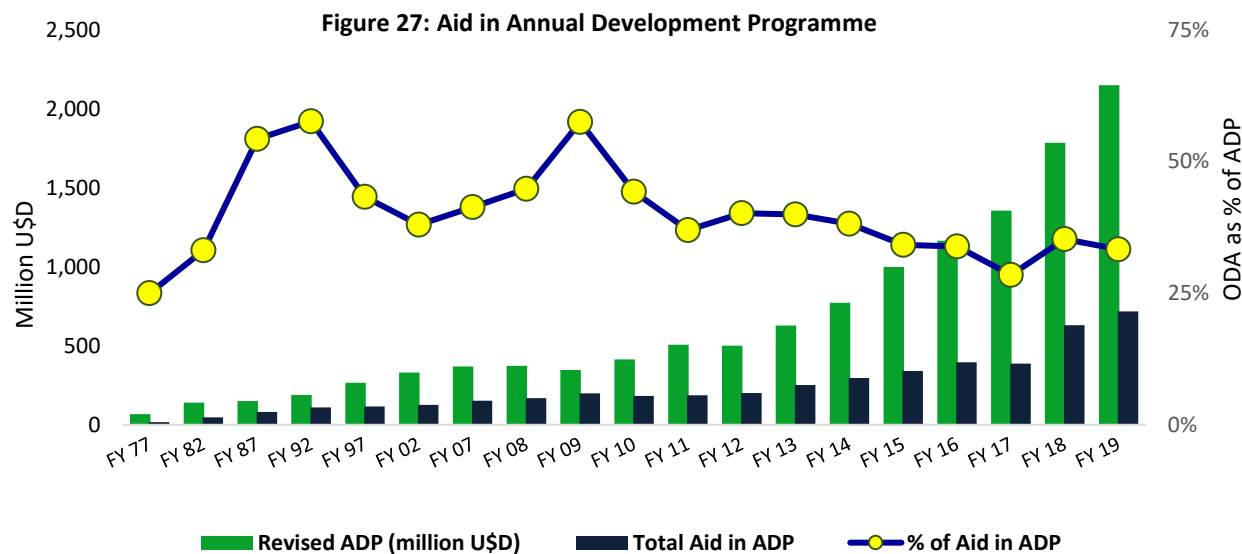
It is important to acknowledge that political economy factors are important in assessing reform initiatives in every sector and it is not only about indicating corrupt practices but also about assessing other dynamics between different groups that impact on desired results. For instance, giving very high and unrealistic revenue targets can encourage the NBR to take a protective stance on trade taxes. Furthermore, when tax measures are to be carried out through ad hoc approaches, the scope of discretionary practices will only flourish. Similarly, it may also be difficult to deal with politically influential groups that are affected by tax reforms and, given the underlying political-economic dynamics, provisions are eventually created allowing measures that will undermine a vision of reforming the system. For instance, Ahmed (2020) finds that between FY2015 and FY2019 as many as 926 Statutory Regulatory Orders (SROs) were introduced, each aiming at providing a special benefit to a target group.

Therefore, tackling political economy challenges is crucial for developing a modern taxation system. This can be done with a reinvigorated political comment considering Bangladesh’s development transitions, including LDC graduation, that will require much enhanced public spending capacity to build further on the socio-economic progress achieved.

LDC graduation and external resource mobilization

Although the dependence of foreign aid has declined over the past decades, overseas development assistance, i.e., grants or loans on concessionary terms, received both bilaterally and multilaterally, has been an important source of development financing for Bangladesh. The Annual Development Programme (ADP) makes use of project aid and technical assistance in implementing social and physical infrastructure projects along with other complimentary interventions. As the government’s fiscal capacity has kept rising steadily, ADP spending, over the years and until the breakout of Covid-19, has generally become less and less aid-dependent (Figure 27). Nonetheless, concessional loans and ODA still provided for more than one-third of the development budget in FY2019. It is important to note that the size of ADP has almost doubled over the most recent years largely due to implementation of various large-scale development projects, primarily in power and transportation sector.

The implementation of large-scale infrastructure projects, strengthening of social protection, improving public service delivery, etc. will continue to demand a huge commitment of resources for which external financing will be critical. Given the low domestic tax base, large-scale foreign financing including ODA and loans will be important for sustaining economic development and smooth LDC graduation. However, there are concerns about rising cost of available funds in the post-graduation era.



