

Chapter 8

RESOURCE MOBILIZATION THROUGH TAXATION

1. Introduction

This chapter is an attempt to judge the performance of the Bangladesh Budget in relation to the mobilization of resources internally through taxation over the period under study, since taxation constitutes more than 80% of the total government revenue. In doing so, after having a brief note on fiscal strategies for raising more revenue through taxation, we shall explain the tax-GDP ratio and tax effort of Bangladesh and also the elasticity and buoyancy of the Bangladesh tax structure. In this connection problems and policy recommendations (prospects) will also be drawn as far as practicable.

Since independence, the public sector has come to play a dominant role in the economy of Bangladesh. Its scope has been widened by the nationalisation of major industries and by the fact that the private sector has been historically dependent on the support from the public sector. So, the size and composition of government development spending has been extremely important in the context of the rate of economic growth in Bangladesh. In spite of the increasing trend of the private sector development outlay, the public sector in Bangladesh, as shown in Table 1, accounted for, on an average, more than 80% of the total development outlay.

Table 1

**Development Outlay in Bangladesh
Projected for Different Plan Periods
(1973-85)**

(Tk. in million)

Period	Public Sector	Private Sector	Total Outlay
FFYP ^a 1973-78	39520 (88.7)	5030 (11.3)	44550 (100)
TYP ^b 1978-80	32610 (84.5)	6000 (15.5)	38610 (100)
SFYP ^c 1980-85	201250 (78.6)	54730 (21.4)	255980 (100)

Note: Figures in parenthesis indicate percentages.

Source: a) The First Five Year Plan (1973-78), GOB.

b) The Two Year Plan (1978-80), GOB.

c) The Second Five Year Plan (1980-85), GOB.

From the very beginning planners, policy-makers and budget-makers of Bangladesh were aware of the shortage of internal resources for financing development programmes. The First Five-Year Plan noted that the economic progress targeted over the plan period was constrained by the amount of domestic resources available for development, given the level of production and income¹. It was also agreed that at the initial stage Bangladesh was 'not in a favourable position to generate sufficient surplus for development'. However, it was hoped to 'break the vicious circle and to take the

initial significant steps towards establishing an efficient pattern of domestic 'capital accumulation'².

2. Strategy Used in Bangladesh

As bulk of the investment was undertaken in the public sector, the major part of domestic resources would have to be generated in that sector. Accordingly, over the period under study, strategies for augmenting resource mobilization were taken on priority basis and various fiscal steps and measures were proposed.

The First Five-Year Plan projected a total revenue receipts of Tk. 23400 million from the existing taxes and tax rates on the basis of 1972-73 budget estimates and a total revenue (current) expenditure of Tk. 18030 million on the basis of 1973-74 budget estimates. With Tk. 6250 million from additional tax measures (Appendix A), total revenue surplus was projected to be Tk. 11620 million as shown in Table 2. After 1975, more emphasis was given by the policy-makers to raise additional revenue through the system of taxation particularly from the agricultural sector.

But in actual, total revenue surplus reached Tk. 4720 million only or about 45% of the projected target was realised and total domestic resources reached Tk. 9570 million only against the Plan target of Tk. 22450 million (Table 3). Table 3 also shows that capital receipts from the 'Public Account' calculated on net basis turned out to be negative to the extent of Tk. 760 million indicating that the payments were larger than the receipts. The expected

Table 2

**Revenue Surplus Projected for the First
Five-Year Plan (1973-78)**

(Tk. in million)

Head	Amount
1. Total Revenue Receipts (Existing Taxes)	23400
2. Total Revenue Expenditure	18030
3. Yield from Additional Measures (Discretionary Measures)	6250
4. Total Revenue Surplus (1-2 + 3)	11620

Source : Compiled from The First Five-Year Plan (1973-78),
Planning Commission, GOB, Chapter IV, pp. 37-41.

Table 3

**Public Sector Financing during the First Five-
Year Plan (1973-78)**

(Tk. in million)

Item	Projected Amount*	Estimated Actual**
A. Domestic Resources:		
1) Revenue Surplus	11620	4720
ii) Net Capital Receipts	3500	-760
iii) Deficit Financing	6270	4810
iv) Other Resources	1060	800
Sub-Total (A)	22450	9570
B. External Resources:		
1) Project Assistance		10180
ii) Project Assistance		15860
iii) Commodity Aid	17070	15860
Sub-Total (B)	17070	30270
Total (A+B)	39520	39840
(A) As Percent of Total	57	24
(B) As Percent of Total	43	76

Note: * At 1972-73 prices

** At current prices

Source : The Two-Year Plan (1978-80), Planning Commission,
GOB. Chapter 1, Table 1.10, p. 14.

amount from additional measures and other sources also did not materialise. As a result, internal resource mobilization fell short of expectation during the Plan period.

The net result of the shortage of domestic resources was the injection of more foreign aid than projected. Table 3 shows that the ratio of domestic resource and foreign aid in financing development programmes turned out to be 24:76 as against the projected ratio of 57:43.

The Second Five-Year Plan also noted the shortage of internal resources as 'a serious challenge to the implementation of the investment programme of the Plan'. Accordingly, 'increasing the share of direct taxes, expanding the tax base of domestic output, and reducing relative dependency on customs' particularly on import duties were proposed to be further intensified'. In this connection a 'crash programme' for improvement of tax administration was also suggested to be undertaken³. The Plan also suggested 'a considerable scope of mobilizing resources through better collection of existing taxes and imposition of taxes on unearned incomes'⁴.

