Bangladesh: Impediments to Enhanced Revenue Mobilization and Equitable and Efficient Spending

Ahsan H. Mansur

Abstract

Despite remarkable success in terms of growth, poverty reduction, and improvements in other socio-economic indicators, Bangladesh suffers from chronic revenue shortfalls and an extremely low tax/GDP ratio. The overall size of the government is also quite small and inadequate to meet the growing demand for public services and infrastructure, primarily due to revenue-generating limitations by the country's tax authorities. Tax rates are generally high but tax bases are narrow, pointing to poor tax efficiency and outdated tax administration. Going forward, the thrust must be on the VAT and direct tax systems along with fundamental reforms in tax administration in all three wings—VAT, customs, and direct taxes—along functional lines. Given the revenue constraint, greater efficiency with resources will be critical for getting better value for revenue spent. Development partners have long supported the government in the areas of revenue mobilization and in improving public financial management, and they remain committed to supporting reforms in these areas in future. However, a strong push from the political authorities will be a prerequisite for increasing the tax/GDP ratio, improving service delivery, and ensuring value for money in public sector projects and programs.

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CGD Policy Paper 167
January 2020

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The Center for Global Development is grateful for contributions from the Bill & Melinda Gates Foundation in support of this work.

Ahsan H. Mansur, 2020. "Bangladesh: Impediments to Enhanced Revenue Mobilization and Equitable and Efficient Spending." CGD Policy Paper 167. Washington, DC: Center for Global Development. https://www.cgdev.org/publication/bangladesh-impediments-enhanced-revenue-mobilization-and-equitable-and-efficient

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Foreword

Despite rapid economic growth in recent years, Bangladesh has mobilized significantly fewer domestic resources than other countries at a similar stage of development. In the past seventeen years, total revenues in relation to GDP have grown modestly by 2 percentage points to 11.6 percent of GDP. The tax-to-GDP ratio remains rather low at 9.2 percent of GDP.

The weak revenue performance has stemmed from both poor policy design and outdated revenue administration. Bangladesh has exempted much of the income emanating from the growing ready-made garment sector and companies producing power or located in certain areas, including the export processing zones. The bulk of corporate tax revenue of 2 percent of GDP is collected from publicly listed companies in banking, telecommunications, and tabacco. This together with a narrow base for income taxes—with only 0.5 percent of population filing tax returns--has hindered growth of revenues from direct taxes.

Because of major structural flaws in the VAT design, revenue growth from this source has been relatively small since early 2000s. A reform of the VAT has met with fierce resistance from vested interests. As a result, VAT revenues from the retail and wholesale levels have remained relatively low. The rivalry between different factions of officials in the National Board of Revenue has not been conducive to modernizing the revenue administration.

Bangladesh spends under 3 percent of GDP on education and health, in part because of insufficient revenues. Despite government anchoring its fiscal deficit at 5 percent of GDP to ensure macroeconomic stability, interest payments on its borrowing have burgeoned to 17 percent of total revenues or 2 percent of GDP. Unless revenues start to grow, there is a risk that the rising interest burden will squeeze meager spending on social sectors.

This study on the impediments to enhanced revenue mobilization and efficient spending in Bangladesh has been carried out by Dr. Ahsan Mansur. It is one of the five country studies (of which four are from sub-Saharan Africa) commissioned by the Center for Global Development to go deep into the political and institutional constraints to raising more revenues domestically. Dr. Mansur lays out an agenda for reform for Bangladesh government going forward. We are confident that the analysis presented in the paper would help stimulate policy debate in Bangladesh and should be of interest to students of development economics and public finance elsewhere.

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Executive Summary

General Macroeconomic Background

The economy of Bangladesh has performed quite well in terms of real economic growth, social development, and macroeconomic stability during the period under consideration (2000–2017). The growth momentum was broad-based, with significant impact on poverty reduction on a sustained basis. This was true despite commodity price shocks, natural calamities, the global economic crisis, and the European debt crisis—even while the EU was the most important export destination for Bangladeshi products. The country managed to grow in terms of real GDP from 5.3 percent during FY00–03 to 7.0 percent in FY14–17. There was a moderate slowdown in growth in FY09 during the global economic crisis, but the slowdown was very short-lived, and the economy rebounded strongly thereafter.

Revenue and Expenditure Developments

Revenue Trends

Historically, public sector resource mobilization in Bangladesh has been well below the level of most countries at a similar stage of economic and social development. This below-par resource mobilization impeded economic growth and social development. Until recently, the collection of tax revenue in Bangladesh has been very low, averaging about 9.2 percent of GDP until FY18. Gains in public resources over time, however, have been very modest. Total revenue in relation to GDP increased by more than 2 percentage points since FY00–03 but remained very low at 11.6 percent of GDP during the period FY14–17.

Expenditure Trends

The overall size of Bangladesh's government is small, ranging from between 12 percent to 18 percent of GDP during the study period. Despite repeated efforts by all government sectors in Bangladesh to increase government expenditure-to-GDP ratio, the ratio never has exceeded 18 percent of GDP, however, and generally has remained within the 14 percent to 15 percent range, due to the government's failure to achieve a higher balance of revenue to GDP. The country's total budgetary expenditures in relation to GDP stood at 13.6 percent in FY99, crossed the 18 percent GDP benchmark in 2014, but then declined gradually in 2017 to 13.6 percent—the level at which it stood almost two decades back. This indicates that Bangladesh has faced a severe challenge over the years in containing government expenditures, primarily due to revenue-generating limitations by the country's national Board of Revenue (NBR). The country's expenditure structure, nevertheless, has evolved steadily, in line with the changing priorities of the Bangladeshi government, especially in light of development goals, population needs, and overall resource requirements.

Political and Institutional Constraints in Raising Domestic Revenues

Direct tax rates are high in Bangladesh, but revenue collection rates are very low, pointing to poor tax efficiency in direct tax administration. Bangladesh has one of the highest corporate and personal income tax rates in the region and globally.

On the personal income tax side, Bangladesh suffers from a very small tax base, a high tax rate, and a very weak tax administration system. Besides personal income tax rates in Bangladesh being high, with a maximum rate of 39 percent, which includes a wealth surcharge, the tax base is very narrow, with about 1.3 million Bangladeshi citizens having taxpayer identification numbers (TINs). Out of this pool, and out of an overall population of 165 million, less than one million (about 0.9 million) actually submit tax returns. **Additionally, despite a rapid expansion of the formal industrial and service sectors, payroll tax collection is very low in Bangladesh.**

Key sectors of the economy remain virtually outside the tax net. Revenue collection from both direct and indirect taxes also was impacted by extensive use of tax benefits offered to key sectors of the economy. These benefits were offered to the ready-made garment (RMG), energy, and power sectors, and included tax breaks given to firms establishing themselves at export processing zones. Tax holidays offered to industries with different criteria, such as location and modernizing capabilities, further drained revenue.

Tax administration is outdated and cannot keep pace with the rapid expansion of the economy and potential tax base. The tax administration system in Bangladesh is almost completely manual and paper based. Additionally, tax administration is virtually unchanged, as it was inherited from the British colonial administration in the 1940s. Further hampering efforts to modernize is the fact that Bangladeshi tax cadres are separated, and information sharing between the three wings of the national Board of Revenue—VAT, customs, and direct taxes—is not coordinated. **Lack of separation between tax policy formulation and tax administration also contributes to decreased focus and a slower reform process in both areas**. Deficiencies, or piecemeal design of reforms, along with half-hearted implementation strategies often devised under pressure from development partners, also contribute to unsuccessful or failed efforts to modernize.

To complicate matters, the political economic environment in Bangladesh has not been very supportive of tax policy and tax administration reforms. Strong political commitment to tax reform is lacking, and the disconnect between field-level tax officials and tax-evading businesses has further undermined tax reform efforts from both within and outside the NBR.

Capacity-building Support by Development Partners

In general, development partners like the World Bank, the International Monetary Fund (IMF), the Asian Development Bank (ADB), the International Finance Corporation (IFC), the United Nations Conference on Trade and Development (UNCTAD), and the European Union (EU), have been very supportive of reform initiatives on the Bangladeshi tax and trade facilitation fronts. The IMF has generally been credited with introducing the VAT law in 1991 and with drafting the new VAT Act of 2012. As usual, the IMF has provided international experts with relevant expertise at different stages of preparation.

In general, development partners were careful to avoid duplicating technical assistance support by forming the Local Consultative Group (LCG), which provides unified support to the Bangladeshi government. The LCG, co-chaired by one of the development partners, meets regularly or as needed to coordinate ongoing support to Bangladesh, thereby preventing duplication of support in any one area.

Overall, development partners are aware that many development initiatives will take massive amounts of resources. Chief among these initiatives are implementing the country's sustainable development goals (SDGs); eliminating absolute poverty by 2031; reducing general poverty to 15 percent or less; and making Bangladesh an upper-middle-income country by FY31. Massive investments also will be needed in human resource and infrastructure development.

On the human resources front, education, health care, poverty alleviation, and the creation of a social safety net will require tremendous outlays of funds. And on the infrastructure front, modernizing utilities (such as electricity, water, and sewage treatment); upgrading transportation systems (such as roads, waterways, railways, seaports, and airports); and developing urban communities (such as satellite towns and planned housing) will demand just as much attention and funding. Most of these public sector investments must come from domestic resource mobilization, and effective functioning of the country's national Board of Revenue will be critical. Thus, development partners are very eager to support tax reform initiatives. A lack of committed political support, resistance from NBR field officials, and opposition from certain quarters of the business community, however, are strong opponents to real progress.

Going Forward

Going forward, the thrust must be on the VAT and direct tax systems. Implementing the VAT Act of 2012 and carrying out automation and reforms within the VAT administration must take priority. Detailed roadmaps for these changes have been completed under the World Bank-supported VAT Online Project but could not be implemented.

On the direct tax side, comprehensive reforms are yet to start. NBR officials have drafted a preliminary version of a possible new direct tax law or direct tax code, but that has many deficiencies and needs to be vetted by international direct tax law experts.

Additionally, tax exemptions of all kinds are significantly eroding the tax base and revenue resiliency. The NBR estimates tax expenditures to be more than 2 percent of GDP—and the actual figure would probably be much higher if calculations were comprehensive. Special tax treatments for the RMG and power sectors, along with generous tax holidays and exemptions for special economic zones, are major sources of tax erosion and must be reviewed.

Going beyond tax *policy* issues, the **NBR also must initiate reforms in tax *administration* in all three wings—VAT, customs, and direct taxes—along the functional lines.** Efforts should focus on completely automating tax administration functions, which would streamline processes and make them efficient without compromising any safeguards. Key functions to automate include assigning taxpayers (both individuals and businesses) **common** TINs for all types of taxes; centralizing tax return processing; implementing a payment system that connects taxpayers, commercial banks, the central bank, and the accountant general's office; and developing an auditing process that selects, monitors, and integrates findings with the payment system and taxpayers' records.

On the expenditure side, the Bangladesh government needs to broaden its range of service delivery and enhance its quality of public services, both of which are hampered by constraints on domestic revenue mobilization. **Greater efficiency with resources is critical to getting better value for revenue spent but** ensuring that resources are used wisely will not be easy, given the prevailing political system, which lacks accountability.

Problems in the public health care system will require strong administrative interventions and de-politicization of government medical colleges and universities. Absenteeism among doctors at government hospitals and clinics has reached epidemic proportions and addressing it will require very strong efforts by health administrators and political leaders.

Implementing a National Social Security (NSS) strategy in phases will be the best way to improve targeting. This will require consolidating the 150-plus social safety net programs into several large programs under the life cycle-based NSS framework. Also required are more public resources for social safety net programs and the ability to distribute these resources according to a plan currently being drawn up with technical assistance from the EU.

Concluding Observations

Reforms must be initiated in all three major areas of taxes—both in tax policy and tax administration—according to points outlined. Key elements of reforms should include (i) separating tax policy functions from tax administration functions and shifting tax policy functions away from the NBR to a separate division under the Ministry of Finance; (ii) introducing the VAT Act of 2012 without making any fundamental changes, despite pressures from business groups; (iii) reviewing the Customs Act and Direct Tax Codes drafts immediately with national and international experts and stakeholders before finalizing them; (iv) automating and streamlining all tax-related business processes; and (v) transforming tax administration along functional lines.

However, reform 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. Business entities are not supposed to pay VAT, which is ultimately to be paid by consumers, and businesses only act as the collection agents. But in reality, they are collecting and not remitting the payment to exchequer or making the playing field uneven by partly passing on the evaded VAT to the consumers to gain commercial advantage vis-à-vis compliant taxpayers. Without strong political commitment to transform the tax administration along functional lines and to automate systems, such unholy alliances cannot be overcome.

Given the country's limited public resources, it is even more imperative that resources be efficiently used. To prevent misuse of public funds, a number of measures are urgently needed to improve fiscal transparency across all government money-handling activities. In addition, massive improvements are needed in the public education and public service sectors. Interventions in public education will require not only massive resource allocation but also major efforts to ensure improvements are made to instruction materials and personnel, laboratory facilities, and internet access. On the health care front, strict monitoring is needed to ensure service quality and attendance by doctors and nurses at clinics and hospitals. Resources allocated to the health care sector must be doubled to at least 1.5 percent of GDP to ensure a minimum standard for public health care delivery.

Until recently, revenue growth was respectable, at more than 18 percent, and thus the government could meet the increasing demand for public resources while limiting fiscal deficits to below 5 percent of GDP. The situation, however, is deteriorating: the average revenue growth in the period FY16–18 was only about 6.3 percent, due to a lack of reforms. The resulting revenue-to-GDP ratio decline, coupled with expenditure growth outstripping revenue, is contributing to higher domestic borrowing. Thus, the pressure is building. As demand for increased services and infrastructure intensifies, and as the growth of revenue slows further in the absence of fundamental reforms, pressures are intensifying on the government to overhaul tax policy and tax administration within the NBR.

On Bangladesh's expenditure front, quality of service delivery and value for money are two important issues. Lack of accountability and weak government oversight have contributed to poor service delivery, and extortion exists at almost every service delivery point. Regarding the country's annual development program (ADP), highly inflated price tags and substandard construction and equipment undermine project quality and return on investment. Without a strong push from high-ranking political authorities to reduce corruption and resource squandering, service delivery and value for money in public sector projects and programs will remain elusive.