Source: Based on data from ERD.

It has been argued that LDC graduation will have negligible impact on the access to foreign financing (Razaque et al, 2020). This is because Bangladesh’s external resources are mostly provided by some bilateral and multilateral donors that typically do not consider LDC status as a determining factor for offering grants and loans. The World Bank uses its own income classifications of countries in granting concessional loans. Providing LDCs with equivalent to 0.15–0.20 per cent of donor countries’ GNI as specified in the Istanbul Plan of Action adopted at the IV UN Conference on the LDCs in 2011 has not been materialized. The trends in aid allocation would rather suggest that recipient countries’ historical and bilateral relationships with donors, and country-specific situations such as civil wars and unrests, natural disasters, health epidemic, and refugee crisis are important determinants of aid inflows.

Most donors have, however, started to raise the lending rates on concessional loans in recent years. This has already begun well before graduation from the LDC group and would have taken place regardless of the LDC status. Having moved from low-income country (LIC) to lower-middle-income country (LMIC) group in 2015, Bangladesh is no longer eligible for the World Bank’s most concessional International Development Assistance (IDA) loans with a typical interest rate of 0.75 per cent, a longer grace period, and other more relaxed terms.¹⁸The Asian Development Bank (ADB) is now only offering market-based Ordinary Capital Resources (OCR) loans with LIBOR (London Inter-Bank Offered Rate) rates. While the

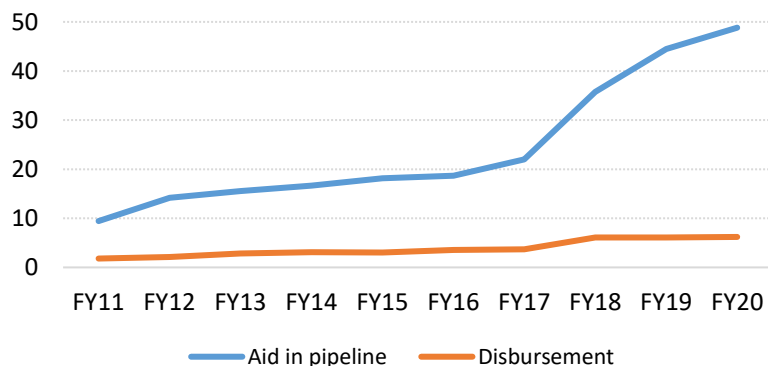
¹⁸ Instead, Bangladesh can apply for less concessional IDA Gap loans. The typical interest rate charges on IDA gap loans are 2 percent. World Bank’s concessional interest rates are generally of four types: (a) IDA only (national per capita income cut-off level currently of less than \$1,165); (b) IDA gap (applicable for countries with income above the cut-off level for more than two years); (c) IDA blend (improved creditworthiness as considered by the World Bank); (d) IBRD (complete graduation from IDA and eligible for IBRD loans). Among others, JICA has been the first major bilateral donors to increase concessional interest rate from a very negligible rate to 1 percent. Two major non-DAC governments that have financed infrastructure development in recent years, China and India are charging 2.4 percent and 1 percent, respectively. Borrowing from domestic sources is a much costlier option as the government has to pay often a staggering 9 percent plus interest rates on national savings certificates for public borrowings.

reduced prospect for low-cost financing is an issue, it would have taken place sooner or later regardless of LDC-graduation.

Post-graduation, Bangladesh may face challenges in accessing some of the LDC-specific funds. LDCs can access the LDC Fund (LDCF) which supports programme under the UN Framework Convention on Climate Change (UNFCCC). Each LDC is eligible to access up to \$50 million cumulative funds from the LDCF.¹⁹ As per the regulation, Bangladesh will lose access to this fund after its graduation.²⁰ The Green Climate Fund (GCF) is dedicated to help developing countries reduce their greenhouse gas emissions and enhance their ability to respond to climate change (Razzaque and Tateno, 2021). LDCs and small island developing States are given special priority in funds allocation from the GCF. Graduated Bangladesh will continue to have access to GCF and the Special Climate Change Fund (SCCF) to formulate and implement national adaptation plans (NAPs).²¹ Access to financial flows and technical assistance under the Enhanced Integrated Framework (EIF) will continue for a period of five years after graduation.