Accordingly, during the Second Five-Year Plan, on the basis of 1979-80 prices, total revenue receipts and total revenue expenditure were projected to be Tk. 129600 million⁵ and Tk. 76030 million⁶ respectively. And with Tk. 15850 million from additional fiscal measures (Appendix B), total revenue surplus was projected to be Tk. 69420 million as shown in Table 4 below. But in actual Tk. 32050 million or 46% of the projected amount was realised⁷. And as a

Table 4

Revenue Surplus Projected for the
Second Five-Year Plan (1980-85)

(Tk. in million)

Item	Amount
1. Total Revenue Receipts (Existing Taxes)	129600
2. Total Revenue Expenditure	76030
3. Additional Fiscal Measures	15850
4. Total Revenue Surplus (1-2 + 3)	69420

Source: The Second Five-Year Plan (1980-85), Planning Commission, GOB, Chapter IV, Table 4.1, p. 3.

result the Plan objective of reducing dependency on foreign assistance was further dampened.

In this connection, it is useful to note that the 'donor agencies', specially the World Bank, were giving much pressure to the Government of Bangladesh for raising more resources internally. They urged that the development of Bangladesh should basically depend upon mobilization of the country's own resources and thus they demanded a declaration of political will for increasing national savings to be followed up by quick and effective action.

In 1974 the World Bank suggested a series of fiscal measures to raise current government revenues with a view to extracting a greater amount of resources domestically. These measures included the raising of the following:

- a) import duties (through increased rates for raw materials and capital goods),
- b) excise duties (specially textile),
- c) sales taxes (with fewer exceptions), and
- d) corporation taxes (to make sure that public sector corporations pay up)⁸.

The Bank also proposed to integrate agricultural and other incomes in the rural sector for tax purposes and to update land records. A gradual 'reduction of subsidies on agricultural inputs, and ultimately the imposition of modest taxes on items like fertilizer, pesticides, seeds and agricultural machineries' were also prescribed⁹. In addition, regarding the case of personal income tax the opinion of the World Bank was that tax administration should be improved and that exemptions, deductions and exclusions should be reduced. In particular, the World Bank urged the GOB to reconsider their decision on the exemption of personal income tax for the civil servants¹⁰.

From the various reports of the World Bank and the statements of the donors, the prescribed strategy for domestic resource mobilization through taxation in Bangladesh may be summarised¹¹ as:

- | | | |
|---|-----------|------------|
| 1) Import duties, through increased rates for raw materials and capital goods, should be raised |

 | World Bank |
| 2) Excise duties should be raised | | World Bank |
| 3) Sales taxes should be raised | | " |

- | | |
|---|-------------------------------|
| 4) Corporation taxes should be raised | World Bank |
| 5) Integration of agricultural and other incomes in the rural sector for tax purposes | " |
| 6) Agricultural inputs should be taxed and subsidies on inputs should be reduced | World Bank, USAID, U.K. |
| 7) In the case of personal income tax, administration should be improved. Also exemptions, deductions and exclusions should be reduced. Higher level of sincerity of the administration is required | World Bank, Norway |
| 8) Revision of the tariff structure of the energy sector by increasing the prices of power and gas | World Bank, U.K. |
| 9) In the case of land tax, tax payment should be borne by the land-owning population | Canada, Sweden, Norway, Japan |

It is obvious that strategies prescribed by the donor agencies to enhance domestic resource mobilization in Bangladesh were designed mainly to increase the tax ratio of Bangladesh. No doubt, the GOB accepted and adopted most of the policies recommended by the donor agencies from time to time. But one may note that the specific policy recommendations towards increasing revenue receipts through a revision of the tax system of Bangladesh were yet to show any positive improvement so far as tax-GDP ratio was concerned during the period under study as examined below.

3. Tax Ratio and Tax Effort

The level of tax collection or tax performance of a country is customarily measured by the ratio of the tax revenue to the gross domestic product (GDP) i.e., the tax-GDP ratio, which may be called simply the tax ratio¹². The tax-GDP ratio of Bangladesh from 1972-73 to 1984-85 is calculated as shown in Table 5. It is observed that the tax-GDP ratio of Bangladesh was as low as 4.2% taking yearly averages of the early seventies. But during the late seventies and the eighties, the tax-GDP ratio increased considerably showing an average ratio of 7.5% and 7.8% respectively.

Table 5
Tax-GDP Ratios of Bangladesh (1972-73 to 1984-85)

(In Percent)	
Year	Tax-GDP Ratio
1972-73	4.5
1973-74	4.5
1974-75	4.2
Yearly Average	4.4
1975-76	7.2
1976-77	7.9
1977-78	7.3
1978-79	7.5
1979-80	7.5
Yearly Average	7.5

Contd..

Table 5 (Contd..)

Year	Tax-GDP Ratio
1980-81	8.3
1981-82	8.0
1982-83	7.9
1983-84	7.3
1984-85	7.5
Yearly Average	7.8

Source: Calculated on the basis of Appendix A to Chapter 5 of this study.

