

Panel Discussion on Economic Policy: ABCD 2023

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Tax Policy Challenges

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1. **Tax Effort** Compatible with a Middle-Income Vision is in the range of 15 to 20 % of GDP; India is practically there (inclusive state-local tax revenues (FY22: 17.9%).
 - The above figure is more than double the current effort, about 8% of GDP.
 - Primary destinations of additional public revenue:
 - (i) UHC: to meet WHO guidelines. 2020 Figure were OOP at 74% vis-à-vis IND (50%), LKA (47%) & UMI (31%)
 - (ii) Investment in human capital: The HCI values for 2020 BDG score is low (0.46): LKA at 0.60 & VNM: 0.69. BD figure has declined a little since 2017.

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- (iia) Exports: Widening of the export potential, a must for faster growth, would require getting into the manufacturing technology goods for exports. This would not be possible with a more skilled workforce.
- (iii) Generate public saving ($T-G > 0$) in order to contribute to the building of public capital.
- (iv) Invest in adaptation technology to climate challenge.

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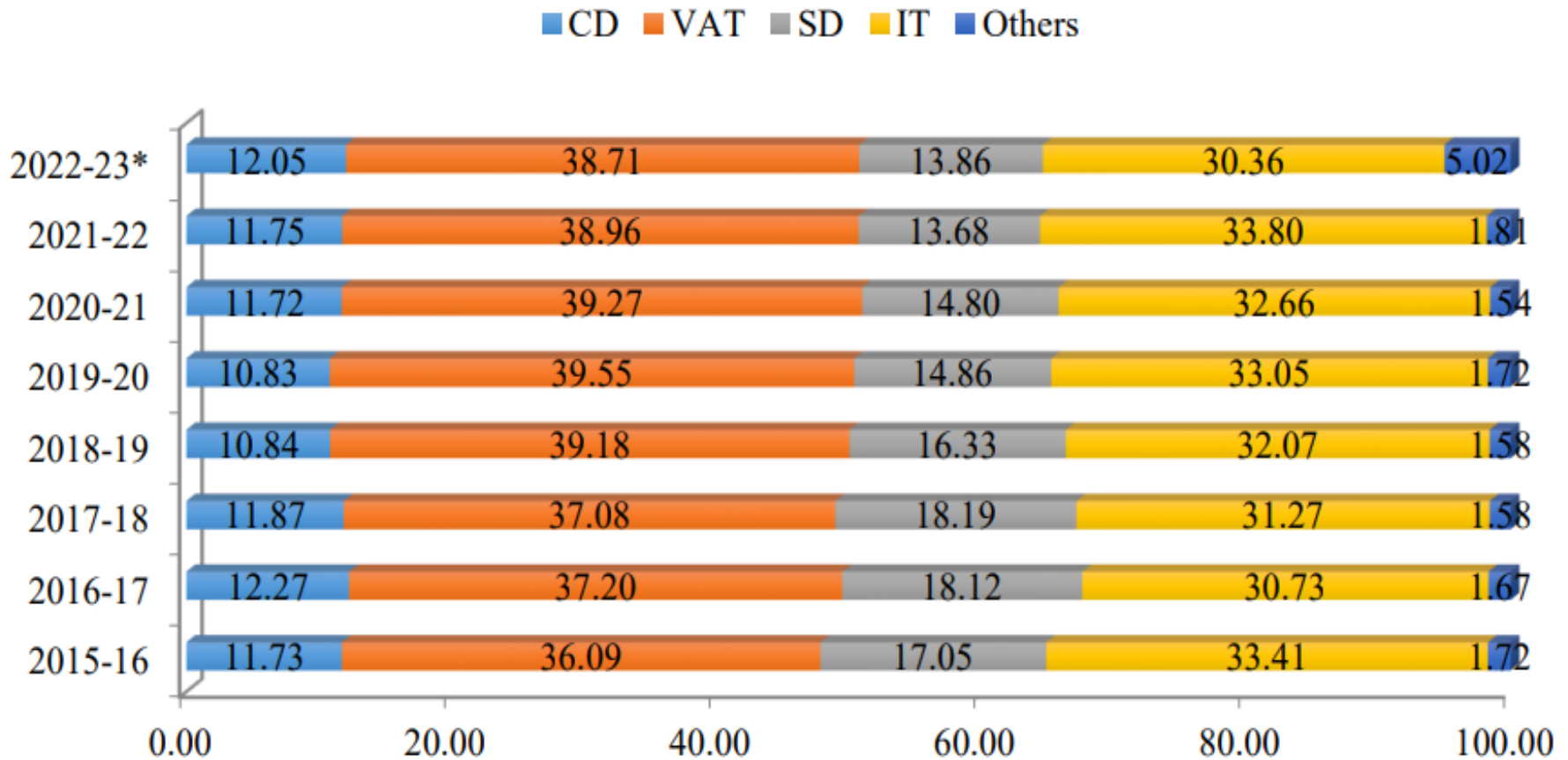
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2. The Inadequacy of the Current **Tax Structure**: The discussion yesterday identified the tax structure as the primary culprit behind the persistent low tax yield, not low income or low tax rates.

- BD tax structure suffers from both an over-exposure (6.5 pp) to indirect taxes and an under-exposure (15.5 pp) to direct taxes vis-à-vis the UMIC group as of 2020 (OECD data). The gap therefore is very large in the direct tax area.
- Stagnancy of BD structure (See Fig 1 & 2): Over the 37-yr period (FY1986 to FY2022), the share of industry has gone up by 17 pp, while the tax structure has hardly budged. Over the past 7-yrs, there is though a feeble increase in the share of VAT revenue by 2 pp.