Along with aid availability it is also important to consider absorptive capacity. Underutilization of aid has been a regular phenomenon of Bangladesh’s fiscal management with the accumulation of foreign assistance in the pipeline has risen from around \$9 billion in FY2011 to more than \$48 billion in 2021 (Figure 28).²² While complex procedural requirements and donor conditionalities could be problems in utilizing aid money, delays in project preparation and implementation are also an important factor for not being able to fully utilize the currently available assistance. Given this, many would argue that availability of aid should not be a major concern for Bangladesh.

Figure 28: Aid in pipeline and absorption by Bangladesh (billion \$)



Source: Based on ERD data.

¹⁹ Information obtained from <https://www.un.org/ldcportal/least-developed-countries-fund-ldcf/>

²⁰ Graduating or newly graduated countries are eligible to access the fund: (a) if a country is classified as an LDC at the time of the approval of the Project Identification Form (PIF) by the LDCF/SCCF Council following technical clearance by the GEF Secretariat, the project is eligible to receive LDCF support; (b) projects already approved by the LDCF/SCCF Council prior to a country’s graduation continue to be supported with agreed LDCF resources until completion. https://unfccc.int/sites/default/files/resource/sbi_2018_8.pdf

²¹ <https://www.un.org/ldcportal/least-developed-countries-fund-ldcf/>

²² More information can be found here: <https://thefinancialexpress.com.bd/economy/bangladesh/project-aid-in-pipeline-soars-to-48b-as-state-agencies-fail-to-utilise-funds-1612836269>

IV. Policy Recommendations for Improving Resource Mobilization

Despite tremendous economic success, Bangladesh's domestic resource mobilization capacity remains limited. The low tax-GDP ratio is constraining the government's fiscal space against the ever-rising demand for public services—including health, education, and social protection—further intensified by the Covid-19 pandemic. The impending LDC graduation and the national objective of becoming a higher middle-income economy by 2031 will require a substantial rise in the country's tax effort in the coming years. Having discussed the current state of resource mobilization in the preceding section, several recommendations are set out below to address the underlying issues and challenges. It should be pointed out here that the 8th Five Year Plan has suggested several tax reforms (Annex I) and the recommendations provided in this paper are largely consistent with those.

1. Reforming the taxation system and tax institutional capacity building should constitute major priorities now if various development targets and envisaged development transitions as set out in national plan documents will have to be materialised.

The current low level of public resource mobilisation is becoming a binding constraint on Bangladesh's further development prospects. Despite recording an impressive economic growth performance, leading to almost two-and-a-half times increase in per capita income over the past decade, the overall size of Bangladesh's public spending remains low and grossly inadequate for the desired level of public investment in various sectors. Macroeconomic frameworks used in preparing the Perspective Plan 2041 and the 8th Five Year Plan (July 2020-June 2025) consider the tax revenue to rise from the currently about 9 per cent of GDP to more than 17 per cent by 2031. While the projected near doubling of tax effort within a decade is clearly a challenging task, this period will coincide with the recovery from Covid-19 disruptions and putting the economy back on the track of high growth path, LDC graduation, implementation of the SDG strategies, and the country's much aspired transition from a lower-middle income to upper middle-income country. Higher government revenues would create the absolutely needed fiscal room for manoeuvre and allow more spending in areas that are important for driving and sustaining growth in the medium to long-term including health, education, and infrastructure, etc. It cannot be overemphasized that without being able to enhance the tax effort significantly Bangladesh will not be able to stick to the development trajectory as envisaged. Therefore, reforming the taxation system and strengthening the tax institutions are today's priority for the medium to longer term development ambitions.

2. Direct taxation should be a major focus of the revenue mobilization effort.

Bangladesh's development aspirations are also about ensuring an inclusive development process and establishing a fair society. In the face of rising inequality, the role of a progressive direct taxation system (along with a redistributive public spending mechanism) is extremely important for ensuring both horizontal and vertical equity. *Horizontal equity* would ensure taxpayers in similar financial condition being treated similarly. *Vertical equity*, on the other hand, means that taxpayers who are better off should contribute more or at least pay the same proportion of income in taxes as those who are less well off. Direct taxation can thus be used to reduce income inequality and promote fairness, while indirect taxes could increase inequality (Webber and Thomas, 2016).