Table 6

Tax-GDP Ratios of Some Selected Developing Countries

(In Percent)

Country	Tax-GDP Ratio
1. Malayasia	24.5
2. Fiji	22.3
3. South Korea	16.7
4. Burma	16.4
5. Solomon Islands	15.6
6. Sri Lanka	15.1
7. Papua New Guinea	14.8
8. India (1979)	14.7
9. Pakistan	13.6
10. Thailand	12.3
11. Philipines	10.4
12. Bangladesh (1980)*	8.3
13. Nepal	7.3

* The year 1980 is chosen on the ground that Bangladesh registered the highest Tax-GDP ratio in that year during the period under study.

Source: Economic and Social Survey of Asia and the Pacific, United Nations, 1984.

Table 5, however, shows two important points. First, the tax-GDP ratio rose considerably from 1975-76 indicating the fact that fiscal measures did play an effective role in mobilizing internal resources through taxation. One of the main reasons, among others, for such an increase in tax-GDP ratio might be the re-introduction of land revenue in the form of Land Development Tax (LDT) in 1976¹³. Secondly, a notable feature is that from 1975-76 to 1984-85, the tax-GDP ratio has remained more or less invariable indicating rather a failure of government efforts in augmenting additional resources through taxation, other things remaining the same (determinants of tax structure).

The tax-GDP ratio of Bangladesh is low compared to other less developed countries (LDCs) of the world. Table 6 shows that the tax-GDP ratio in Bangladesh remained one of the lowest in some of the selected developing countries. In fact, among the 13 selected developing countries, Bangladesh occupied the 12th position. Only Nepal had a lower tax-GDP ratio of 7.3% than 8.3% of Bangladesh.

However, any judgement of tax performance based merely on such comparison of simple tax-GDP ratios may be misleading, since it fails to take into account the fact that taxable capacities of different countries may vary. So, the actual tax-ratios must reflect both taxable capacity and tax effort. 'Tax effort is the degree to which taxable capacity is used'¹⁴. In the words of Richard Goode, "Tax effort analysis represents an attempt to go beyond simple comparisons of tax ratios to a comparison that takes account of measurable variables that significantly affect taxable capacity"¹⁵.

Using regression technique, a number of studies at the IMF have investigated the statistical relationship between the variables (noted below) affecting taxable capacity and actual tax ratios in developing countries¹⁶. The variables include per capita income, the openness of the economy (the ratio of export plus import to GDP), and economic structure particularly the relative size of agriculture and mining, etc¹⁷. Most of the studies, however, showed a positive relationship between taxable capacity and the shares of these variables in GDP and was statistically found significant by customary standards.

Tait, Gratz and Eichengreen¹⁸ have made an attempt to measure tax effort for a sample of 63 developing countries including Bangladesh for the years 1972-76 by using regression technique incorporating economic variables mentioned above. According to the level of tax effort, countries are grouped into high index, medium index, and low index, where Bangladesh belongs to the low index group¹⁹.

Another attempt is made to measure the tax efforts for a sample of 17 developing countries including Bangladesh in 1984-85 by Chowdhury and Hossain²⁰. The authors incorporated per capita GDP and ratio of exports plus imports to GDP as major explanatory variables²¹. The result (tax effort indices of the 17 selected developing countries) as depicted in Table 7 shows that Bangladesh ranks 16th among 17 selected developing countries both in terms of actual tax-GDP ratio and index of tax effort. Table 7 also shows that the normative tax-GNP ratio of Bangladesh in 1984-85 was

greater than Nepal, Pakistan and even India. But in case of actual tax-GNP ratio it was placed only above Nepal. This is an indication of the fact that the tax administration of Bangladesh (other things remaining the same) failed to mop up the tax potentiality of the country at its desired level.

Table 7

International Comparison of Tax Effort (1984-85)

Country (1)	Actual Tax-GNP Ratio (2)	Normative Tax-GNP Ratio (3)	Index of Tax Effort (2/3) (4)
1. Tunisia	0.278	0.211	1.31
2. Chili	0.251	0.163	1.54
3. Egypt	0.248	0.212	1.17
4. Morocco	0.230	0.204	1.13
5. Sri Lanka	0.211	0.216	0.98
6. Kenya	0.195	0.181	1.08
7. Indonesia	0.183	0.163	1.12
8. South Korea	0.167	0.255	0.66
9. Yemen	0.165	0.149	1.11
10. Turkey	0.149	0.160	0.93
11. Thailand	0.145	0.173	0.84
12. Pakistan	0.123	0.128	0.96
13. India	0.112	0.093	1.20
14. Philipines	0.103	0.151	0.68
15. Burma	0.086	0.083	1.04
16. Bangladesh	0.083	0.133	0.62
17. Nepal	0.076	0.129	0.59

Source : O.H. Chowdhury and M. Hossain, "Tax Structure of Bangladesh : An Overview", The Bangladesh Development Studies, Vol. XVI, No. 4, December, 1988, BIDS, Dhaka, p. 75.

However, mere low tax effort compared to other developing countries is not sufficient to conclude precisely that the tax performance of Bangladesh is poor. A country may be classified as having low or high tax effort. But it does not always indicate that taxes should be raised or lowered. Yet, it provides helpful information to both politicians and policy-makers and suggests 'where to begin in addressing a budget problem'²².

