B A N G L A D E S H

National Budget 2002-03

10 June, 2002

Ambitious, Arduous, Precarious yet Understandable but Blurry as Elusive El Dorado Yearns for More Rabbits from the Hat

Tax span sprawled

- **Budget size** — **Tk448.54 billion ↑ 13.57%**
- **Revenue collection target** — **Tk330.84 billion ↑ 19.57%**
- **Current expenditure** — **Tk239.72 billion ↑ 5.56%**
- **Annual Development Plan** — **Tk192.00 billion ↑ 20.00%**
- **Local contribution to ADP** — **54.11% ↑ 5.42%**
- **Total budget deficit** — **3. 09% of GDP ↓ 0.40%**
- **Projected GDP growth** — **6.00% ↑ 1.20%**

The national budget proposal for the fiscal year 2002-03, the first for the BNP-led government in its current stint and the eighth for the incumbent finance and planning minister marks a visibly conscious and compulsive shift from the ordinary, albeit with due regard to continuity and specks of compromises. Mashed with mellows on poverty reduction, tax-tariff rationalization, primary education, and financial discipline, the budget also records an ambitious annual development program, bulged revenue target, continued borrowing to fuel the mid-night SOEs, box the middle class under the belt and of course some ritual gray promises on governance issues.

With no-nonsense urgency and crosscutting endeavors the minister has literally rolled out the magic carpet on his five year journey to the proverbial El Dorado; the Millenium Challenge - reducing incidence of poverty by 50% by 2015, and in paying for the ticket he had to flap all and sundry with the wings of taxes. There are pangs and there are pains but he has to bring out more rabbits from the hat, or else miss the train, since it is not the quantity but quality that matters at the end. Vision and dream are not really the same thing.

The success hinges on the resilience of the farmers and the middle class, reining imports, diversification of export base, revenue generation and the acceptability of the PRSP.

Start with good *stats*

Against projected hefty growth in revenue at 19.57%, resulting to increase in Revenue-GDP Ratio by 1.1% to 10.8% next year, the growth of current expenditures has been capped at 5.56%. The budget deficit for the outgoing fiscal (2001-02) could be reduced at 4.3% of GDP against a staggering 5.9% of the previous year (2000-01). Such trapeze of fiscal sustainability could be performed by the incumbent veteran finance minister through a decline in the Expenditure-GDP Ratio to 14.2% in 2001-02 as against 15.1% the previous year as well as increase in Revenue-GDP Ratio to 9.7% from 9.2% during the year 2001-02 and 2000-01 respectively. In this backdrop, the capping of projected budget deficit at 3.9% of GDP in 2002-03 appears plausible, more so as the dwindling foreign aid and grant have been accounted for in the forecast (almost zero, 0.1% to be precise, growth as percentage of GDP).

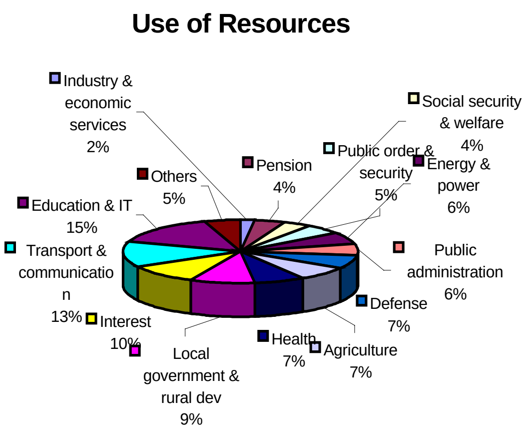
Budget snap shot

Tkbillion

	Budget	*Budget 2001-02*	
Revenue	*2002-03*	*Revised*	*Original*
Tax	255.00	219.30	220.23
Non-tax	75.84	57.40	64.33
Total Revenue	**330.84**	**276.70**	**284.56**
Expenditure			
Current expenditure	255.00	226.92	231.07
ADP	192.00	160.00	190.00
Non-ADP projects	3.71	3.13	2.84
Food	2.34	(0.06)	3.62
Non-ADP FFW projects	6.63	7.33	6.22
Internal loan and advances	(5.64)	(3.84)	(4.88)
Capital expenditure	9.78	1.47	4.78
Total Expenditure	**448.54**	**394.95**	**433.63**
Budget Deficit	**117.70**	**118.25**	**175.26**
Budget Deficit financed by:			
External Sources	**61.73**	**62.40**	**76.98**
Foreign grants	30.41	34.81	36.63
Foreign borrowing	61.39	53.13	65.59
Repayment of foreign loans	(30.07)	(25.54)	(25.24)
Domestic Sources	**42.39**	**39.03**	**50.51**
Term debt (net)	0.39	(2.18)	3.94
Budgetary surplus	2.00	1.50	2.50
T&T Bond	2.00	1.71	2.00
Savings certificates (net)	38.00	38.00	43.02
Borrowing from banks	**13.58**	**16.82**	**21.58**
Total Financing	**117.70**	**118.25**	**175.26**

The decline in projected budget deficit should relieve pressure for borrowing from the banking system and through high interest saving certificates with soaring debt servicing liabilities as well as crowding out the private sector. The debt service liabilities during the last two years were 17.07% and 16.74% of revenue respectively. The ratio of domestic financing to GDP should now decline to 1.9% of GDP from 2.3% in the outgoing year and 3.9% the year before. In a rational and prudent move, borrowing from the banking system is projected at 6% of total domestic financing in the next year, compared to 38% and 28% during 2000-01 and 2001-02 respectively.

