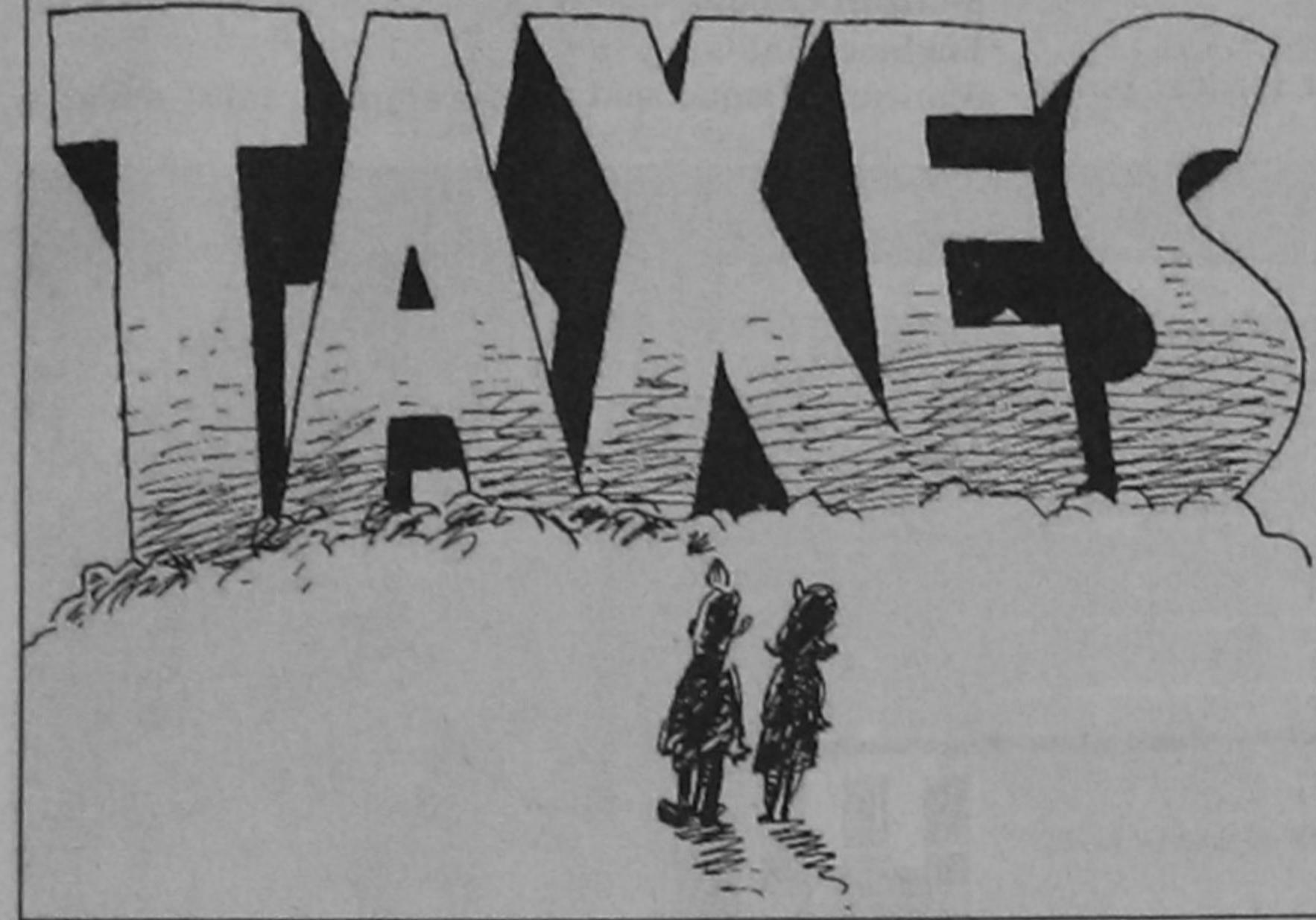


An anatomy of pre-budget discussions

Some special concessions may have to be provided in the tax regime to contribute to the achievement of some socio-economic objectives; but these have to be time-bound and performance based.



MIRZA AZIZUL ISLAM

THE preparation of the 2009-10 budget must be in top gear. Bangladesh has developed a tradition of holding pre-budget discussions with a wide range of stakeholders. Representatives of the business community, academia, journalists and civil society are invited to such discussions.

The finance minister has already held several rounds of meetings. I held similar discussions in each divisional headquarter also. The suggestions offered are

numerous, running into hundreds.

The scope of this paper does not permit enumeration of all suggestions; however, I present below some of the important ones as samples, especially in light of discussions while preparing the 2008-2009 budget.