We, therefore, need an optimum level of tax-ratio for developing countries to test whether the tax ratio of Bangladesh is below or above the optimum level. What is the optimum level of tax ratio? The answer is, however, indeterminate and debatable also. Experience does not provide any reliable guidance as to what level of taxation is optimum for less developed countries. No doubt, less developed countries possess low tax ratio and it can be raised through administrative and legislative efforts. But no doctrinaire answer can be given as to where the optimum level lies. For, the factors affecting tax ratio differ greatly from country to country. Critics like Bird and Bolnick argue that conditions differ so greatly among countries that general theorising and quantitative comparisons are not helpful in evaluating policies in a particular country²³.

But nonetheless, attempts have been made to visualize a certain level of tax ratio for IDCs. Martin-Lewis model²⁴ suggested a tax ratio of 20%. U.K. Hicks²⁵ seems to veer around this figure. In a later study Arther Lewis²⁶ suggested that most IDCs need to

raise at least 17% of GDP in taxes and other government revenues. These are the optimum ratios in their view and the tax ratio of Bangladesh is no doubt well below the optimum level.

Perhaps the most acceptable level of tax ratio for Bangladesh is noted by an IMF study²⁷ in 1979. This study viewed that given the structural rigidities of Bangladesh, the tax-GDP ratio should be about 10%. But with 8.3% in 1980-81 or 7.5% in 1984-85, the tax-GDP ratio of Bangladesh, no doubt, showed a poor tax performance.

In this connection, it may be noted here that during the FFYP and the SFYP the tax-GDP ratio of Bangladesh was targeted to be 10%²⁸ and 9.5%²⁹ respectively. According to the Planning Commission's calculation these were the optimum levels of tax ratio for Bangladesh which, however, was never realised.

Furthermore, Bangladesh's tax-GDP ratio is below not just the average for all developing countries (17.5%) but below the levels in Sub-Saharan Africa (17.6%), Asia (14.9%) and Latin America (17.93)³⁰ indicating rather a relatively poor tax performance.

The very low tax-GDP ratio means that tax revenue collections have not kept pace with the growth of the tax base and that the base itself has not grown adequately. Therefore, tax revenue collections can be increased by broadening the tax base and by improving the efficiency of the tax collecting authority.

4. Elasticity and Buoyancy of Bangladesh Tax Structure

The adequacy of a tax system as a toll for mobilizing more resources internally through fiscal measures can also be judged by its elasticity and buoyancy values. The automatic growth in tax revenue due to changes in national income is generally known as the elasticity of tax system which is sometimes called built-in elasticity. On the other hand, the growth in tax revenue caused both by the increase in national income and from discretionary measures such as changes in the rate of tax structure and/or in tax base is known as the buoyancy of tax system.

The measure of income elasticity may be given as:

$$Te = \frac{dT}{dY} \cdot \frac{Y}{T}$$

Where Te = elasticity of tax revenue,

T = tax revenue in the earlier period, and

Y = national income in the earlier period.

A tax system or a particular tax is said to be elastic if the measure exceeds unity and inelastic if it is less than unity.

In an adequate tax system, tax revenue must increase with the growth of the economy without frequent rate adjustment. For, it is not politically always advantageous and palatable to enhance the rate of tax and/or tax base to increase tax effort frequently through legislative measures. So, in an economy like Bangladesh the elasticity of the tax system must be sufficiently high.

But in case of Bangladesh, as shown in Table 8, the elasticity of the tax system was found to be rather low. The elasticity for the whole tax system was less than unity (0.85) indicating the fact that the growth in tax revenue was less than that of national income. Elasticity of indirect tax as a whole and for all its components other than sales tax on import were less than unity. Elasticity of tax on foreign trade was in fact unity, and taxes on domestic goods and services were very inelastic. Direct tax as a whole as well as its components were also very inelastic. Thus the tax revenue in Bangladesh increased less than proportionately to overall growth of national income without discretionary measures³¹.

Table 8

Estimated Buoyancy and Elasticity of Different Taxes in Bangladesh (1975-76 to 1984-85)

Tax Head	Average Buoyancy	Average Elasticity	Contribution of Discretionary * Measures (In percent)
1. <u>Direct Tax</u>	1.08	0.78	27.8
a) Income Tax	1.99	0.94	13.8
b) Other Direct Tax	1.07	0.29	72.9
2. <u>Indirect Tax</u>	1.02	0.87	14.7
i) <u>Taxes on Foreign Trade</u>	1.09	1.01	7.3
a) Import Duty	1.11	0.97	12.6
b) Sales Tax on Import	1.10	1.14	-3.6
ii) <u>Tax on Domestic Goods and Services</u>	0.90	0.61	32.2
a) Excise Duty	0.99	0.66	35.9
<u>Total Tax</u>	<u>1.03</u>	<u>0.85</u>	<u>17.5</u>

* Average buoyancy minus average elasticity as a percent of average buoyancy

Source : O.H. Chowdhuri and M. Hossain, Elasticity and Buoyancy of Bangladesh Tax Structure, Research Report, No. 80, BIDS, Dhaka, November, 1988, Table 3.1, p. 10.