Sectoral allocation in the proposed budget has a more pronounced tilt towards social development and agriculture sector with an eye to poverty reduction. Education, like last few years, continues to top the recipient list with 14.96% of the total budget (Tk67.1b). Civil administration has received particular attention in the proposed budget amid increasingly deteriorating law and order situation that has been hampering business and commerce. Health sector also received due importance but defense saw a slight decline in allocation. However, the qualitative aspect has always been important against quantity.



Reforms zoomed

- **Revenue & Administration**
  - Public Expenditure Review Commission (PEC) headed by a former Comptroller & Auditor General formed to oversee and examine the efficient uses of public resources as well as recommend plugging wastage and unproductive allocations.
  - Revenue Reform Commission (PRC) headed by a former Secretary to the government formed to advise on revenue sources and efficient tax & tariff management by the government.
  - A welcome mid-term budget performance review proposed for the first time.
  - Medium-term Fiscal Framework to be adopted with a three-year rolling investment program, instead of the traditional Five-Year Plan.
  - Apart from the earlier declaration on the closure of the Jamuna Bridge Authority, Statistical Division, Trading Corporation of Bangladesh and few branches of the Export Promotion Bureau, no new measure for downsizing government has been articulated.
  - Bangladesh Telecommunication Regulatory Commission (BTRC) already established; Energy Commission in the offing.
  - Compulsory AIT on vehicle registration that aided tracking potential assessees has been withdrawn, which might hinder identifying new taxpayers.
  - Effective separation of Judiciary from Executive branch, appointment of Ombudsmen, independent Anti-Corruption and Human Rights Commission promised but no distinct allocation made.
- **Banking & Finance**
  - Committee formed to recommend measures to reign in non-performing loans, chaired by an eminent economist and Chairman of an earlier Banking Reforms Commission (1998).
  - Bangladesh Bank to have more powers on three area i.e. banking policy formulation & implementation; monetary policy formulation & implementation; and supervision & monitoring of banks. Relevant banking laws are in the process of amendment.
  - Developing Money Market of government securities by introducing Repos and other measures under IMF recommendation initiated.
  - Expected further rationalization of high interest rates on National Saving Schemes did not materialize, last deceleration being in October 2001. Rather withholding tax reduced to 5% from 10%, but exemption limit of Tk25,000 withdrawn.
- **Privatization**
  - New policy empowering the Privatization Commission to select and privatize SOEs irrespective of profit/loss status.
  - Petroleum and oil marketing companies to be privatized on fast track.
  - However, no clear articulation on privatization. Rather hike in import tax on sugar and slapping of SD speaks of protectionism aimed at the ailing local industry.
  - Tk4.0b earmarked for golden handshake retrenchment at SOEs on privatization list and more resources promised, if needed. However, revenue receipt from privatization during the fiscal not spelled out.
- **Trade & Tariff**
  - Supplementary duty withdrawn from 120 out of a total 170 import categories.
  - Supplementary duty on 31 categories brought into 5 slabs in place of a wide range (2.5-270%).
  - Band of duty and tariff rates on imports brought down to 7.5%-32.5% replacing the existing 10%-37.5% band.
  - Corporate tax rate save banks, insurance and financial institutions reduced by 5%.
  - Stamp Duty on transfer of land and apartments reduced to 5% from 10%; with withdrawal of VAT tax incidence on the sector reduced to 13.5% from 30%.
  - Discretionary powers of tax officials curtailed and disputes resolution process simplified.
- **Others**
  - Tax holiday for extension of industrial units withdrawn and qualified.
  - Government employees to register TIN with the salary statement and submit return.
  - Individual taxable income threshold reduced to Tk75,000 from Tk100,000, receiving thumbs-down from salaried middle income group.
  - Commercial activities of NGOs brought under tax net
  - Undeclared income will not be questioned and taxed if invested during the next 3 years in industry and service sector.

Pat on agriculture and social front

The number of recipients of needy senior citizen's allowance proposed to be raised from 420,000 to 600,000 and monthly allowance increased from Tk100 to Tk125. Recipients of destitute women allowance will also be raised from the existing 210,000 to 300,000 and monthly allowance increased similarly. At present some 4.5m female students are receiving stipends across the country up to secondary level (class X). The proposed budget extends the facility to higher secondary level (class XII), and tuition fees for female students up to higher secondary level have been exempted. Tk6.5b has been earmarked for the families who will receive Tk100 per month if one child is enrolled in the school and Tk125 for more than one child. Some Tk250m has been allocated for recruitment of 8,000 new primary school teachers. Ten thousand computers will be provided to the secondary schools during the next three years. To foster the health sector, some 2,000 new nurses have been proposed to be recruited.

