Chapter 1

INTRODUCTION

1. Statement of the Problem

Budget-making, or for that matter fiscal policy in its wider sense, has come to be recognised as the most potent instrument of economic policy in modern times. Generally speaking, the annual budget serves as a barometer of the nation's financial health, a projection of the country's income and expenditure for the next twelve months and a tool for the management of the nation's fiscal affairs.

Prior to the 'Great Depression' of the 1930s, in the age of 'Laissez Faire', when the involvement of the government was considered undesirable in economic activities, the art of budget-making comprised only a few simple rules. At that time a popular slogan was that the most successful Finance Minister is one who keeps government expenditure low and consequently keeps taxes light. Government borrowing or deficit financing was taken to be a sign of weakness and had to be avoided at any cost except in national emergencies like war or some natural calamities. To be good, the budget had to be neutral.

But those days are past and changed partly as a result of experience gained and partly as a result of development of thought. It gradually came to be recognised that everything that was done by the government by way of raising resources and spending them had far-reaching implications for the economy.

The tasks of budget-making and its working thus involve a clear and penetrating analysis of all the diverse effects of measures taken by the government. And a conscious effort is made to combine these elements in such a manner that the budget as a whole serves the overall objectives of economic policy like(i) allocation (ii) distribution and (iii) stabilization.

In the developed capitalist countries the main objective of budgetary or fiscal policy has been to maintain economic stability. Economic development in these countries results mainly from the initiative of the private sector. There is a sizeable well-organised industrial sector as well as agricultural sector which has a built-in-system of saving and investment for growth and expansion and is responsive to market incentives with highly developed infrastructure. A large number of institutions have evolved which channel savings of the people to the productive sectors of the economy and income being high, high savings and investment take place automatically.

But for the less developed countries (LDCs) of which Bangladesh is selected in our study, the main problem is to face the 'vicious circle' of poverty and stagnation. These countries were by and large dependent territories or colonies and have gained independence only during the two decades following the end of World War II. The industrial and agricultural revolutions which changed the pattern of social, cultural and economic life in the developed capitalist countries were never experienced in the LDCs. Moreover, Bangladesh (former East Pakistan), as a part of Pakistan freed from the British colonial administration in 1947, had to pass another 25 years under the colonial exploitation of West Pakistan till independence in 1971. In actual, the whole period of united Pakistan was based on the transfer of resources from East Pakistan to West Pakistan[1].

It is generally agreed that the transformation of a stagnant backward economy like Bangladesh to the stage of self-sustained growth is limited by a number of constraints of which two are stylized as the saving gap (popularly known as saving-investment gap) and the trade gap (popularly known as export-import gap). The former relates to the inadequacy of domestic saving in relation to the required volume of investment and the latter relates to the shortage of export earning in relation to import cost causing a deficit in the current account balance of payment[2].

Under the above circumstances what is needed for development above everything else, is the speeding up of the rate of capital formation in the economy. The main reason for stagnation in the economy is that the capital stock is just sufficient to produce an income which bearly suffices to maintain current consumption and replacement of capital which is depreciating. There are under-employed and unemployed human resources along with known but undiscovered natural resources.

Admittedly, employment of labour and discovery of natural resources and their productive use need some tools and implements. Even the employed labour can produce much more if more advanced technology is used. This in turn requires more capital. More capital can be created by larger savings of the people, which it may be difficult to generate for a poor country like Bangladesh and other LDCs characterized by the vicious circle of poverty.

Given the limited scope of generating private savings, it is in breaking this vicious circle that the government can play an important role through its budgetary measures. In other words, the immediate goal of economic policy is to break the stagnation of the economy and to set the forces of growth in motion. The task is, however, difficult and requires an all-out effort. What is needed above all, is that the government must play a positive role in achieving the ideal of a better standard of living for the masses and the budgetary policy of the government must reflect this effort.

A conscious effort can be made by the government in framing the budget to provide for investment in the public sector. What is essential is that the government can raise more resources by taxation, pricing of government enterprises or by borrowing, and spend less on current consumptions. Economic development sustained by the allocation of increased domestic resources for investment and the better pattern of resource use can bring about a fundamental change in the structure of the economy.