The buoyancy value of the tax system of Bangladesh which combines both the automatic growth in tax collections and the effects of discretionary actions, was estimated to be only 1.03. However, Table 8 shows that the buoyancy values vary from a low of 0.90 for taxes on domestic goods and services to a high of 1.11 for import duty. Interestingly enough, except for taxes on domestic goods and services and its component excise duty, the value of buoyancy for all the major tax heads was greater than unity. Nonetheless, the very low buoyancy value of overall tax system (1.03) indicates why the overall tax-GDP ratio of Bangladesh changed marginally from the mid-seventies to the mid-eighties as noted earlier.

The fact that the buoyancy value was generally greater than the value of elasticity, was the reflection of the positive contribution of discretionary measures to the growth in tax revenue in Bangladesh. The contribution of discretionary actions to the whole tax system, as shown in Table 8, came to around 18% and its contribution to the growth in direct taxes and taxes on domestic goods and services were around 28% and 32% respectively. Strikingly enough, impact of discretionary measures on taxes from foreign trade was very little and in fact its impact had been negative on sales tax on import (-3.6).

The above finding reflects the fact that the tax yield from direct taxes and taxes on domestic goods and services was not only very low compared to that from foreign trade, it was also augmented primarily by frequently introducing new legislative measures. Clearly it was mainly the defective tax system (among other reasons)

that failed to mop up the tax potentiality of the economy. In other words the highly positive contribution of discretionary measures reflects the fact that the tax potentiality of the country was more than what the tax system actually realised without discretionary measures.

It may, however, be noted here that the highly positive contribution of discretionary measures to the growth in tax revenue was due largely to the unequal distribution of income in Bangladesh where the higher income group is not taxed adequately.³² Thus there is the possibility of raising tax revenue by making the higher income group people to pay more taxes. In other words, the discretionary measures, which have proved to be effective in Bangladesh, should be incorporated into the regular tax system.

However, the estimates of elasticity and buoyancy shown in Table 8 reflect some interesting features of the tax system of Bangladesh. First, the elasticity of all direct taxes taken together (0.78) was lower than that of all indirect taxes taken together (0.87). But the buoyancy value of direct tax (1.08) was greater than that of indirect tax (1.02). This is an indication of the fact that discretionary actions played more important role in raising revenue in the case of direct taxes than in the case of indirect taxes.

Second, the highest buoyancy value as well as elasticity was reported for import duty and sales tax on import (individually) and the lowest was in the case of domestic goods and services. Thus imports into Bangladesh were quite highly related to the growth of

income and at the same time, dutiable imports were more responsive to the growth of income than that of total imports.

A decomposition of elasticities of some of the tax heads may provide us with some important information about the tax structure

Table 9
Decomposition of Tax Elasticities (1975-76 to 1984-85)

Tax Head	Built-in Income Elasticity	Built-in Tax-to-Base Elasticity	Base-to- Income Elasticity
1. Direct Tax	0.78	0.71	1.11
2. Income Tax	0.94	0.85	1.11
3. Import Duty	0.97	0.85	1.14
4. Sales Tax on Import	1.14	1.06	1.03
5. Excise Duty	0.66	0.62	1.03

Source: O.H. Chowdhury and M. Hossain, Elasticity and Buoyancy of Bangladesh Tax Structure, Research Report, No. 80, BIDS, Dhaka, November, 1988, Table 3.2, p. 13.

of Bangladesh. Tax elasticity can be decomposed into two components i.e., tax-to-base and base-to-income elasticities³³. Table 9 reveals that in Bangladesh, tax-to-base elasticities were much lower than base-to-income elasticities for the period between 1975-76 and 1984-85. It is found that the low elasticity of excise tax (0.66) was due to the very low tax-to-base elasticity (0.62) compared to a quite high base-to-income elasticity (1.03). Clearly, tax collections failed to keep up uniformity with the tax base or in

other words, excise duty failed to cover its base. This finding supports the view that substantial tax evasion and inefficient tax administration made excise duty an inelastic source of revenue.

Again, Table 9 shows that base-to-income elasticity of direct taxes and its component income tax was greater than unity for the said period in Bangladesh. But tax-to-base elasticity was less than unity. This also indicates the fact that the inefficient tax administration of Bangladesh failed to collect sufficient revenue as direct tax and thereby caused income elasticity of direct tax to be low.

We, therefore, conclude that collection of government revenue in the form of direct tax as well as indirect tax (mainly domestic goods and services) may be increased through improving the efficiency of tax administration thereby covering successfully the bases of such taxes.

5. Avenues for More Revenue

It is, however, practically very much difficult to suggest any tax policy reform for a developing country like Bangladesh. For, the economic system is too complex to allow the design of a formula that works adequately in all situations.

No doubt, Bangladesh is one of the poorest countries with low per capita income in the developing world. Yet, she possesses some potential pockets of generating more resources internally through restructuring the economic system in general and the tax system in particular, as noted earlier. "No nation is so poor that

it cannot save 12% of its national income if it wanted to", observed W.A. Lewis³⁴. Therefore, Bangladesh as an underdeveloped country (with serious shortage of domestic resources) that is determined to break the vicious circle of poverty and to avoid economic stagnation, will have to find ways and means of raising large and growing amount of tax revenue.

However, our observation is that while in the long run much will depend upon how the planning strategy is effectively geared up to enforce policy (structural) changes in the economy, a lot can be achieved in the short run by increasing the flexibility of the tax structure, by improving the efficiency of the tax administration, by reducing tax evasions as well as by broadening the tax base.

