National Budget 2001-02

10 June, 2001

no direction for recovery of the ailing capital market and foreign exchange reserve; no fresh tax with massive debt service liability augurs elusive revenues for the years to come …..

Hefty borrowing from banking system alive and kicking

- **Budget size** — **Tk 447.65 billion ↑ 4.45%**
- **Revenue collection target** — **Tk 272.39 billion ↑12.57%**
- **Current Expenditure** — **Tk 220.38 billion ↑12.25%**
- **ADP** — **Tk 195.00 billion ↑11.43%**
- **Contribution of local resources to ADP** — **↓48.70%**
- **Total budget deficit** — **Tk 175.26 billion ↓ 6.09%**

Like the past years of the ruling government, the proposed budget continues with a high borrowing content from internal sources. For the next fiscal year, the proposed borrowing is around Tk 89.17b of which Tk 21.58b or around 24.2% are to be from the banking system. During the passing fiscal, total borrowing from the banking system was Tk 33.06b that include Tk 3.78b in addition to the provisioned amount. Annual Development (ADP) size has been proposed to increase by 11.43% or Tk 15b to Tk 190b. Last year the budgeted ADP was Tk 175b that was later revised to 182b. The revised ADP has reportedly been stretched by Tk 5.3b at the dictate of the Prime Minister's Office, as requests for more fund are still pouring into the Ministry of Planning, expecting to reach Tk 185.0b. Share of local resources in the next ADP is going to shrink again, to 48.7% from 50.2% provisioned in the original budget last year.

Education, like last few years, continues to top the recipient's list with an allocation of 13.47% of the total budget, followed by defense 8.36%, local government 7.9%, roads and railway communication 7.65%, energy 6.51%, health 6.42%, and civil administration 3.79%. It may be noted that roads and transport has received particular attention in the proposed budget, while police and local government get a remarkably increased share of budget that suggest tacit recognition of the increasingly deteriorating law and order situation.

6.04% GDP growth emanates from bountiful harvest

GDP growth of the current fiscal year (2000-01) estimated by the Bangladesh Bureau of Statistics at 6.04% on constant price (1995-96) against last year's 5.5%, evinces the country's strong desire to outpace all its poverty ratios. However, in the old accounting system (based on 1985-86), the growth would be around 6.6%. Like last year, the growth was mostly due to an opulent crop harvest, at around 26.4m tons of food grain against last year's 24.3m tons, with 8.64% growth amid a waning arable land. As rice contributes more than 50% to agriculture and agriculture around 30% to GDP, thus we at AIMS estimate that the reported growth in rice production is to fuel a growth of 1.3% in GDP.

Industrial growth is estimated at 9.1% in the current fiscal compared to 4.76% of the last year. As industrial production constitutes to be around 11.0% in the GDP, we expect the reported growth in industrial production to contribute 1.0% growth in GDP, which together with above agriculture growth show that service sector has contributed the highest to the GDP growth. Although the proposed budget refrains from quoting figures on this, indicators make us skeptical about such a high growth of the service sector.

On the other hand, domestic and national savings in the current fiscal year were 18.76% and 23.78% respectively of GDP. The investment rate, estimated at 23.63% of GDP, looks healthy and the major portion of this has been made by the public sector, but rationale for such investment, especially the quality of investments in productive sectors and their efficacy remains doubtful. Although revenue has grown in the current fiscal, this may not increase as much as expenditure if the existing net is not widened. During the first 10 months of the current fiscal, revenue collection has increased by 22.48% over the realized revenue during 2000-01.

Budget at a glance

Tk billion

	Budget 2001-2	Budget 2000-1 Revised	Budget 2000-1 Original
Revenue			
Tax	220.23	194.90	192.78
Non-tax	52.16	46.83	49.21
	272.39	**241.73**	**241.98**
Expenditure			
Current expenditure	220.38	206.62	196.33
ADP	190.00	182.00	175.00
Non-ADP projects	2.84	1.33	4.13
Non-ADP food projects	6.22	7.73	5.83
Food	3.62	(1.21)	3.95
Non-ADP FFW projects	6.22	7.73	5.83
Internal loan and advances	(4.89)	(4.21)	(4.89)
Repayment of foreign loans	24.70	23.80	24.80
Capital expenditure	4.78	3.89	5.44
	447.65	**419.95**	**428.59**
Budget deficit	**175.26**	**178.22**	**168.61**
Budget deficit financed by:			
External Sources			
Foreign grants	36.63	23.29	31.83
Foreign loans	65.59	59.93	62.38
	102.22	**89.22**	**94.21**
Domestic Sources			
Term debt (Net)	3.94	4.22	3.29
Budgetary surplus	2.50	2.50	2.50
T&T Bond	2.00	2.00	2.00
Savings Certificates	43.02	42.64	31.47
	51.46	**51.36**	**39.26**
Extra financing from the banking system	21.58	37.64	35.14
Total Financing	**175.26**	**178.22**	**168.61**