Environment has received renewed attentions. The government has already earned kudos for banning polythene at all levels and reintroducing jute bags. Import and plying of two-stroke powered vehicles will be banned. Installation of catalytic converter has been made compulsory for all vehicles. Introducing lead-free and low-sulfur petroleum, setting up more CNG filling stations are other laudable measures. Besides, use of wood as fuel in brick kilns has been restricted, and legal measures have been initiated to free the rivers from illegal occupation and pollution.

Agriculture sector has received particular attention in the proposed budget. Subsidy in agriculture has been raised during the current fiscal from Tk1.0b to Tk2.0b, which will continue in the next fiscal. An Equity and Entrepreneurship Development Fund (EEDF) with Tk3.0b will be set up to help the development of computer software and agro business. Although a similar fund was set up earlier with Tk1.0b, but due to lack of policy guidelines, it could not be utilized. In addition, tax on agro-processing industry and VAT on power in the agriculture-related consumption has been withdrawn. This would foster the agro-based industries and is in line with the poverty reduction strategy.

Infrastructure structured

Some 175,000 fixed-line telephone connections will be added to the existing 700,000 and analog system in all districts and 142 upazilas will be converted into digital. Call charges have been cut by 40-50%, although multi-metering system for local calls are to be introduced. The telecommunication sector will receive Tk14.43b in 2002-03. Power sector has also received due emphasis. Under a power system master plan, 18 power plants with 2,238MW generation capacity will be built on BOO basis by 2006-07 to meet a total 6,071MW demand. Power sector will receive Tk22.75b in 2002-03.

Communication sector has also received impetus in the proposed budget with withdrawal of tax on commercial motor vehicles/vessels. This should help the transport sector growth.

Service sector services growth

GDP growth in the current fiscal year (2001-02) estimated by the Bangladesh Bureau of Statistics at 4.8% on constant price (1995-96) against last year's 5.2% can still be regarded as comfortable since poor trends of all indicators during the first half of the fiscal tempted the Asian Development Bank (ADB) to forecast a maximum 4.5% growth. Food grain production marked a growth of 1.15% over last year's actual production. Crop harvest will reach nearly 27.06m tons against last year's 26.76m tons. Agriculture is expected to mark 3.0% growth against last year's 5.5%, and along with other sub-sectors, it contributed 0.69% growth in GDP.

Industrial growth is estimated at 5.0% in the current fiscal compared to 6.29% of the last year. As industrial production constitutes to be around 16.68% in the GDP, we expect the reported growth in industrial production to contribute 0.86% growth in GDP, which together with agriculture show that service sector has contributed the highest to the GDP growth, around 3.25%. The service sector has 58.73% share in GDP. The GDP growth rate for the next fiscal has been projected at about 6% in the budget.

Bloated ADP eye at *i*PRSP

The annual development program (ADP) size will increase by 20% to Tk192b. Last year's budgeted Tk190b ADP by the outgoing Awami League (AL) government was later trimmed to Tk160b by the present finance minister terming it quixotic and overambitious, amid poor implementation as well as failure in achieving revenue targets.

Share of local resources in the next ADP will increase to 54.11% from 48.7% provisioned in the original budget of last year.

Amount of Internal Resource in ADP Financing

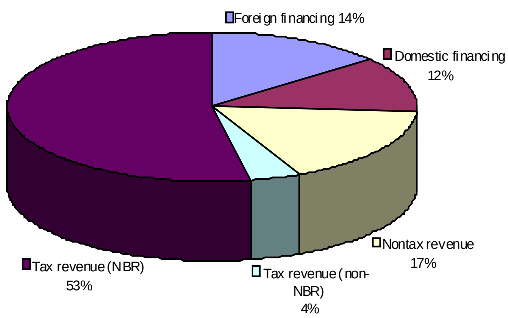
(as per revised allocation, mTk)

Year	ADP	Internal Resource	Internal Resource as % of ADP
1992/93	81,210	21,300	26.23
1993/94	96,000	34,400	35.83
1994/95	111,500	47,980	43.03
1995/96	104,470	44,140	42.25
1996/97	117,000	57,250	48.93
1997/98	122,000	55,210	45.25
1998/99	140,000	43,470	31.05
1999/00	165,000	82,260	49.85
2000/01	182,000	95,300	52.36
2001/02	190,000	92,510	48.69

Source: Finance Division, Ministry of Finance

The minister tried to justify the bloated size of ADP to ensure at least 10% growth in development expenditure in real terms, while the rest 10% allocation is to compensate for inflation and devaluation, seemed indefensible, since personal taxable income threshold has been proposed to be brought down in this budget. In fact it is quite apparent that political compulsion had its finger on the pie and commitments given during whirlwind electioneering had to be given a place on the platter. There could very well be compromises on quality and value for money.

Resources Coming From



In the face of shrinking foreign aid, loan and grants to finance development projects and programs, the plan relies more on revenue generation projected to grow by about 20%. However, if the target is not achieved, like the passing year, the government shall either have to prune the plan or resort to hefty borrowings, frowned upon when resorted by the previous government in following an expansionary policy. It is only hoped that the fiscal sustainability so painstakingly achieved is continued and in the face of revenue target shortfall, overall deficit target maintained by curtailing expenditure and the ADP. Historically, implementation of ADP was always short of target, actual or revised and if the minister has succumbed to pressures from colleagues in chalking such a high ADP with the presumption that target will not be met, it belies the whole process and efface planning.