The underdeveloped as well as unorganised nature of both money and capital markets in the economies like Bangladesh makes it necessary that the government takes an active part in the mobilization of domestic savings. In what way the Bangladesh Government can and does raise resources we would discuss in the forthcoming pages of our study. For the present, it is important to realise that budgetary policy explicitly aiming at raising government savings assumes a crucial importance in the mobilization of domestic resources to finance public investment. This should be the first criterion on which the budget of any underdeveloped country like Bangladesh must be judged.

However, the story does not end here. The development effort places certain additional burden on the administration of the country allowing some rise in what is popularly known as 'non-development' expenditure. More has to be spent for keeping accounts, auditing and maintaining the existing level of services including law and order.

In addition, where development programmes create services, recurring expenditure rises for their maintenance. When a school building & hospital is constructed, for example, teachers or doctors should be employed respectively whose salaries must be paid out of non-development funds. Last but not the least, when development programmes generate upward pressure on prices, the government finds it necessary at some stage to adjust the salaries of government employees.

So, it is not possible for the Finance Minister of a developing country like Bangladesh to check a rise in non-development expenditure without jeopardising the progress of development effort itself. Effort is continually made to check the rise in unnecessary current expenditure, and the principles of austerity is declared to follow from time to time, but some increase must be allowed in any case. Thus in budget-making while care has to be exercised to avoid wasteful expenditure and to economise the cost of production, this has to be done without imparing administrative efficiency needed for running development programmes. This leaves the task of budget-making more or less confined to finding resources for financing investment.

Resources, of course, must be found, because the only alternative is deficit financing which is undesirable. The government can obtain resources not only by taxation and borrowing but also by creating new money, almost at will[3]. But the consequences of the latter method are generally far from happy causing inflation.

Secondly, higher prices, inter alia, raise the cost of the development programmes being implemented by the government. The government thus needs more money and may resort to more deficit financing resulting in a still higher rate of inflation. Again, the inflationary situation, redistributing income unfairly, discourages savings and whatever savings take place are diverted to speculative channels like black-marketing, smuggling, etc.

This is not to suggest that deficit financing is harmful under all circumstances. Within limits it may play a useful part. In beget-making, therefore, the approach to deficit financing may have to be rather cautious. However, the considerations on which deficit financing may be justified are not easily justifiable and do not lend themselves to precise measurement.

Given the limited scope for deficit financing in rational budget-making, the government must make a concerted effort to raise the level of its revenue and capital receipts. It may, however, supplement domestic resources by borrowing from abroad or by obtaining outright grants. In any case, foreign assistance, while it can provide some relief, would not remove the necessity of raising resources internally.

Foreign assistance can at best meet the foreign exchange gap and in some cases to some extent the savings-investment gap. But a continual higher inflow of foreign aid in the LDCs like Bangladesh, as we shall see later, irrespective of their conditionality, to meet the savings gap and more seriously enough, to meet the deficit in the revenue budget, is not by any logic desirable. All these indicate a considerable scope for mobilization of domestic resources on the part of the government through budgetary measures.

In search of revenue, on the other hand, the government of an underdeveloped country like Bangladesh faces some dilemma. It needs more resources for financing development programmes. At the same time it finds it necessary to offer certain tax incentives which would encourage savings and investment in the private sector. Moreover, the absolute poverty of the people sets a limit to the level of taxation which can be considered practicable. It is often observed that the people who insist on higher development outlay and better social services from government, also criticize the government for raising more taxes and for the new tax proposals without an adequate appreciation of the financing aspect.

Another dilemma is that while increased taxation or severe austerity is politically unpopular, heavy dependence on foreign assistance is also not palatable to the politicians. For the former imposes sacrifices on current consumption and the latter restricts the freedom of action in domestic as well as international policies. But the objective conditions of the LDCs like Bangladesh, such as low level of social services, unsuitable infrastructure, rising trend of population, etc., always demand a higher development expenditure. The policy makers thus are always faced with the difficult choice in this respect which involves a 'wide range of complex and interrelated political and economic considerations'[4].