No significant reform envisioned

The following reform measures have been proposed:

- **Revenue administrative reform**
  - Revenue Board to be established for assessing the fiscal policy impacts and devising ways for mobilization of more resources.
  - A Public Expenditure Review Commission (PERC) will be set up to monitor the appropriate uses of public resources.
- **Banking reform**
  - Definition of 'default' changed to encourage defaulters to pay back.
- **Capital Market reform**
  - No new reform plan for capital market has been declared.

- **Trade reform**
  - Average import duty has been lowered from 17.0% to 13.7% to facilitate cheaper import of industrial raw materials, and capital machinery, etc.
- **Other reforms**
  - Administrative reform commission is at work and expected to submit their report in a short period.
  - Agrani Bond and Equity and Entrepreneur Development Fund have been set up to facilitate IT and agro-based export-oriented industries.

However, we observe the steps so far taken are taking time to bear expected results. The proposed Revenue Board and Public Expenditure Review Commission reveals unfinished agenda of augmenting earning and arrest expenditures, to maintain internal balance and reduce deficit, that has been shelved for the future, albeit recognized.

Unconvincing inflation claim

Inflation turned out to be lowest in past five years, 1.59%, and claimed to be a manifestation of successful macroeconomic management falls much behind ground realities. When food, transport, power tariff, accommodation, apparels, and all other necessity goods record a price hike of more than 10%, such a low year-on-year inflation figure hurls the question on the very measurement process. To crown it all, it is claimed that heavy borrowing from the country's default-plagued banking system and continued expansionary monetary policy had no direct impact on inflation.

However, an alarmingly new nadir of foreign exchange reserve, waxing debt service burden and poor investment demand indicated by significant idle reserve of over Tk 40b in the banking system do not conform to the claimed happy scenario of the macro-economy. Satisfactory production of food grains with poor demand from the private sector due to low growth of private investment might have contributed to the reported low level of inflation, if at all.

Another spate of bank borrowing to oil the machine

Like the previous year, the government continues to self-righteously defend borrowing from the banking system to be not as harmful as feared since it did not trigger inflation and banks have excess liquidity. But excess liquidity evinces to be emanated from a recent reform drive. As banks have streamlined their credit sanctioning and disbursement so as to curb a bulging default and maintains high lending rates (as much as 15%) due to heavy borrowing by the government at high interest rates, it happens to deter private investment resulting in an unutilized investable fund that turns to be termed as excess liquidity.

Persistent expansionary policy augurs inflation

As appears from the budget proposal, the government is to continue with the expansionary monetary policy through borrowing from the banking system. Last year, cash reserve requirement was lowered from 5% to 4% and discount rate reduced from 8% to 7% that caused broad money supply (M2) to grow by 10.31% in the first 9 months of the current fiscal, against last year's 15.38%. Domestic credit grew by 14.93%, while government borrowing through selling various savings instruments for past 9 months of the fiscal rose to Tk 49.59b against a targeted level of Tk 47.99b. If food production fails to sustain at the current level, which is not unlikely for a calamity-prone Bangladesh, such a persistent and rapid monetary swelling could trigger inflation.

Debt servicing liabilities may lead to a vicious circle

Although revenue collection is auspiciously bright and signs showing a better collection in future, run away expenditure is forcing the government to borrow from all available sources at hand, pushing the debt-servicing liability (principal repayment and interest) high. This in turn makes revenue look inadequate and therefore plunging the government to borrow again. In 2000-1 debt servicing has taken out Tk 123.8b, or 27.66% of the total budget. In the budget for 2001-2, the liability is estimated to increase to Tk 143.86b, 16.2% up from the last year. Constant borrowing urged by dire needs of financing the proposed or politically committed projects and regular public expenditure would soon accumulate to a towering figure that will not only surprise the next incumbent government with haunting wake, but will also plunge to grapple with a recovery endeavor.