Implementation of ADP

(Taka in million)

Year	Actual Target	Revised Target	Actual Expend.	Expenditure as % of Revised Target
1991/92	75,000	71,500	60,240	84.3
1992/93	86,500	81,210	65,500	80.7
1993/94	97,500	96,000	89,830	93.6
1994/95	110,000	111,500	103,030	92.4
1995/96	121,000	104,470	100,160	96.0
1996/97	125,000	117,000	110,410	94.0
1997/98	128,000	122,000	110,370	90.5
1998/99	136,000	140,000	125,090	89.4
1999/00	155,000	165,000	154,710	93.8
2000/01	175,000	182,000	161,510	88.7
2001/02	190,000	160,000	NA	NA

IMED, Ministry of Planning

On the other hand it would not be out of place to suspect that the minister has a wand under his sleeves and the budget did not reveal all, especially the high expectations of acceptance of the interim Poverty Reduction Strategy Paper (*i*PRSP), now at final draft stage, by the IMF, World Bank and other donor agencies, which will open up avenues for concessionary funding from the multilateral agencies. Otherwise, the seasoned minister would not have risked his reputation on the line of fire. But whether it would happen at all remains a million-dollar question.

Inflation under strap but ...

Inflation appeared to be contained during the past fiscal, although following the hike in petroleum prices during the second half of the year a sharp spiral was felt that still pervades. Almost all essential food, fuel, accommodation, transport, utilities, apparels, and other necessity goods have marked price hike by an average of 10-15%, thus a low year-on-year inflation of 2.8% in the immediate past year seems unsustainable. The government had to continue borrowing from the ailing banking system and the expansionary monetary policy had also directly impacted on inflation, which the reported rate, based on a tilt towards foodgrain and bare necessity basket, has in all likelihood failed to reflect. Besides, the expatriate Bangladeshis have remitted a record amount of cash during the year. Injection of such fund has its impact on inflation, but the reported rate does not manifest it. The government appears unconcerned about inflation, but price hike triggered by budgetary measures may ignite pressures on wages level in the not so distant term.

Per Capita GDP, GNI & NNI and NI

(current market price)

Subject	1998/99	1 999/00	2000/01	2001/02
GDP (mTk)	2,196,970	2,370,860	2,532,550	2,711,240
GNI (mTk)	2,272,500	2,457,990	2,627,900	2,812,930
NNI (mTk)	2,097,200	2,270,210	2,426,310	2,598,440
Population (m)	128.10	129.80	129.00	131.20
Per/GDP (Tk)	17,150	18,270	19,595	20,673
Per/GNI (Tk)	17,740	18,944	20,332	21,448
Per/NNI (Tk)	16,372	17,495	18,809	19,805
Exchange Rate (per US$)	48.06	50.31	53.96	57.13
Per/GDP (US$)	357	363	363	362
Per/GNI (US$)	369	377	377	375
Per/NNI (US$)	341	348	349	347
National invest Rate (% of GDP)	22.19	23.02	23.11	23.18

Source: Bangladesh Bureau of Statistics, 2001-02 FY Statistics

Revenue target in helium balloon ?

The proposed budget envisages total revenue collection of Tk330.84b in the next fiscal year (of which Tk255b or 77% are expected to be from tax sources), which is 19.57% higher than the last year's revised budget. Even with the proposed drastic rehaul of the tax-tariff regime, there are valid grounds of skepticism on such a high ceiling. During the first 9 months (July-March) of the current fiscal, revenue fetched Tk138.46b against target of Tk141.57b, missing by about 2.19%. At this pace total tax revenue might not exceed Tk185b, falling short of the target by Tk34.7b. Tax revenue declined in all major sectors, save the value added tax and it declined drastically at the import level. Breakup of revenue receipt till March 2002 was as under:

Revenues	Target	Achieved	Shortfall
Total tax on import	Tk77.42b	Tk74.26b	4.08%
Customs duty	Tk38.97b	Tk37.77b	3.08%
VAT on import	Tk28.38b	Tk26.79b	5.60%
Supplementary duty	Tk10.06b	Tk 9.68b	3.78%
Tax from domestic level	Tk39.20b	Tk39.59b	(0.99%)
Domestic VAT	Tk19.91b	Tk21.43b	(7.63%)
Income tax	Tk23.67b	Tk23.42b	1.06%

Although revenue could not achieve target, it has grown in the current fiscal. The proposed budget envisages a huge growth (19.57%) in revenue in the next fiscal heavily banking on the new tax regime and structure and liberal import. However, the impact on exchange reserve may very well create a Catch 22 situation compelling import restriction.