The data from the Bangladesh Bureau of Statistics show that the income share of the bottom 40 per cent of the population fell from more than 17 per cent in the 1990s to 13 per cent in 2016. The same share for the bottom 5 per cent declined from 1.03 per cent to just 0.23 per cent. Therefore, the objective of any taxation reform should not be only about raising revenue but also to deal with this growing inequality as much as possible. Dependence on indirect taxes (e.g. VAT and customs duties) can make the existing income distribution worse. Almost two-thirds of NBR revenues are currently sourced from indirect taxes, which can affect disproportionately affect households on lower incomes. Therefore, going ahead, Bangladesh will have to transform its resource mobilization structure to generate more revenue from direct taxes.²³ It is important to note that NBR has drafted a preliminary direct tax law and associated direct tax codes. There should be a comprehensive stakeholder engagement in finalizing the law. The essential preparatory work should start immediately for its proper and effective implementation.

3. Broadening the tax net and sources are critical for enhanced domestic resource mobilization.

Bangladesh is facing multiple challenges in broadening the tax net both in terms of direct and indirect taxes. As mentioned earlier, there is some evidence that revenue collection from personal income taxation for the highest income decile groups can be raised from the current level of 1 per cent of GDP to 3.8-5.7 per cent even without the need for tax rate increase (Ahmed, 2020). One major challenge in broadening the tax net is the presence of large informal economy. Business enterprises and employees of the informal economy tend to hide their income to escape from taxation. A pragmatic approach must be found to immediately bring the relatively better off part of the informal economy.

Several initiatives have been undertaken in improving corporate taxation. Still, the overwhelming focus remains on a few formal sectors such as tobacco, mobile telephone operators, and the banking sector. Other corporate and business activities must also be brought under consideration for ensuing equity, which should also increase collection. Efforts are currently underway to expand the VAT net including through the distribution of Electronic Fiscal Devices (EFDs) for VAT administration. However, these measures remain mainly metropolis-centric leaving out many emerging growth centres. In fact, the tax effort until now has not been able to take advantage of the high and sustained economic growth that Bangladesh has experienced over the past several decades. The retail sellers are mostly out of the tax net despite the fact consumers in most instances are charged for VAT. It is time to consider an enhanced role of local government institutions—that should have more information on business and economic activities of the people at the local level—in strengthening the tax mobilization drive.

4. A faster implementation of the digitization and automation process is extremely important.

The complexity of tax filing process with mostly paper-based, manual system rather than an automated and online submission-based system poses a serious problem for many taxpayers and for the overall tax administration. Tax filing requirements are complex requiring onerous documents including bank

²³ A survey undertaken by Ahmed (2020) shows that developed countries raise more than 50 per cent of their revenues from direct taxes.

statements, income statement, wealth, and expenditure statements, etc. The complex nature of tax administration and long list of manual documentation requirements discourage tax filing. This also generates opportunities of corruption, informal negotiation between taxpayers and collectors, discretionary practices, and unequal treatment of taxpayers with comparable situations. There is a broad consensus that the tax administration needs a complete overhauling by introducing an efficient, automated, and digitalized system. The automation process should be simplified so that more people can spontaneously file their returns. Submission of unnecessary paperwork should be avoided being sensitive to environmental consideration while promoting e-governance. An efficient automaton process with clearly specified and simplified processes will greatly help reduce the discretionary practices and improve administrative efficiency. The digitisation process may involve developing a central database within NBR linking all three wings along with the central bank, commercial banks, and the Office of the Controller General of Accounts, linking Integrated VAT Administration System (iVAS) with the central database. Simplifying the process through the introduction of a one-pager return in conjunction with electronic tax payments can strongly encourage many individuals to enter the tax net.

The NBR has recently introduced automated income tax payments through online return submission. This is a welcome initiative which should be revamped. However, automation does not only involve online submission, but it should also upgrade fundamental business processes and functions. Initiatives needs to be undertaken to digitise the whole process including front- and back-end functions. There are some progresses in customs tax administration which needs further strengthening. The digitalization of the VAT administration must also be a priority. The improper and malfunctional tax auditing system should be simplified by following structured methods rather than being ad-hoc and discretionary in nature. The improper tax auditing incentivizes corrupt practices. The tax auditing should be centralized and should be random and based on pre-defined criteria.

5. Tax exemptions should be consolidated and rationalized. Truncated VAT system should be phased out in a gradual manner.

