

This Year's Budget Some Fundamental Reform Issues

by Abdur Rah

THIS year's budget can perhaps claim to have made some departure from most earlier ones in some respects. First, it attempts to address numerous tax reform issues with an earnestness which has not usually been seen in this country. Second, at the same time, it also seeks to raise as much revenue as possible, and, in the process stipulates one of the largest increases in tax revenue in Bangladesh's history. Third, it offers substantial tax incentives to import substitution industries and subsidies to export industries. For all these reasons, the Finance Minister and his supporting staff in the Government — especially the National Board of Revenue — can, at best, with some qualification, claim a legitimate credit. The budget proposals seem, by and large, to have been more enthusiastically welcomed by the business community this year. The following is a brief review of the budget proposals and of some of their implications.

The Finance Minister in the concluding section of his speech has underlined the special significance of this year's budget. However, whether he has succeeded in presenting a budget which represents a serious attempt on his part to meet the challenges of the coming millennium is a question that is debatable or at best not clear enough. Let me elaborate.

Some of the tax reform proposals such as those to simplify income tax administration and minimize tax officials' discretionary powers, introduction of a mandatory pre-shipment inspection (PSI) system, rationalization of customs duty rates by unifying rates within certain customs heads, some reduction of the maximum duty rate, rationalization of the VAT on imports and domestic products to make it trade-neutral and several other reform proposals are very welcome for proposed changes. The PSI system, which will replace administratively predetermined "tariff values" will be well in accord with the Uruguay Round Agreement which, under the Agreement on Valuation of Imported Goods, requires Bangladesh to shift to using actual transaction values for valuation of imports by the year 1999. The Finance Minister himself has admitted that introduction of the PSI will result in lower import values, an admission which reflects the truth that such tariff values have so long essentially served to provide additional protection to domestic industries, a feature of the import tariff system which was not economically desirable. To counteract the possible revenue loss which may follow from the PSI introduction, additional supplementary duties have been proposed. This is not to be abhorred, since supplementary duties are also trade-neutral in their effects, if appropriately collected from both imports and domestic products. The supplementary duties can, of course, be open to criticism if the rates are excessive. These proposed changes are in the direction of preparing Bangladesh to face the millennium challenges. But these do not go far enough.

The reduction of the maximum customs duty rate by only 2.5 percentage points to 37.5 per cent makes little departure. It could have been brought down to at least 35 per cent, as in Pakistan. Bangladesh should take lesson from South East Asian and Latin American countries which have liberalized trade at a much faster pace and shown a higher long-term growth performance (leaving aside the short-term aberrations or shocks that resulted from the financial and currency turmoil). It is not clear for how long the infrastructure development surcharge of 2.5 per cent which was presumably introduced as a temporary measure, will continue. This surcharge on imports, an additional protective element, was inappropriate in the first place and should have been withdrawn by this budget. The large-scale reduction of duties on industrial raw materials and intermediate inputs have been highly welcomed by the business community as well as by opposition groups. However, this measure misses one impor-

tant reform issue. Lowering the duties on inputs without not proportionately lowering those on outputs increases tariff dispersion and increases effective protection to domestic industries. Such duty reductions on the inputs that largely go into export production are quite appropriate. But duty reductions on the inputs of import substitution industries are not at all desirable. Such tariff reductions unnecessarily increase tariff escalation and put Bangladesh further behind in the process of trade liberalization.

No elaborate exercise has gone into the implications of these tariff escalations and it is most likely that many of the industries which are beneficiaries of such tariff reductions have been provided with excessive levels of effective protection. Let me illustrate this point by giving two simple examples with simplified assumptions. Products which are protected by, say, a tariff of 42.5 per cent (37.5% CD + 2.5% license fee + 2.5% IDS) on the finished product and 10 per cent tariff (5% CD + 5% LF and IDS) on its raw materials and other intermediary inputs will enjoy an effective protection rate of as much as 118 per cent (Bela Balassa method, with a 30 per cent world-priced value added to output ratio). In another case, with, say, a 20 per cent total tariff (15% CD + 5% other tariffs) on the finished product and no tariff on inputs, the resulting effective protection will be, on the same basis as in the first case, 67 per cent. Note that in both cases the effective protection is considerably higher than the nominal tariff rates on the products.

