

## Some thoughts on Budget 2010

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It is that time of year again when the game of tariff adjustments will be played out – ostensibly in consultation with key stakeholders. In this case, the National Board of Revenue will play the final arbiter, with policy guidance from the Minister of Finance. The role of Ministry of Commerce as the final arbiter of the level and scope of tariff protection to domestic industry has long vanished – or, shall we say, usurped by NBR, perhaps by default, more than by design.

The tradition of pre-budget discussions with the chambers of business and industry has taken hold. This participatory approach has all the ‘feel good’ connotations that one could look for in a democratic society. Policymakers take home many ideas and a good sense of the problems that afflict the business community. A number of tariff proposals are tabled as part of these consultations. More keep coming round the year. The grand finale is acted out behind closed doors at the NBR in the last days preceding budget announcement. Coming as it does from the business community, most of the tariff proposals are intended to raise current profitability of firms. Quite often, they might not be consistent with the long-term interests of the industry or the economy. Besides, the largest stakeholders – consumers – appear to be absent as a group from these deliberations. And yet, the ultimate burden of tariffs falls on their shoulders. They are the ones who pay the tariff-ridden prices of consumer goods. Even if the tariffs are on industrial inputs, producers eventually pass on the tariff burden to consumers via cost-plus pricing. At the end, policymakers are left with making an astute balancing act for the budget.

What seems missing in the tariff proposals is guidance on general principles or rules to be followed. Often, tweaking a tariff here, and a tariff there, passes as the outcome of most consultations focusing on tariffs. While this may solve existing problems in some industry or firm, such micro-management could result in a complex tariff structure, and is seldom equitable. Inherent in these proposals is a preference of one industry over another, or one sector over another. Make no mistake, small changes in tariffs on inputs or outputs could mean large gains or losses for an entrepreneur.

In what follows are a sampling of some general rules that might help guide policymakers in making rational judgments in adjusting tariffs in the forthcoming budget. The primary objective of these rules is to make the tariff structure simple, transparent, and equitable across sectors.

First, the trend towards uniformity of tariffs should be continued. Back in 1992, when the first phase of tariff reforms was started, the Customs Tariff was riddled with as many as 17 customs duty slabs along with their concessional rates. Today, there are only four non-zero tariff slabs: 3, 7, 12, and 25. In the Bangladesh context, this means fewer hassles over tariff assignments. Pressure to add new slabs ought to be resisted.

Second, it is also good policy to assign tariffs on products within a generalized system, making only a few exceptions which should not exceed, say 0.5 per cent of all tariff lines (about 6400 8-digit HS Codes). Micromanaging tariffs for specific products, industries, or sectors, opens a Pandora's box that becomes hard to manage. NBR has appropriately moved towards such an approach by assigning tariff rates for broad commodity categories: final consumer goods, intermediate goods, capital goods, and basic raw materials (Table 1).

Table 1. 2009 Tariff bands and commodity classification: General pattern

Tariff bands (%)	Commodity categories	Stage of processing
3	Capital machineries	
7	Basic raw materials	First stage
12	Intermediate goods	Semi-processed
25	Final consumer goods	Final stage
0	Ranges from raw materials to final goods, like life saving drugs	

These tariff assignments by product categories serve several useful purposes: they make the tariff regime simple, transparent, and more uniform; disputes regarding classification of goods are eliminated; and the scope for malfeasance is minimized. It also makes it easier for NBR management to pursue an identifiable general rule of tariff assignment without having to yield to myriad requests for tariff adjustments based on individual product or company circumstances which is symptomatic of some of the proposals emanating from the various chambers.

However, there are exceptions to the above rule where we find intermediate goods and even basic raw materials having 25 per cent duty. It would be appropriate to rectify these anomalies.

Nevertheless, it must be acknowledged that, by following a general pattern of tariff assignment, some order has been brought to the tariff structure. To reinforce this trend, a second approach followed by NBR over the years has been to reduce multiple tariff rates within each HS-4 heading. The idea is to have, as far as practicable, only one rate for products that are similar in nature. This eliminates the scope of disputes regarding classification of goods. Bangladesh uses 8-digit Harmonized System (HS) codes for describing import and export products. Products are different from one HS-4 heading to another. But

within a HS-4 digit code, listed products are similar except that slight variation from each other occur due to some degree of processing. As a matter of policy, having more than one tariff rate within a four-digit heading should be avoided.

The presence of para-tariffs, such as supplementary duty, trade VAT, AIT, and so on, adds complexity to an otherwise simplified tariff structure. SD is the most pervasive of all para-tariffs, being applied on over 1000 tariff lines in which the existing CD is 25 per cent. Over the past several years, many para-tariffs – infrastructure development surcharge, regulatory duty, license fee – have been eliminated. It is now time to systematically phase out SD over the next couple of years. In one sweep, SD on 200 tariff lines of RMG products could be eliminated right away. There is no revenue implication here and RMG needs no tariff protection. A long list of consumer goods produced domestically have nominal tariffs exceeding 100 per cent, with much higher effective rates: chocolates and confectionery, cereal preparations, tableware, mineral water, doors and window frames, etc. It is time to reduce protective tariffs on these products.

The top rate of 25 per cent has remained unchanged for the past five years at a stretch, while input rates have come down under pressure from business lobbies. Consequently, consumers in Bangladesh got no relief from the tariff regime, except ad hoc adjustments that were made intermittently to reduce prices of essentials, such as foodgrains, edible oils, onions, etc. It is only fair to give consumers some relief in the forthcoming budget by scaling down the top rate of 25% by 2.0-3.0 percentage points, regardless of what is done to input tariffs.

Tariffs declined most rapidly from FY92 through FY96; from that time on the decline was more gradual. Average MFN (most favored nation) tariffs were 74 per cent in FY92; it came down to 20 per cent in FY09. Yet, Bangladesh remains behind most of its comparators in terms of tariff levels – in South Asia as well as globally. This is not a matter of perception but

a reality based on computational evidence emerging from Bangladesh's tariff structure. Bangladesh has been reducing average tariffs by roughly two percentage points every year. This is not because it is required by WTO, where its tariff bindings are well above applied rates. It is because Bangladesh, like most emerging market economies, realizes the benefits of trade openness which, by ensuring competitiveness, has yielded higher export and output growth in Bangladesh. It would be appropriate to maintain the downward trend in average tariffs in the next fiscal year.

Finally, while the country's tax effort needs to be made more effective in order to mobilize more revenue, at the same time, the traditional reliance on import-based taxes must be paired down. Import taxes distort business incentives much more than income taxes or consumption taxes (e.g. VAT). The stylized facts of revenue mobilization indicate that as countries develop, their reliance on import-based taxes diminish, and revenue generation from domestic taxes increase. In USA, Japan, and Germany, customs revenues contribute less than 2.0 per cent to tax revenue. It is under 7.0 per cent in China, and 17-18 per cent in India and Vietnam, compared to Bangladesh's 42 per cent today. The good news is Bangladesh's reliance on customs revenue is on the decline, but not fast enough to match the progress made by its comparators. It amounts to a strategic shift of focus, nevertheless, in revenue mobilization. This trend ought to be sustained in the next budget and beyond.

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