A haphazard tax incentive system (including exemptions and special treatment of activities and entities) is eroding the tax base significantly, thus lowering the revenue yield. In most instances, the exemptions and privileges are designed in ad-hoc manners without proper assessments. It has been suggested that tax revenue as proportion to GDP could be 2 percentage points higher in the absence of various benefits (Mansur, 2020). There is a need to assess all such tax incentive schemes and their impact on productivity and other positive returns for which those facilities are provided in the first place. Special tax treatments for large sectors, including RMG and power sectors, tax holidays for investment in export processing zones and special economic zones should be rigorously reviewed. The use of numerous SROs in offering benefits to certain people and sectors only generates competition for more widespread tax exemptions and lobbying campaigns, which have long been recognised as directly unproductive rent seeking activities in the political economy literature. Tax incentives must be consolidated and rationalized while keeping in mind the long-term development needs of the country.

The current VAT system deviates from the motive of the original VAT and Supplementary Duty Act 2012. As discussed above, there are lots of exemptions. The introduction of truncated VAT rates has made the system more complex while affecting tax collection significantly. The determination of the VAT across

different sector is a complex task. A comprehensive assessment of the truncated rates should be undertaken and moving towards a gradual phasing out of truncated VAT rates should be a pragmatic policy option.

6. Tax policy should be separated from tax collection.

Currently the NBR is the sole authority for tax policy formulation and tax administration. The lack of separation between tax policy and administration results in reduced focus and a slower reform process in both areas (Mansur, 2020). The 8FYP proposes to separate tax planning from tax collection starting in FY2024 (Annex I). The preparatory work should start immediately. The NBR should be entrusted with the primary responsibility for collecting tax revenue and implementing reforms. A separate tax policy unit should be established with the primary responsibility of designing tax policies based on proper assessments. The tax policy unit should be independent and free from political economic factors. The single-minded focus of both the administration and policy units should improve efficiency thus can contribute to the collective goal of broadening the tax base.

7. Reducing further dependence on import tax revenue should provide immense trade policy flexibility that Bangladesh needs in improving incentives for investing into the export-oriented sector and exploring new trading opportunities through free trade agreements.

Bangladesh has substantially reduced dependence on trade taxes for domestic revenue mobilization purposes over the past three decades. Despite such progress, there is a general perception about high dependence on import taxes, which makes the NBR uneasy about tariff rationalisation, which is important to improve the relative incentive structure for export-oriented investments. Furthermore, as Bangladesh graduates from the group of LDCs to forgo unilateral LDC-specific trade preferences granted by many trading partners, new export market access opportunities should come from negotiating free trade agreements. This will require undertaking tariff reduction commitments. Thus, reducing dependence on import tariffs should generate trade policy flexibility. Until now, Bangladesh's approach to bilateral trade negotiations has been less than proactive due to the concerns about loss of tariff revenue. However, as mentioned earlier in the paper, VAT receipts from imports are around 37 per cent of all import revenue. Any reduction in customs duty is likely to boost imports and thus VAT revenues.²⁴ Additionally, tariff rationalisation can boost domestic economic activities, enhancing revenue-generating capacity further. It is a salient feature of economic development that as countries' per capita income rises, they reduce their dependence on revenue from trade taxes.

8. Enhancing in-house technical capacities of the NBR is important for improved tax administration and for implementing tax policy reforms.

²⁴ It is however true that any reduction in customs duties will reduce the tariff inclusive import prices, on which VAT rates are imposed. Thus, lowering of import duties will also have a downward pressure on VAT, but the overall rise in imports (due to tariff reduction) should more than offset any falling VAT revenue.

While the automation of tax administration will improve efficiency, the NBR needs to adapt with the digitised system. There is little capacity to undertake tax policy analysis and enhancing such capacity can help improve the tax effort. The BCS Tax Academy, responsible for training of the tax officials, should be strengthened to offer trainings on amongst other legal and quantitative aspects of tax policy. Currently the NBR is staffed with civil service officers only. However, a stronger combination of professional experts and civil service officials can help analyse various information that the NBR possesses (e.g., highly disaggregated trade data, tax submission records, etc.). Currently, this information remains unutilised, making the NBR reliant on indiscriminate and ad hoc approaches. Analytical in-house capacity would allow NBR conducting surveys and/or analysing other national databases, e.g., the Household Income and Expenditure Survey (HIES) and labour force surveys of the BBS to assess sector-specific economic activities/growth benefitting different households from various regions and occupational groups with potential for the expansion of the tax net. The issues of equity and efficiency of the taxation system can be best appreciated when the underlying analytical work is carried out inhouse.