Bangladesh's impressive performance in terms of growth and social development, despite its very high population in a small land mass, is the result of strong commitments to poverty alleviation and social sector development by all major political parties. A very vibrant NGO community led by BRAC, Grameen Bank, Proshikha and several others contributed to social mobilization for health through WASH programs, education for all, and access to income generating assets for the ultra-poor in remote areas of the country. In these aspects, Bangladesh's development strategy was somewhat unique and exemplary—what is often referred to as "Bangladesh Paradox". However, sustaining the growth momentum will be a challenge without adequate physical infrastructure and higher public spending on health and education. Very low levels of DRM—if not addressed appropriately--will certainly constrain both growth and social development in the medium to long term.

1. General Macroeconomic Background

As noted at the outset of this study, the economy of Bangladesh has performed well in terms of real economic growth, social development, and macroeconomic stability during the period under consideration. Growth has been broad-based, despite worldwide setbacks, and the country has managed to grow in terms of real GDP, from 5.3 percent during FY00–03 to 7.0 percent in FY14–17. Table 1 shows a breakdown of macroeconomic indicators.

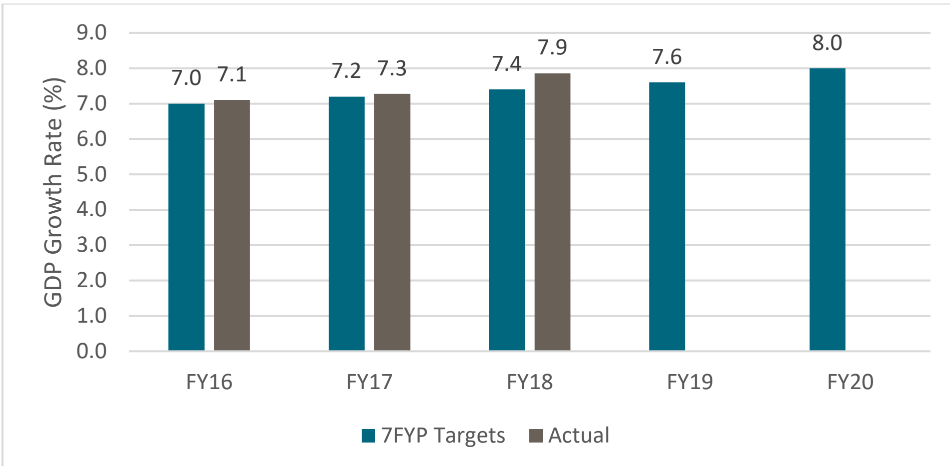
Table 1. Macroeconomic indicators

Metric	**Reference period (1)**	**Economic crisis period (2–3)**		**Recent period (4)**	**Change between col. (1) and col. (4)**	
	Average for 2000–2003	**2008**	**2009**	**Average for 2014–2017**	**Value**	**Unit**
GDP per capita *(in US$, PPP)*	1,477.5	2,325.3	2,442.2	3,797.5	61.1	%
Growth of real GDP per capita *(percent)*	2.8	4.8	3.9	5.6	2.8	pp
Growth of real GDP *(percent)*	5.3	5.5	5.3	7.0	1.7	pp
Inflation *(percent)*	3.4	8.9	4.9	6.1	2.8	pp
Current account balance *(percent of GDP)*	0.0	1.0	3.5	-0.1	-0.1	pp
Official development assistance *(percent of GNI)*	2.0	2.1	1.1	1.3	-0.7	pp
General government gross debt *(percent of GDP)*	_	40.6	39.5	33.7	_	pp
General government overall deficit *(percent of GDP)*	3.0	4.0	3.2	3.5	0.5	pp

Sources: Bangladesh government publications (various).

A moderate slowdown in growth occurred in FY09 during the global economic crisis, but the slowdown was very short-lived, and the economy rebounded strongly thereafter. As seen in Figure 1, the growth rate has picked up even more since FY16, and has been exceeding the growth targets set in the country's Seventh Five-Year Plan (FY16–20). On average, the Seventh Plan average growth target for the period FY16–18 was 7.2 percent, while the actual growth rate was more than 7.4 percent. GDP per capita (USD PPP-based), which stood at $1,366 in 2000, increased by 210 percent by 2017, to $4,237.3.

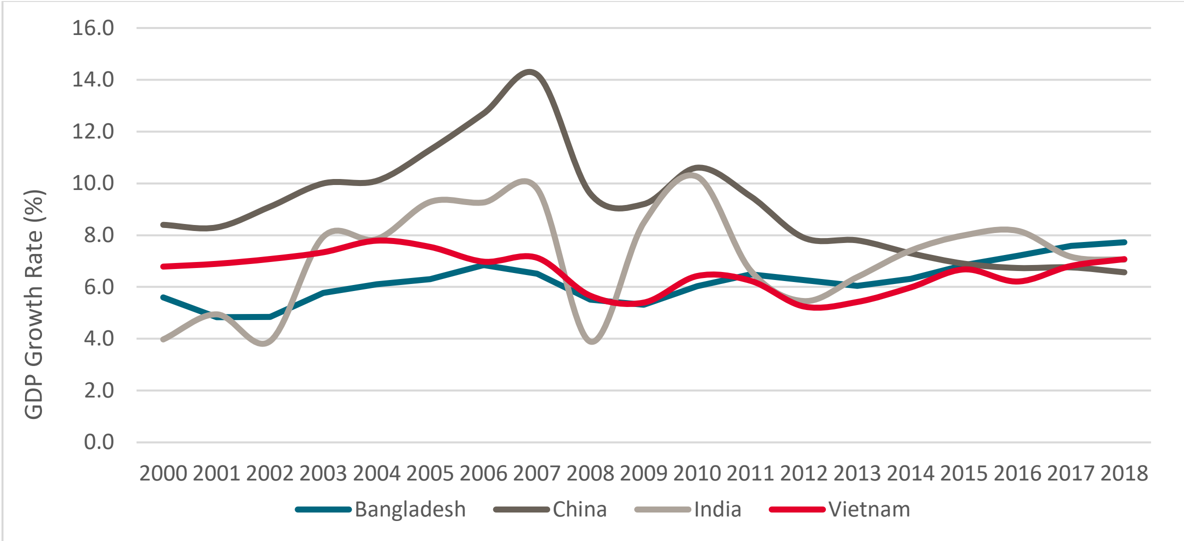
Figure 1. GDP growth rate—Seventh plan targets vs. actual



Sources: Seventh Five-Year Plan of Bangladesh, *Economic Review*, Ministry of Finance

Bangladesh's most recent growth performance in the global and regional economic context has been impressive, even when compared with regional high-performing comparator countries like China, India, and Vietnam (Figure 2). The Bangladesh economy is leading in terms of economic growth over the last two years (FY17 and FY18). Additionally, Bangladesh has firmly established itself among its cohorts as a fast-growing Asian developing economy.

Figure 2. Regional cross-country comparison—GDP growth (%)

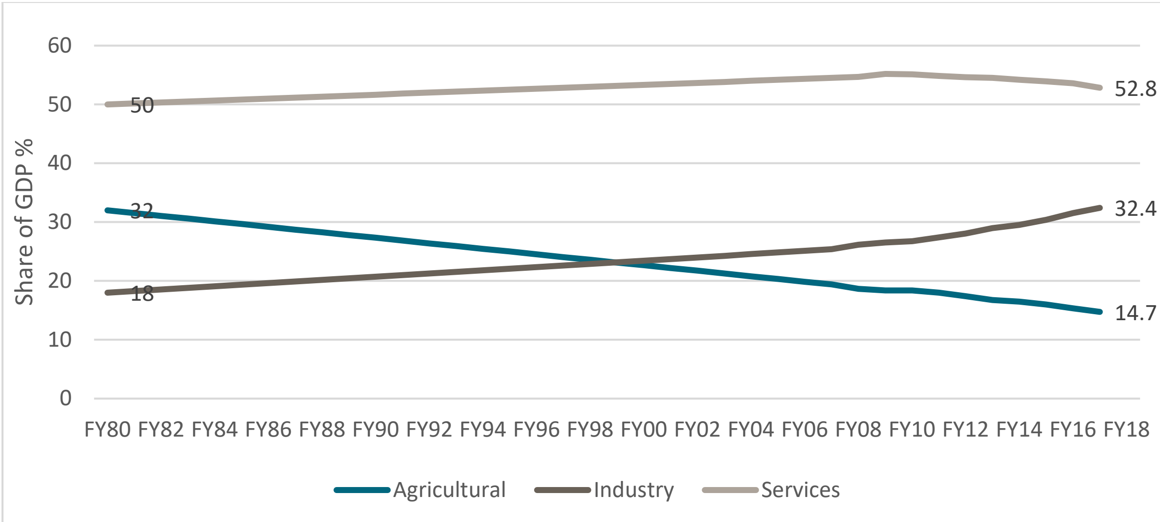


Source: IMF World Economic Outlook Database

1.2 Structural Transformation of the Bangladesh Economy

Bangladesh's broad-based growth has been led by the industrial sector. The structural shift in the economy has been gradual but steady, moving away from agriculture to manufacturing and service sectors. Despite almost tripling its production of its main staple crop rice since the 1970s to 35 million tons in recent years, Bangladesh's contribution of agriculture to GDP has declined from 32 percent in FY80 to less than 15 percent in FY18. Within agriculture, the share of its crop sector has declined to 9 percent, and the remaining growth is attributable to the relatively fast-growing and higher-priced subsectors of poultry, seafood, and livestock. Besides agriculture, income growth in the rural economy of Bangladesh has been supported by strong nonfarm economic activity. More than 60 percent of rural household income now originates from nonfarm activity. Within the industrial sector, manufacturing activity has been the most dynamic, growing at double-digit rates throughout the period under consideration (see Figure 3).

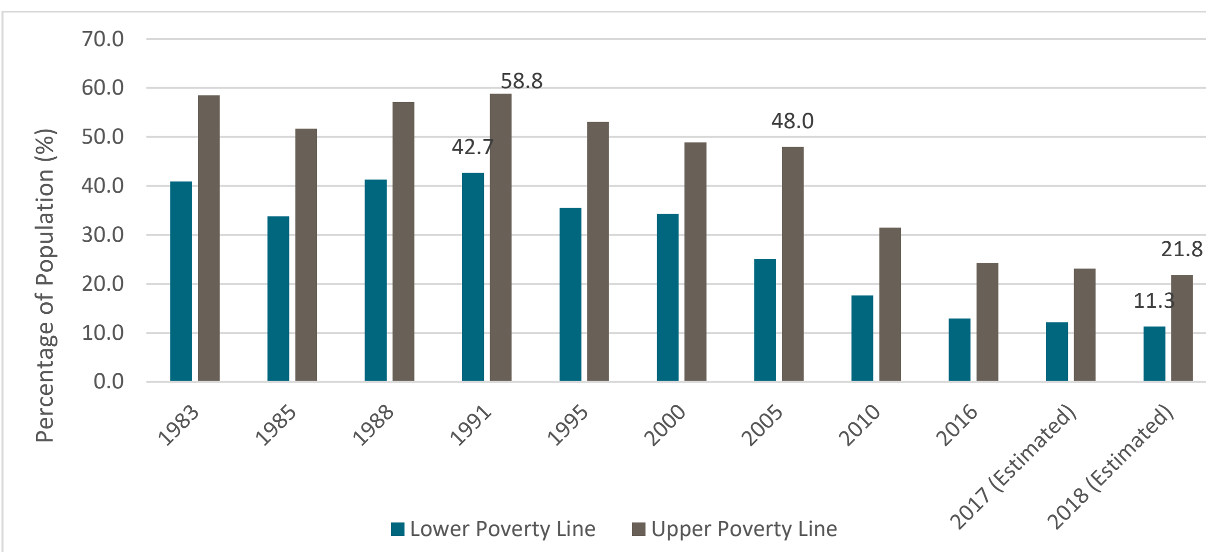
Figure 3. Structural transformation of Bangladesh's economy, FY1980–2018



Sources: Economic Review, Ministry of Finance and Statistical Yearbook, Bangladesh Bureau of Statistics

These shifts in the rural economy and in the country's overall economic structure have contributed to workers migrating from the less productive agriculture sector to the more productive industrial sector. The shifts also have ushered in increased labor productivity, growth in wage income in real terms, and a steady reduction in poverty. Since the 1970s, when more than 75 percent of its population was below the poverty line, Bangladesh has come a long way in terms of reducing poverty to 22 percent in FY18. Most of these improvements have happened in the last 10 years, with the poverty rate declining by more than half since 2005 (see Figure 4).

Figure 4. Poverty reduction trends



Source: Household Income and Expenditure Survey, Various years, BBS

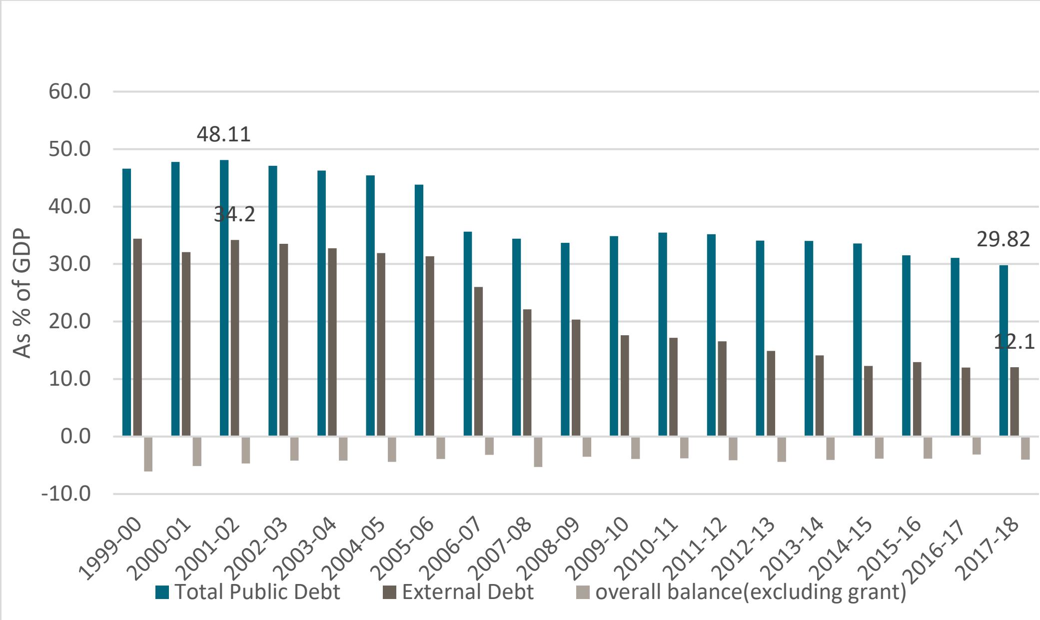
Bangladesh has generally enjoyed macroeconomic stability throughout the review period, with a strong balance of payments position, prudent fiscal and debt management, and reasonably stable inflation performance. The strong balance of payments position was characterized by surplus positions in the external current account balance during most of the years under consideration. This was due in large part to sustained growth in exports and inflow of workers' remittances, and to declining foreign debt and debt service ratios.