As a matter of fact, the budget can never be wholly satisfactory to all the segments of the society, as it involves a compromise of various objectives. It is inconceivable to have all the four things simultaneously: more development, less taxes, reduced dependence on foreign aid and no deficit financing. This is why it is necessary to view the budget as a whole. Viewing it in parts one may be led into a wholly irrational and self-contradictory view. Bearing all these into mind, the budget and its effectiveness in mobilizing resources internally in a developing country like Bangladesh is to be evaluated.

2. Purpose and Hypothesis of the Study

In the light of the above statement the main purpose of the proposed study is to analyse the working of the Bangladesh Budget and to evaluate the effectiveness of various budgetary measures in the way of domestic resource mobilization from 1972 to 1985.

Although the working of the Bangladesh Budget remains the main focus of our study, it is worth noting at the beginning that mobilization of internal resources for financing public investment is the most relevant task of budget-making in Bangladesh.

This study is not to engage in a theoretical discussion, rather it attempts a brief analysis of the revenue receipts, revenue expenditure, capital receipts and capital expenditure of the Bangladesh Budget during the period under study with the help of available data. Before doing so, we like to introduce the nature and extent of economic exploitation before independence (Pakistan period 1947-71) and economic conditions of Bangladesh just after liberation along with the system of government budgeting in practice in Bangladesh. Finally, we like to view the overall budgetary position of the Government of Bangladesh (GOB) and the performance of budgetary measures especially taxation towards mobilization of domestic resources over the years.

It should, however, be noted here, that the beginning of Bangladesh was not promising enough. In 1971, she inherited a poor and undiversified economy, characterised by underdeveloped infrastructure, stagnant agriculture, low industrial base and a rapidly growing population. She had, as noted earlier, suffered from years of colonial exploitation and missed opportunities with debilitating effects on initiative and enterprise. Superimposed on all these were, the effects of the war of liberation which caused serious damage to the physical and organisational apparatus and disruption in established external trading relations.

Throwing light on the economic position of Bangladesh of that period Mr. Tazuddin Ahmed, the first Finance Minister of Bangladesh, in his first budget speech pointed out that the new Government inherited a paralysed and bankrupt economy after a nine-month war of liberation. The new Government had to start almost from zero, for there was neither any revenue nor any foreign exchange in the coffers[5]. Considering the economic condition of Bangladesh in the early seventies Just Falland (World Bank) and J.R. Parkinson (IBRD) termed Bangladesh as the 'Test Case of Development'[6]. For, if the extremely difficult problems of Bangladesh could be solved, the problems of other LDCs could also be solved.

The starting point from which economic development of Bangladesh was attempted was not promising enough — income per head was estimated at US $ 70 only in 1972[7]. In the UN General Assembly Report, 1975, Bangladesh has been termed as one of the 28 'Less Developed Countries' of the world with the following characteristics:

a) predominance of backward agriculture,
b) undeveloped industrial sectors,
c) heavy depencence on foreign assistance, and
d) over-population with a very low per capita income.

Most of these would not matter if Bangladesh were rich in natural resources and under-populated. Moreover, she suffered from the almost routine-wise onslaught of natural calamities like flood, cyclone, droughts, etc. which unpredictably caused great damages to life and property every year. As has been said, "Nature, not man, is in charge of the situation in Bangladesh"[8].

The Bangladesh economy grew only at the rate of about 6 per cent during the First Five-Year Plan (1973-78), declining to the rate of about 3.5 per cent and 3.8 per cent during the Two-Year Plan (1978-80) and the Second Five-Year Plan (1980-85) respectively. During the period between 1972-73 and 1984-85 gross investment and saving on an average were about 15 per cent and 4 per cent of the GDP respectively, reflecting a saving-investment gap of about 11 per cent on an average, which, however, was to be filled up by foreign assistance[9]. This will be easily understood from the macro-economic changes in the economy in different plan periods as shown in Table 1.

Table 1

Macro-Economic Changes in the Economy of Bangladesh (1973-85)

Macro Indicators	First Plan (1973-78)	Two-Year Plan (1978-80)	Second Plan (1980-85)
i) GDP Growth (%)	6.1	3.5	3.8
ii) Export Growth (%)	1.8	-3.2	4.9
iii) Import Growth (%)	0.5	12.3	4.5
iv) Foreign Aid Growth (%)	-2.1	2.3	3.3
v) Investment as a % of GDP (Terminal Year)	13.5	15.9	17.3
vi) Saving as a % of GDP (Terminal Year)	4.6	4.2	4.2
vii) Tax-GDP Ratio (Terminal Year)	7.5	8.0	8.2

Source: The Third Five-Year Plan (1985-90), Planning Commission, GOB, Chapter 1, p. 5.

