B A N G L A D E S H

# National Budget 2004-05

22 June 2004

**on the highway to next election with a do good feeling for rural Bangladesh without substantive and sustainable action plan whilst further appeasement for donors in more import liberalization**

## The indicators

| | | |
|---|---|---|
| · **Budget size** | **Tk572.48b** | ⇧ **15.96%** |
| · **Revenue collection target** | **Tk413.00b** | ⇧ **16.67%** |
| · **Current expenditure** | **Tk305.18b** | ⇧ **13.84%** |
| · **Annual Development Plan** | **Tk220.00b** | ⇧ **15.79%** |
| · **Local contribution to ADP** | **55.5%** | ⇧ **14.18%** |
| · **Total budget deficit** | **4.3% of GDP** | ⇧ **0.10 % pnts** |
| · **Projected GDP growth** | **6.00%** | ⇧ **0.48 % pnts** |

## Budget 2004-05:a voter-friendly tax scheme

The national budget proposal for FY2004-05 shifted its usual emphasis on employment-driven poverty reduction to rural development, might have been propelled by Indian election syndrome. Though inclination on agro-based and export-oriented apparel industry remained, however, withdrawal of duties on imported finished goods and imposition on raw materials may plunge many small local industries on the precipice. Income tax has been restructured to relieve the lower income-group taxpayers, but most of the tax and duty facilities would rather benefit the rich and widen the gap.

The first year of the 3-year rolling program went without any review. However, both exports and imports grew significantly and kept the foreign exchange reserve at a comfortable level. Though budget deficit was contained, mostly due to failure to use foreign assistance, the budget proposed for a greater deficit in the next year indicating a larger overall outlay.

Despite rhetoric and some intermittent bold actions in the past few years, privatization appears to have come to a complete halt, most likely out of a fear of political backlash, yet trade liberalization continues to reign on. The proposed relief for the importers may very well convert the economy to a trade-driven one instead of being export-oriented. With continuous deterioration in law and order cost of business has soared to a new height, but the proposed budget does not have a detailed outline as to how to curb the criminalization of economy. Liberalization would thus only weaken the industrial base of the country, instead of creating a stronger foothold for stiffer competition in a quota-free world in 2005.

The government sticks to its endeavor to augment revenue. The budget targeted a revenue collection growth of 16.67% for FY04-05 to finance a yet swollen ADP, withering SoEs and the growing non-ADP expenses while the country remains highly indebted to both domestic and foreign sources.

GDP in the outgoing year fetched an expected 5.52% growth, with relatively lower contribution from agriculture and a slightly higher share from industry and services. Inflation could not be contained below 5%, and the currency was freely floated, yet per capita income reached a new high in terms of dollars, at $444, first time above the $400-mark. Despite there was no sign of rationalizing the size of government, expansion in the public outlay suggests that government is at a loose end on corruption mitigation and management of resources.

## Budget snap shot

*Tk in billion*

| | *Budget* | *Budget 2002-03* | |
|---|---|---|---|
| **Revenue** | *2004-05* | *Revised* | *Original* |
| Tax | 336.40 | 283.00 | 290.71 |
| Non-tax | 76.60 | 71.00 | 71.00 |
| **Total revenue** | **413.00** | **354.00** | **361.71** |
| **Expenditure** | | | |
| Non-Development Rev. Exp. | 305.18 | 268.07 | 277.26 |
| ADP | 220.00 | 190.00 | 203.00 |
| Non-ADP Projects | 2.96 | 4.19 | 3.90 |
| Capital Expenditure | 26.90 | 17.66 | 19.08 |
| Domestic Loans & Advances | (9.74) | (9.28) | (8.75) |
| Net Outlay for Food | 2.15 | 5.08 | 5.19 |
| Non-ADP Dev. Exp includ. FFW | 6.83 | 5.85 | 5.22 |
| Non-Development Programs | 8.60 | 2.10 | 0.00 |
| Structural Adjustment Expend. | 9.60 | 10.00 | 14.90 |
| **Total expenditure** | **572.48** | **493.67** | **519.80** |
| **Overall deficit** | **159.48** | **139.67** | **158.09** |
| **Deficit as % of GDP** | **4.3** | **4.2** | **4.8** |
| **Budget deficit financed by:** | | | |
| ***External Sources*** | **88.49** | **79.92** | **93.09** |
| Foreign grants | 18.89 | 26.63 | 25.96 |
| Foreign borrowing | 94.41 | 84.21 | 98.05 |
| Repayment of foreign loans | (24.81) | (30.92) | (30.92) |
| ***Domestic Sources*** | **46.29** | **46.75** | **38.97** |
| Term debt (net) | 1.29 | 2.01 | 4.37 |
| Public Account Transaction (net) | 45.00 | 44.74 | 34.60 |
| **Borrowing from banks** | **24.70** | **13.00** | **26.03** |
| **Total Financing** | **159.48** | **139.67** | **158.09** |