Income and other direct taxes

- Raising exemption of personal income tax to Tk 2,50,000; highest rate to be reduced to 20% for income above Tk 10 crore.
- Exemption limit of women entrepre-

neurs and senior citizens to be fixed at Tk. 3,60,000 and Tk. 4,50,000 respectively.

- For companies; assessed income not exceeding Tk.1 crore to be taxed at 20% for listed companies and 25% for unlisted; rates for income above Tk.1 crore should be 25% and 30% respectively.
- Commercial undertakings of NGOs, if listed, should be taxed at 35%, if not 45%.
- Scope of industries/products for tax holiday to be increased -- duration of tax holiday should be longer.
- Extension of benefit of tax holiday for foreign investment in infrastructure.
- Tax holiday to cover not only new undertakings, but also expansion.
- No questions to be asked for investment in purchase of land, buildings, apartments and cars, investment in government bonds, BMRE, loan repayment, investment in capital market etc.
- Reduction of fines for delayed submission of tax returns.
- Raising allowable investment allowance and the rate of tax credit.
- Exemption of dividend income, if reinvested.
- Subcontracting factories relating to RMG to be exempted.
- Reduction of tax rates for insurance companies.
- Inclusion of banks and insurance companies in the differential between listed and unlisted companies.
- Exemption of all expenses in connection with ISO certifications, improvement of product standards and research and development, royalty and technical know-how.

Customs duty

- The basic rates of duty should be 1% for capital goods and raw materials, 5% for intermediate goods that are not produced domestically and 12% if there is domestic production, and 25% for finished goods with enhanced supplementary duty.
- Specific duty on selected industrial raw materials.
- Exemption of duty on capital machinery and intermediate goods for a sizable number of specified industries.

Value added tax

- Increase in the number of sectors to be subjected to flat rate of 4.5 percent tax.
- For the purpose of exemption/reduced rate of VAT for SMEs, capital and turnover criteria should be redefined as Tk. 25 lakh and Tk. 50 lakh respectively from Tk. 15 lakh and Tk. 24 lakh.
- Withdrawal of VAT at import stage on trucks, pick-up vans and other vehicles in CKD condition.

It will be seen that most of the suggestions received fall in the following categories:

- (a) erosion of tax base, (b) reduction of tax rates, and (c) greater differentiation of tax rates by source and use of income, nature, size and geographical location of industries, and end-use and nature of particular products.

Public expenditure

Suggestions with respect to government expenditure usually relate to enhanced allocation for agricultural development, food security, employment generation, energy (gas, electricity etc.), infrastructure (transportation, port development) human resources development, SME, IT, R&D and cash incentives for priority sectors.

Government borrowing

In this respect, economists often suggest strict limits on government borrowing, particularly from domestic sources, to ensure adequate flow of credit to the private sector. They also suggest that while the government should seek external assistance, no conditionality should be accepted.

Concluding observations

This brief resume of suggestions emanating from pre-budget discussions makes it abundantly clear that these do not constitute a coherent whole to facilitate macroeconomic management.

Nevertheless, such discussions are useful in three ways:

First, the tax regime in Bangladesh is quite complex. The discussions are useful in extending the perimeters of the finance minister's personal knowledge of many details, which would not otherwise come to his attention.

Second, the complexity of the tax

regime sometimes generates anomalies at product or sectoral level. The discussions provide a sound basis for correcting such anomalies.

Lastly, the discussions are particularly helpful in identifying and amending rules and practices of tax administration which create complications for tax payers, vest tax officials with unwarranted discretionary powers and open opportunities for corruption.

From the point of view of macroeconomic management, budget preparation should be guided by the following principles:

- Bangladesh should be ashamed of having the lowest revenue-GDP ratio in Asia. The country has to improve its performance in this respect.
- Some special concessions may have to be provided in the tax regime to contribute to the achievement of some socio-economic objectives; but these have to be time-bound and performance based.
- The greater the differentiation in tax structure, the greater the opportunities for misuse by both tax payers and tax officials and consequently greater scope for corruption.
- Perpetually low import duties on capital goods and intermediate products in combination with high duty on finished products encourages inefficiency and militates against domestic production of capital goods and intermediate products.
- Allocations for public expenditure should be consistent with available resources and should be properly utilised.

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Double standards

Roger Cohen of the New York Times, himself a Jew, commented recently, Israel "has walled, fenced, blockaded, and road-blocked the roughly 4 million Palestinians in the West Bank and Gaza into a pitiful archipelago of helplessness."

CHAKLADER MAHBOOB-UL ALAM

ACCORDING to the United Nations charter, all member nations are pledged to achieve "universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language or religion."

In the 1948 Universal Declaration of Human Rights, the UN again called for the acceptance of all "human beings as free and equal in dignity and rights."