Bangladesh, despite being a least developed country, has had a relatively strong track record of prudent fiscal management. The first two decades of the country's fiscal history have been marked by several shocks, but through trial and error in fiscal management strategies, the 1990s and 2000s have been relatively structured and stable. During this time frame, there have been several important changes in fiscal management and deficit financing through firm expenditure control and conservative financing strategies. Keeping the fiscal deficit and public debt at sustainable levels, despite very limited resource mobilization from the public sector, has anchored Bangladesh's continued macroeconomic stability and manifests its sound fiscal management.

Despite the country's good fiscal management, however, service delivery from its public sector, in terms of coverage and quality, were seriously constrained by poor resource mobilization. Because of the country's low revenue-to-GDP ratio and chronic shortfall in domestic revenue mobilization, Bangladesh authorities had to cut expenditures in order to maintain the overall fiscal deficit at a level, below the targeted 5 percent of GDP. Until recently, public debt management has been very prudent, particularly with respect to reliance on external debt. Bangladesh relied almost entirely on highly concessional long maturity (IDA-type) loans from official multilateral and bilateral sources, which contributed to very low debt servicing costs, and Bangladesh never faced difficulties in meeting its foreign debt obligations. Bangladesh has consistently received official development assistance (ODA) of 1–1.5 percent of gross national income (GNI) in recent years (from FY09 onward), which is a significant reduction from earlier years. This indicates that the country's dependence on ODA has declined over time, and ODA resources are now mostly directed to financing the development budget and budget financing. Outstanding public debt has declined steadily, from 48.1 percent of GDP in FY02 to 29.8 percent of GDP in FY18. The decline in external debt has been even more phenomenal, decreasing from more than 34 percent of GDP in FY02 to only 12 percent of GDP in FY18.

In the last two to three years, Bangladesh has relied on non-concessional foreign borrowing to finance many large infrastructure projects, which will likely contribute to faster debt buildup and debt service payments in the coming years. This has not been reflected in the data for debt and debt service obligations until now (see Figure 5).

Figure 5. Trends in Total and Foreign Public Debt and the Overall Fiscal Balance, FY00–18



Source: MTMPS, Ministry of Finance

Bangladesh also has maintained a reasonable degree of price stability, with an average inflation rate of 6 percent during FY00 through FY10, and about 7 percent during FY11 through FY17. In FY11, the inflation rate reached a peak of 11.5 percent before corrective monetary tightening and other supportive measures were taken. Other than this episode, the inflation rate has been stable at around a 5 percent to 6 percent range. While monetary management has been moderately prudent, price volatility has typically been caused by exogenous factors like global commodity price shocks and occasional cyclone- and flood-inflicted domestic supply shocks.

2. Revenue and Expenditure Developments

2.1 Revenue Trends

Historically, tax resource mobilization in Bangladesh has been far behind advances made in most countries at a similar stage of economic and social development. Unsurprisingly, this below-par resource mobilization has impeded both economic growth and social development. Until recently (FY18), the contribution of tax revenue in Bangladesh to its GDP has averaged about 9.2 percent (Table 2).

Table 2. Tax effort in South Asian countries, 2015–2018 (% of GDP)

Countries	FY15	FY16	FY17	FY18	Average tax revenue	Average income tax	Average value added tax	Average GDP per Capita US$
Bangladesh	9.4	9.0	9.1	9.3	9.2	3.1	3.86	1,528.1
India	19.9	20.2	19.8	20.6	20.1	6.4	10.7	1,862.9
Nepal	20.8	23.3	24.4	25.5	23.5	6.8	5.9	824.9
Pakistan	14.5	15.5	15.5	15.3	15.2	4.2	6.3	1,491.5
Sri Lanka	13.3	14.2	13.8	13.5	13.7	2.2	2.7	3,960.1

Sources: IMF World Economic Outlook, Reserve Bank of India, State Bank of Pakistan, Central Bank of Sri Lanka, and Nepal Rashtra Bank

As Table 3 (below) shows, gains in public resources over time have been very modest. Total revenue in relation to GDP increased by more than 2 percentage points, from 9.4 percent during FY00–03, but remained very low at 11.6 percent of GDP during the period FY14–17. The increase was solely because of a rise in tax revenue from both personal and corporate sources, while non-tax revenue in relation to GDP declined modestly. The VAT also increased by one percentage point to 3.4 percent of GDP during FY14–17. Additionally, there was a marked shift in the sources of revenue as reliance on trade-based taxes continued to decline, with the focus shifting more toward domestic taxes and away from import-based sources. This is borne out in the fact that the share of trade taxes in total revenue declined to 23 percent, at 2.67 percent of GDP during FY14–17.

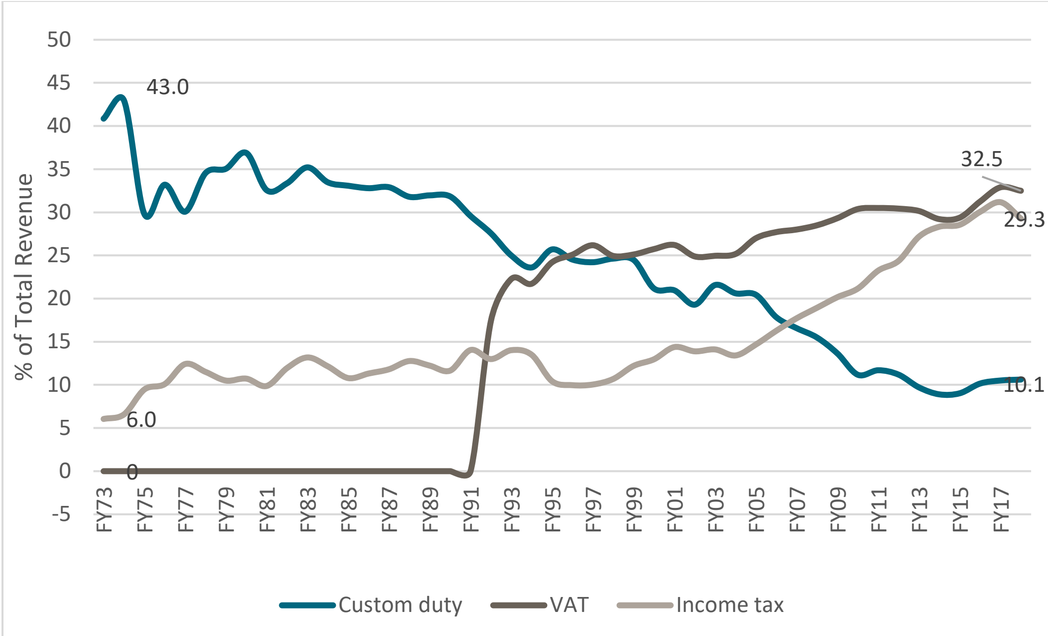
Table 3. Evolution of public resources, 2000–17

	In relation to GDP (%)		In relation to total revenue (%)	
	2000–2002	2014–2017	2000–2002	2014–2017
	Mean	Mean	Mean	Mean
Total revenue	9.44	11.66	100.00	100.00
Tax revenue	7.47	9.99	79.30	85.88
Income tax revenue	1.30	3.28	13.75	28.22
Personal income tax	0.56	1.09	42.99	33.57
Corporate income tax	0.74	2.02	57.01	60.98
Value added tax (VAT)	2.41	3.41	25.62	29.32
Trade taxes	3.76	2.67	39.96	23.11

Sources: Ministry of Finance and the National Board of Revenue (NBR).

Over the years, a number of efforts were made to strengthen tax revenue mobilization and improve the country's tax structure. In 1991, Bangladesh embarked on a major tax reform initiative by introducing the VAT system. Simultaneously, significant reduction of import tariffs occurred. Prior to these reforms, trade-based taxes dominated the tax structure in Bangladesh, with customs duties alone accounting for about a third of tax revenue during the first two decades of Bangladesh's fiscal history (Figure 6). Following the introduction of the VAT in 1991, the share of VAT revenue increased substantially, growing to 29 percent in the decade 2004–14, while the share of customs duties declined to 10.8 percent during this same time frame.

Figure 6. Major tax components as % of total tax revenue



Source: National Board of Revenue

Revenue lost from trade-based taxes was compensated through the expansion of VAT coverage to many services, as well as to the wholesale and retail levels. Although the base of the VAT system has been expanded, however, because of political expediency numerous distortions have crept in over time. Because of these problems, the VAT system started to underperform considerably, given its potential.

It is evident that a narrow tax base, widespread exemptions, and administrative inefficiencies are the main factors driving the low tax-to-GDP ratio in Bangladesh, compared to its comparator countries. These factors also imply that tax efforts over the last decade could not bring about significant changes in Bangladesh's tax efficiency and productivity (Table 4).[1] To estimate a country's tax efforts, this paper relied on the stochastic frontier tax analysis, using panel data and taking into account country-specific demographic, economic, and institutional characteristics that may change over time. The paper uses a relative method to predict tax efforts, analyzing and comparing data along the lines of Ricardo Fenochietto and Carola Pessino (IMF Working Paper No. WP/13/244 2013).

[1] Tax effort measures the ratio of *actual* tax collection as a share of GDP to *potential* tax collection as a share of GDP. The potential collection, or taxable capacity, is the predicted tax-to-GDP ratio that can be estimated with a cross-country regression, taking into account a country's specific macroeconomic, demographic, and institutional features.

The method determines if a country's tax capacity is high or low in comparison with the tax capacity of other countries. The stochastic frontier tax function is an extension of the regression model, which is based on the premise that a production function represents the maximum level of tax revenue that a country can achieve against a set of inputs, such as GDP per capita, inflation, and level of education. The stochastic frontier model of Aigner, Lovell, and Schmidt ("Formulation and Estimation of Stochastic Frontier Production Function Models," *Journal of Econometrics*, Vol. 6, pp. 21–37; 1977) is the standard econometric platform for this analysis.

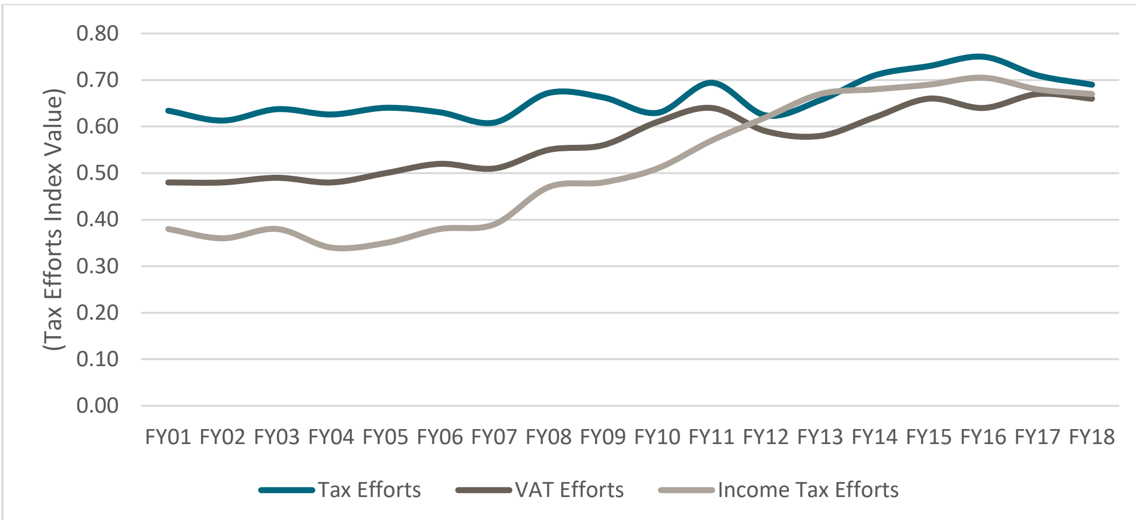
Table 4. Tax efforts and potential for selected countries (on average, 2001–2016)

Country	Tax revenue to GDP	Tax efforts	Potential tax to GDP
Bangladesh	7.3	0.58	12.5
India	16.2	0.68	23.9
Pakistan	10.3	0.55	18.6
Sri Lanka	12.3	0.59	20.8
Nepal	12.0	0.62	19.4
South Korea	18.3	0.67	27.4
Philippines	13.7	0.55	24.9
Bhutan	13.7	0.58	23.6
China	17.6	0.71	24.8
Côte d' Ivoire	15.0	0.48	31.3
Ghana	10.0	0.58	17.2
Indonesia	12.0	0.52	23.0
Kenya	16.6	0.73	22.7
Malaysia	14.9	0.54	27.7
Thailand	16.8	0.64	26.3
Tanzania	11.4	0.54	21.2
Vietnam	17.9	0.72	24.9
Uganda	12.6	0.68	18.6

Source: PRI Staff Estimates

A closer analysis of Bangladesh's tax efforts shows that tax efforts for direct taxes have increased over the period under consideration, while indirect taxes have slowed (Figure 7). The improvement in direct tax effort has somewhat offset the deterioration of indirect tax effort, and therefore the overall tax effort has increased modestly in Bangladesh in this time frame.