The proposed budget is highly susceptible to a host of extra-economic risks. Growing political flux, deterioration of law and order, corruption and utter deficiency in government services delivery, poor infrastructure, lack of public safety are to remain at the core of a risk fabric that would pose severe challenges to the economic plans and schemes. Among the economic risks are ominous competition and shrinkage of export market, closure of the small and medium-sized industries, currency instability and alarming inflation that might plunge the plans at jeopardy. But none of these has been addressed in the budget with adequate details. The proposed budget appears to be much shorter in details compared to others in previous years.

## Ambitious revenue target too stretched

The proposed budget for FY04-05 sets a target of mustering Tk413.0b in revenue, 16.67% up from last year's Tk354.0b. Of the amount, Tk336.4b (or 77.23%) would come from income tax, value added tax and customs duty. Collection of nontax revenue remained poor during the past few years, but special measures could not bring any major change in the situation. The target for non-NBR tax has been fixed at Tk76.6b, with increased revenue in land registration, stamp duties, transport fees, etc. among others.

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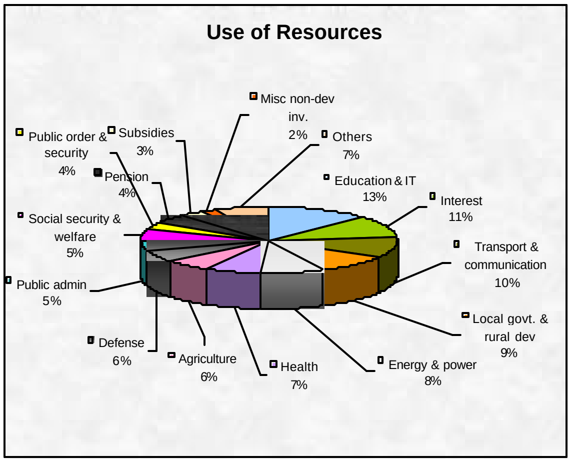
The following table illustrates the performance of the revenue target (bTk):

| Revenues | Target | Achieved | Deficit | ? Deficit |
|---|---|---|---|---|
| Total | 239.83 | 227.64 | 12.19 | 5.08% |
| Import | 124.50 | 118.60 | 5.90 | 4.74% |
| Domestic | 72.57 | 70.45 | 2.12 | 2.92% |
| Income tax | 39.26 | 35.90 | 3.36 | 8.56% |
| Other taxes & duties | 3.50 | 2.70 | 0.80 | 22.86% |

The revised target for the outgoing fiscal was Tk354.0b, but till May 2004 only Tk227.64b has been collected, being Tk12.19b or 5.1% short of the Tk239.83b periodic target and is very unlikely to be achieved. The proposed increase for the next year thus remains yet highly ambitious, and challenging, as already recognized by the Finance Minister himself.




The government in an ambitious attempt to increase income tax by 19% to Tk61.73b has targeted more new taxpayers for the next year. Though both the tax exempt and maximum tax limits have been raised, the total revenue from income tax is expected to grow as the NBR has already enlisted 0.24m more taxpayers to reach 1.55m, with a potential for another 0.3m in the next year.

## ADP bloats though the last one under surgery

For the past couple of years the government seems to be in an endless sway between proposing a hefty Annual Development Program (ADP) with bloated hopes and then shearing it by the end of the fiscal year owing to abysmal implementation status. The exercise is again on board for FY2004-05, as the government has tabled a Tk220b ADP, 16% larger than the revised one of last fiscal. Last year the proposed Tk203b ADP was trimmed to Tk190b due to weak implementation and poor disbursement of foreign assistance. The proposed ADP would constitute 55.5% in local currency contribution, with rest 45.5% provided by foreign development partners.

In the development budget the highest allocation of Tk43.51b (19.8%) is proposed for the fuel and energy sector, followed by transport and communications with Tk41.90b (19%), local government and rural development Tk38.83b (17.7%), education and technology Tk31.53b (14.0%), health Tk20.80b (9.5%), agriculture TK19.36b (8.8%), public services Tk10.60b (4.8%) and social security & welfare with Tk9.33b (4.2%). Moreover, development program for TK8.60b will be financed from the revenue budget. Among it, 62% of development and 42% of non-development budget have been allocated for direct and indirect poverty reducing programs.