Devaluation forces Taka to plummet again …. and again

To halt an alarmingly declining foreign exchange reserve, now at $1.22b only, the Central Bank has devalued Taka during the current fiscal against US dollar by 12.7% in two phases that towed it down to 57.50 from 51.00. With the last adjustment, external value of Taka depreciated on a cumulative basis by 33.49% since the fiscal 1996, when the present government took office. If devaluation continues in the coming fiscal, this may not deter inflation to reemerge that remains content in a hefty crop harvest. Government flashed the export card every time they devalued arguing that this would give an exchange leverage to the exporters, but due to lack of elasticity of the very base, export failed to evince any perceptible growth concomitant to the devaluation rates. To our dismay, but not surprisingly, export fell in the last quarter of the current fiscal when a fresh devaluation dwarfed the Taka once again.

Moderate export growth, but sustainability susceptible

The export earnings during the first 9 months of the current fiscal reached at US$4,781m marking a 15.9% growth over its corresponding figure in last year. The third quarter of the fiscal also exceeded its target by US$ 45.84m, as Export Promotion Bureau reports. This may be considered moderate compared to last few years, especially when it drastically fell to 2.9% a year back due to damage caused by deluge. But indicators show that export started to fade away in the fourth quarter, due to an imminent global recession, raising the alarm. During the first 8 months, export figures was as under :

Sector	Up/down from last fiscal, %	Export, $ million	Short/above target, %
RMG	↑ 13.54%	2303.40	↑ 4.72%
Knitwear	↑ 23.82%	972.15	↓ 1.47%
Frozen food	↑ 28.70%	270.93	↑ 16.11%
Leather	↑ 21.94%	155.60	↑ 8.56%
Jute goods	↑ 19.49%	154.43	↓ 22.79%
Chemicals	↑ 18.56%	60.93	↓ 8.61%
Raw Jute	↑ 5.28%	43.93	↓ 12.10%
Tea	↑ 58.57%	19.33	↓ 3.35%
Handicraft	↑ 43.88%	4.82	↑ 22.79%

Bulging imports dwarf export performances

Growth in import of industrial raw materials, finished goods and capital machinery has outpaced exports. During the first 9 months of the current fiscal, goods valuing Tk 364.28b (about US$6.65b), mostly industrial raw materials, petroleum and petroleum goods, capital machinery and equipment has been imported, which is 23.8% more than the corresponding period of the last year. Imports bulging at a much higher rate than exports and the waning remittances made by the expatriate Bangladeshis have resulted in the ongoing foreign exchange reserve crisis. If the recent devaluation fails to deter the import spree, it would only add woes to the importers of basic necessities, and sap the exporters' strength owing to increased costs of imported raw materials.

Myth of foreign direct investment fading ?

The budget speaks little about the declining foreign direct investment (FDI). Earlier, enthusiasm of the foreign oil and gas explorers died down due to a loud disagreement between the foreign exploration companies and the government over the issue of gas export to India. Although during the past 5 years around US$1.9b has been invested in gas, power, port, and telecommunication sectors, FDI has reportedly dropped to less than US$150m in the current fiscal. We anticipate the figure to further decline in the coming years as foreign gas exploration companies are reportedly reconsidering their stake in Bangladesh, though the outgoing government appears to be in a hurry to conclude the second round bidding process.

Agricultural credit brings dividend; the silver lining

Agricultural credits continue to soar in line with demand. During the last five years an average Tk 23.95b was disbursed per year, while in 1998-99 alone it was Tk 32.45b, along with credit facilities extended to the sharecroppers. Such a healthy disbursement, however, has brought results in recent bumper harvest of crops. Agricultural sector will have a total Tk 9.37b as its share in ADP in the proposed budget. To ensure fair price for the producers and to arrest foreign exchange reserve erosion, duty on rice imports has been increased.

Privatization paces snail

Despite repeated rhetorical commitment for endeavor to bring changes in the mode of transferring State Owned Enterprises (SOEs) to the private sector, progress is evidently slow. The following changes have been adopted:

- Privatization Board has been converted into a more powerful Privatization Commission.
- Paying dues of the employees before offering for sale of the SOEs earmarked for privatization.
- Considering handing over the ownership to labor unions.
- Treating the excess land of the enterprises separately for sale.

During the last 5 years, only 14 SOEs have been successfully privatized, while some 9 more are awaiting hand over. Lack of a strong political commitment, bureaucratic red tapism, and conflicting interests seem to have slowed down the expected pace of privatization.