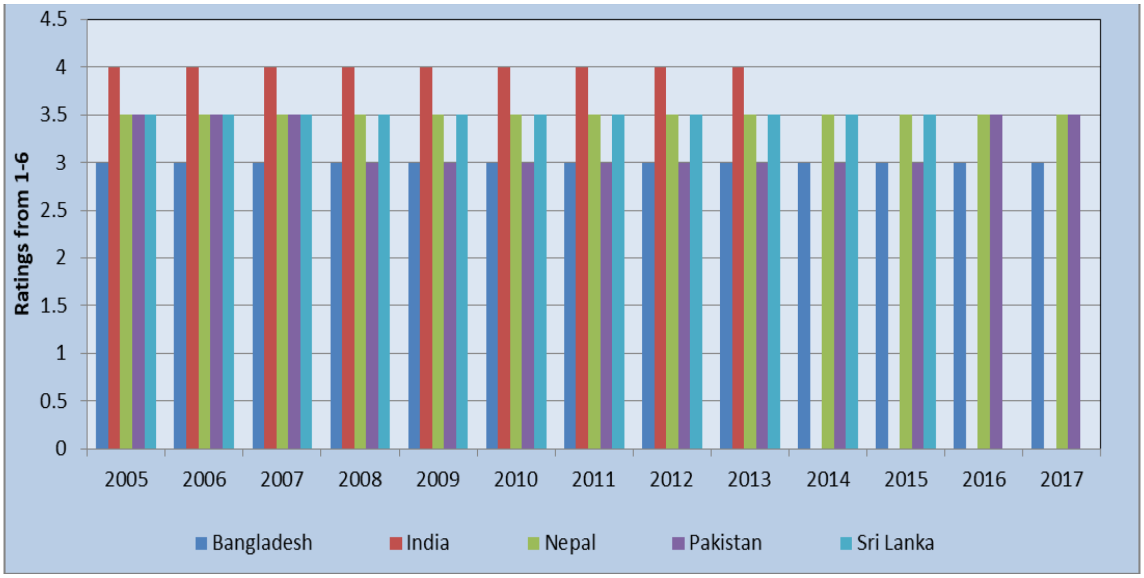
Figure 7. Trends in tax efforts in Bangladesh



Source: PRI staff estimates

Despite the marginal improvement, however, tax effort indices for both direct and indirect taxes are quite low, implying that Bangladesh has substantial untapped potential for raising revenue collection from both categories of taxes. Another major drawback of Bangladesh's tax system is its inefficiency, especially in tax administration. Figure 8 (below) shows that Bangladesh and Pakistan both have one of the lowest efficiency scores among the South Asian countries compared. Furthermore, no improvement was shown between 2009 and 2017.

Figure 8. Cross-country, Country Policy, and Institutional Assessment (CPIA) Efficiency of Revenue Mobilization Rating (1=low to 6=high)



Source: World Bank Databank

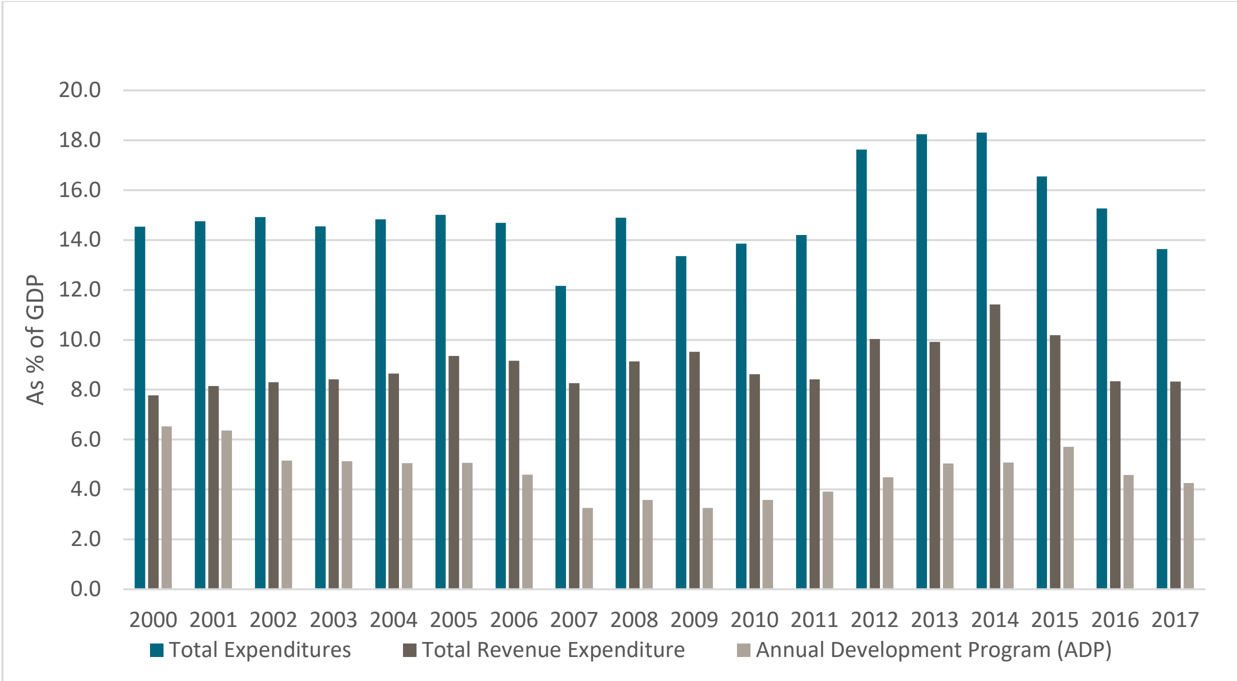
*Data for India was unavailable from 2014 onward

2.2 Expenditure Trends

As previously noted, the size of Bangladesh's government is relatively small, ranging from between 12 percent to 18 percent of GDP during the study period. Despite repeated efforts by all government sectors in Bangladesh to increase government expenditure-to-GDP ratio, the ratio never has exceeded 18 percent of GDP, however, and has generally remained within the 14 percent to 15 percent range. Budgetary expenditures in relation to GDP have risen and fallen significantly over the period studied, indicating that Bangladesh has faced a severe challenge over the years in containing government expenditure pressures. The country's expenditure structure, nevertheless, has evolved steadily, in line with the changing priorities of the Bangladeshi government.

Total recurrent expenditures always constituted more than half of total government expenditures in Bangladesh, even reaching a peak of 72 percent of total government expenditure in 2009—about 60 percent of total government expenditure. A similar trend is clear when considering total recurrent expenditures as a percentage of Bangladesh's GDP. For the decade FY99–08, total recurrent expenditures stood at 8.5 percent of GDP, which, on average, increased by almost one percentage point to 9.4 percent during FY09–17. On the positive side, since FY09 the share of recurrent expenditures has been declining, while the share of ADP, comprising investment projects funded through the budget, has increased (see Figure 9).

Figure 9. Total expenditure and major expenditure components (as % of GDP)



Source: Ministry of Finance

As Table 5 shows, there has not been any major shift in most of the components of expenditures over time. Outlays on compensation of employees declined modestly in relation to GDP, while outlays on goods and services increased somewhat when compared to the averages for these outlays in relation to GDP between 2000–03 and 2014–17. Marked increases are apparent in two areas: (i) in interest payments, which increased from 1.59 percent of GDP in 2000–02 to 1.96 percent of GDP during 2014–17; and (ii) in social benefits, which increased by 1.35 percentage points to 3.49 percent of GDP during 2014–17.

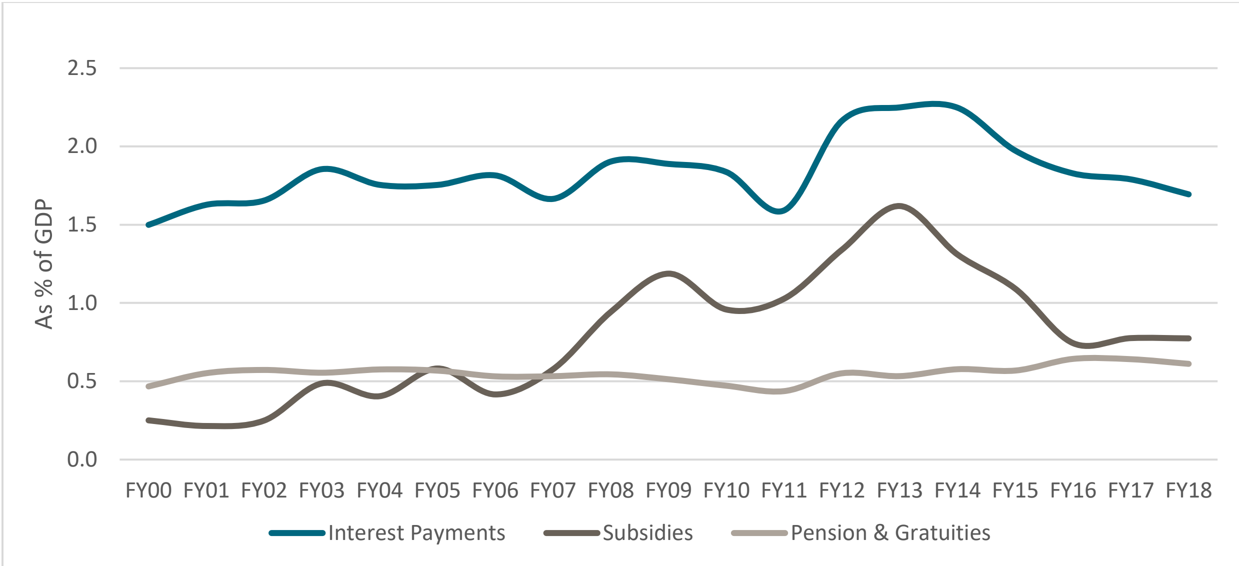
Table 5. Trends in major components of recurrent and capital outlays in Bangladesh

	In relation to GDP (%)		In relation to total expenditure (%)	
	2000–2002	2014–2017	2000–2002	2014–2017
	Mean	Mean	Mean	Mean
Outlays on goods and services	1.14	1.20	7.73	7.58
Compensation of employees	2.43	2.31	16.47	14.74
Interest payments	1.59	1.96	10.81	12.32
Social benefits	2.14	3.49	14.50	22.09
Capital expenditures + Annual Development Program (ADP)	6.43	5.45	43.68	34.32

Source: Estimates based on Ministry of Finance data.

Notwithstanding these developments, if developments in the worrisome areas of interest payments, subsidies, and pensions and gratuities are observed, it appears that all three components are largely within reasonable and sustainable ranges throughout the review period. This is true despite some ups and downs and has helped contain the growth of total recurrent expenditures (see Figure 10).

Figure 10. Selected components of recurrent expenditures

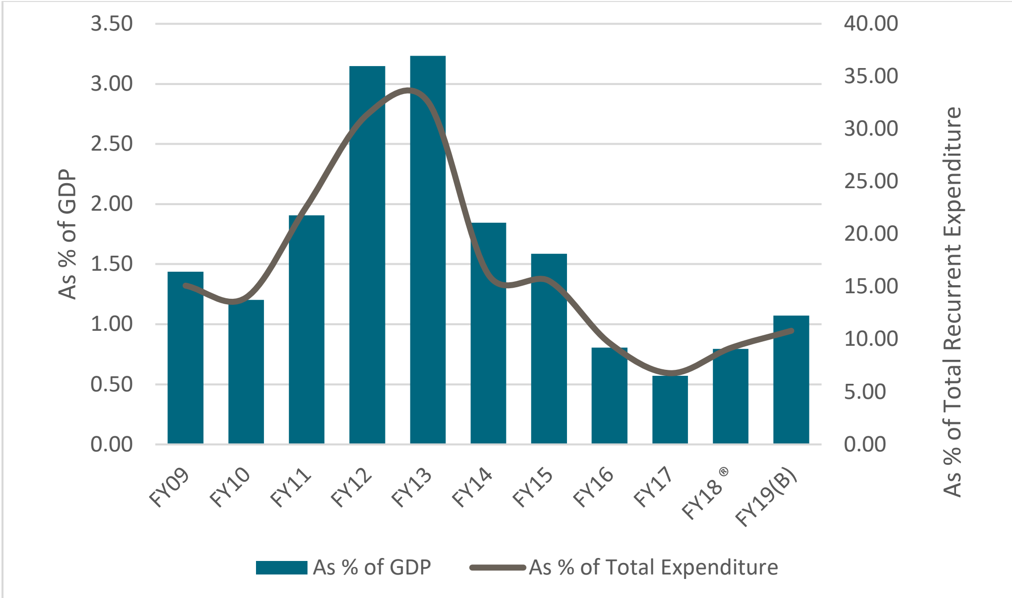


Source: Ministry of Finance

The subsidy bill of the government is one of the most volatile components of the budget, fluctuating from a low of 1.4 percent of total budget size (0.2 percent of GDP) in FY00 to a high of 9 percent of the budget (1.5 percent of GDP) in FY13. After remaining quite stable at less than 0.5 percent of GDP, the subsidy bill of the government started increasing in FY06 and peaked in FY13, reaching a level of 3.6 percent of GDP and accounting for 37.6 percent of recurrent expenditures.

Developments in the subsidy bill over the years indicate that certain pressures are emerging, due to external shocks to the economy and domestic policy considerations. The increase in the subsidy bill during FY06–08 was primarily because of (i) the global commodity price shock, with world prices for rice and petroleum products reaching historically high levels in the international market; and (ii) the domestic supply shock resulting from cyclone and floods, which hit Bangladesh in those two years. As the subsidy bill started to decrease, the newly elected government of that time (beginning FY10) embarked on an ambitious power sector expansion plan. This was launched on an emergency basis in order to overcome power shortages and was implemented by establishing rental power plants with high generation costs. This, in turn, contributed to a surge in subsidy payments during FY10–13. The increased cost of power was passed on to consumers in phases during the following years, contributing to a significant lowering of the subsidy bill by FY16 (see Figure 11).

Figure 11. Total cash loans, subsidies, and incentives



Source: Ministry of Finance

The trend of the main subsidy components shows that the government has tried to direct increased assistance each year to the sector that required it the most by absorbing higher costs in the form of subsidies. In FY13, a rise in fuel prices in the international market created upward pressure on domestic fuel prices, and to avoid shocks about 40 percent of the total subsidy was directed to this sector. As global oil prices started decreasing in FY14, the subsidy bill also came down significantly.