9. Efforts to mobilise external resources must be enhanced in the run-up to LDC graduation and beyond.

LDC graduation does not imply that there should not be any need for external resource mobilization or opportunities for accessing resources from bilateral and multilateral development partners should necessarily get constrained. In fact, most of the largest recipients of overseas development assistance is from non-LDC group of countries. With economic transitions, the cost of borrowing should rise but still the cost of external borrowing remains much lower than that of ODA. After LDC graduation Bangladesh will lose access to some of the LDC-specific financing including LDCF, the Enhance Integration Framework (EIF), etc. However, these sources so far have been an insignificant portion of the overall foreign assistance outlay. Therefore, Bangladesh should continue to engage with development partners in mobilising resources for productive usage. Bangladesh can partner-up with other graduating LDCs to look for additional support for graduation-related adjustments. In the aftermath of Covid-19, there are opportunities LDCs, graduating LDCs and many other developing countries to demand more resources from developed and relatively advanced developing countries in light of the commitments made by the global community to realise the Sustainable Development Goals (SDGs). As a climate vulnerable country facing LDC graduation challenges with a solid past record of socio-economic progress, Bangladesh will be seen as a credible contender for any development assistance programme of development partners.

Improving absorptive capacity and utilising external resources should also be important priorities. By effectively and promptly utilising the funds accumulated in the aid pipeline, Bangladesh can stage a rapid recovery from Covid-19 induced socio-economic shocks and mitigate any challenges of LDC graduation. Furthermore, improved absorptive capacity and effective utilization of resources can also help development partners to allocate more resources.

10. Non-tax revenues can also boost domestic revenue mobilization efforts.

Non-tax revenues, comprising charges for economic services, profits and dividends from state-owned enterprises and other government organisations, fines and penalties, stamp duties, import and export processing fees, visa fees, tolls from roads and bridges, etc. remain low: around 1 per cent of GDP. The comparable figures for some other countries are: 12.9 per cent in Bhutan, 3 per cent in China, 2.2 per cent in India, 1.9 per cent in the Philippines and 3.7 per cent in Thailand (OECD, 2020).²⁵ The Perspective Plan 2041 has set a target of non-tax revenue of 2.2 per cent of GDP by 2031. A careful assessment and implementation strategy about improving the non-tax revenue situation can be considered as part of enhanced domestic resource mobilisation effort.

11. Decentralizing tax responsibilities to local government institutes can help resource mobilization.

Fiscal decentralization is one way of boosting the revenue mobilization drive. Strengthening the capacity of local government institutions (LGIs) in this respect can play an important role in increasing tax and non-tax revenues (Ahmed, 2020). The LGIs in the urban areas are assigned to collect property taxes while all other tax responsibilities are confined to the NBR. However, due to the absence of a well-defined property taxation system, improper valuation, low tax rates, weak administration, etc. tax revenue collected by urban LLGs remains low. According to the Perspective Plan 2041, if property taxation is designed and implemented properly, LGIs can generate tax revenue in the range of 1-1.5 per cent of GDP against the current level of just 0.16 per cent. The lack of decentralization is considered as a major challenge to the growth of LGI as a major service delivery agency. The expansion in widespread economic activities that Bangladesh has seen over the past decades offers tremendous opportunities for LGIs to be more proactive strengthening their capacity can help improve the overall government revenue.

12. Building public awareness for tax payment should be regarded as a critical ingredient in the overall strategy for domestic resource mobilisation.

Public awareness towards state and social responsibilities can help voluntary tax payment. The government has initiated several awareness building initiatives. For instance, the NBR organizes Income Tax Day, VAT Day, and Customs Day to reward top taxpayers, institutions, and individuals. Tax cards have also been introduced. Regular campaigns through print, electronic and social media, can help build further awareness among taxpayers. This along with a simplified tax-filing system and confronting negative perceptions about unfair treatment and harassment of taxpayers can motivate many enterprises and individuals to come forward with their tax contributions. The government needs ensuring and convincing its citizens that their contribution is being utilized in an effective manner, e.g., in delivering quality public infrastructure and other services while tackling any corrupt practices involving public funds.

²⁵ Information on China has been taken from Zhang, and Huang (2019).

13. The need for a strong commitment toward fulfilling the basic principles of an effective tax system and dealing with political economy factors in driving an effective reform process cannot be overemphasised.