Unfortunately, since then in spite of these lofty ambitions, the world has seen innumerable violations of human rights in different parts of the world. The 2001 World Conference against Racism, held in Durban, was a major attempt to address this issue, but it turned into a rancorous event because of clashes over the legacy of slavery, colonialism, and Israeli treatment of Palestinians.

The US and Israel walked out of the conference because basically they did not want the subject of Israel's racist practices against the Palestinians to be discussed at all at the conference.

The primary objective of the 2009 World Conference against Racism held recently in Geneva was to review the progress made in this field. But even before the start of the

conference it became clear that instead of making progress, the world may have actually regressed on this issue.

Fearing that the subject of Israel's racist policies would again come up for discussion, the US, Israel, Canada, New Zealand, Germany, Italy, Sweden, the Netherlands, Poland, and Australia announced that they would not participate in the conference. The subject, of course, came up.

The speech made by Iran's president Mr. Ahmedinejad accusing the Israeli government of being a racist government, provoked a walkout of 23 European countries, because, according to them, it was a hate speech without substance. (Most of them came back later.)

While Ahmedinejad may be accused of occasional verbal incontinence, this time, his statement was based mostly on facts. He said: "In compensation for the dire consequences of racism in Europe, they helped bring to power the most cruel and repressive racist regime in Palestine."

Leaving aside the destruction of Jerusalem in the year 70 A.D. by the Roman legions which effectively swelled the number of Jews in the Diaspora (many of whom were forcibly brought to Europe by Rome), it was Europe's deep-rooted anti-Semitism which was the principal cause

for the rise of Zionism as an international movement and the subsequent creation of Israel on Palestinian land.

Violent acts like mass expulsions, inquisitions and pogroms affecting the Jewish people have taken place in Europe for many centuries. As a result, it was during the latter part of the nineteenth century and the first half of the 20th century that international Zionism was conceived, a collective feeling of guilt took root in the European conscience, and the Balfour Declaration (1917) was made promising the establishment of a Jewish homeland in Palestine. After the end of the First World War, at the San Remo conference of the Allied powers (1920) the Balfour Declaration was confirmed and the Palestine mandate was given to Britain. The rise of Nazism in Europe and the magnitude of the horror of the Holocaust enhanced the sense of guilt in the European conscience.

After the end of the Second World War, in order to soothe this guilty conscience, the European leaders together with the US decided to implement the Balfour project by establishing a haven in Palestine for the Jewish survivors of the Holocaust without taking into consideration the inherent rights of the Palestinians who had been living there for centuries.

Thus, with the crucial support from the United States, on May 14, 1948, the state of Israel came into existence. From a European point of view, it is not pleasant to hear that racism as practised in Europe for centuries played a significant role in the creation of Israel, but this unfortunately is the bitter truth.

Since the end of the 1967 war, Israel has

pursued a policy of racism and ruthless colonisation of the rest of Palestine (only 23% of original Palestine). In fact, it has built an apartheid state. It has dotted the whole of the West Bank with hundreds of garrison-like settlements, fenced highways connecting the settlements (for settler use alone), watchtowers and innumerable checkpoints where Palestinian men, women, and children suffer daily humiliations. The separation wall built on Palestinian lands, delves deep into Palestinian territories and snakes through the West Bank to include the major Israeli settlements.

According to Noam Chomsky, in comparison with the ghettos in the West Bank where the Palestinians live, the Bantustans of apartheid era South Africa looked "like symbols of freedom, sovereignty, and self-determination."

Roger Cohen of the New York Times, himself a Jew, commented recently, Israel "has walled, fenced, blockaded, and road-blocked the roughly 4 million Palestinians in the West Bank and Gaza into a pitiful archipelago of helplessness."

This abominable situation dismayed a group of Holocaust survivors to such an extent that they published a manifesto decrying Israel's descent into a "quagmire of violence, brutality, disrespect for human rights and contempt for human life." I wonder what more proof is required by the West to convince itself that Israel has become a racist state.

The current government of Israel has

provided further proof of its racist inclinations. The new prime minister not only refuses to accept the very notion of Palestinian statehood, but now has come

At the centre of the storm

up with a demand that prior to any peace negotiations, the Palestinians must recognise Israel as a Jewish state.

The new foreign minister, who lives in one of the West Bank settlements, campaigned on the need of a loyalty oath to Israel as a Jewish state from all Israeli Arabs as a condition for Israeli citizenship. Those who refuse to do so would lose their citizenship. During Israel's bombardment of Gaza in December, he even insinuated that Israel should drop nuclear bombs on Gaza.

It seems that his intention is to continue with the 42-year occupation of Palestinian land indefinitely and further consolidate the apartheid system by building more Jewish settlements.