Revenue Collection *(Taka in million)*

	1998-9	1999-0	2000-1	2001-2
Total revenue	197,670	200,740	235,010	266,470
Tax revenue	161,670	160,790	197,660	219,300
Non-Tax rev	36,000	39,950	37,350	47,170
Revenue Collection as % of GDP				
Total revenue	9.00	8.47	9.28	9.83
Tax revenue	7.36	6.78	7.80	8.09
Non-Tax rev.	1.64	1.69	1.47	1.74

Source: Finance Division, MoF, NBR & BBS

Similar growth was however earlier achieved by the present finance minister back in 1991-92 (21.67%) and in 1992-93

(16.21%) due to introduction of the VAT system, but this time it remains to be tested in a more hostile environment and trade regime. The fingers would be kept crossed for quite a long time to come.

Static Savings & Investment

Domestic and national savings as a percentage of GDP in the current fiscal year remained static hovering for the last few years in a tight band, at 17.91% and 23.18% respectively.

Savings GDP Ratio

Year	Domestic Savings % of GDP	National Savings % of GDP
1990/91	14.57	19.66
1991/92	13.86	19.30
1992/93	12.30	17.96
1993/94	13.10	18.79
1994/95	13.13	19.12
1995/96	14.90	20.17
1996/97	15.90	21.58
1997/98	17.41	21.77
1998/99	17.71	22.31
1999/00	17.88	23.10
2000/01	17.90	22.32
2001/02	17.91	22.43

Source: Bangladesh Bureau of Statistics, 2001-02 FY Statistics

The investment GDP ratio however registered a healthy growth during past one decade. It is now estimated at 23.10% of GDP. The major portion (16.08% of GDP) of this has been made by the private sector. However, the quality of such investments in productive sectors and their efficacy is not beyond question.

Investment GDP Ratio

Year	Total Investment (% of GDP)	Public Investment (% of GDP)	Private Investment (% of GDP)
1990/91	16.90	6.63	10.27
1991/92	17.31	6.97	10.33
1992/93	17.95	6.48	11.47
1993/94	18.40	6.65	11.76
1994/95	19.12	6.74	12.38
1995/96	19.99	6.42	13.58
1996/97	20.72	7.03	13.70
1997/98	21.63	6.37	14.26
1998/99	22.19	6.72	15.47
1999/00	23.02	7.41	15.61
2000/01	23.11	7.26	15.86
2001/02	23.18	7.10	16.08

Source: Bangladesh Bureau of Statistics, 2001-02 FY Statistics

Remittances plug reserve

The convalescent foreign exchange reserve has now been taken to $1,511m at end May after adjusting for payments to Asian Clearing Union. A hefty remittance inflow, $2,043m in first 10 months, 35% up from previous year's corresponding period, riding on invigorated efforts of the state-owned commercial banks has pumped up the reserve. The inflow has saved the forex reserve, which was waning following export decline, dwindling foreign aid disbursement, payment to IOCs and interest payments on suppliers' credit. In a major incentive, the proposed budget has granted tax-free status on the worker's remittances if sent through banking channel. However, hike in travel tax by 38% pronounces insensitiveness of the government to some extent.

Borrowing reigned - servicing continue

Once critical of huge borrowing from the banking system by the previous government, the government of the day eventually had to resort to the practice to meet revenue expenditure. During the fiscal, about 20.7% of the revenue expenditures have been paid as interest for the borrowing made in previous years. If the government fails to collect target revenue or trim the politically prioritized ADP projects, borrowing may not be harnessed at a comfortable level in the coming days, and consequently the servicing costs may not come down, more so with a marked determined money market rate as being envisaged.

Expansion tethered but alive

An expansionary monetary and revenue policy reigned during the past five years that bloated the broad money (M2) at an average rate of 14%. The present government in a desperate bid to reverse the course ended up containing growth at 7.14% during the first 9 months of the fiscal year, compared to 10.3% in last year's corresponding period. The broad money supply now reached Tk933.98b in March 2002. Domestic credit till the date grew by 8.63% to Tk913.68b. Banks were suffering from excess liquidity problem till the first half of the current fiscal, which has been managed through bank interest cuts (by 1%) across the table and also changes in the Statutory Liquidity Requirement (SLR) regime by abrupt withdrawal of the cash reserve requirement (CRR) qualification on foreign exchange holdings of the commercial banks in February last, understandably at IMF insistence. The measure also contributed in foreign exchange reserve buildup. The last quarter of the fiscal saw call money rates shooting up to a record level of 50%.

Incentives rolled as export cringes

The export earnings during the first 9 months of the outgoing fiscal reached $4,449m marking a 6.96% shortfall over last year's corresponding figure, mostly due to global recession, turbulence and war mongering. Although there was a sign of recovery in the third quarter of the fiscal, total export may not even reach the revised target of $5,950m, downsized from the original $7,150m.

In a bid to rejuvenate the export sector the government has declared a pre-budget new band of cash incentives for export-oriented industries effective for the next 3 years at cascading rates exhausting by 2005. Interest on the term loan for export-oriented industries has been reduced by 1% to 9%. Agricultural banks will provide loan at 9% instead of 12-12.5% to the agro-based industries except cold storage.

The commerce ministry was busy throughout the second half of the fiscal in seeking new export markets and products and the new incentives manifest a clear desire to breakout from the traditional export product base and venture into new territory. Income from software development and export and IT training has been made tax exempt (up to 30 June 2005) in the proposed budget. However, the contentious issue of pipeline gas export has been conspicuously avoided.