The revenue reductions in the short run that are likely to be faced by such tax rate reductions will be more than compensated in the long run by growth in the economy. In the current industrial scenario with a low growth record, a very dull and sagging stock market and low investment growth, some such major stimulants are needed to reinvigorate the industrial sector.

With such cascaded tariffs on inputs and outputs, it can be shown that resulting effective protection rates will vary widely across industries and the variations will depend not only on the differences in tariffs on outputs and those on inputs but also on the differences in the value added proportions of industries. Such variations in resulting effective protection rates which determine policy-created profitabilities for industries thus provide discriminatory incentives for different industries and are thus not only economically undesirable but also socially inequitable and unjust. Such practices have been discouraged by the Uruguay Round Agreement. This populist policy stance has been the tendency not only with the present Government, but was also practiced by previous Governments. Bangladesh has, however, no alternative policy option except to sufficiently liberalize imports by lowering the overall level of tariffs and rationalizing tariffs toward a more uniform structure to create a more conducive environment for more rapid and diversified export growth as well as for more efficient and rapid industrialization. Even though the Finance Minister states that "inward-oriented policies have become anachronistic in the context of the globalized world today", the proposed tariff changes are, by and large, essentially inward-oriented.

The Finance Minister has sought to be outward-oriented by offering subsidies to certain sectors. An allocation of Tk 561 crore has been proposed to provide subsidies and financial assistance to exports of some specified industries. A subsidy at the rate of ten per cent on jute goods will be continued and new subsidies of similar levels will be provided to ex-

ports of selected leather products, quilts and fresh and artificial flowers. For a poor cash-strapped economy such as Bangladesh which faces an uphill task to mobilize financial resources for public expenditures, and especially in a situation where the Government finances its expenditures with a growing borrowing from banks, the wisdom of a policy of subsidizing exports is highly questionable. If subsidies cannot, and will not, be applicable uniformly across all export goods, their application to specific products is both socially and economically unjustified. Such subsidies have no intrinsic economic merit if they fail to serve the intended purpose, i.e., to increase the exports of the subsidized products. Subsidies are inefficient measures as these cannot always be targeted appropriately. In the past as well, Bangladesh provided substantial subsidies to jute goods, but to no effect. Such subsidies failed to avert the historical steep decline in jute goods exports. It is not clear either whether the current subsidization of jute products is really helping such exports as these further went down during the last year.

The Uruguay Round Agreement allows Bangladesh, as a least developed country (LDC), to freeze subsidies at the 1986-88 levels for agricultural products. Since Bangladesh did not provide subsidies to any export products during that base period, it cannot newly introduce any subsidies for any agricultural products such as fresh flowers. Other products proposed to be subsidized are in the industrial category. Bangladesh, as an LDC, seems

to be allowed to provide subsidies to such manufactured goods, according to WTO rules, but it is hardly clear if Bangladesh should go for such subsidies. To vigorously promote exports, Bangladesh should rather further liberalize imports and rationalize exchange rate policy and at the same time address the problem of reducing transaction costs of doing business by improving necessary infrastructure and institutional facilities for ensuring efficient marketing and transportation facilities, reducing port congestion and handling costs, and ensuring uninterrupted power supplies and communication facilities.

Rationalization of the exchange rate is of immense importance to exporters and helps also producers of domestically marketed products. The exchange rate policy is one area where Bangladesh clearly seems to be lacking forward-looking vision. It has been following an extremely archaic and conservative exchange rate policy even in the event of wide swings in the currencies of other countries. It has been ignoring the fallout it has indirectly received from the currency turmoil in South East Asia, a fallout the pinch of which is being felt by the exporters in the form of low international prices and lost competitive edge to competitors whose currencies have fallen. Nor does it seem to have given enough attention to what has happened to the currency of neighbouring India with which Bangladesh has a large and growing trade deficit in official trade and from where smuggling on a wide scale has remained unabated. The authorities seem to be hardly realizing what appreciation of the Bangladesh Taka costs to the economy in terms of lost growth of the traded sec-

tors of the economy. I do not intend to elaborate this point further here. (For details on this point, see the author's earlier article which appeared in The Daily Star of November 24, 1998 under the title 'Managing the Exchange Rate: What's Wrong With Periodic Devaluations?').