I have difficulty in understanding the

Western boycott. While I agree with the Western standpoint that a UN conference on racism should not focus only on Israel, it is wrong not to allow the conference to address the issue at all.

If the objective of the boycott was to undermine the position of Ahmedinejad, it achieved just the opposite. His position was not only strengthened in the wider Muslim world, but also on his return from Geneva, he received a hero's welcome from his fellow citizens. I agree with Jeremy Paxman of the BBC that the boycott was a "stunt" that merely exposed the West's double standards on the Israeli-Palestinian issue.

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'I am Dr. Realist'

Most other economists rolled their eyes when Nouriel Roubini warned in a September 2006 speech to the International Monetary Fund that the global bubble was going to burst. They nicknamed him "Dr. Doom" -- and then the hard times hit. They might consider listening to what Roubini has to say now. The New York University professor told Newsweek's Lally Weymouth why he sees more trouble ahead and what the recovery will look like. Excerpts:

Weymouth: What do you believe is happening to the economy today?

Roubini: The rate of economic contraction you have seen in the last two quarters -- 6 percent annualised -- is going to slow down. The optimists are already talking about the "green shoots" of spring, about economic activity becoming positive. [They say] we will have positive growth in the third quarter, and in the fourth quarter we will grow 2 percent over the previous quarter. They expect that next year, growth will go back to above 2 percent.

Compared with this optimistic consensus, I believe that the rate of economic contraction is going to slow from minus 6 percent in the last two quarters to minus 2 percent



Dr. Roubini

by the fourth quarter. Next year, I believe that the growth rate is going to be 0.5 percent for the US average. Even if we are technically out of a recession, we are going to feel like we are in a recession. The bottom of the economy is not going to be in three months, but rather toward the beginning of next year.

So you are still Dr. Doom?

No, I am not Dr. Doom. I am Dr. Realist. I don't believe we are going to end up in a near depression. Six months ago I was more worried about an L-shaped near depression.

Today, after the very aggressive policy actions taken by the US and other countries, the risk of that near-depression L has been reduced

when Treasury Secretary Tim Geithner came with details, made the markets rally sharply. Each one of these three programs has some flaws.

The fiscal stimulus could have been more front-loaded. For the mortgages, eventually you are going to need a reduction of the face-value principal of the mortgages. And on the banks, I believe after the stress tests it is going to be obvious that even some of the largest banks are so fundamentally in trouble that you cannot buy their toxic assets. You need to take over these banks on a temporary basis, clean them up and then sell them back to the private sector.

You have to nationalise these banks?

Yes. If you do not like the dirty N word, you can call it a "temporary takeover."

How about the deficit the banks are building up?

In the short term I am supportive of it, because if we didn't have these fiscal deficits, the recession would become a depression. On the other side, I do agree that this is not a free lunch. We are going to add trillions of dollars to our public debt, which is going to go from 40 to 80 percent of the GDP. There are only a few ways in which you can finance that extra public debt. If you rule out default and a capital levy on wealth, you either have the "inflation tax"

or you have to painfully cut spending or raise taxes, and either one is not going to be politically palatable.

What is going to fuel the next growth cycle?

That is a difficult question. The periods of high growth in the United States in the last 25 years have been characterised by an asset and credit bubble. Whatever the future growth is going to be, this time around it needs to be sustainable and not bubble-prone because we are running out of bubbles to create. We had the real-estate bubble, tech bubble, housing bubble, hedge-fund bubble, private-equity bubble, commodities bubble, even the art bubble -- and they are all bursting.

What makes you different from the other economists?

We think usually that crowds -- on average -- can be wiser than individuals. In this case, most people got it wrong because whenever we are in an irrational, exuberant bubble, people fail to think correctly. Do you believe this is a bear-market rally or do you think it is the market anticipating an economic recovery?

As we reach newer lows, we may be closer to a level of the market that is fundamentally right. A year ago we were not as close to a true bottom. Today we are closer to it.

As we become closer to the bottom of the economy, the stock market looks ahead and sees the light at the end of the tunnel and rallies. In spite of these caveats, I would argue that even the latest market rally is a bear-market rally.

Do you worry about China getting tired of holding our bonds?

In the short run, China has no option but to accumulate more reserves and dollar reserves. Why? Because if they stop doing that, their currency would appreciate sharply while their exports are plunging. So in the short run, they are going to keep on accumulating. But I have seen a huge number of new initiatives in the last month that suggest [the Chinese] are pushing for the yuan to become an international currency and a reserve currency.

They are moving away from the dollar? Yes, slowly they will. First they have to establish their own currency as an international currency. That will take years, but already in a month they have done more than in the last 10 years.