In the light of above assumptions we suggest the following changes in the tax structure of Bangladesh that may help in raising more revenues to the GOB.

The very low contribution of direct tax as a whole to the total tax revenue was due mainly to the narrow tax base and poor tax net (low coverage). In 1982, the Finance Minister of Bangladesh in his budget speech noted that roughly 75% of the total income tax came from taxes on companies alone. More seriously enough, in 1982-83, the country had only 280,000 tax payers or less than 0.05% of the total population were covered in the tax net³⁵.

In Bangladesh there are a large number of self-employed persons engaged in small enterprises (shopkeepers, small traders, etc.) both in rural and urban areas along with urban professionals (consultants, designers, etc.) who have assessable income but do not

pay income taxes. They do not and even cannot maintain any proper accounting records required under the prevailing income tax law. These groups successfully escaped the tax net availing the weakness of the income tax law as well as its administration leading to tax evasion. Again, some businessmen do not keep adequate records and accounting books; others maintain two or three books to evade the payment of taxes.

It is, therefore, necessary that through an intensive survey these self-employed persons with assessable income are brought within the tax perview as far as practicable. In this connection, complications in respect of assessments and payments should be ruled out by designing a simple procedure for small business enterprises and other self-employed persons which would improve tax compliance and reduce the work load of tax officials. In addition, the marginal rate of income tax may be reviewed and moderated which is expected to improve tax compliance. Lower marginal income tax rate will also serve as an incentive for stimulating investment and thereby generating more income which will ultimately increase the total tax revenue.

But it demands close attention that the broadening of tax base should not be accompanied by the lowering of tax rates (except the marginal rate) in a country like Bangladesh where tax evasion is pervasive³⁶. For example, to ensure better tax compliance or to make the black money white, tax rates were lowered in Bangladesh in 1976, on the ground that the prevailing high tax rates made tax evasion rather lucrative. In 1976, the Martial Law Regulation-VI

(MLR-VI) gave complete amnesty from any legal consequences and fixed a flat rate of tax of only 30% for the declaration of untaxed income, and again in 1982, MLR-V declared tax amnesty with still lower rate of tax of only 15% for the untaxed income³⁷.

But the response was very poor. Only Tk. 0.08 billion and Tk. 0.37 billion respectively was collected as income tax following the two regulations, whereas the black money in the economy was roughly estimated to be as high as 60 billion taka in 1982 (unofficial Planning Commission data)³⁸. Not only this, out of about 9000 declarants who took the opportunity of paying the tax at the lower rate, only about 5500 paid taxes in actual. Clearly the defect was not in the higher rate of taxation but in the very system of taxation and in tax administration. This leads us to conclude that the reduction in the tax rates can not be justified under the conditions prevailing in Bangladesh³⁹.

In Bangladesh unearned incomes derived from speculative transactions, scarcity rents, intermediations and trade in properties were not properly focussed by the fiscal system throughout the whole period under study. Again, capital gains were also lightly taxed thereby rewarding a non-productive class.

So, the fiscal system needs to focus on all unearned incomes derived from the said sources and should be brought under the income tax perview. Some transactions such as trade in properties can be captured through taxation of capital gains. The rate of capital gains

tax should be increased further. Again, in Bangladesh where wealth is highly concentrated, a large amount of revenue can be obtained from a vigorously enforced tax on a few wealthy persons.

Unlike many other developing countries of the world, the practice of not taxing the salary income of the government employees in Bangladesh was perhaps one of the most serious defects of the tax system. The departments employing these employees were supposed to pay taxes on behalf of them to the Revenue Department, which meant that the income tax payment within the government became a matter of book transfer only. This was not all. In the face of roaring inflation, as noted in Chapter 6, the government not only raised the basic salary of the employees, but also other benefits like house rent, medical allowance, etc. which dampened government savings further. Obviously there was no economic ground to leave them such a tax bonanza where there were to pay taxes.

We, therefore, suggest that the practice of taxing the salary income of government employees should be introduced and no discrimination should be made between different types of income. A general system of income tax payable by everyone earning above one exemption limit should be introduced. In other words, all incomes of a person should be integrated into a 'global statement' of incomes for tax purposes in order that everyone will enjoy only one exemption limit. This will not only increase government revenue but will also have a favourable effect on savings as salaried personnel may like to subscribe in insurance policies, shares and securities (savings bank certificate, etc.) to avail of tax exemptions. But

any unnecessarily high reduction in tax for household and enterprise savings should be avoided by the tax system. For, such a reduction may go against the goal of collecting more tax revenue. In addition, the government officials who have other sources of income including rental income from renting their own houses and apartments should pay taxes on such income. But attention is also needed that taxes should not unduly limit the capacity and willingness to work.

The issue of agricultural taxation in the form of direct tax had been the subject of very much debate and controversy in Bangladesh since liberation. Although this sector constituted almost 60% of the GDP, it could not prove itself as a significant source of revenue to the government for the whole period under study for a variety of reasons.

It is striking enough that while the government of the newly emerging Bangladesh was exploring all the possible sources of revenue in the face of acute resource problem, the government itself froze an important source like land revenue. In mid-1972 the GOB introduced two important changes in the system of land revenue and agricultural income tax through an act generally known as the 'Presidential Order' 96⁴⁰. First, there was the postponement of collection of agricultural income tax for two years from 1973-74; and the second step was to abolish land revenue on land holdings upto 8.3 acres in size⁴¹.