The Budget Speech mentions the devaluations undertaken in the current year and the last two years, which ranged between only 4.4 per cent and 5.7 per cent. Such mini-devaluations just scratched the surface in the event of major slides in the currencies of several countries competing with Bangladesh in the export market. Suffice it to say that such a conservative exchange rate policy has not paid — has not been conducive to rapid export growth, or for that matter, to overall growth of the economy — in the current Bangladesh situation where the government follows independent monetary policy, incurs large budget deficits substantially financed by domestic borrowing, and where there are downward rigidities in wages and prices of other non-traded goods and services, where improvements in labour and capital productivities are absent or low and where, and not unimportantly, the financial sector is bedeviled by a large and growing amount of unrecovered bank loans.

Questions have been raised from several quarters about the wisdom of stipulating 22.5 per cent increase in revenue in FY 99-00 from the realized (revised) revenue in the current year. Even given that the current year has been an abnormal one, considering the flood effects, the figure does not seem to have been amply explained in the Budget Speech. Of the total stipulated net revenue increase of Tk 2,650 crore, as much as Tk 1,600 crore has been expected to come from autonomous growth of revenue. But it is not clear how this big autonomous growth will materialize — how much from industrial and import growth, and how much from possible devaluation effects. Also importantly, what impact the tax and revenue growths are expected to make to tax to GDP and revenue to GDP ratios is an important issue to consider. Even by standards of other low-income developing countries, these ratios have remained at low levels (respectively at about 9% and 12%) and clearly need to be raised over time. If this year's budget succeeds in raising these ratios, it will be a commendable achievement.

Proposed simplification of income tax procedures and substantial expansion of the VAT base are very welcome steps. To stimulate investment and industrial growth, some desirable changes such as exemption of dividend income up to Tk 30,000 and introduction of 10 per cent withholding tax on interest income on Savings Certificates are also proposed. The latter does not seem in view of the fact that taxation of dividend income results in double taxation of income coming from the same source, i.e., corporate income which is already taxed at the corporate level, complete exemption of dividend income would have been economically even more desirable. Greater direct and indirect tax incentives will be of real worth to industries. Other such incentives will come from lowering of the corporate tax rate and the VAT rate.

Corporate and VAT tax rates are high in Bangladesh compared to those in some of the South Asian countries. Corporate tax rates should be unified and lowered to 25 per cent, the highest marginal rate that is applied under personal income tax. The VAT rate should be substantially reduced to something like 10 per cent. The rate is even lower in Thailand. The revenue reductions in the short run that are likely to be faced by such tax rate reductions will be more than compensated in the long run by growth in the economy. In the current industrial scenario with a low growth record, a very dull and sagging stock market and low investment growth, some such major stimulants are needed to reinvigorate the industrial sector.

The author is an independent economic consultant

Liberation and Beyond

by J N Dixit

(The Daily Star is serialising extracts from the book through exclusive contract with University Press Limited (UPL), publisher of its Bangladesh edition.)

War and the Birth of Bangladesh Part-II

THE Polish and Soviet resolutions which generally supported Bangladesh's cause and the Indian stance received similar veto treatment from the Western permanent members of the Security Council. It is only when the war reached the concluding stage between December 12 and 14 that some resolutions in the Council such as those moved by France began to refer to the need for a political settlement and a response to the Bangladeshis' aspirations. The broad outcome was that because of India's close relations and strategic equations with the Soviet Union, which were bolstered by the Indo-Soviet treaty of August, 1971, the Security Council was prevented from taking any mandatory, punitive action against India that could have frustrated the liberation struggle. Had there not been a Soviet veto, President Nixon's pro-Pakistan tilt would have found expression in a Security Council initiative which would have aborted the Bangladesh freedom struggle and resulted in a monumental strategic setback to India.