2.3 The Annual Development Program (ADP)

Bangladesh's annual development program (ADP) is the portion of its national budget, or total expenditure, that is directed to projects spearheaded by the various line ministries of the government. The ADP covers capital or investment outlays in sectors such as energy and power; water resource management and flood control; and projects to improve major roads and highways, rural roads, waterways, seaports, and airports. It also includes capital spending on social sectors such as health, education, and workforce skill development. About 40 percent to 50 percent of ADP funds come from project loans or grants from bilateral and multilateral institutions and are directed to meet specific development needs of important sectors.

The ADP has been, on average, 5 percent of Bangladesh's GDP during FY99–17, and constitutes approximately one-third of the total government expenditure. The share of ADP in total government expenditure was more than 40 percent at the beginning of the new millennium, and then steadily declined to very low levels ranging from between 26 percent to 29 percent during FY07–10. It then started to increase steadily in recent years, spiking again to about 40 percent of the government's total expenditure.

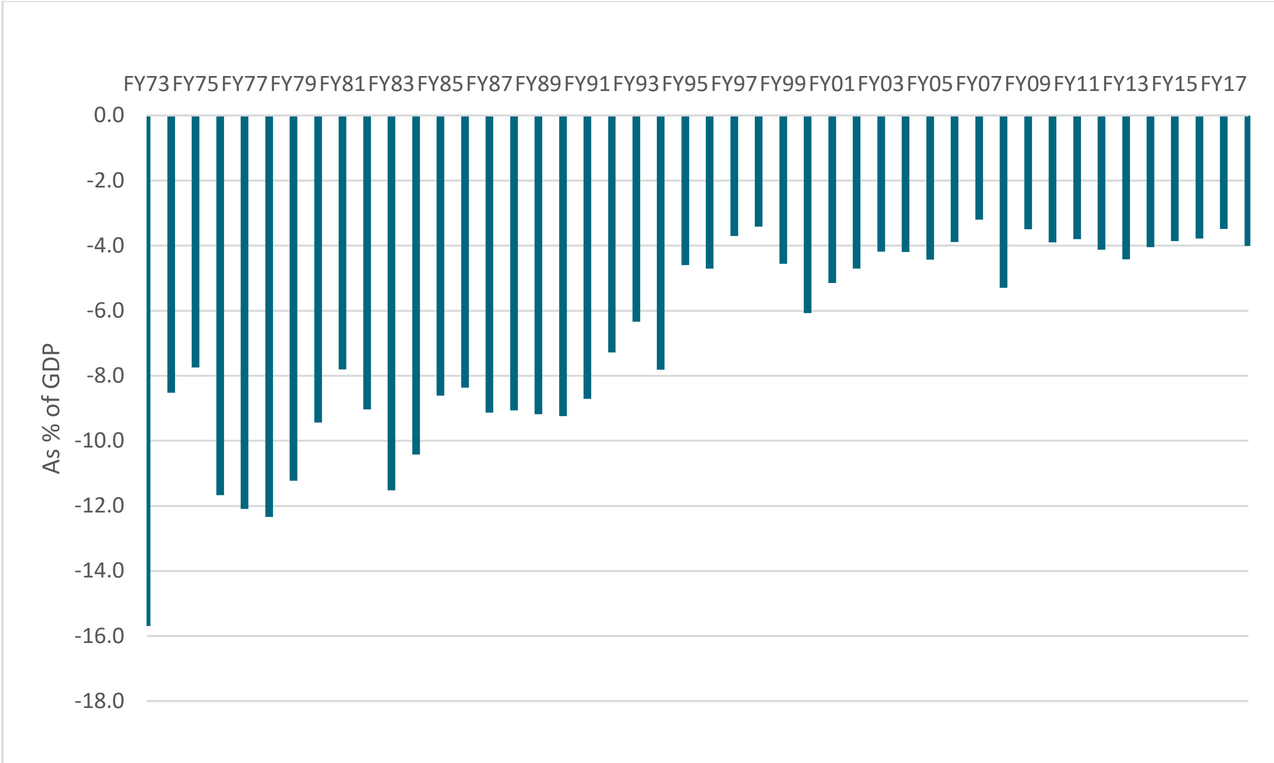
In recent years, the major focus of ADP has been on six sectors—agriculture, electricity, energy and minerals, education, health, and transportation. During FY09–FY11, the education sector was given priority over all other sectors, followed by transportation. While this was a healthy indication of the social development goals of the presiding government, it shifted momentum away from the equally important power sector.

Lack of sufficient power has been a major problem for the manufacturing sector of Bangladesh, and therefore a reduction in development funding for this sector did not bode well for the economic health of the country. Complaints from the business community were heard by the government, however, and it responded by providing the power sector with the highest allocation of ADP in FY12 and FY13. Thereafter, the government prioritized the transportation sector, including the construction of the self-funded $4 billion Padma Bridge project. Padma Bridge would be a major step in infrastructure development, as it connected the northern and southern parts of the country with a standard road system—a great milestone in developing the southern regions of Bangladesh. Altogether more than 10 mega projects, including the $13 billion Ruppur nuclear project, the $7 billion Matarbari deep seaport, and the Karnaphuli tunnel, are currently under construction.

3. Fiscal Deficit and Financing

Until the mid-1990s the overall fiscal deficit was on the high side, ranging from between 8 percent to 12 percent of the country's GDP most years. In those initial years, Bangladesh received much higher external financing in the form of grants and loans, allowing the government to maintain high levels of fiscal deficit (excluding foreign grants) without any significant reliance on domestic borrowing, particularly from the country's own banking system. A look back at this trend shows that the overall fiscal deficit was about 8 percent of GDP almost consistently during FY73–FY94, and that deficit levels also rose to between 11 percent and 12 percent of GDP on several occasions. However, the government since then has managed to contain the overall deficit at levels below 5 percent of GDP, except for one or two outlier years, due to special circumstances. This is a great achievement for a developing country like Bangladesh, which faces political instability, revenue constraints, and recurring natural calamities (see Figure 12).

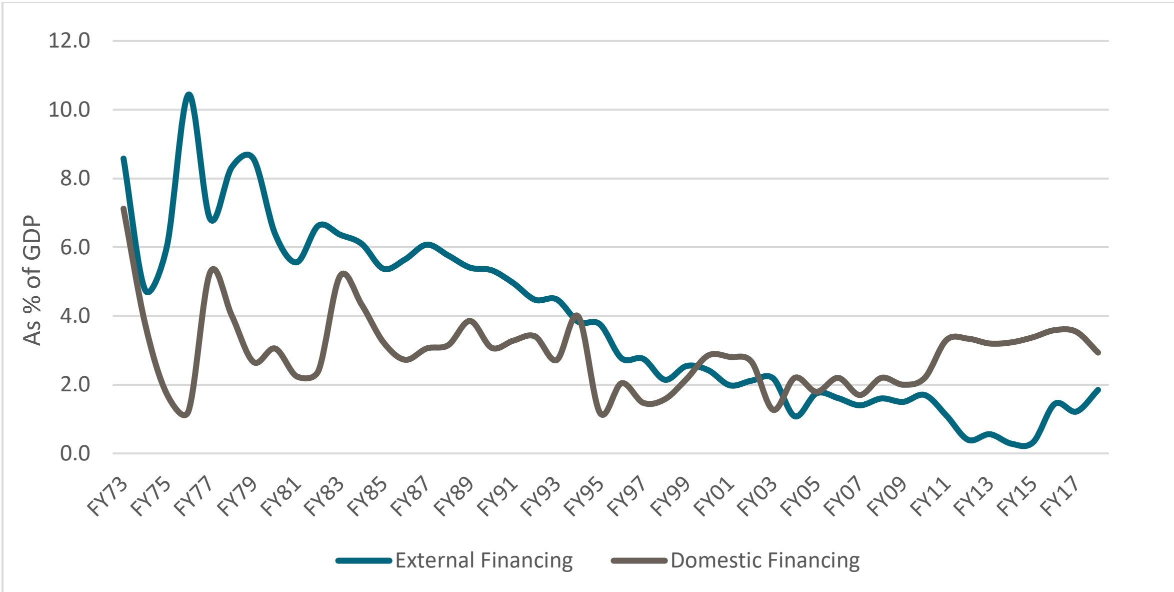
Figure 12. Historical fiscal deficit



Source: Ministry of Finance

The financing strategy adopted by the Bangladeshi government entailed using highly concessional external financing from multilateral organizations like the World Bank and the ADB and bilateral sources for the purpose of budget and balance of payments financing. During the first two decades that Bangladesh kept official financial records, the export base was very narrow and was dominated by agricultural products like jute and tea. During these decades, inflow of workers' remittances also was limited. In those early and economically difficult years, the government needed higher levels of external financial support to pay for the imports necessary for maintaining food security and for running the economy. A large part of the support coming from development partners was provided to the government in the form of grants, which enabled the country to continue with large fiscal deficits (excluding grants) without creating macroeconomic instability. At its peak, Bangladesh's reliance on external financing was more than 10 percent of its GDP (see Figure 13).

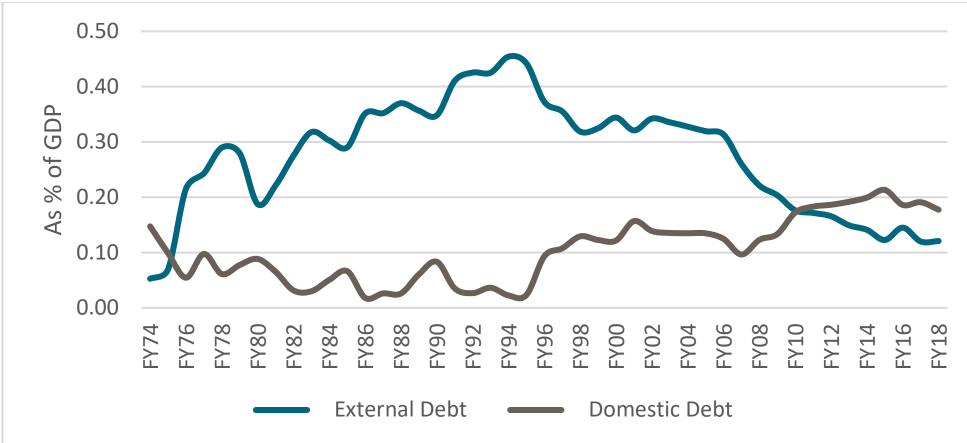
Figure 13. Historical deficit financing trend—external and domestic



Source: Ministry of Finance, Bangladesh Bank

The strategy, however, has shifted since the mid-1990s, as external financing became more difficult to secure in the wake of the collapse of the former Soviet Union and the growing demand for donor support from Eastern European and African countries. Bangladesh's economy also gained strength in the meantime, expanding its RMG-based manufacturing exports and growing its inflows of remittances from Bangladeshi workers abroad. As a result, the economy was in a position to reduce its dependence on external financing and withstand internal pressures arising from higher domestic borrowing, a feat it accomplished by using domestically generated foreign exchange receipts. This shift in financing consequently led to the steady buildup of domestic debt since mid-1990s and the resulting increase in interest payments on domestic debt (see Figures 14 and 15; see also Figure 16 for interest on foreign debt).

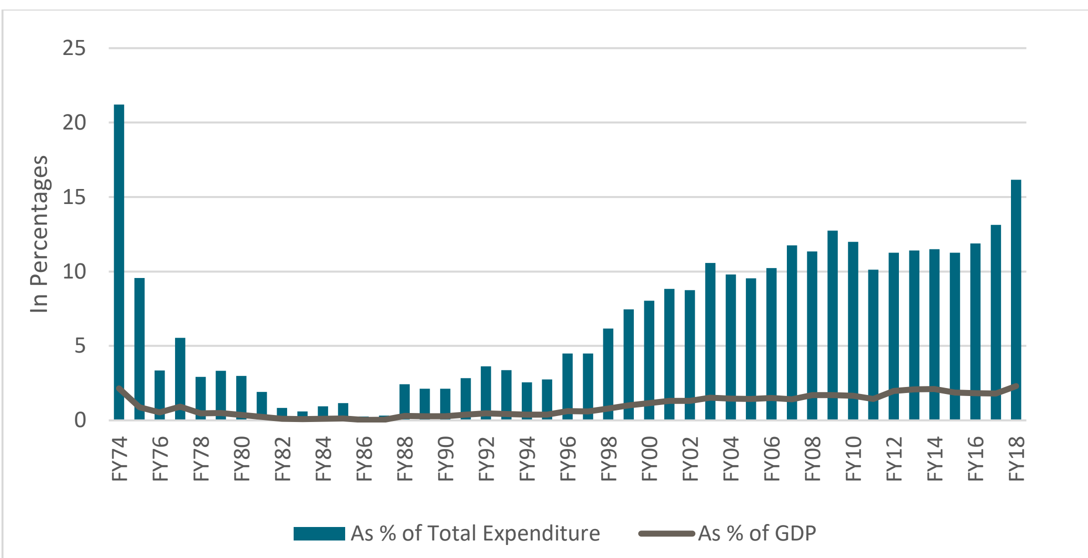
Figure 14. External and domestic public debt



Source: Ministry of Finance, Bangladesh Bank

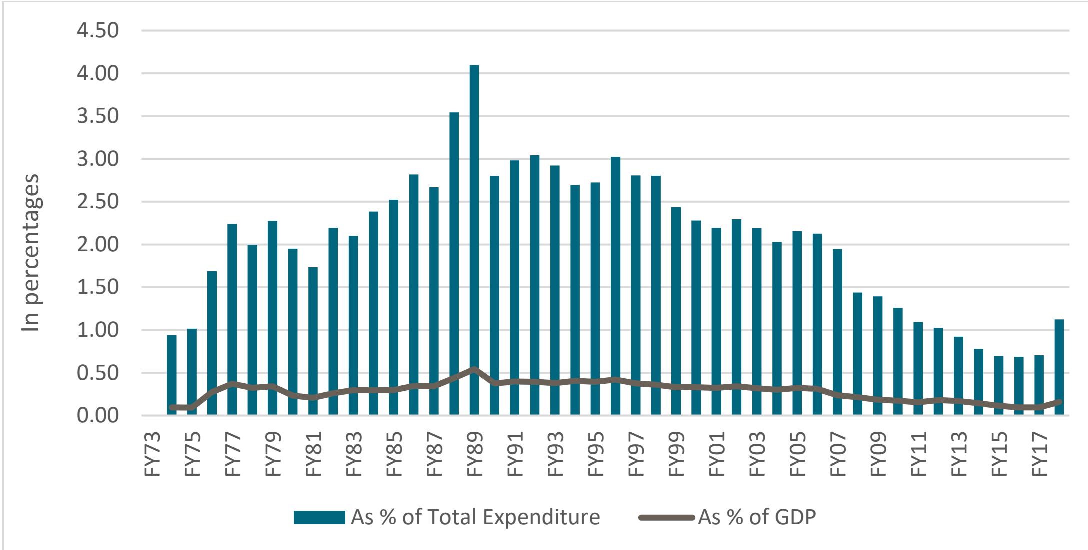
Interest payments constituted 1.8 percent of the country's GDP and 20.4 percent of total expenditure during the period FY99–17. During this period, external financing accounted for more than one-third of the country's budget deficit financing, and rose to 37.1 percent in 2018, from 24.4 percent in 2017. On the other hand, domestic financing is primarily done through bank and non-bank borrowing, the latter being at very high interest rates, which in turn contributes to the rapid buildup of interest payments on domestic debt.