The proposed ADP is still too large to manage given the historical experience. The ADP of the outgoing year was trimmed by 6.4% to Tk190b and only 45% of it was implemented till March, far less than the original plan. The ADP of 2002-03 also witnessed 45% execution while it was 42% in 2001-02. Back on concerns of development partners and economists, the government could spend only Tk38.12b or 19% of the Tk 203.0b development budget in the first 6 months of fiscal 2003-2004, making the target unrealistic to achieve. The slow pace of development spending is basically due to weak implementation capacity and poor disbursement of the foreign aid component. As per available data, foreign aid and loan of $6.2b is now clogged up in the pipeline, as a major part of disbursed aid remained unutilized due to various factors, including harsh donor conditions, inefficiency in implementation and bureaucratic hassles.

One reason for underutilization of ADP allocation this time is apparently due to a lack of enthusiasm in project preparation and initiation by the respective departments and different ministries after the implementation of the new stringent public procurement guidelines that has been introduced at the behest of the on-going IMF-WB reform program. This has made bloated programs and cost overrun difficult as well as brought about transparency in the process in bridling run away corruption in public procurements.

## Internal Resource in ADP Financing

Gradually the development budget has been able to reduce dependency on foreign assistance over the years, as the following table would testify (as per revised allocation, figures in bTk):

| Year | ADP | Internal Resource | % of ADP |
|---|---|---|---|
| 1993-94 | 96.00 | 34.40 | 35.83 |
| 1994-95 | 111.50 | 47.98 | 43.03 |
| 1995-96 | 104.47 | 44.14 | 42.25 |
| 1996-97 | 117.00 | 57.25 | 48.93 |
| 1997-98 | 122.00 | 55.21 | 45.25 |
| 1998-99 | 140.00 | 58.12 | 41.51 |
| 1999-00 | 165.00 | 82.26 | 49.85 |
| 2000-01 | 182.00 | 95.30 | 52.36 |
| 2001-02 | 160.00 | 77.85 | 48.66 |
| 2002-03 | 171.00 | 88.59 | 51.81 |
| 2003-04 | 190.00 | 95.90 | 50.47 |
| 2004-05 | 220.00 | 122.10 | 55.50 |

*Source: Finance Division, Ministry of Finance*

The shift has been augmented through increased internal revenue, domestic borrowing including from the banking system as well as dwindling inflow of foreign assistance. The next fiscal targets the highest ever local contribution in development program.

## GDP growth mark time

The economy is likely to achieve an annual growth of 5.52% during the current fiscal year compared to 5.26% last year.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Amount of GDP increased over last year by $5.0b with both per capita GDP and national income at over the $400 mark. With larger contribution of manufacturing sector, services and foreign trade, increasing domestic demand is also attributed to the higher GDP. Manufacturing sector, which comprises small, medium and large industries, is expected to grow by 7.41% compared to 6.75% in the previous year, while service sector by 5.38%. The per capita income rose to Tk25,945 in 2003-04 which is 9.14% more than the income in 2002-03.

Following some structural adjustments, losses of the state-owned enterprises (SoEs) dropped to 0.4% of GDP this year from 1.0% in 2000-01. GDP has been targeted at 6% and 7% in the next two years depending on successful undertaking of medium term macroeconomic framework (MTMF) with a pro-poor bias. The government has set a target to raise the revenue-GDP ratio to 12% in 2007-08 from 10.5% at present to mobilize more local resources for carrying out development programs, which would also see the public expenditure-GDP ratio at 16.2% from the existing 14.5%. Implementation of the MTMF will, however, depend on effective mobilization of necessary domestic resources and foreign assistance. A shortfall in resources might force the government to revise the macroeconomic framework.

The Asian Development Bank (ADB) anticipates the country's economic performance to achieve the targeted 5.5% GDP growth for fiscal year 2003-04 against previous year's 5.3%. This is, however, a scaled down estimate from ADB's earlier prediction of 5.7% that foresaw a bumper boro harvest. ADB observes that a substantial hike in government and private consumption is expected from an upturn in the private sector credit including agro and industrial term loan disbursement and flow of foreign direct investment.

Regionally, Bangladesh lags behind the race in GDP growth rate. The ADB projected growth in South Asia to be 7.0%, slightly up from the 6.9% recorded for 2003. India's GDP growth for the year has been forecasted at a buoyant 7.4% and at 7.6% in 2004-05. Pakistan's outlook is also for stronger growth of 5.5% this year and 5.8% in 2004-05. Sri Lanka's growth is projected to be 5.0% this year and 5.5% in 2004-05, Nepal's at 4.0% and 5.0%, and Bhutan at 7.0% and 8.0%.