This assessment is partially based on my experience as Secretary to the Indian delegation at Security Council meetings throughout December, 1971. It was the polemics of the Security Council debates and the tactical political moves made by India and Pakistan which lent a sense of drama to the discussions on the East Pakistan crisis. Half way through the debate, some time between December 9 and 12, the Chinese permanent representative, Huang Hua, while reacting to the Soviet veto on one of Beijing's resolutions, indulged in ideological polemics and criticised the Soviet Union. He questioned the Soviet Union's socialist credentials, condemned its inability to sustain socialist solidarity in the world and accused Moscow of supporting India's hegemonic motivations. Jacob Malik's response was witty. I recall that after he had answered all the points of criticism he told Hung Hua that the Soviet Union had no complexes about its socialist identity. It is China which should do some introspection. Malik said China had once sent an emperor to Russia (the reference was to the last Ming emperor who went to Manchuria that had come under Soviet control) whom the Russians transformed into a librarian and sent back home where he did useful work as a Chinese citizen. The contrast was that the Russians once again sent a Chinese back home after training him in library science (a reference to Mao Zedong) and China catapulted him to be an emperor, full of whims and fancies. Which country was then genuinely socialist... Malik wondered.



The savage killing by the occupation forces.

Swaran Singh arrived in New York on December 10 for the Security Council debate. He told us that he wanted to make a substantive and strong statement at the Security Council on behalf of the Government of India. The task of preparing the first draft of the speech was entrusted to me and CV Rangnathan, then first secretary in our permanent mission at the UN, and later ambassador to China and France. Both of us laboured on the speech and prepared a compressed, and to the point, peroration. Swaran Singh took one look at the draft and declared that it will not do. He said we must prepare a long speech covering the entire history of the alienation of the people of East Pakistan from their parent country. He added that he proposed to speak for at least two days beginning on December 12. We, accordingly, prepared a long speech which ran into 20 printed pages. The statement had an amplification section which ran to another nine printed pages. Swaran Singh delivered this speech on December 12 and 13. Once in a while he insisted on consecutive rather than simultaneous translation. The Security Council is the only forum where a delegate can demand that his speech is sequentially translated in four official UN languages from the language in which he is speaking, not allowing a simultaneous translation. This is allowed because of the seriousness of the issue the delegate is speaking on. The obvious result is that the speaker gains time.

By the morning of December 14 local time in New York it was clear that the military conflict would end in another 12 to 24 hours. We asked Sardar Swaran Singh why he was insisting on a long speech which might cause a distraction in the Security Council members' attention from the issue. His response was that he had to ensure such a drift because his main objective was to gain sufficient time for India to bring the conflict to a decisive end without being thwarted by any Security Council decision. His political assessment about this obstacle was accurate, as it was obvious by December 11-12 that patience was wearing thin at the United Nations. Even the Russians had started urging India to end the conflict quickly as they felt they could not continue their opposition to the West's moves at the UN for very long.

As events progressed towards the defeat and surrender of the Pakistan army in Dhaka the Security Council met on December 16. Zulfikar Ali Bhutto who was leading the Pakistan delegation at the Council was vitriolic in his denunciation of India. In view of the time difference between New York and the sub-continent, Sardar Swaran Singh received information about the surrender at Dhaka some time during the morning of December 16, local time in New York. He addressed the Security Council giving information about the surrender and also India's decision to declare a unilateral ceasefire on the Westernfront from 8 pm Indian

Standard Time on Friday, December 17, 1971. He urged the Security Council to ensure that India's unilateral ceasefire declaration is respected and implemented. Zulfikar Ali Bhutto, sitting three to four yards from Sardar Swaran Singh at the right hand edge of the circular conference table, tore up all the Council documents in front of him, fumed and accused India of violence and aggression and declared that Sardar Swaran Singh had blood-stained hands. He then asserted that the Security Council can not play any useful role when the vital interests of member countries are affected. Bhutto then walked out of the Council meeting. The permanent representative of Pakistan, Aga Shahi, had the presence of mind not to walk out because he realised that this was the moment when Pakistan needed international support and sympathy. He continued to hold his seat till the Council was adjourned.