Classified loan wanes, yet lingers on ……

Banking reform is yet to make any tangible improvement in the sinister default culture. About 35% or Tk 228.57b of total outstanding loans of Tk 654.11b by the banks are now classified of which 95% or around Tk 217b are bad debts with faintest possibility of recovery and the rest 5% are sub-standard or doubtful. However, volume of classified loans has decreased by 6.16% in the fiscal 2000-1 compared to that of the last year. It declined from a record 41.16% in 1999-2000 though still remains much higher than that of 1996-97, i.e. 31.49%. Of the total classified loans, state-owned commercial banks account for 42.14% and private commercial banks 20.85%.

Foreign aid flow tapers

During the first 8 months of the fiscal 2000-01, foreign aid disbursement has plummeted to its record low. Till Feb 2001 some US$733.3m has been disbursed, much lower than the committed US$1,800m. The figure is lower than the country's annual debt servicing liability, at around US$767m. The amount marked a record 28.1% decrease compared to the previous year's corresponding period, around US$1,020m, very close to the committed amount of US$1,030m. Amid a declining inflow, the proposed budget suggests an increased amount of foreign aids, Tk 734b more than that received last year, to pour in. As foreign donors are increasingly raising question on performance and utilization of their aids, such an expectation might end up in surprise. Future aid commitment by the lenders might tag itself with ADP performance, which has failed to utilize even 80% by the first week of June 2001.

No change in income tax

Ahead of the imminent national election, the government has gingerly averted a tax increase. However, government expects to raise the revenue income by around Tk 7.25b through various administrative reforms and rationalization that seems apparently too arbitrary as no tenable explanation or direction has been provided. During the current fiscal, collection of income tax is expected to stand at around Tk 36.0b, while number of taxpayers to rise to 1.2m. However, with bulging deficit and soaring borrowing there may be no room in the days ahead without tax enhancement, as has been experienced previously through extra-budgetary measures like statutory regulatory orders (SROs).

Changes in tax provisions

- Tax provisions remain same as last year other than few changes for local government agencies and advanced income tax.
- Local government commercial agencies that also provide services will pay tax at 25% instead of 40%.
- Advanced income tax will be paid once a quarter if total income exceeds Tk 200,000 instead of Tk 100,000.
- Spot assessment for income up to Tk 500,000 been reduced to Tk 1,000 from various amounts.
- Tax holiday facilities for poultry, agro seeds, tourism, etc have been extended upto 2005.
- All companies whether making profits or not must submit income tax returns.
- Travel agencies will pay tax in conventional return submission system instead of paying in advance.
- Those who receive or pay donations and show fishery or poultry business as income entitled to tax holiday would pay tax in conventional return submission system instead of self-assessment.
- Import duty on galvanized products has been increased from 25% to 37.5% while duty on its raw materials has decreased.
- Net of tax-at-source and VAT has been expanded.
- Tax on imported CNG-propelled buses, other vehicles and three-wheelers has been reduced from 37.5% to 15%.
- Import duty on advertising materials has been raised from 5% to 15%.
- Duties on raw materials of electronic and electric goods, dry cell battery, bulb, agro juice, biscuits, chocolate, ballpoint pen etc have been reduced.
- Duties on imported health drinks, rice, etc have been raised.
- Duties on POY and DTY will be same at 15%.
- Duties on imported auto coner, bobbin, shuttle, loom spindle, etc have been reduced.
- Supplementary duties on locally made cigarette paper, ethylene polymer sacks, etc have been raised.

Capital Market : the forgotten agenda

Amazingly capital market remains completely out of focus of the proposed budget. Other than iterating the past reform steps there was no new direction or policy incentives for the sector that was necessary to galvanize the moribund market. While bank financing is evidently expensive for the entrepreneurs due to high lending rates, capital market should have been a prime concern for the government to continue its much-hyped industrialization vision to come true, but that remains utterly elusive in the present budget. Besides, long awaited measures for development of a bond market, central depository system or credit-rating agency were ignored in the budget speech.

Incentives for domestic Industries should pay back

Although some measures seem to have been taken with the forthcoming election in mind, the proposed budget indeed offers some new lifelines to the country's fragile industrial base that is going to face dire competition in the near future. Textile, agro-based and food processing, electrical goods, PVC products, ceramic and melamine, poultry and fishery, CNG and battery-driven vehicles, paper, footwear, tire and tubes of bicycles, ballpoint pen, and some chemical industries have received duty concessions on import of raw materials in the budget as a continuity of the policy. On the other hand, to provide a better foothold for the flourishing domestic industries, duty on certain imported goods have been raised. Ceramic ware, tube light, tetra pack, components of electric fan, advertising materials, paper cartons, plastic goods, shower and washing ware, steel pipes and tubes, etc will have more duties. These measures should also contribute to hold back inflation.