The ratio of savings to the GDP is very low in Bangladesh. The savings ratio which was 4.5% in 1972-73 improved slightly to 4.6% in the terminal year of the First Plan Period (1973-78), but declined to 4.2% during the Two-Year Plan (1978-80) and remained stable by the end of the Second Plan Period (1980-85) against the target of 7.4%[10]. Even compared with the other low-income Asian Developing Countries, the savings-GDP ratio in Bangladesh is pitiably low as shown in Table 2.

Table 2

Savings Ratios of Some Asian Countries

Country	Savings as Percent of the GDP
Bangladesh (1984-85)*	4.2
Pakistan	5.0
Nepal	12.0
Sri Lanka	13.0
Philipines	13.0
Burma	14.0
Thailand	21.0
India	21.0

Source : World Bank, Bangladesh: Promoting Higher Growth and Human Resource Development, March, 1987.

* The Third Five-Year Plan (1985-90), Planning Commission, GOB, Chapter 1, p. 5.

It is thus clear that the low savings-GDP ratio and hence the saving gap has been the dominant and binding feature in Bangladesh, which is, however, enough to convince one of the necessity of increasing domestic resource mobilization efforts. And this renders the present study highly significant. Furthermore, this leads us to the hypothesis that the Government of Bangladesh failed to mobilize adequate resources internally through budgetary measures needed for financing development programmes and this virtually made Bangladesh an aid-dependent nation over time.

No doubt, the GOB attempted to raise government saving from time to time[11]. How to generate resources was the key question to the policy makers from the beginning. Despite the fact that Bangladesh was a country of great poverty, she had some pockets of generating surplus which could be mobilized for investment. Of these, agricultural surplus, trading profits, and industrial profits were the most important potential sources of capital accumulation.

But the path was, however, not prime rose-strewn. The 'interplay of economics and politics' and the 'competing claims of divergent pressure groups' and 'interest groups'[12] drastically limited the scope of generating further resources from the said sources. Thus as shown in Table 1 the Tax-GDP ratio which was 7.5% at the terminal year of the First Plan improved slightly to 8.0% at the end of the Two-Year Plan with a marginal positive change at the end of the Second Five-Year Plan, which is low as compared to the South Asian as well as other LDCs of the world.

Since liberation, the affluent farmers, traders, merchants, small scale entrepreneurs and industrial trade unions appeared at the most powerful interest and pressure groups in Bangladesh. They played a preeminent role in the economic life of the country and in the political process as well. The members of public services, including the army, the professionals and the intelligentia were almost all drawn from these interest groups. Naturally, the political leadership both in power and in opposition was the representative of these interest groups[13].

The pressure of the affluent farmers was reflected in the fact that land revenue on holdings upto 8.3 acres in size (which was quite a high limit considering the high population pressure in Bangladesh) was abolished and the collection of agricultural income tax was postponed for a period of two years after 1973[14]. In addition, the agricultural inputs were highly subsidised which mainly benefited the big farmers but decreased government resources. In fact, the big farmers were the 'vote brokers' and the 'key figures' in the rural support base of the ruling as well as the opposition parties of 'all complexions of right and left'[15]. Thus there was little scope to extract surplus from them through fiscal instruments or pricing policy by the ruling authority and, in fact, the state itself became a source of subsidy to this class.

In the trading sector again, high profits earned by the merchantitle class were not possible to tax adequately for it was contended that higher taxes would push prices further up. The small scale industrialists, on the other hand, enjoyed the facilities of 'tax holidays', tax exemptions, low tariff, etc., instead of sacrificing any surplus to the government.

Thus the big farmers, the traders and the industrialists guided by their vested interests were not as yet ready to accept any increase in the burden of taxation or surrender the benefits of subsidy.