The surrender at Dhaka took place at 4:30 pm on December 16, 1971 at the Race Course Maidan. Lt. General Niazi signed the Instruments of Surrender while Lt. General Aurora signed the documents accepting the surrender. There was some drama preceding the surrender ceremony to which I will come later. To come back to the UN. As the Security Council meeting was coming to an end on December 16, Sardar Swaran Singh passed on a note to Foreign Secretary TN Kaul saying that he wished all the Indian delegates to meet him in the lounge outside the Council Chamber immediately after the meeting is adjourned. We were all curious about the purpose of this meeting. Sardar Swaran Singh came out and explained that the purpose was to convey two or three very precise instructions which we were to follow strictly. He said that no Indian delegate should be seen at the bar in the delegates lounge in the coming 48 hours. He also cautioned us not to be boastful or jingoistic in our conversations with other delegates about the victory of the Indian army and the liberation of Bangladesh. He said we must limit ourselves to responding to inquiries instead of holding forth on our own on the events in the sub-continent. He stressed that in our responses we should underline that the break-up of Pakistan was a tragedy, that the cause of the tragedy was entirely the unreasonableness of the Pakistani military regime, that India's support to the liberation struggle was unavoidable and that our declaration of unilateral ceasefire in the western theatre of war was proof that India had no aggressive designs on Pakistan.

We were all impressed by his political sensitivity and foresight as indicated by these instructions. The prescription which he gave could still apply to similar events and moments in history.

One incident in the military operations preceding the surrender of the Pakistani forces at Dhaka, is worth mentioning. The Cabinet of the Government of East Pakistan was summoned for a meeting by the Governor of East Pakistan around December 13/14 to decide on measures to counter the increasing and imminent pressure of Indian military advances. The Indian military intelligence received advance information about this meeting and its timing. The meeting was to be held in the large conference room in the left wing of the building as one faces it from the main gate of what later came to be known as 'Banga Bhawan' Indian Air Force jets carried out a precision rocket attack on this room a few minutes before the meeting was due to begin. No other part of the building was damaged. I saw this room soon after the surrender on December 16. The rockets hit and extensively damaged only this room and its conference table. My Bangladeshi friends told me later that this air operation specially unnerved the East Pakistani rulers and perhaps hastened a quick response to the Indian call for unconditional surrender.

To get back to the UN once again, it would be pertinent to mention that there was a direct message from General Niazi to the UN Secretary General on December 11 or 12, that a ceasefire be immediately demanded under the aegis of the United Nations, and that Pakistani armed forces be evacuated by ships and planes arranged by the UN. The message was signed by Major General Rao Farman Ali, Niazi's political adviser and Chief of Staff. His message did not have any formal endorsement from president Yahya Khan. In any case the conflict was in its last stages during the week of December 10 to 17, 1971.

The last act of the play at the Security Council meeting was the adoption of a resolution (No. 307 of 1971) on December 21, 1971. Taking note of the cessation of hostilities, the Indian declaration of unilateral ceasefire and Pakistan's acceptance of the ceasefire, the Security Council demanded that the ceasefire be made durable! It recommended the withdrawal of Indian and Pakistani forces from either country. It called upon member states to refrain from any action which might aggravate the situation in the sub-continent or endanger international peace. This particular clause was perhaps a signal to Pakistan and China that they should not join together to revive the conflict. I call this resolution 'a play' because throughout the East Pakistan crisis the UN, virtually subject to super power politics, failed to comprehend its seriousness and took no initiative to address the substantive issue, that is fulfillment of the political aspirations of the people of East Pakistan. Nor did the UN or the Security Council take any step to stop the genocidal military operations of the Pakistan army against the people of Bangladesh. Even as the Council dealt with the issue, the division of opinion was purely along strategic and cold war lines. In a manner this helped India carry through its policy of supporting the freedom struggle with Soviet support. But the most significant lesson which Indian learnt again (a lesson previously discerned from the manner the UN dealt with Pakistani aggression in Kashmir) was that the UN cannot play an effective role in resolving political crises on merits of any issue unless there is consensus among the five permanent Council members. Without such a consensus the UN remains marginalised and ineffective. The lesson is still valid in terms of the UN's post-cold war responses to crisis situations.