The net effect of exemption of land revenue on land holdings

below 8.3 acres in size was that it virtually exempted 90% of the agricultural land and 99% of the rural people from land revenue⁴². As a result, the government lost a potential revenue of Tk. 61.5 million annually during the period upto 1976⁴³. Clearly, these measures were in direct conflict with the revenue needs and the resource mobilization efforts of the government.

These measures were, however, taken as a step towards the fulfilment of the commitment given by the party in power in its election manifesto (1970)⁴⁴ to ensure social justice and equity to the poor peasants of the then East Pakistan (Bangladesh). But there were sound reasons for the reintroduction of land revenue on the owners of land over, say, 5 acres, especially in 1974, when the country was going through a severe economic and financial crisis. For, in the rural areas, people owning 5 to 8 acres of land were well-to-do ones, particularly due to the rise in the prices of agricultural products as well as the rise in production with the spread of new technology in agriculture⁴⁵. As N. Islam (the then Deputy Chairman of the Planning Commission, GOB) observed, "... at least a beginning could have been made with low rates, which could have been increased over time"⁴⁶.

In the face of the fall in revenue, a beginning was, however, made from 1976 through the introduction of 'Land Development Tax (LDT)' merging land revenue and other taxes. The LDT consisted of a flat rate with a two-tier system for agricultural land: Tk. 3 per acre for all household owning land upto 8.3 acres and Tk. 15 per acre for those owning land above 8.3 acres. In 1982 the

agricultural rates were made highly progressive, with nominal rate ranging from Tk. 3 per acre to a minimum rate of Tk. 145 per acre for land holdings above 25 acres⁴⁷.

But the result was still unsatisfactory due to the problems of implementation. In Bangladesh the farmers virtually kept no accounting records where much of the actual tax assessments were based on discussion and imagination. In addition, home consumption, various exemptions and reductions, lack of political support and difficulty for the tax officials to reach a large number of tax payers in the rural areas made agricultural taxation almost impossible to administer⁴⁸. These together with tax evasion made it an insignificant source of government revenue. The extent of tax evasion was so high that in 1975-76, the yield fell to 16% only of the level reached in 1969-70⁴⁹.

Thus the share of land revenue in the total tax earnings was reduced from 2.2% in 1975-76 to only 1.6% in 1981-82. And in 1982-83 even after the introduction of LDT, the share of land revenue in the total revenue fell to a meagre 1.1%⁵⁰. On the contrary, administrative cost of collecting agricultural tax was so high that in 1985-86 it reached 66% of the tax collections leaving only 34% of LDT revenue available for government use⁵¹.

Another tax relating to land is the stamp duty collected at the time of land transaction. According to a statistical source, the earnings from the stamp duty also fell from 5.36% of the total tax revenue in 1980-81 to 3.9% in 1985-86⁵².

In practice, it is, however, very much difficult to design any tax policy for the agricultural sector. For, it is too inflexible to deal with the instability in agricultural incomes and with the administrative and political difficulties. Politically, the surplus farmers in rural Bangladesh proved themselves as the most powerful pressure group in Bangladesh's politics and limited the scope of extracting more revenue from rural Bangladesh. In the words of R. Sobhan, "The surplus farmers had been a key figure in the rural support base of not just the ruling party but the opposition parties of all complexions of right and left"⁵³.

Despite the problem of administration and politics, however, we believe that there always remains a very considerable scope of raising more and more revenues from the agricultural sector of Bangladesh. In principle, taxation can be levied on input used by the agriculture, on the output produced by this sector, on the incomes generated, on the expenditure made out of those incomes and on the land itself (land tax).

In order to collect a higher incremental income as well as to make the tax system more equitable, an agricultural income tax based on 'potential income' taking into account the differences in productivity of land and cropping intensity, may be introduced. And a presumptive basis of assessing agricultural income may be applied.

In view of the administrative and political problem associated with land tax as well as agricultural income tax we accept the suggestion that the best method of utilizing land taxation is in

financing local governments because it would be seen as a benefit tax or simply as a user charge for local public services⁵⁴. A local land tax with proceeds used for local betterment may enjoy greater acceptance in rural areas than a Central Government tax used to finance projects in far-away places.

In many districts of Indonesia, for example, 60% to 70% of discretionary local revenue is provided by the land tax, despite its low rate of only 0.1% of assessed value⁵⁵. Country experiences (particularly in Latin America) also suggest the brightest future for agricultural land taxation as a resilient source of financing local government expenditure⁵⁶.

A recent survey study⁵⁷ in Bangladesh also confirmed the above view. By an opinion survey this study concluded that the rural people are agreeable to bear additional tax burden if the tax proceeds are spent within the locality for development of physical infrastructure and for provision of input subsidy. But one should note that the local government units in Bangladesh are usually dominated by the rich surplus farmers who may act against this policy. However, a beginning should be made and in this context, tax assessment should be made from the Centre. Above all, there must be some political initiative in its favour.

The present tax structure of Bangladesh, as noted in Chapter 5, is dominated by the share of indirect tax. The situation is unlikely to change in the near future since the preconditions (like monetised economy, honest and reliable accounting, large degree of voluntary compliance, honest and efficient administration

etc.)⁵⁸ for the success of direct taxes are inadequate in Bangladesh. But the most notable feature is that the indirect tax structure is dominated by the foreign trade sector particularly import duty and sales tax on imported goods, financed mostly by foreign aid. This is no doubt a source of uncertainty in revenue collection and hence not desirable.