The following table shows the new export incentives and changes:

Particulars	Old	New
Interest on cash credit	14%	13%
On loans for import of capital machinery	15%	9%
Letter of credit margin	25-30%	20%
Cash incentive on textile (Jul '02-Jun '03)	25%	15%
Cash incentive on textile (Jul '03-Jun '04)	15%	5%
Cash incentive on leather (Jul '02-Jun '05)	10%	15%
Cash subsidy on frozen food (Jul '02 -Jun '05)	10%	15%
Cash subsidy on agri-produce (Jul '02-Jun 05)	Nil	15%
Cash subsidy on fresh fruits (Jul '02 -Jun '05)	Nil	20%
Cash incentive on handicrafts export (for 80% local raw materials)	Nil	15%
Cash incentive on handicrafts exports (for 50% local raw materials)	Nil	10%
Cash incentive on export of bicycle (for 40% local raw materials)	Nil	15%

Imports liberalized

The tariff structure in the proposed budget has been aimed at more liberalization of import as per WTO compulsions. The proposed new structure is radically venturous and to some extent, courageous. Along with trade liberalization protection of sensitive local industries also received priority. The tax and tariff regime has been restructured and coordinated to make the system distortion free and simple. Supplementary duty that distorts the tax incidence has been withdrawn from 120 import categories out of a total 170, while on 31 categories brought into 5 slabs in place of a wide range (2.5-270%). Along with this license fees have also been withdrawn to bring parity with other SAARC economies. Import duties have been rationalized by reducing on most of the categories to 7.5%-32.5% replacing the existing 10%-37.5% band. Contrary to the immediate reaction to the market, this will reduce the total tax incidence on imported goods and encourage import in the next fiscal, which will lower the cost of living as well as increase revenue income.

FDI dry

The budget speaks little about the foreign direct investment (FDI), which has been declining fast. Earlier, there was a growing enthusiasm among the foreign investors in the oil and gas sector, but non-consensus on pipeline gas export to India eventually put them off. The registration of FDI drastically dropped to a paltry $37.4m till December 2001, but with improvement in global scenario and holding of national elections, the situation improved to reach $192m in March.

Registered Investment with Board of Investment

from 1991/92 to 2001/02 FY (US$ in million)

Year	Local	Foreign	Total
1991/92	91	25	116
1992/93	90	53	143
1993/94	457	850	1307
1994/95	846	677	1,523
1995/96	1,171	1,554	2,725
1996/97	1,108	1,054	2,162
1997/98	1,043	3,156	4199
1998/99	1,183	1,926	3,109
1999/00	1,219	1,950	3169
2000/01	1,370	1,227	2,597
2001/02 (up to 2001)	563	37	600
Total	**9,141**	**12,509**	**21,650**

Source: Board of Investment

However, there is unfortunately no reliable statistics of how many of the registered investments actually did happen and what are the different stages of implementation.

Privatization unlimited

Soon after the change of government there was a renewed attempt to address the divestment issue. Since establishment in 1993 as Privatization Board, now a Commission (PC), the PC has so far privatized 41 state-owned enterprises (SOEs) only, 26 through direct sale and 15 through selling of shares. The PC has marked out 71 sick SOEs under axe list with 51 in priority. Seven more SOEs are now in sales process, of which 4 will go off very shortly.

During the current fiscal the likely loss incurred by the SOEs and sector corporations are estimated at Tk17.99b against last year's Tk26.59b, which marks a 32.34% improvement, thanks mostly to petroleum and utility price hikes. Among the corporations where loss has declined significantly Petroleum Corporation tops with Tk5.62b loss down from last year's Tk15.44b, followed by Dhaka WASA with profit of Tk142.4m from Tk17.5m, Inland Water Transport with profit of Tk110.5m from Tk29.4m, Shipping Corporation with profit of Tk50.1m from net loss of Tk124.6m and Trading Corporation with profit of Tk197.3m from Tk72.9m. SOEs have also received a total subsidy of Tk1.46b during the period.

Government Grant/Subsidies to SOEs

(1998-99 to 2001-02, mTk)

Name of Corporation	1998/99	1999/00	2000/01	2001/02 (revised)
BCIC	30.00	30.00	30.00	30.00
BSEC	1.00	1.00	1.00	1.00
BJMC	562.50	541.00	598.40	685.40
BIWTC	5.00	5.00	5.00	5.00
RDA	0.80	1.00	1.00	0.80
BFFWT	114.60	162.50	162.50	162.50
BIWTA	169.50	177.50	219.5	209.50
BSCIC	155.00	166.00	186.50	184.50
REB	140.00	120.00	80.00	80.00
BHB	33.20	40.40	41.70	40.50
BSB	29.10	29.30	41.70	44.60
Total	**1240.70**	**1274.10**	**1356.80**	**1460.30**

The PC is now theoretically empowered to select enterprises for divestment without recourse to the line ministries and the privatization is not to be characterized by the profit-loss status of the enterprise. SOEs marked for privatization are to be put under the PC control to expedite the pace of privatization, but there is dearth of required skilled human resources to efficiently handle the cases. In the proposed budget Tk4.0b has been earmarked for severance pay for the employees of the SOEs that have been marked for privatization. But since there was no clear outline for utilization of the fund and in absence of a time bound framework, efficacy of usage remains in doubt.