Figure 15. Interest on domestic debt



Source: Bangladesh Bank

Figure 16. Interest on foreign debt



Source: Bangladesh Bank

4. Political and Institutional Constraints in Raising Domestic Revenues

4.1 Institutional Constraints to DRM

Based on the developments in revenue mobilization, it appears that **Bangladesh's tax system suffers from serious deficiencies in both the tax policy and tax administration fronts.** In the 48 years since its independence, only in the early 1990s did the country attempt reforms in this area. These reforms were implemented through (i) introducing the VAT Act of 1991, with support from the IMF and the United Nations Development Partnership (UNDP); and (ii) completing, in part, reforms of the import duty and tariff structure. In the latter reform, the maximum customs duty rate was reduced to 25 percent from much higher rates, and the number of duty slabs was reduced to six slabs—0 percent or exempt; 3 percent; 5 percent; 10 percent; 15 percent; and the maximum 25 percent. The logic of the structure was based on World Bank-supported trade reform initiatives. These twin reforms also furthered shifts in the country's overall tax structure, lessening its dependence on customs duties and increasing its reliance on domestic-based taxes like direct taxes and the VAT. The tax-to-GDP ratio also improved in the 1990s, despite a significant reduction in Bangladesh's reliance on trade-based taxes through tariffs.

Gains in VAT revenue collection could not be sustained beyond one decade in the absence of supporting reforms and in the presence of distortions created over time. As part of the VAT overhaul, the VAT system was expanded in the late 1990s from its original role in imports and manufacturing to selected wholesale and retail sectors. This expansion was met with substantial resistance from various trade and industrial associations, such as the Retail Shop Owners' Association, the Jewelry Association, the Sweet and Pastry

Shop Owners' Association, and many other retail organizations that were mostly outside the VAT network. As part of a political compromise, the government agreed to adopt a mixed system with lower effective tax rates (using what they called a truncated tax base), or fixed annual amounts for shops that met certain criteria. This latter option, called the "package VAT," was based on a sliding scale, with different amounts set for different locations. Some key sectors, like construction, steel rerolling mills, and jewelry industries, were brought under the truncated VAT system, with various effective lower tax rates. Introducing these distortionary measures, however, did not yield any positive results, and tax collection rates at the retail and wholesale levels remained very low. Additionally, many of the promises made by various trade organizations proved empty when it came to tax compliance. At the time of negotiations, these organizations made commitments to the government that they would collect hundreds of billions of taka in additional revenue from the package VAT, but in reality tax compliance was so poor that total collection did not exceed even Tk. 0.3 billion in any of the following years.

Customs tariffs initiated in 1990s also could not be sustained, and in part reversed in the following two decades. The Bangladeshi government's efforts to rationalize the customs tariff structure, with a view to boosting the economy, also was sabotaged in the last decade from domestic manufacturers seeking higher degrees of protection. The tariff was implemented primarily by introducing para-tariffs, such as regulatory duties, on a range of imports at 5 percent, and by applying supplementary duties only on imported goods (under the VAT Law of 1991). The original VAT Law of 1991 intended the supplementary duty structure to be applied at equal rates to both domestic and imported goods and services in a non-discretionary manner. However, in the event, supplementary duties only were imposed on imports, and at various rates, ranging up to 450 percent on automobiles and cigarettes. In many instances, the supplementary duty rates were so prohibitive, they virtually eliminated possibilities for imports.

Direct tax rates are high in Bangladesh, but the revenue collection level is very low, pointing to poor tax efficiency in direct tax administration. As previously noted, Bangladesh has one of the highest corporate and personal income tax rates in the region and also globally. The maximum corporate tax rate is 35 percent for companies not listed on the stock exchange, and 25 percent for the 300-plus companies listed on the Dhaka and Chittagong stock exchanges. Some sectors, like banking, telecommunications, and tobacco, are taxed at even higher rates, such as 40 percent for banks, and 45 percent for telecommunications companies and the tobacco industry. Much of the corporate income tax is collected from these three sectors, which are mostly publicly listed. However, tax collection from non-listed companies, which compose the overwhelming majority of companies in Bangladesh, has been very modest, due to improper accounting, tax exemptions and holidays, and collusion with tax officials.

On the personal income tax side, Bangladesh suffers from a very low tax base, a high tax rate, and a very weak tax administration system. As noted at outset of this paper, personal income tax rates in Bangladesh are quite high, with a maximum personal income tax rate of 39 percent, which includes a wealth surcharge. Complicating matters, the tax base is very narrow, with about 1.3 million Bangladeshi citizens having taxpayers' identification numbers (TINs), and less than one million (about 0.9 million) actually submitting tax returns. The number of TIN holders in Bangladesh in fact accounts for less than 0.8 percent of the country's population, and the actual number of tax returns submitted is even less, at only 0.5 percent of the population. A generous threshold level and frequent upward adjustments on the exemption level also have hindered personal tax collection efforts. Currently set at Tk. 250,000, the exemption level in Bangladesh is almost 160 percent of per capita income in the country. Although household income has been expanding at a satisfactory pace, the frequent upward adjustments to the exemption level have enabled most Bangladeshi citizens to remain below the tax threshold.

Despite a rapid expansion of the industrial and service sectors, payroll tax collection is very low in Bangladesh. The National Board of Revenue (NBR) has expanded its regime of withholding wage taxes over time, and this accounts for a growing proportion of direct income tax collection in Bangladesh. However, much of the withholdings have been applied to contractors, importers, and even to sales of iron and steel to developers, homeowners, and owners of automobiles—in the case of automobiles even varying according to the size of the vehicle. The income tax law also requires employers to withhold 10 percent of employees' salary as payroll tax and deposit the amount collected every month to the Bangladesh treasury. However, the amount collected is not monitored closely by the NBR or tracked either centrally or locally by tax commissioners. The fragmented nature of tax administration, based on geographic administrative units rather than on functional distribution, has contributed to virtually no monitoring of withholding mechanism. Lack of centralization of information and database has led to fragmentation of tax administration and missing information resulting in double counting of taxes as well as missing of taxpayers or diminished tax compliance. As a result, many employers may not be fulfilling their legally mandated withholding requirement, and in many instances, employees are not filing their personal income tax returns, either.

Key sectors of the economy remain virtually outside the tax net. Revenue collection from both direct and indirect taxes also has been impacted by extensive use of tax benefits offered to key sectors of the economy. These benefits extend to the RMG and energy and power sectors, and also include tax breaks given to firms establishing themselves at export processing zones. Tax holidays offered to industries with different criteria, such as location and modernizing capabilities, further drain revenue.

The RMG sector is, by far, the most dynamic sector in Bangladesh, with gross exports standing at more than 12 percent of the country's GDP—but the sector pays hardly any taxes. The corporate tax rate for RMG is only 12 percent, compared to 35 percent for all other non-listed companies. To make matters worse for revenue collection, even that percent is not paid by most RMG firms, however, and thus the government has imposed a minimum tax of 0.3 percent as a gross turnover tax on RMG export products. The energy and power sector is another sector to which the government grants generous VAT, customs, and income tax benefits, supposedly to encourage private sector investment in power generation. These tax benefits, coupled with generous power purchase guarantee agreements, while lowering overall revenue collection, have, however, worked to attract a large number of domestic and foreign investors to the lucrative power generation and liquefied natural gas terminals in Bangladesh. In some instances, VAT exemptions also are offered to certain emerging industries, like electronics, to promote and protect the domestic electronic sector. While necessary from political economy ground, the combined cost of these various tax benefits to Bangladesh was estimated by the NBR to be about Tk. 450 billion (2.1 percent of GDP) in FY18.

Tax administration is outdated and cannot keep pace with the rapid expansion of the economy and the expansion of the country's potential tax base. Tax administration in Bangladesh, as noted earlier, is almost entirely manual and paper based. Tax collection is provincial, a vestige of the British colonial administration in the 1940s, and information sharing between the three wings of the NBR—VAT, customs, and direct taxes—is further hampered by the separation of tax cadres into two parts: customs and VAT; and direct tax. Both cadres operate provincially, where all tax-related issues are handled by VAT, customs, and direct tax commissioners working in silos. To quash cooperation even further, past efforts to merge the two cadres have been undermined by strong resistance from the customs and VAT officials, who consider themselves superior to the direct tax officials. The rivalry has seriously undermined domestic revenue mobilization efforts, and measures to streamline the VAT administration, as set forth in the VAT Act of 2012, have been resisted by powerful field officers, who see the measure as usurping their power.

Lack of separation between tax policy formulation and tax administration contributed to a lack of focus and slower reform in both areas. The NBR's aim is to collect taxes across Bangladesh for each of the three tax wings through main administrative units called commissionerates, which are led by senior field-level tax officials called commissioners. In the early part of the new millennium, there was a proposal to separate the tax policy formulation functions from the NBR by establishing a separate division under the Ministry of Finance called the Tax Policy Division.

The proposed Tax Policy Division was supposed to be staffed with tax policy experts from inside and outside the government, who had the exclusive role of continuously reviewing emerging developments and challenges in order to make necessary changes in tax policy. It was intended that they would take into account various issues, like the need for reforms in certain areas of tax policy, and that they would amend relevant tax laws or rules, or even draft new laws and rules in order to bring about fundamental changes. The NBR strongly resisted such a fundamental reform, however, on the grounds that separating tax policy from tax administration would undermine tax efforts and ownership of certain revenue targets. Eventually given its way, the NBR was then allowed to establish separate tax policy departments in all three wings of the NBR, under three newly created positions—VAT member (policy), direct tax member (policy), and customs member (policy). The establishment of three separate tax policy departments in three separate wings of the NBR only further separated policy formulation functions among the three wings. Furthermore, since these senior positions were awarded to high-level tax administrators from the field, this change failed to bring about any measurable advances in tax policy formulation or in related reform strategies.

Deficiencies and incomplete design of reforms, along with half-hearted implementation from development partners under pressure, also contributed to unsuccessful or failed efforts. The NBR has initiated many piecemeal reforms in recent years, such as automating income tax payments, which was done to improve a single process while leaving front- and back- end functions unchanged. Additionally, this did not address any fundamental business processes and only minimally improved the tax payments side with technology upgrades while leaving all other manual processes unchanged. Introducing electronic cash registers for all sales, in order to track VAT-registered enterprises, was one measure that could have garnered real returns, but the measure failed, due to procurement problems and noncooperation from VAT-registered enterprises.

4.2 Political Constraints to Domestic Resource Mobilization

The political economic environment in Bangladesh has not supported necessary reforms in tax policy and tax administration. Strong political commitment to tax reform is lacking in Bangladesh, and the disconnect between field-level tax officials and tax-evading businesses has further undermined tax reform efforts from both within and outside the NBR. An example of this can be seen in the lack of political commitment to the VAT Act of 2012. The VAT Act of 2012 was drafted by the NBR with technical assistance from the IMF and IFC in an effort to improve the tax system—specifically the elasticity of the VAT and the efficiency of its administration. IMF staff, Policy Research Institute senior consultants, and NBR team members worked for four years during FY10–FY13 to finalize the VAT law, extensively consulting with parliamentary committees and business communities. A committee headed by the adviser to the prime minister of economic affairs also consulted with representatives from business organizations before finalizing the new law. Once finalized, the new VAT was signed into law by Parliament in December 2012, with the aim to make it effective on July 1, 2015, a date set as one of the IMF's program conditions. As the IMF program lapsed and as the Bangladeshi government's financial position improved with the central bank's reserves exceeding eight to nine months of goods and services imports, the government lost interest in the IMF program.

The new VAT law was first delayed by one year, to FY17, on the grounds of a lack of administrative preparation. After one more year of preparations, however, when the NBR was willing to implement the VAT at last and the finance minister was fully committed to it, as well, Bangladesh's government once again postponed the new VAT law by two years, to FY20. This move was because of strong resistance and political lobbying by the Federation of Bangladesh Chamber of Commerce and Industries and was further influenced by the general elections of December 2018. Although the government was interested in getting more revenue through an improved VAT system, the election cycle and its associated political considerations ultimately postponed the new VAT law.

A lack of commitment from high-level policymakers also was reflected in other areas of tax reform. For instance, a new customs act draft was prepared several years ago, with support from the World Bank, and was promptly submitted to the Bangladesh cabinet for approval—to no avail. And though there is a widespread realization that direct tax codes in Bangladesh need reform, due to resistance from the NBR and a lack of political commitment, reforms have ground to a halt. The IMF, the World Bank, and the European Union have been offering technical assistance for reforms on this front, but still there is not much government engagement.

The NBR adopted a modernization plan for itself in 2012, and it submitted this to Parliament for feedback. This was a fairly good initiative, was prepared in a cooperative manner with all relevant stakeholders, was supported by the IFC, and had a great degree of ownership by the NBR. With the change in NBR leadership, however, the initiative got shelved and did not reach the implementation stage until recently.