There have been extensive discussions based on international experiences that tax reforms need a strong political commitment and cannot succeed “without reform champions at the highest level” (Ahmed, 2020, p.16). Given the current challenges associated with resource mobilisation, as discussed above, it is most essential to consider some of the most important characteristics of an effective tax system and assess the Bangladesh situation through these lenses. According to the Oklahoma Policy Institute, a good tax system should meet five basic conditions as:²⁶

- *Fairness or equity* (as described above in terms of horizontal and vertical equity) implying that people should pay a fair share of taxes
- *Adequacy* suggesting that taxes must provide enough revenue to meet the basic needs of the society
- *Simplicity* meaning that taxpayers should not be subject to complex form-filling requirements, which should reduce the costs of compliance.
- *Transparency* indicating that taxpayers can access to the information about the tax system, how audit selection is done through a fair process and settled, and how the tax money is used.
- *Administrative ease* meaning that the tax system is not too complicated or costly either for taxpayers or tax collectors.

The relevance of above five basic characteristics needs no further elaboration. Almost all the discussion on tax reform can be related to the above five principles and should be borne in mind in employing various policy option in Bangladesh. Along with this, it is now also recognised that political economy factors can seriously weaken the governance of the taxation system. For instance, Ahmed N (2021), writes, “The persistent weakness of the existing tax system is the product of well-established informal rules, norms, and networks that have served the broader interests of several political, business, and bureaucratic elites (political settlement). This political settlement has ensured predictably low tax rates and the strategic distribution of economic rents despite the existence of widespread corruption, discretion, and informality.” Therefore, any tax reform is likely to be undermined by the persistent political economy forces unless it will be backed by a strong political commitment to institute a taxation system based on the above principles.

V. Conclusion

After sustained economic growth over the past decades, Bangladesh is passing through a dual transition in its development trajectory: from low-income country to lower-middle-income country (officially took place in 2015), and graduation from the group of least developed countries (set to take place in 2026). Bangladesh also aspires to become an upper middle-income country by FY2031 and high-income country by FY2041. With the on-going economic progress, there is the need for increased public investment in various sectors. Historically, the size of public expenditure in proportion to GDP has been much lower in

²⁶ This information can be found here <https://okpolicy.org/resources/online-budget-guide/revenues/an-overview-of-our-tax-system/characteristics-of-an-effective-tax-system/> and for this paper it was accessed on 9 September 2021.

Bangladesh compared to many other countries at a similar level of development. The Covid-19 global pandemic has only exacerbated the widespread demand for public spending in such areas as health, education, social protection, etc. Bangladesh's upcoming LDC graduation is an important development achievement, but it would also bring in new challenges especially the loss of preferential market access and potentially unfavourable prospects for development assistance. Preparing for a smooth LDC graduation should also involve increased demand for public resources.

The tax effort in Bangladesh has been low as the tax-GDP ratio is around 9 per cent, which should double over the next decade if Bangladesh's development aspirations are to be materialised. It is rather striking that despite high tax rates and buoyant economic activities—as reflected in the national per capita income being more than doubled between FY2010-FY2019—the tax effort has largely stagnated. A combination of such factors as an extremely narrow tax net, legal tax exemptions and loopholes, corrupt practices, complexities of tax assessments and collection, inefficient and improper tax audits, political economy factors undermining tax reforms, the presence of a large informal economy, etc. has contributed to weak fiscal performance for Bangladesh.

Going forward, broadening the tax net for both direct and indirect taxation and streamlining the tax administration, through amongst others, faster implementation of automation and digitisation processes are critical for improving domestic resource mobilization. The 8th Five Year Plan provides a list of specific reform measures, effective implementation of which should constitute a major priority. Bangladesh should also have a strong commitment in fulfilling the basic principles of tax reform and tackling political economy factors that prompt rent seeking activities and encourage tax evasion and corrupt practices.

Finally, despite LDC graduation, there are opportunities for external resource mobilization. These must be utilised effectively. Furthermore, improving absorptive capacity of the committed funds from development partners can greatly help Bangladesh address the resource mobilization challenges.