NPL unmoved

Despite some banking reform it is yet to make any dent to the mounting volume of non-performing loans. About 31.6% or Tk235.99b of total outstanding loans of Tk746.48b of the banks are now classified of which 86.6% or Tk204.36b are bad debts with faintest possibility of recovery and the rest 13.4% are sub-standard or doubtful. As volume of loans has increased more than classified loans, in terms of percentage the latter has come down from 34.94% to 31.61%. Of the total classified loans, state-owned commercial banks account for about 51.8% with Tk122.27b. As per an *AIMS* study the recapitalization needs of the banking sector ranges between US$1.5b to US$2.9b under different standards. The annual cost of inefficiency and servicing the required recapitalization at market rates varies between 0.88% and 1.18% of GDP. The budget does not address the burning issue head-on.

Aid : disbursement up commitments wane

Foreign aid disbursement has increased during the fiscal, but new commitment stood still. The Bangladesh Development Forum (BDF) in Paris was virtually noncommittal that could embolden the government to rely on foreign aids for 48% of the bloated ADP. However, the government has now been seriously pondering on the PRSP, which is expected to meet an IMF condition to secure at least $600m in concessionary assistance.

Till March 2002 some $998.4m has been disbursed, 11.6% higher than $895.0m ($393.57m grant and $604.8m loan) in last year's corresponding period. The figure is 67.2% higher than the annual debt servicing liability of $597 in 2000-01. Despite BDF has tagged aid flow with tough conditions of law and order situation improvement at home, the government expects $1.53b to come in grant and loan form ($510m and $993m respectively).

Capital market got a shot

Capital market received some attention at last in the proposed budget. Reduction of corporate tax of listed companies by 5% has been a welcome development. To induce the listed companies to declare higher dividends, a 5% tax has been imposed on the undistributed profits in case declared dividends are less than 15% despite having sufficient divisible profits. Listed companies will get rebate of 10% on tax if they declare dividends at 20% or more, for which the earlier ceiling was 25%. Tax on stock-dividends has been withdrawn, hoping for capital formation. Anomaly on tax exemption for mutual funds has been removed. All these measures are directed to bring positive results in the market. On the other hand, reduction of exemption of tax on dividend income from Tk40,000 to Tk25,000 would discourage the small investors. However, the deep-rooted crisis of confidence may not be withered away with fiscal measures only.

The reduction of Stamp Duty on conveyance from 10% to 5% should by default favor asset securitization. However SD at 5% is still very much on the higher side and initiation of a securitized debt market would require total exemption of any tax on conveyance for asset securitization.

Cost of living to bare fangs

Cost of living situation is feared to aggravate consequent to some of the proposed tax restructuring. Amid a conspicuously growing inflation, taxable income limit has been reduced instead of being enhanced, which may fuel aversion to tax payment. Mere comparison of threshold with neighboring countries as done by the minister is not an enough justification since purchasing power parity indicate the lower cost of living in those countries.

Besides, tax and duties have been increased on some essential items like sugar, milk, edible oil, fish, soft drink, fruit etc which will hard hit the lower and middle income group. Furthermore, net increases of duties by 4.5% on computer and accessories and 7.5% on paper will impede the policy of ICT development, and will thwart rapid spread of computer orientation in the academic institutions. It is argued that such an imposition is to thwart smuggling bids across the border. But instead of holding the border guards responsible for poor patrol quality, shifting the burden on the consumers' shoulder is barking up the wrong tree. The 15% supplementary duty on satellite channel distributors shall increase revenue, but the middle class with little opportunity for entertainment will have to dig deep in their pocket. The reduction of duty on cinema halls was not their asking.

In a surprise move the proposed budget has banned the import of reconditioned cars, and instead, lowered the tax range from 125-256% to a band of 59-150% on new cars. Though the quantum shift has been conveniently attributed to environment concerns, suspicions are ripe that the step seemed to have been galvanized by coterie interests of the importers of brand new cars. This will certainly deprive the middle-income segment from owning cars at cheaper and affordable price. On the other hand, the abrupt ban is likely to affect families of some 500,000 people engaged in the automotive trade, while cheap sub-standard Indian cars may find a way to the market that will rather aggravate the deteriorating environment.

Law and order missed

The proposed budget speaks little on law and order situation, one of the current burning issues. However, it proposed to provide better training, arms and equipment to the law enforcing agencies. Police force will have 6,000 new recruits, and border guards will be beefed up with new battalions. But without a timely step to improve the deteriorating law and order situation business and commerce as well as economic growth would be adversely hampered.

Ride for the launders

In an apparently unethical move justified on practicability, the holders of untaxed money have been given an option to invest in production and service sectors without question and payment of any tax. Earlier a 10% tax was imposed on such untaxed income, without any tangible result. This militates against those who have been paying taxes meticulously. It would have been prudent, if it could be termed so, and more beneficial instead if the bank defaulters were given the option of repayment through such undeclared incomes. This is quite an irrational and iniquitous incentive.