5. Capacity-building Support by Development Partners

5.1 Capacity-building Support on Domestic Resource Mobilization

In general, development partners like the World Bank, the IMF, the Asian Development Bank (ADB), the IFC, UNCTAD, and the European Union (EU) have been very supportive of reform initiatives on the tax front and trade facilitation fronts. The IMF has generally been credited with introducing the VAT law in 1991 and with drafting the new VAT Act of 2012. Also, the IMF has provided international experts with relevant expertise at different stages of preparation. First, it started with legal experts who helped draft the new law together with national experts provided by the IFC. Second, the IMF provided international experts to help establish the VAT implementation cell and prepared a detailed strategy for implementing the new VAT law in Bangladesh. Finally, IMF experts, together with the VAT implementation cell, prepared the Terms of Reference (TOR) of the VAT Online Project, which was financially supported by the World Bank.

UNCTAD has been helping the customs wing of the NBR modernize the customs clearance process at the main port of Chittagong and has subsequently been instrumental in expanding this to other major ports like Mongla and the Benapole Land Port with India. UNCTAD helped implement the Automated System for Customs Data (ASYCUDA) system in the late 1990s, and then upgraded that to the ASYCUDA Plus system, which it in turn recently upgraded to the ASYCUDA World system. These ASYCUDA projects, while implemented by UNCTAD experts, were funded by different donors and the World Bank.

The IFC has helped the NBR improve tax administration and reform certain aspects of tax policy, with a view to improving the ease of doing business and boosting the investment climate. It helped the NBR introduce the Alternate Dispute Resolution (ADR) System to resolve the huge number of unsettled tax cases stuck in the court system. The IFC helped draft laws, in coordination with the Ministry of Law and the NBR and helped apply international best practices related to ADR to settle tax disputes. The IFC also helped establish the Bangladesh International Arbitration Center to help resolve the ADR and other commercial disputes. Additionally, the IFC helped the NBR undertake small-scale reforms related to the VAT, with the aim of moving toward comprehensive VAT reform in light of the VAT Act of 2012. The IFC also helped automate the income tax payments system, although that piecemeal approach did not have any real impact.

The World Bank has been helping the NBR on customs tariff rationalization, reform, and the expansion of its customs-bonded warehouse system to the non-RMG sector. It also is helping with trade facilitation issues. Support in these areas is being provided over the long-term, in the form of technical assistance, as needed. Since 2015, the World Bank has helped the NBR with the VAT Online Project rollout.

The ADB also has helped the NBR with partially automating a direct tax system. However, this intervention was also piecemeal in nature, did not involve changes in the business processes, and failed to achieve any noteworthy improvements in direct tax administration by the NBR.

More recently, the EU has reached an agreement with the government of Bangladesh to aid the NBR in implementing its modernization plan. This is currently at too early a stage to have an impact. The World Bank is about to embark on developing a Medium- Term Revenue Strategy (MTRS) that can eventually be adopted by the government. The Expression of Interest (EOI) is soon to be issued by the government and World Bank for selection of a consulting firm to draft the MTRS.

In general, development partners were careful to avoid duplicating technical support by forming the Local Consultative Group (LCG), a consortium of all development partners providing support to the Bangladesh Government. The LCG, co-chaired by one of the development partners, meets regularly or as needed to coordinate ongoing involvement in Bangladesh and avoid duplicating support by development partners in any one area.

As noted earlier, development partners are aware that many development initiatives undertaken by the government will take massive amounts of resources. Chief among these initiatives are implementing the country’s sustainable development goals (SDGs); eliminating absolute poverty by 2031; reducing general poverty to 15 percent or less; and making Bangladesh an upper-middle-income country by FY31. Massive investments also will be needed in human resource and infrastructure development. On the human resources front, education, health care, poverty alleviation, and the creation of a social safety net will require tremendous outlays of funds. And on the infrastructure front, modernizing utilities (such as electricity, water, and sewage treatment); upgrading transportation systems (such as roads, waterways, railways, seaports, and airports); and developing urban communities (such as satellite towns and planned housing tracts) will demand just as much attention and funding. Most of these public sector investments must come from domestic resource mobilization, and effective functioning of the country’s national Board of Revenue will be critical. Thus, development partners are very eager to support tax reform initiatives. A lack of committed political support, resistance from NBR field officials, and opposition from certain quarters of the business community, however, are strong opponents to real progress.

5.2 Capacity-building Support Provided by Development Partners on PFM

The Bangladesh government has been reforming public financial management (PFM) since the 1990s, with successive donor-supported projects. The first major PFM project was funded by the Department for International Development (DFID) of the UK government and was called reforms in budgeting and expenditure management (RIBEM). The principal outcome of this project was to improve the timeliness and availability of financial information related to budgetary operations. Building on the gains made under RIBEM, the government undertook a new five-year project in 2003 called the Financial Management Reform Programme (FMRP). This new project was a multi-donor initiative comprising DFID of the UK and the Royal Netherlands Embassy, and had five objectives. These were to strengthen the auditing process and boost parliamentary scrutiny of PFM; to enhance aggregate fiscal management and develop a regulatory framework for financial management; to improve resource allocation and utilization; to strengthen financial management in line ministries; and to build the Financial Management Academy as a sustainable center of excellence for financial management training of government officials.

Following the FMRP, a multi-donor initiative, called the Strengthening Public Expenditure Management project, was spearheaded by the World Bank in 2010 to cover the time frame 2010–2015. Although the outcome of this project was mixed, significant improvements were made in financial management in several areas. These areas included strengthening the medium-term budget framework (MTBF) and expanding the MTBF process to all line ministries; adopting a modern budget classification across the government; strengthening the debt management capacity of the Ministry of Finance by installing internationally accepted software packages; and expanding and improving the Integrated Budgetary Accounting System, up to the lowest level of the central government. This last improvement enabled real-time monitoring of all fiscal outlays anywhere in Bangladesh. Efforts also were made to integrate the MTBF with the Five-Year Plans of the government so that the Five-Year Plan objectives would be appropriately reflected in future MTBF proposals submitted by the line ministries.

Development partners like the World Bank, the United Nations Development Partnership (UNDP), and the Japan International Cooperation Agency (JICA) also have provided technical support to the Ministry of Planning in formulating the Five-Year Plans. They also have been instrumental in conducting background studies and quantitative modeling (World Bank and UNDP); in preparing operational plans consistent with the Five-Year Plans (UNDP); and in strengthening the evaluation and monitoring of projects under the ADP (JICA).

Development partners also have helped the Bangladesh government improve economic statistics and monitor socio-economic developments in various ways, assessing issues such as poverty, the labor force, household income and expenditures, vital statistics, and census data. The World Bank also has provided assistance to the Bangladesh Bureau of Statistics in identifying poor households through Proxy Means Test methods, for possible use in offering social benefits to poor households.

In general, development partners have assisted the government in a range of areas, with a view to improving budgetary efficiency through improved planning, monitoring, and evaluation. Generally, projects have been demand-driven, and in almost all cases relevant sectors of the government have shown interest in improving PFM, project design and implementation, and evaluation of project and program performance.

Looking forward, development partners should continue to support PFM-related reforms in areas covering central government operations. These areas include reforming the social safety net system, with the goal of improving its targeting methods. This would involve restructuring the entire social safety net system, which comprises more than 150 programs, into a comprehensive life cycle-based social security system. Reforms also are needed to strengthen public financial management within local government institutions like the Union Parishads (councils), the Upazila Parishads (sub-district councils), the Zila Parishads (district councils), municipalities, and city corporations. The public sector service delivery system also needs to be reformed, and the Integrated Budgetary Accounting System needs to be expanded beyond the central government to include local government sectors receiving fiscal transfers from the government.

6. Going Forward

6.1 On the Domestic Resource Mobilization Front

Bangladesh's main challenge is to increase its tax-to-GDP ratio to a level commensurate with its state of development. Under the sixth Five-Year Plan (FYP) covering FY10–15, the government tried to increase the tax-to-GDP ratio by more than 4 percentage points, to about 14 percent of the country's GDP. Failing in this attempt, it achieved an increase of less than one percentage point over the five-year period. Once again, the government aimed to increase the tax-to-GDP ratio by 4 percentage points under the ongoing seventh FYP covering FY16-20. While Bangladesh is approaching the final year of the seventh FYP, however, the tax-to-GDP ratio has declined only marginally, and it seems very unlikely that the NBR will achieve its target for revenue mobilization.

Bangladesh has made some progress in rebalancing its tax system by reducing its dependence on trade-based taxes and increasing its reliance on domestic taxes like the VAT and income taxes. This healthy structural shift will likely continue in the coming years, with reliance on the VAT and income taxes growing over time.

Trust in government in delivering services is certainly low. Poor service delivery, low level of coverage for basic services, widespread corruption which forces people to buy services which are supposed to be free, and low quality infrastructure projects certainly undermine public interest in paying taxes for public services. Nevertheless, the government has introduced Tax Cards for regular taxpaying citizens, the NBR organizes VAT Day, Income Tax Day and Customs Day to reward the institutions and persons who are the top taxpayers. Regular advertisements are made through TV and print media to create awareness among taxpayers and to ensure conducive environment for paying taxes (through Tax Fairs for income tax payers). These efforts notwithstanding, ultimately it is through credible and efficient tax administration that countries collect taxes. Bangladesh needs to focus in the core areas of VAT and direct taxes, as noted below.

Going forward, on tax policy front, the focus must be on the VAT and direct (income) tax systems, as the significance of trade- based taxes will continue to decline over time. Implementing the VAT Act of 2012 and carrying out automation and reforms within the VAT administration, must take priority. Detailed roadmaps for these changes have been completed under the World Bank-supported VAT Online Project, but could not be implemented, due to resistance from VAT commissioners. However, the so-called "new" VAT act, adopted in the FY20 budget, has reversed reform efforts, and the system has become more complicated. New reforms to the VAT law are needed to undo the damage done through the current VAT act.

On the direct tax side, comprehensive reforms have yet to start. NBR officials have drafted a preliminary version of a possible new direct tax law or direct tax code, but that has many deficiencies and needs to be vetted by international direct tax law experts. Delays in implementing the new VAT law, and the lack of political support behind it, have essentially shelved the new law on direct taxes. This issue needs to be addressed promptly, with technical assistance from the IMF and the World Bank, in order to modernize the direct tax codes and implement them effectively. Even if the process starts immediately, it will take at least five years to complete reforms on this front.

Tax exemptions of all kinds are significantly eroding the tax base and tax elasticity. The NBR estimates Bangladesh's tax expenditure to be more than 2 percent of GDP, and the actual figure is probably much higher. Special tax treatments for the RMG and power sectors, along with generous tax holidays and exemptions for special economic zones, are major sources of tax base erosion, and must be reviewed.

Going beyond tax policy issues, the **NBR also must initiate reforms in tax administration in all three wings—VAT, customs and direct taxes—along functional lines.** Efforts should focus on completely automating tax administration functions, which would streamline processes and make them efficient without compromising any safeguards. Key functions to automate include assigning taxpayers (both individuals and businesses) common TINs for all types of taxes; centralizing tax return processing; implementing a payment system that connects taxpayers, commercial banks, the central bank, and the accountant general's office; and developing an auditing process that selects, monitors, and integrates findings with the payment system and taxpayers' records.

Along with restructuring tax administration along functional lines, the **NBR also needs to integrate information sharing among the three wings.** At present, the VAT and customs wings are using business identification numbers for identifying VAT-registered entities, while the direct tax wing uses the TIN for identifying individual taxpayers. There are two parallel registration systems, in other words, and neither is communicating with the other for sharing taxpayer information.

The key lesson learned on DRM front is that important structural changes, while prepared in consultation with stakeholders, must be forcefully pushed forward from top down. The field formations of the NBR have very well-entrenched vested groups who would not support any effective restructuring and automation of tax administration and any modernization of tax laws in line with international best practices because such changes would reduce the discretionary authorities of the tax officials and thereby help reduce corrupt practices. On every occasion, NBR field formations opted for maintaining the status quo through fear mongering such as taxpayers will be abusing the new system. Real and effective change management have been a problem and in most cases failed leading to failure in reform programs.

Based on consultations with development partners, it appears that all relevant development partners are ready to provide technical assistance to the NBR and financial support to the government to initiate reforms in the areas mentioned above. The World Bank has been supporting the VAT Online Project with a pay-for-results type program, but that will not improve the outcome of the project without strong political commitment and a clear understanding of the issues.

6.2 On the Expenditure Front

Looking forward, Bangladesh needs to broaden its range of service delivery programs and enhance the quality of its public services. The scope of Bangladesh's public service delivery programs will continue to be limited by constraints on domestic revenue mobilization. Greater efficiency with resources is needed in order to get better results from money spent. Ensuring that resources are used wisely will not be easy in the prevailing political system, which has virtually no accountability. Nevertheless, some progress can be made through enhanced transparency. Areas where transparency is particularly needed are in project selection; in strengthening the PFM system; and in strengthening the implementation and monitoring of public sector projects. Measurable improvements to the non-project public service delivery program will be even more difficult to make because this area requires improving education, improving public health care service delivery, and improving the efficiency of social safety net programs.

Given Bangladesh's good expenditure control, as demonstrated in its ability to keep the fiscal deficit below the 5 percent of GDP target, Bangladesh does not really need a fiscal rule. For all practical purposes, the 5 percent of GDP target is a benchmark to ensure continued fiscal discipline and has anchored macroeconomic stability in Bangladesh.

In terms of fiscal transparency and PFM reforms, Bangladesh needs to do better. Some progress has been made with e-tendering of projects by ministries, and Bangladesh has made significant progress on the PFM front and in fiscal transparency. However, fiscal transparency is a continuous process and new initiatives are constantly being added to enhance fiscal transparency internationally. Notwithstanding the gains, Bangladesh has weak spots and is challenged to catch up in many areas. To address these weak spots, some simple interventions have been identified, which, if implemented, would enhance Bangladesh's standing on this front globally. Interventions can be done in the short-term (one to two years) to help Bangladesh improve its fiscal transparency, and since Bangladesh does not meet certain criteria set by international agencies (including the US State Department), and hence ranks poorly among international rankings, such as the GFS Index and the Open Budget Index, interventions could improve Bangladesh's fiscal transparency significantly.