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Annex I: Tax reform for attaining tax targets in the 8th Five Year Plan (July 2020 – June 2025)

Tax reform for attaining tax targets in the Eighth Five-year Plan

Tax Policy Reforms

- Full adoption and effective implementation of the original VAT and Supplementary Duty Act 2012 starting in FY2022
- Incorporating Alternative Dispute Resolution (ADR) in Income Tax, VAT and Custom Acts
- A thorough overhaul and simplification of Income Taxes with implementation in FY2023
- Adoption and implementation of the new Customs Act in FY2022.
- By end of FY2022, introduce a proper system of property taxes with revenues earmarked for local governments
- Starting FY2024, separate tax planning from tax collection.
- Starting FY2024, selection of NBR Chair and the new Chair of the Tax Policy Unit should be done on a professional basis with a 5-year fixed term appointment.
- Provide adequate resources and autonomy to NBR Chair and the Chair of Tax Policy Unit to modernize their respective offices with modern technology, professional staffing and policy and research capabilities.

Tax Administration Reforms: Income Tax

- **Broadening of the taxpayers' base**- This will require monitoring of the ownership of all sizable physical and financial assets of taxpayers and determining the income generation out of those assets.
- **Broadening of the tax revenue sources**- Traditionally there has been an excess dependency on taxing financial institutions and a few large non-financial corporations. The tax department should explore other smaller organizations in the formal sector as well various corporations.
- **Focusing on income from service providers and self-employed (who are difficult to tax)**
- **Treating all sources of income equally for the tax purpose without discrimination for the households.** This would imply taxation of capital gains from land, real estate/housing, and stock market. Wealth accumulation in Bangladesh is primarily happening through accumulation of urban land and real estate, untaxed/low tax income of the rapidly growing RMG sector, and relatively low tax incidence on income through financial instruments. This must change.
- **Automation of TIN registration and linking TIN with National I.D.**
- **Integrated Revenue Management Programme: Business Process** an integrated revenue management programme seeks to connect the three departments at transactional level by linking the taxpayer identification numbers i.e. TIN and BIN in the database. The methodology for setting up such an integrated system is to first centralize the database and transaction processing of the three departments at one location and then to build an information system that can mine data in the three databases and thereafter process the same for exception reports. The integrated revenue management programme will enable the desired flow of information and consequent synergy among the three tax wings of the NBR.
- **Integrated Revenue Management Programme: Digitalization Programme** This programme will seek to set up a country-wide integrated ICT platform to capture all tax payment information from tax returns, banks, TDS detectors, third party collection agencies etc. The integrated revenue management system will also receive third party returns i.e. TDS returns, Annual Information Returns (AIR) etc. and generate MIS reports, exception reports etc. Under this programme, a Central Processing Centre is to be set up for processing all Income-tax and VAT returns, whether e-filed or paper filed at one integrated processing centre.
- E-Filing of income tax returns and online payments. To enable this, the tax form will be simplified, and the wealth statement requirement will be deleted for certain income threshold. NBR tax account will be opened up with selected banks to send online payments.

- Aggressive imposition and expansion of withholding taxes, particularly on individual taxes which could potentially improve tax compliance, expand the income tax base and address administrative issues pertaining to tax collection efforts through increased transparency and efficiency.
- Strategic Communication and Taxpayer Outreach, Education and Assistance Bangladesh has a very narrow tax base and a very small percentage of the population bears the burden of taxation. Most of the direct tax revenues come from tax deduction at source (TDS) whereas a large percentage should be coming from corporate tax as well as from businesses and professions through advance tax (PAYE). The logical inference is gross under reporting or non-reporting from various eligible categories. The taxpayer education programme will make available a menu of offerings through remote outlets like websites, internet etc. as well as through customers facing one to one or group interface with the NBR Customer Service Wing.
- Selective and productive audits: Institute an audit system where only a limited number of tax cases will be audited based on computer- based criteria. The system will be designed to be highly productive in terms of revenue collection and low-cost of collection in terms of staff time.

Tax Administration Reforms: VAT and Custom

- Implementation of the new VAT Act.
- Expanding VAT base especially on businesses and organization.
- Incentivizing VAT payment with benefits for small businesses to bring them into the VAT coverage as well as promoting increased formalization of businesses currently operating in the informal sector.
- Reform of the VAT administration along functional lines
- Automation of the whole tax administration through Central Data base including Central VAT Registration; electronic submission and return processing
- Comprehensive taxpayers' education and information campaign about the new VAT law and Rules.
- Selective and productive audits as in the case of income taxes

Source: Adapted from 8th FYP.