So, the heavy relative dependency on the foreign trade sector for tax revenue is to be gradually reduced by increased taxation of domestic goods and services. Domestic excise net is to be expanded to new goods hitherto untaxed, rates should be modified with growth of income, and duties should be increased on types of goods previously lightly taxed. Items still under specific rates should be converted into advalorem rates in the context of administrative convenience and rising price level.

The tax base of domestic goods is particularly narrow because of exemptions/reductions allowed to a large number of items subject to excise and sales tax. Many of the exemptions/reductions cannot be justified either on grounds of productivity or social equity⁵⁹.

Thus the yield of tax revenue may be increased substantially by withdrawing or reducing exemptions (tax holidays etc.) and reductions. Rates of import duties should be increased further and higher rates should continue to be applied to luxury items particularly. But special incentive for industrial production and tax incentives for employment creation may be allowed. In other

words, the objective of both protection and revenue enhancement should be secured. In taxing commodities, however, unintended and excessive protection to domestic production should be avoided. Again, explicit and implicit taxes on exports of primary products may be used step by step.

Experiences suggest that for low income countries like Bangladesh, very large revenue gains are not expected from the broadening of bases of excise and sales taxes and therefore the 'Value Added Tax (VAT)',⁶⁰ the most important innovation of the second half of the twentieth century, is expected to be the mainstay of the revenue-raising effort of the government. Moreover, the revenue enhancement⁶¹ and tax neutrality (economic efficiency)⁶² arguments in favour of VAT are well documented. Recently, the GOB, after a long debate introduced VAT replacing turnover or sales taxes in some selected areas which should be broadened as far as practicable.

The local government units in Bangladesh depend to a considerable degree on grants from the Central Government. Although there are provisions for a variety of local taxes, fees, etc. in generating resources internally, only a few are utilized⁶³.

We, therefore, propose that the concept of matching grants to local authorities which rewards local fiscal enterprise and efficiency in resource collection and use may be encouraged. In order to find more stable sources of income, the local government units may be asked to identify new sources of revenue, and

contribution from national government to each local unit may be linked with their own efforts to mobilize local resources. "Neither decentralization nor representative administration can be sustained if local authorities do not develop fiscal self-reliance and become less dependent on grants from the Central Government"⁶⁴.

The tax administration in Bangladesh also lacked much to be desired. Shortage of personnel, inadequate emphasis on training, surveys and investigations, lack of logistic support and arbitrary assessment due to absence of commercial practices in business firms leading to corruption were all weaknesses of the tax administration as pointed out by the Planning Commission of Bangladesh⁶⁵. The staff strength of tax offices has not been increased proportionately with the increase in income and assets particularly in urban areas. All these resulted in rampant evasion of taxes and accumulation of arrear taxes.

In 1977-78 outstanding arrears on account of income, sales and urban property taxes were Tk. 3520 million⁶⁶. In 1973-74 total number of families with taxable income were about 0.5 million, whereas in 1978-79 total number of income tax assesses were only about 0.2 million indicating the extent of tax evasion by individuals⁶⁷. This evasion was rampant, especially in the case of self-employed persons who spread far and near and whom the tax officials could not reach with their existing staff.

Thus improvement of tax administration offers considerable scope to raise additional revenue from the existing taxes. Short and long term programmes for staff development should be undertaken,

training and logistic support should be worked out and implemented on priority basis to upgrade knowledge and skills of tax officials, and modern equipments should be provided. The twentieth century government needs more revenue for development but 'it also demands twentieth century administration'⁶⁸.

In addition, tax education making people more conscious about their tax obligations and tax officials more honest may play an important role in the improvement of tax compliance by the people. "Willingness to be taxed may be affected adversely if the people have no faith in the honesty and integrity of the tax collection system"⁶⁹. Thus the credibility of the tax system needs to be improved. For, a stable tax policy environment encourages tax payers and increases voluntary tax compliance.

Last but not the least, a decisive political as well as administrative will needs to be undertaken to collect revenue through fair and efficient enforcement of the prevailing laws. As Lady Hicks states, "There is no country so poor that it cannot quickly raise additional tax revenue if it has the will to do so"⁷⁰.

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$$T/Y = a + b_{Y_p} + cF/Y = u$$

where a is any constant and u is a stochastic disturbance term and

T = Total tax revenue

Y = Gross national product (GNP)

Y_p = Per capita GNP

F = Sum of import and Export.

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Appendix AYield From Additional Tax Measures Projected
for the FFYP (1973-78)

(Tk. in million)

Year	Amount
1973-74	250
1974-75	600
1975-76	1100
1976-77	1750
1977-78	2250
Total	6250

Source: The First Five-Year Plan (1973-78), Planning Commission,
Government of Bangladesh, Chapter 4, p. 41.

Appendix BYield From Additional Tax Measures Projected
for the SFYP (1980-85)

(Tk. in million)

Year	Amount
1980-81	800
1981-82	1850
1982-83	2950
1983-84	4250
1984-85	6000
Total	1,5850

Source : The Second Five-Year Plan (1980-85), Planning Commission,
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