In addition to the interventions, efforts should be made over a five- to 10-year period to address areas where more time will be needed. These reforms will require rigorous work and strong political-economic decision making. These reforms, noted below, will help improve fiscal transparency and expenditure efficiency in Bangladesh.

- All **quasi-fiscal activities** by government agencies and the Bangladesh Bank should be clearly defined as quasi-fiscal activities, and some estimates should be provided in the budget. The cost of all quasi-fiscal expenditures needs to be quantified, and the assessments need to be relayed to Parliament and posted to the Ministry of Finance (MOF) website.

- The **budget draft should be intensively scrutinized and vigorously debated**, as well as amended with justified alterations, by the legislature.

- **All contracts relating to the extractive industry and mega infrastructure projects must be made transparent and publicly available**. All production sharing contracts (between international corporations in the resource sector and the government must be put in the public domain.

- Detailed **breakdowns of subsidies to public corporations** should be explicitly bolstered with budget documents.

- **Any supplementary budget** requesting authorization for additional spending **should be presented to Parliament before actual spending** is incurred.

- All fiscal reports and information should be updated online. The data should be readily available in both Bengali and English in user-friendly ways.

- Clear boundaries of the roles and legal provisions of various government bodies involved in fiscal management should be comprehensively defined under one document.

- **Clarity is needed on how profit transfers or dividend payments** from nonfinancial public enterprises **get passed on to the government budget, and this transfer process needs to be determined and enforced.**

- All government procurements should come under the Electronic Government Procurement program of the government, which is currently underway.

- The medium-term framework for the budget needs to be better aligned in accordance with different national plans, including fiscal year plans.

- Debt management should be done by a single agency or division of the Ministry of Finance.

- Fiscal accounts of the nonfinancial public sector need to be derived by consolidating the budgetary accounts of the central government, local government entities, and the nonfinancial public enterprises.

- Forecasting of the national budget and revenue needs to be streamlined and made more realistic. Forecasting needs to be undertaken jointly by the NBR and the macroeconomic wing of the Ministry of Finance.

- Bangladesh has a **huge unfunded liability, due to civil and military pension systems**. The current pension policy needs to be actuarially forecast, and the issues need to be made public.

- Bangladesh needs to **participate in the Construction Sector Transparency Initiative** to standardize its massive anticipated infrastructure spending.

- Bangladesh must **start building a general government account**. It could start with city corporations and expand to all municipalities.

- More information must be made available to Parliament and to citizens for an **informed public debate on the size and composition of the country's defense budget and its appropriateness in the overall security context**.

- A budget analysis of the impact new policies will have on society needs to be carried out.

Strengthening the oversight system for projects under the ADP will require technical support and capacity-building for the implementation, monitoring, and evaluation division (IMED) of the planning commission. At present, IMED only monitors the amount of money disbursed to projects and does little to monitor physical progress and quality of project implementation. IMED does not have the qualified engineers or other experts who could determine project implementation against contractual specifications. IMED also does not inspect most project sights or perform evaluations. This area will require much improvement, since almost 40 percent of the country's budget is implemented under the ADP, and beyond line ministries IMED is the only government body with the authority to ensure quality project implementation.

Ensuring quality improvements in public service delivery will continue to be difficult, given the weak administration and widespread corruption and politicization across the health care and education ministries. After the issues of universal access and gender balance in the education sector were tackled, the focus shifted to boosting the quality of education in public institutions and vocational schools, in order to minimize skill mismatches in the workforce. Given the decline in quality public education in recent decades, despite the government's success in ensuring universal primary education and broader access to educational institutions, a renewed push must be given to improve quality of instruction and skill development in the country's public education system.

Problems in the public health care system will require strong administrative interventions and de-politicization of government medical colleges and universities. Absenteeism among doctors at government hospitals and clinics has reached epidemic proportions and will require very strong efforts by the health administration to curb. This effort needs to be backed by political leadership. Enhancing the skill level of doctors and medical technicians also is critical, in order for them to keep pace with the rapid changes in the medical field and in medical technology. Along with at least doubling budgetary allocations, ensuring quality health service delivery by government doctors and nurses is required.

Implementing the NSS strategy in phases is the best way to improve targeting. This will require consolidating the 150-plus programs into several large programs under the National Social Security (NSS) framework. It also will require the allocation of more public resources for social safety net programs. The only way to achieve this is in phases that are in line with the plan currently being drawn up with EU technical support.

6.3 Quality of Spending, Relative Shares and Levels of Public Spending, and Related Issues

Despite a good legal framework and strong expenditure management by the Ministry of Finance, Bangladesh suffers from the following problems: (i) inadequate allocation of resources to important social and infrastructure sectors, due to very limited resources; (ii) volatility in the amount or proportion of resources allocated to various sector-based investment programs, due to shifting priorities and limited resources; and (iii) poor quality of project implementation, due to inadequate supervision and corruption.

Bangladesh spends only about 2 percent of its GDP on education. This is grossly inadequate for a developing country with a very young population suffering from poor education and a serious skill mismatch against what is required of them in the workforce. Although enrollment at the primary school level is close to 100 percent in Bangladesh and the primary dropout rate has declined, primary schools generally suffer from poor facilities and a poor quality of teachers and teaching methods. Bangladesh has achieved remarkable success in achieving a gender balance at the primary and secondary school levels, through free education for all and a stipend program for girls attending schools. Additionally, the dropout rate at primary schools has decreased significantly, but remains high at the secondary and higher education levels. There is, however, a growing education divide between rich and poor households. This is due in large part to the adoption of English as the preferred language of instruction, and rich families send their children to English language schools, while poor families depend on lower-quality public schools in which Bengali is spoken. The digital divide also is contributing to a greater education divide, as well as a greater economic and social divide. The standard of higher education is also poor, and most students graduate with only general skills, which contributes to the skill mismatch in the workforce and to unemployment among educated youth. The Madrasa, or religious education system, also contributes to education gaps.

Addressing these issues will require that more public resources be allocated to the education sector. The government understands this but is handicapped by the lack of domestic resources caused by weak revenue mobilization. Efforts to increase resources for the education sector have been repeatedly frustrated by the lack of revenue collection in most of the FYPs. In the education sector, emphasis has been put on enhancing the skill level of the workforce, but this strategy suffers from a lack of properly trained instructors, a lack of training instruments, and the social stigma associated with skill development for blue color jobs.

Public sector resource allocation for the health care sector has been very low in Bangladesh, ranging between 0.6 percent and 0.8 percent of GDP. It is because of Bangladesh's very limited revenue base that the government is unable to spend more on the health care sector. This sector also suffers from a chronic shortfall in resource utilization, as a sizable part of resources allocated every year cannot be used during the fiscal year. Health care expenditure also has been identified as one of the major causes for many households to fall below the poverty line, as low-income families often cannot cope with medical expenses when someone in the family is struck with a serious illness or with an accident that incurs high medical costs. At the same time, the overall state of public health has improved significantly in Bangladesh, with positive developments in various vital statistics. This is borne out in the fact that the average life expectancy in Bangladesh has increased to above 73 years, which is better than the life expectancy rate in India, Bhutan, Pakistan, and Nepal. The child mortality rate also has come down to 22 per thousand, which also ranks above the South Asian countries just noted. Maternal mortality rates also came down in recent years, and these gains notwithstanding, the government understands that allocations for the health care sector need to be increased to at least 1.5 percent of the country's GDP—a possibility if the tax-to-GDP ratio improves.

Budgetary allocations for social safety net programs suffer from resource constraints and administrative problems. The amount allocated to social safety net programs is reported to be about 2.1 percent to 2.3 percent of Bangladesh's GDP. However, this amount also includes at least 0.6 percent to 0.8 percent allocated to the government pension system.

Thus, real spending for social safety net programs amounts to about 1.5 percent to 1.6 percent of GDP, which is inadequate for a least developed country like Bangladesh, which has more than 30 million people below the national poverty line. It also is believed that up to 40 percent of the resources allocated for social safety net programs are misdirected, due to inefficient targeting and corruption in the distribution and selection of beneficiaries. Administration of the social safety net program also has been complicated by the very large number of programs offered (more than 150 and increasing) and by the large number of ministries (more than 20) responsible for administering the programs. The number of programs has ballooned over time, due to the lack of a central delivery system. In many instances, in fact, supports are provided by development partners in ad hoc manners.

The government is in the process of improving the targeting system by introducing cash transfers directly to beneficiaries' bank accounts or by transferring money to accounts electronically. At present, about 50 percent of recipients receive cash transfers directly to their bank or mobile accounts. Following up on this, the National Social Security branch has started to design a strategy already adopted by the government with EU technical support. The aim of the NSS strategy is to consolidate all social safety net programs into one comprehensive program based on a life cycle approach.

On the ADP side, serious quality and cost escalation issues exist, which underscore the importance of prudent money management in Bangladesh's public investment programs. This is particularly true in the area of ADP implementation. The size of the ADP has been increasing in recent years, particularly with the ongoing rollout of a number of mega projects, each costing billions of dollars. Many of the mega projects are in the area of power generation, including nuclear power (one project cost $13 billion). The construction of a deep seaport, for handling coal for power plants, and the establishment of a power hub, which cost about $7–8 billion in the initial stage, also have taken priority. A bridge over the Padma River ($4 billion), and a railway line over the bridge, along with connectivity ($5 billion), have required massive outlays of funds. Total ADP size in the new FY20 budget is more than $24 billion, which accounts for about 38 percent of the total budget. It is generally believed that the mega projects are overpriced, contracted without an open bidding process, and often awarded to unsolicited bidders with Chinese and Russian government funding. Many of these large projects have been accepted and contracted without proper appraisal, and without environmental and socioeconomic cost benefit analyses, raising concerns among Bangladeshi citizens, NGOs, and environmentalists.

About two-thirds of the ADP is financed from domestic resources. There are more than 1,200 projects in the ADP beyond the 10 to 12 mega projects. These large, medium, and small projects suffer from project mismanagement, planning, and compliance problems. Many of the smaller projects in rural areas are implemented by a special agency called the Local Government Engineering Department (LGED), under the aegis of the Ministry of Local Government and Rural Development. Major roads and highways are developed and maintained by the Roads and Highways Division (RHD). Corruption is rampant in these infrastructure projects, which are mostly awarded to paper-based contractors affiliated with the ruling party, who then subcontract projects out to other contractors, after deducting their payouts from the contract. The LGED and RHD are highly corrupt departments, and the quality of the projects they oversee is generally very poor.

7. Concluding Observations

Bangladesh has made remarkable progress in terms of economic growth and poverty reduction. The outlook for sustaining the growth momentum is good but will require continued prudent fiscal and other macroeconomic management. The government must increase its role in providing physical infrastructure oversight and efficient service delivery. The fiscal equilibrium that has been maintained so far in terms of low revenue, low fiscal deficit, and a low size of government will not keep pace with sustainable development goals (SDG). If Bangladesh is to be transformed into an upper-middle-income (UMI) country by FY31 and a high-income country by FY41, drastic measures must be taken. To achieve the SDG and UMI country status will require massive public sector investments in education; health care; poverty alleviation; efforts to mitigate the impact of climate change and other related natural calamities; and in efforts to ensure industrial growth in an environmentally sustainable manner. Bangladesh cannot meet these growing demands with its current levels of domestic resource mobilization.

Accordingly, reforms must be initiated in all three major areas of taxes, both in terms of tax policy and tax administration. Key reforms should include (i) separating tax policy functions from tax administration functions and shifting tax policy functions away from the NBR to a separate division under the Ministry of Finance; (ii) introducing the VAT Act of 2012 without making any fundamental changes, despite pressures from business groups; (iii) reviewing the drafts of the Customs Act and Direct Tax Codes with national and international experts and stakeholders before their finalization; (iv) automating and streamlining all tax-related business processes; and (v) transforming tax administration along functional lines.

Given the limited public resources in Bangladesh, it is even more imperative that they are efficiently used, to ensure best value for money. Several recommended measures have been suggested to improve fiscal transparency and cut down on waste across all government fiscal and quasi-fiscal activities. In addition, massive improvements are needed in the quality of public education and public health care delivery. Interventions in the education sector will require not only a massive increase in resource allocation but also major efforts to ensure improvements in quality of instructors and instruction materials, laboratory facilities, and access to the internet. On the health care front, strict monitoring of doctors and nurses is needed to ensure their attendance and service quality. This can be accomplished through improved human resource administration, and health care sector resources must be doubled to at least 1.5 percent of GDP to ensure a minimum standard for public health delivery.

The government has already identified many of problems and expressed its desire to address these fundamental issues. The Seventh Five-Year Plan and the Perspective Plan 2041 indicated the Bangladeshi government’s commitment to achieve the objectives. However, as in the past, wide gaps between commitments and actual implementation exist in most areas.

Reforms in the areas of tax policy and tax administration will require strong political commitment, which is lacking. Until recently (FY11–15), revenue growth was averaging around 18.4 percent annually, broadly in line with the nominal growth of GDP. Although the level of revenue-to-GDP remained almost unchanged at a very low level, the nominal growth in revenue, with its relatively low rate of inflation, was considered adequate for meeting the increasing demands for outlays. Weak implementation capacity also helped contain expenditure growth and thus the government could meet its fiscal requirements while showing double-digit revenue growth. However, in recent years, as revenue growth slowed to about 6.3 percent (average during FY16–18), expenditure growth is outstripping revenue and contributing to higher domestic borrowing, due to lack of reforms. Thus, pressure is building. As the demand for increased services and infrastructure development intensifies, and as the growth of revenue slows further in the absence of fundamental reforms, pressure may be intensifying on the Bangladeshi government to undertake serious tax policy and tax administration reforms at the NBR.

On the expenditure front, quality of service delivery and value for money are two important issues. Lack of accountability and weak monitoring and evaluation have contributed to poor service delivery, and extortion exists at almost all service delivery points. Concerning the ADP, highly inflated price tags and substandard construction undermine project quality and return on investment. Without a strong push from the highest-ranking political authorities, ensuring value for money in public sector projects will remain elusive.