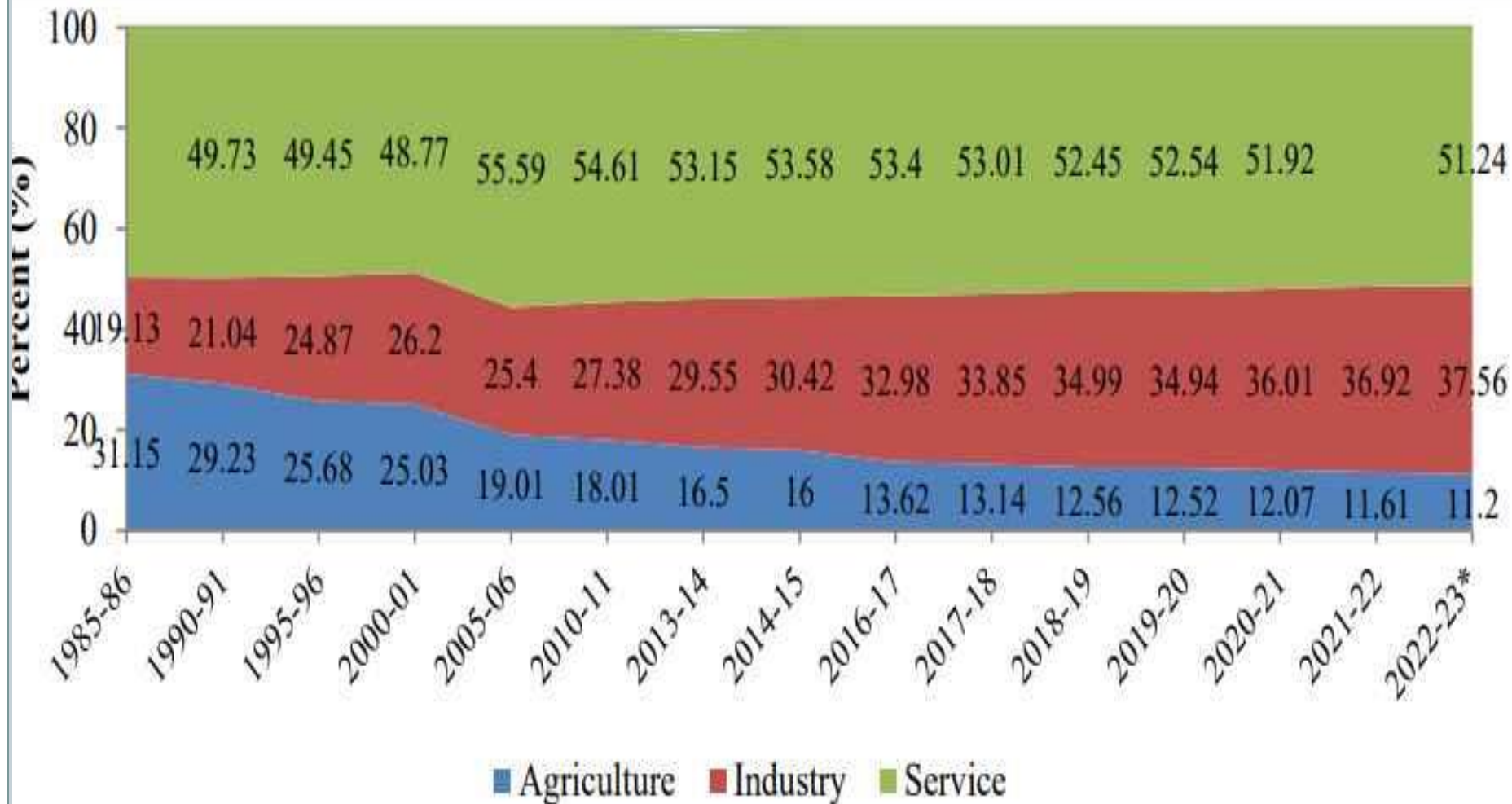
Fig 1: The Stagnancy of BGD Tax Structure: FY2016-23 (MoF, 2023, p35)

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(* July- February, 2023)

Fig 2: Sectoral Share of BGD GDP (in Constant Prices): FY1986-2023 (Source: BER, 2023, p16)



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- Of course, raising income/direct taxes would require innovations in the areas of base broadening, withholding taxes, capital gains taxation, technology, & presumptive taxation
- Base broadening involves widening of the tax base as well as # of tax-paying units.
- In BD we gather mere 1.4% of citizens filed an income tax return, the comparable figure in India has reached 5.2% in 2023 (GoI).
- Need to include the fast growing capital income from rental and land values (e.g., capital gains).
- Tax collection technology: Need to modernise NBR practices: Staff training, IT technology, remuneration/compensation package.

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- Informal Sector: This appears to be another reason behind lower tax effort.
- Recent reliable data availability is an issue: Schneider (2002) reports 35.6% share of GDP.
- How to bring it under the tax net? The literature suggests that strengthening the financial system is key first step.
- Informal firms must have easy access to financial services at competitive terms.

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- Finally, I draw attention to the issues of overall administrative weakness and corruption in tax administration: Need firm commitment of the State backed up by robust law and order, technology, and well-supervised financial system.
- Primacy of Low Inflation: This would help lower the extent of inflation tax, mainly borne by the poor & savers.
- New Tax Handles: ... Land tax, Tobin Tax, ..