It is time to move to events in India and Bangladesh between December 3, 1971 and January 9, 1972. The day after the afternoon shed in the history of Bangladesh because it was on the afternoon of January 9 that Sheikh Mujibur Rahman returned to Dhaka after a period of nearly nine months. During the course of his long period of imprisonment in West Pakistan he was on the brink of execution by the military authorities more than once.

(Continued)

Kashmir Crisis: Wanted Leadership, Not Platitudes

by Benazir Bhutto

Less than a hundred days ago, G-8 leaders applauded the Lahore Declaration, when much optimism was expressed of a breakthrough in relations between the two countries.

THIS weekend the leaders of the G-8 nations rightly expressed deep concern about the worsening conflict over Kashmir. While sentiments that India and Pakistan must cease the fighting and resume dialogue are welcome, now is the time for the international community to take direct action and do for Kashmir what was done to resolve Northern Ireland and the Middle East.

The Kashmir conflict has gone largely unnoticed, lost in the shadow of Kosovo. For world peace and security, however, the Kashmir conflict should be cause for heightened concern and heightened action, not communitaries.

Since May 9th, the two sides have fired thousands of rounds of mortars across the Line of Control, killing and wounding thousands and causing over 100,000 people to flee their homes. This is the most destabilizing tension in the region in over 30 years.

The larger geostrategic context of this conflict cannot go unheeded. Just one year ago, both India and Pakistan shocked the world when they detonated nuclear devices. Both countries proudly proclaimed that nuclear capability, acting

as a deterrent, would prevent war over Kashmir. That threat is being severely tested in the snow-bound Kargil sector, where artillery and MIGs have pounded positions since mid-May, with both sides sending tens of thousands of troops to the border region.

The two countries have gone to war three times in fifty years. One of those wars led to the dismemberment of Pakistan. Less than a hundred days ago, G-8 leaders applauded the Lahore Declaration, when much optimism was expressed of a breakthrough in relations between the two countries. But the Lahore summit was more style and less of substance. It lies in tatters lost in the blood-soaked snows of Kashmir.

In fact, during the last two years all the talks of peace have rung hollow as India and Pakistan marched down the dangerous road of war. Dreams of a nuclear-free zone in South Asia or a zero-missile regime evaporated as India and Pakistan embarked on testing eleven nuclear devices between them - and testing nuclear capable missiles with the potential to carrying nuclear warheads deep into each other's territory. In spite of the so-