The performance of the nationalised sector, on the other hand, was far from satisfactory. This sector suffered losses or earned very low profits for various reasons, particularly for managerial and organisational deficiencies, among others[16]. The industrial workers, on the other hand, did obtain high wages partly on the initiative of the government and partly through collective bargaining. In addition, subsidies on food-grains distributed under the rationing system to the urban population, including all categories of public servants, public sector employees and industrial workers, irrespective of their incomes further compounded the difficulty of mobilising resources internally for investment.

Non-development expenditure, on the other hand, has continued to grow at an accelerated pace ever since 1972-73 and the rate does not seem to have settled down. Bangladesh is continual suffering from a top-heavy bureaucratic administration. Besides, Bangladesh like other LDCs suffers from obstacles like, 'bad planning and bad administration', 'conspicuous prestige expenditure' to show the greatness of the new state in comparison with its neighbours, 'corruption', 'lack of democracy' in its true sense, 'high population growth rate' and 'disillusion and disappointment'[17].

Last but not the least, it is useful to note that Bangladesh never experienced political stability during the period under study. The years since 1971 have been a period with different styles of government with different ideologies. The brutal assassination of President Shiek Mozibur Rahman in August 14, 1975 and the subsequent coups and counter-coups on November 3 and 7 (1975) and once again in May, 1981 the murder of President Ziaur Rahman — these are some instances of political instability in the country[18]. These had grave and unpredictable effects on the economy.

Thus the disaster-prone economy, low per capita income and pressure of various competing interest groups in favour of tax exemption along with high non-development expenditure, weak administration, defective policies, corruption and tax evasion basically limited the scope of working of the Bangladesh Budget and the effectiveness of fiscal instruments in the way of raising resources for financing development programmes. Under these circumstances with no surplus available for financing investment within the prevailing system, the dependency on foreign aid was 'built into the inheritance of Bangladesh'[19]. And over the years foreign assistance become 'an integral prop' of budget-making to the government, 'militatimg against any pressure to generate internal resources'[20].

3. A Brief Review of the Existing Literature and the Importance of the Present Study

There is a study relating to the Bangladesh Budget by G. Hossain (1978) wherein the origin, evolution and development of the Bangladesh Budget are shown. The studies of M. Hossain (1982) and G. Kibria (1976) have shown the system of national accounts, budgetary procedures, methods of approval and their implications in Bangladesh. Another study by S.U. Patwari (1985) has shown the financial administration of Bangladesh.

But these studies are concerned mainly with the theoretical and technical aspects of the Bangladesh Budget and none of them viewed the budget in relation to the problem of internal resource mobilization in Bangladesh. M. Hossain (1987), however, apart from delineating the system of government budgeting in Bangladesh has tried to explain the problem of resource mobilization.

There are some excellent research papers of which M. Hossain and O.H. Chowdhuri (1988), O.H. Chowdhuri (1986, 1988) and A. Rahman (1985) are noteworthy. These works tried to explain the problem of resource generation by pointing out the inadequacies and problems of tax and revenue structure of the Bangladesh Budget. Another research work by M. Hossain, A. Rahman and M.M. Akas (1985) signified the problem of raising additional revenue from the agricultural sector. Almost all of these works are, however, policy-oriented in nature.

As far as our knowledge go, almost all the studies viewed the Bangladesh Budget partly, taking its tax revenue receipts portion only. But viewing the budget partly may mislead one into a wholly irrational and self-contradictory view. In fact, without considering both the non-development expenditure, and capital or development expenditure sides of the budget, it is not wise to throw any conclusion in this field.

So, there remains an analytical gap in this field and in our study we have made an attempt to fill up this gap by viewing the Bangladesh Budget as a whole. We thus humbly hope that this study will add something new to the existing literature on the subject. At the same time we also believe that when everything is done and said, there always remains a scope for further research and study in this field.

4. Methodology and Data Used in the Study

The methodology of simple statistical tabular form of data processing is used in this study. We selected the period from 1972 to 1985, not because of any desirable statistical property but because of the fact that this period covers about one and a half decades, three plan periods and more significantly this period represents ideologically two different types of government. Compound growth rates and percentage rates are used to show the changes and order of magnitude. Other statistical tools are also used. In the case of different plan periods yearly averages are used. In some cases, officially arranged fiscal data under major and minor heads are rearranged on priority basis and also for the sake of analytical simplicity.