Apartment goes flat

Stamp duty on transfer of assets has been proposed to be slashed from 10% to 5%, and additional tax of 1% and VAT have been withdrawn, which brings down the net tax incidence to 13.5% from 30% and will relieve the land and flat-owners. But on the other hand, duty on GI pipe and cement clinker has been increased by 22.5% and 5% respectively, and bricks tariff by 50% that will increase the cost of construction.

Netting the fish

Although revenue income grew faster than public expenditure during the past couple of years, a larger ADP compels the government to resort to extract more tax through widening the net. The proposed budget has redesigned the income tax structure tilting more on the large income group. In a rare regressive step the taxable level of income has been brought down from Tk100,000 to Tk75,000 with pushing minimum lump sum payment to Tk2,400 from Tk1,000 only. This will severely affect the lower end of the middle income group, already hard hit on price spiral. Moreover, increase in slabs from 4 to 5 will only reduce the tax burden of the higher income group. Whether it would act as an incentive to pay taxes by a greater number of the upper income group is not beyond question.

Corporate tax rate, excepting bank, insurance and other financial institutions has been reduced by 5%; for listed companies from 35% to 30%, which will allow them to pay more dividends to the shareholders, it is assumed.

Incomes of NGOs from commercial activities except micro-credit operation have been brought under tax net for the first time, which was argued by the business chambers to create a level playing field. The English medium schools and private universities are also caught in the net. Though government employees have been brought under compulsory TIN registration and Tk500m earmarked in the budget for payment of tax of the officials by the government, this may not generate any revenue, as 'other incomes' of the government employees remain mostly unreported. As long as there is no self-checking system, it may not bring any positive impact on the exchequer. On the other hand, government pay scale is yet to be rationalized compared to private sectors, and in the context of existing inflation level.

Changes in tax provisions

- Taxable income threshold for individual assessees has been reduced while minimum income tax increased.
- Corporate taxes except bank, insurance and financial companies has been reduced.
- Rate of dividend for eligibility of receiving tax rebate by the listed companies reduced by 5% to 20%. Punitive tax (5%) on undistributed profits of listed companies, except bank, insurance and financial companies, if dividends are less than 15% despite having sufficient profits.
- Capital gain tax reduced from 25% to 15%.
- Government employees have to register their TIN with the salary statement, and submit return.
- Branch office in Bangladesh of foreign companies will pay 15% tax on their repatriated profit.
- All commercial activities of NGOs except microcredit comes under tax net.
- Tax holiday facility for expansion units has been withdrawn and only separately incorporated projects will be eligible for such facility. Reinvestment limit for the companies enjoying tax holiday has been increased from 30% of profit to 40%.
- Newly set up industries, depending on situation, have been given 100% accelerated depreciation allowance in the very first year instead of first two years. Newly set up (between 01 July 2002 to 30 June 2005) companies that would not get tax holiday facilities will pay tax at reduced rate of 20% for 5 years. No application or approval will be required for this.
- Initial depreciation on plants at 25% and on factory building at 10% in the first year has been reintroduced for the newly set up industries.
- In self-assessing system, up to 15% income (instead of 25% earlier) from any amount (instead of Tk2.0m earlier) can be declared during the first year of business. No audit is required, and income must be 20% more than previous year's (instead of 15%).
- Discretionary power of the tax officials has been curbed to reduce harassment and corruption.
- Withholding tax on transfer of non-moveable assets has been reduced.
- Tax at source on interest on savings instruments has been reduced from 10% to 5%, and exemption up to Tk25,000 withdrawn.
- Tax at source on indenting commission has been reduced from 5% to 3.5%.
- Tax at source on physicians' income has been reduced from 10% to 5%.
- 10% tax at source on royalty and technical know-how and 5% on clearing and forwarding agencies, private security services and stevedore services have been imposed.
- Annual VAT is Tk5,400 for the shops in the city, Tk3,600 outside the city.
- SD on cinema halls cut to 35 % from 85%.

Points to ponder

- Projected income growth appears to be unrealistic.
- Highest allocation in education may not yield desired result unless the quality of education is ensured.
- Withdrawal of tax holiday on expansion unit will curb the increasing trend of misuse of the facility, but may act as a disincentive to genuine entrepreneurs.
- ADP size is bloated, highly ambitious, dependent much on popped up revenue and less committed foreign aids, however, the finance minister has kept a room for retreat, the mid-term review of ADP. But such review, traditionally ineffective as it takes place at the verge of last quarter when nothing more can be done than trimming the size, may not add any value. However, it is still a convenient instrument for him to adjust to emerging realities.
- No monetary framework has been proposed in which fiscal balance will be placed to achieve a 6% growth rate and the assumed level of inflation for the fiscal 2002-03, which is necessary to give an indication of credit resources that might be available for the private sector to contribute to the growth of GDP.
- Foreign assistance and direct investment is necessary to achieve an average 7-8% GDP growth per year to make a meaningful dent in poverty reduction, as is intended in the vision statement, but the proposed budget underplayed its importance.