## Deficit yawning debt service bulging

Budget deficit during the current fiscal year has grown up to 4.31% of GDP, as against 3.4% last fiscal. However, in terms of absolute figure it is 24.75% higher than the revised deficit of last fiscal. The proposed budget suggests taking steps to keep the level at 4.2% for the next fiscal year. The increase in expenditure could be attributed to the 28.4% rise in repair and maintenance of infrastructure, 15.5% increase in interest on loans (both domestic and foreign), 19.8% in assistance grants and significant rise in block allocation for various projects under natural disaster, workers retraining, microcredit, agro-based industry promotion, entrepreneurship development, and filling vacant government posts. However, underutilization of foreign aid is also a major factor in the deficit. The proposed high spending in the coming fiscal might be supported by the Tk88.49b foreign financing, with a 10.7% rise, much of which will come as soft loans from multilateral agencies.

Even if the ambitious revenue target is achieved, it would have to depend largely on the foreign loans and assistance (Tk88.49b) and domestic borrowing of Tk46.3b to meet the bulging deficit. The situation might not look salubrious with a debt servicing of Tk34.55b and growing defaulted loans in the banking sector.

The ambitious deficit budget is poised to hang on heavy debt from domestic sources. Though last year debt service liability had been reduced by retarding bank loans and borrowing less than before, the proposed budget, however, reverses the situation by raising bank borrowing to Tk24.7b from last year's Tk13.0b, up by 90%, while mustering Tk45.74b from various savings instruments.

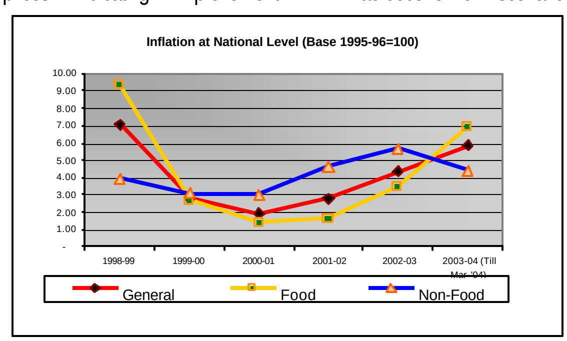
During the outgoing fiscal year interest expenses for domestic and foreign debts have increased. Though in a continuous bid to reduce borrowing cost and rationalize interest rates, the government has cut rates on different savings certificates, but due to high expenditures, it had to resort to raising sale of savings certificates to balance the budget. The gross sales of SCs was Tk74.58b in 2003-04, with a 6.24% increase from the last fiscal, against a targeted Tk82.64b. The following table shows the details (July to March, bTK ):

| | 2002-03 | 2003-04 | Change |
|---|---|---|---|
| Gross Sales | 70.20 | 74.58 | 6.2% |
| Interest Paid | 37.66 | 42.36 | 12.5% |
| Net Borrowing | 32.54 | 32.22 | (1.0%) |
| 3-months NSC (Sales) | 27.38 | 20.57 | (24.9%) |
| Post Office FDR (Sales) | 13.57 | 17.15 | 26.4% |
| 5-year SCs (Sales) | 7.07 | 9.99 | 41.0% |

The budget has proposed allocation of Tk9.74b for servicing domestic borrowing and Tk24.81b for foreign borrowing for the next fiscal. The debt servicing provision was Tk9.28b and Tk30.92b respectively for the last fiscal year. During the first 11 months of the current fiscal year Bangladesh has received foreign assistance of some $645m (nearly Tk37.94b) taking the cumulative foreign borrowing to $17,475m, equivalent to 30.8% of GDP.

## Inflation pop up

The average rate of inflation stood at 5.9% during the first 9 months of outgoing fiscal year, against 4.38% of the previous year indicating that the weighted basket of goods and services have experienced a general rise in prices. The point-to-point inflation declined to 6.5% in December 2003, 6% in January 2004 and 5.8% in February with a declining trend in food prices indicating improvement in macroeconomic scenario.





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Previous higher prices, to some extent, were not domestically induced, but was on increased international prices, mainly in oil and food items. During FY2003-04 the agriculture sector is likely to show steady growth with strong indications of good summer and winter food crops, like several previous years. However, high domestic price triggered a significant rise in rice imports during the year.

The budget continues with an expansionary monetary policy and increased investment activities, which would keep the price level as high as it is, if not more. The budget has proposed a new salary and wages scale for the government employees, which may reduce their purchasing power instead of enhancing as expected, as historically such wage hike fueled inflation further, but revenue expenditure will rise.