But leaves more questions than answers ……..

- Capital market remains largely unaddressed in the budget as no new policy reform or incentive measure has been proposed.
- A total Tk 143.86b or 32.14% of the total budget will simply be eroded away as debt servicing, both foreign and domestic, how such a huge outlay would impact the total budget has remained unexplained. While the first few bites are likely to abrade the ADP by large, accumulated debts, if continues to grow even at the present rate, would have a heavier burden on the economy in the years to come.
- The proposed budget claims to be able to receive Tk 7.25b from tax administrative simplification and reform, but no basis of such a large amount has been explained at all.
- Foreign aids have been harshly reduced in the current fiscal than committed, how an increase of Tk 7.34b is expected in the proposed fiscal is beyond comprehension.
- Foreign loan has been reduced in the current fiscal, and some proposals have been turned down by the international lending agencies, how an increase of Tk 5.66b can be drawn in the next year is not clear.
- Certain duty incentives to the export-oriented and import substitution industries have been proposed, but how these incentives without being propped by other relevant policy changes and infrastructure developments can be proved enough is a point to ponder.
- Foreign aids and loan dependency has not been reduced in ADP concomitant to the GDP growth and other positive macroeconomic indicators, which evidently suggests the ADP projects are in fact not rationalized, but this was not been adequately addressed.
- Domestic loan from the banking system, if continued at the present rate, would accumulate to a prodigious amount that would in the near future start to fall back on the overall domestic financing alarmingly. The proposed budget offers no policy decision in this regard.
- Interests on national savings schemes still remain at a high level than the commercial deposit rates that usually attracts public savings into government instruments and, at the same time, allows commercial banks to resort to invest in fixed-interest instruments that eventually deters them to go for real investment. No policy reform has been offered in the proposed budget to rationalize the rates.
- Actual revenue expenditure was 11.2% of GDP against a targeted 6.3%, there was no policy change in harnessing or rationalization of public expenditure size, although setting up of a Public Expenditure Review Commission (PERC) is in active consideration. Instead of rationalizing ongoing expenditure, the government continues to condone all sorts of increases and excesses of allocations. During the current fiscal, pecuniary defalcation of Tk 6b has been detected by the Auditor General. There was no policy change or reform proposal for putting a leash on the corruption that rapidly percolates through the society.
- Government was urged to bring its employees into the tax net, which again fell apart in the proposed budget. Such a move would have not only widened the tax net, but also rationalized the increasing public expenditure. But like few past years, the current budget remains silent on the matter.
- In the proposed budget no new tax has been imposed, and for many goods duties and supplementary duties have been reduced, but whether the government would resort to raise revenue through subsequent issuance of SROs remains in question. Previous practices of silent imposition of taxes through extra-budgetary SROs suggest that such a measure might not surprise the trading community but would only add to their resentments.
- Foreign exchange reserve has recently been the crux of the question for all financial quarters, but the proposed budget remains mum on how the crisis could be overcome when some payments in hard currency become due shortly on gas and power. The recent defense purchases (a US$100m frigate and US$114m 8 MiG-29s) have not been mentioned that contributed to the erosion of the reserve.
- Emphasis on IT sector developments has been reiterated in the current budget in continuity with that of the previous year. Tax concessions remain the same as last year, and no new policy measure has been adopted. Where to go from here is a question.
- The proposed budget offers no policy reform to speed up the privatization process, which has already been proven too slow. A mere transformation of the regulatory body may not expedite the process if not any policy change takes place in the decision making level.
- Power crisis remains loud as before despite much rhetoric on private power generation. The proposed budget has not addressed the matter as to how generation capacity could be improved along with reducing devouring system losses and widening distribution. Without real improvement in the sector, industrialization process will also fall back.
- Amid a growing deficit in financing revenue expenditure and development projects, especially a highly foreign aid-dependent ADP, certain allocations seem to be impolitic and willfully designed. For holding next parliamentary and local body elections Tk 1.6b has been earmarked, while for a much-hyped NAM summit Tk 2.0b, and for increasing allowance for local body officeholders, Tk 1.94b. Although election budget could not be avoided, an increase in the allocation in the revised budget seems to be driven towards election gratification. Besides, NAM summit cast strong doubt as to how such an extravaganza could bring any fruit for Bangladesh in the ongoing geopolitical scenario that is so ephemeral in nature and complex for self-positioning.