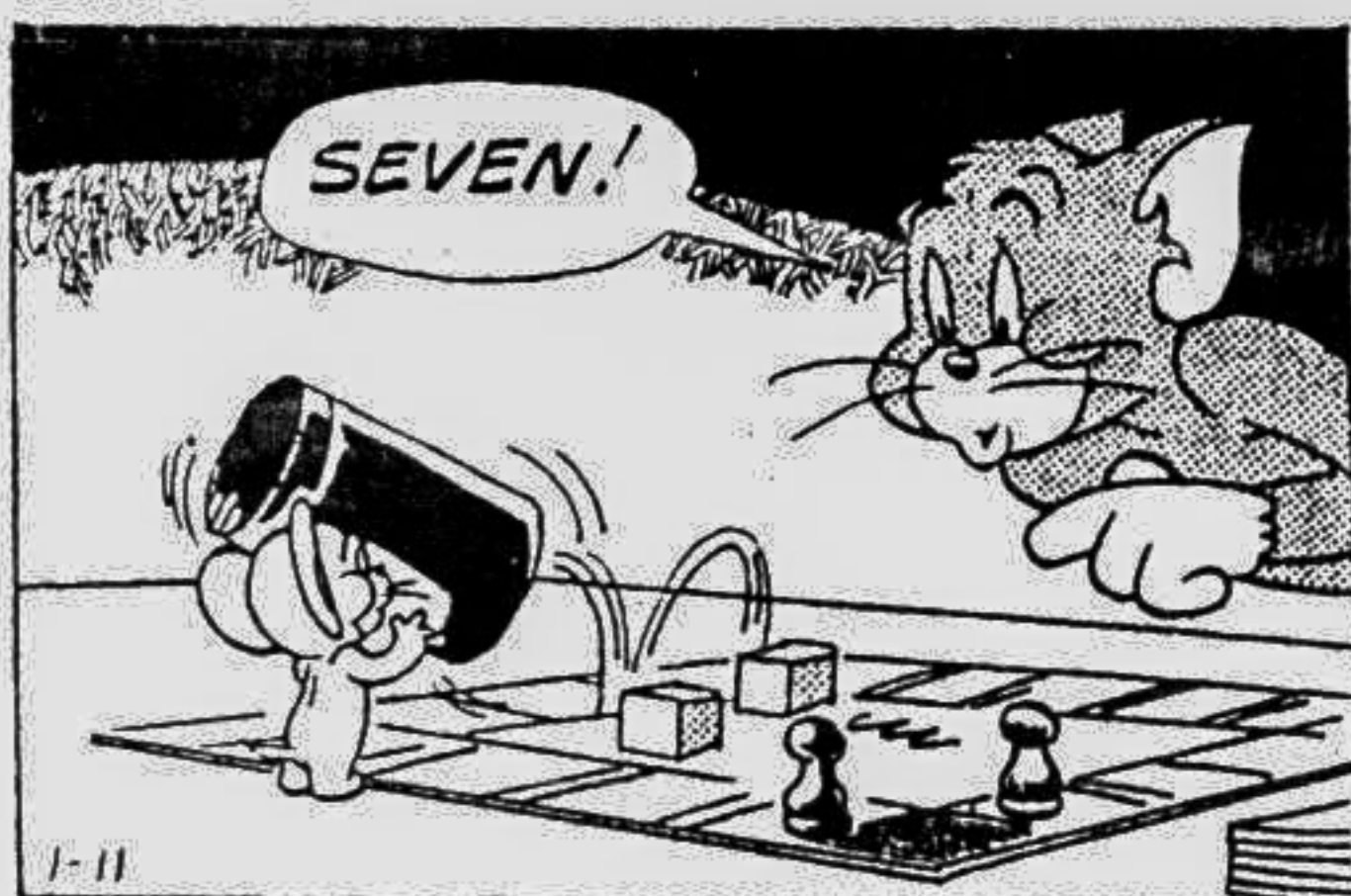
called nuclear deterrent, open warfare has broken out. Talks between India and Pakistan, while welcome and urged by the world's leaders, inspire little confidence. The last round on June 12th is a case in point, whereafter only one hour, the foreign ministers cut off talks with heightened animosity, not less. The agendas of the two nations are widely divergent. India wants Pakistan to ensure that the Kashmiri Mujahideen retreat from the positions across the Line of Control, as the cease-fire line is called. Pakistan says that while it has sympathy for the Kashmiri Mujahideen, it lacks control over them.

Muslim militants have already declared the talks between the two countries a "conspiracy". Who are they (Pakistan) to deal on our behalf? the spokesman for one of the groups, the Lashkar-e-Tayyaba, has asked.

As Pakistan's leader of opposition, I have urged a series of moderating steps, including a suggestion that the five permanent members of the Security Council broker a cease-fire in the region and initiate a peace process bringing together Pakistan, India and the representatives of the Kashmiri people.

The author is former prime minister of Pakistan. This piece was published June 24 issue of The Dawn of Pakistan.

TOM & JERRY



James Bond



By Hanna-Barbera