This study is necessarily based on secondary data. Fiscal data like revenue receipts, revenue expenditure, capital receipts and capital expenditure are available from the Ministry of Finance, GOB, National Bureau of Revenue (NBR) and Planning Commission, GOB. Other government sources of fiscal data are Bangladesh Bureau of Statistics (BBS), Fiscal Statistics, Statistical Year Book (SYB), Bangladesh Bank, etc. Computed and processed data are also used from the publications of the World Bank, the IMF, the Bangladesh Institute of Development Studies (BIDS), etc., where needed.

The annual publications of the Economic Advisory Wing, Finance Division, Ministry of Finance, GOB, like Economic Survey of Bangladesh, Economic Analysis of Budget, Budget in Brief, etc., are mostly exploited as data sources. The most comprehensive data relating to aid to Bangladesh are available in the Flow of External Resources, an annual publication of the 'Economic Relations Division' (ERD), formerly known as External Resource Division, Ministry of Finance, GOB. Beyond these basic sources of statistical data a variety of other government publications, recognised academic journals, books and research findings have been drawn upon with due acknowledgement.

Problems of working with secondary data, specially government data, may perhaps have been commonly felt by all research workers. In Bangladesh statistics are liable to wide margins of errors. Poor processing, incorrect and inadequate recording and lack of uniformity in the process of data recording make it all the more difficult to work with the government data. Even in different publications of the same government office, conflicting fiscal figures are found. We, therefore, note that figures from different tables may not be comparable if they are from different sources. In this study we have made a cautious effort to exclude all such misleading and unreliable figures as far as practicable.

NOTES AND REFERENCES

1. The highly segmented economic growth in favour of West Pakistan at the cost of East Pakistan caused disintegration of united Pakistan and the birth of a new state 'Bangladesh', after a successful 'National Liberation Movement' in 1971. See for details Emajuddin Ahmed, Bureaucratic Elites in Segmented Economic Growth : Bangladesh and Pakistan, University Press Limited (UPL), Dhaka, 1980.

2. In this study, we are not, however, concerned with trade gap but savings gap only.

3. Technically, in modern times, the government does not directly create money by printing notes. It simply borrows from the central bank, with which lies the monopoly of printing new notes.

4. See Nurul Islam, Development Planning in Bangladesh: A Study in Political Economy, UPL, Dhaka, 1979, p. 180.

5. See Tajuddin Ahmed, The Budget Speech,1972-73, Ministry of Finance, Government of Bangladesh (GOB), Dhaka, 30th June, 1972, p. 6.

6. See J. Falland and J.R. Parkinson, Bangladesh : The Test Case of Development, C. Hurst and Company, London, 1976, p. 6.

7. World Bank, Bangladesh : Development in a Rural Economy, Report No. 455b-BD, September, 1974.

8. See J. Falland and J.R. Parkinson (1976), p. 1.

9. The Third Five-Year Plan (1985-90), Planning Commission, GOB, Chapter 1, pp. 1-8.

10. Ibid, Chapter 1, p. 9.

11. This study is not concerned with private savings but government savings only.

12. See for details, Nurul Islam (1979), pp. 1-17.

13. Ibid, p. 3.

14. Ibid., p. 195.

15. See Rehman Sobhan, The Crisis of External Dependence: The Political Economy of Foreign Aid to Bangladesh, University Press Ltd., Dhaka, 1982, p. 3.

16. See for details, Rehman Sobhan and Muzaffar Ahmed, Public Enterprise in an Intermediate Regime : A Study in the Political Economy of Bangladesh, BILS, Dhaka, 1980, Chapters 14 and 15. Also see The Second Five-Year Plan 1980-85, Planning Commission, GOB, Chapter IV, p. 2.

17. See Adrean Moyers, and Teresa Hayter, World III : A Hand Book on Developing Countries, Overseas Development Institute (ODI), London, 1964, p. XV.

18. See Raunoq Jahan, Bangladesh Politics : Problems and Issues, UPL, Dhaka, 1980, p. 197.

19. See Rehman Sobhan (1982), p. 6.

20. Ibid, p. 8.