### Governance remains a burning issue

Governance continues to draw flack from home and abroad as no visible improvement has yet been noticed, despite a number of measures is afoot. Lower judiciary still remains under government influence, despite repeated attempts to initiate the long-awaited separation. There is no development budget for the judiciary. And judicial reforms still drift on a thin layer of rhetoric. Although an extra amount of Tk3.06b has been allocated for police, given the poor state of equipment, skill and lack of accountability of the police force, increased criminalization of politics and a confrontational political fabric, this might not result in any effective deterrence to the deteriorating law and order situation. Despite all leading political parties appreciating that law and order situation has become not only a social crisis but an economic malady the government is yet to launch any credible plan as to how to contain the demon.

Corruption, another vice plaguing the government machinery, also remains unabated at every tier as before. However, the government has earmarked Tk50m for creating an independent Anti-Corruption Commission as per condition of the IMF-WB lending program. The amount seems inadequate compared to the enormity of corruption. The relevant enactment that was promulgated some months back lacks necessary teeth to fight corruption perpetrated at higher ranks of the government. On the other hand, proportionate allocation of lump-sum grants for local government institutions, including city corporations, has been reduced in the proposed ADP by almost half.

ADB has classified key governance constraints in Bangladesh into 5 groups, (i) the law-and-order situation and limitation of the judiciary and law enforcement agencies in checking crime and corruption; (ii) weak public administration; (iii) regulatory environment; (iv) inadequate national policy and resource commitments to local government reform; and (v) the impact of intensifying partisan tension in many areas.

The constraints in the sphere of core governance in fact limit all sectoral initiatives. Studies reveal that major governance issues that need immediate concentration are widespread corruption, impunity of the corrupt, persistent bureaucratic resistance to reform, excessive centralization of decision-making authority, lack of judicial autonomy and inadequate transparency and public awareness on governance standards. However, the proposed budget had had little to address the above.

### Poverty reduction slow and not steady

Despite efforts with aid from the multilateral lenders and donors, poverty reduction as a drive remains low and slow as overall macro economic growth is yet to reach a desired level of over 7%. The government in its proposed budget has retarded from last year's inclination on local producers. Small entrepreneurs will be hard hit with the reduction of the highest tier of import duty by 5% applicable to finished products to 20% at the behest of IMFWB, while the lowest tier applicable on raw materials remain at 7.5%.

The proposed budget has earmarked a large chunk, Tk49.02b for rural development, of which Tk4.75b has already been put up for raising the living standard of the extreme poor living in the distant isles of disaster-prone riparian areas. Though some Tk3.15b has been allocated for microcredit program in the rural areas, the existing conduit for distribution of such credits (through the ministries) to the targeted group may not be adequate or corruption free. An effective government-NGO linkage in this regard is yet to take shape. Peasants decline to approach the specialized banks for finance, as their poor service and rent seeking makes borrowing preposterously costly and untimely. The proposed budget allocated Tk2.0b to three such banks for the envisaged microcredit program, but their performance has not been up to the mark. The Tk2.19b allocation for microcredit program through the apex institution Palli Karma Sahayak Foundation (PKSF) may not also come to good effect, as PKSF's wholesale lending at low interest to NGOs eventually ends up at 30% when it reaches the recipients, who can hardly make any good business with such usurious borrowing.

The budget also proposed a Tk1.25b for natural disaster and house building for extreme poor, but no explanation was given as to how to use the money. Question on the quality of implementation of these plans remain aglow as the budget provides no clear directive in this regard. Thus pace of poverty reduction remains slower than expected despite increased cut in the budget every year. However, during the past decade the income-poverty line has shifted downward from 58.8% to 49.8%.

Poverty incidence is highest among the farming community in Bangladesh, a key contributor to the GDP. Though the portion of people living under poverty line is 33.7% at national level, incidence of poverty is as high as 39.9% among the farming and fishing communities. Poverty incidence is 35.9% among service providers, 33.1% among government officers, 31.2% among people in the production and transport sectors and 22.6% among sales persons. Poverty also runs 22.2% among unemployed people, 18.8% among professional and technical persons and only 4.9% among people in the administrative and managerial positions.

The income share of the poorest segment of the society came down from 0.88% in mid-'90s to 0.67% in 2000, while the share of income by the families of the top 5% rich soared from 23.62% to 30.66% during the same period.

### Banking sinking in NPL

Classified loans, the most haunting and crippling impediment in the banking sector, has soared again after a lull of a couple of years. The banks wrote off bad debts of Tk54.3b crossing 5 year tenure with 100% provisioning till December 2003, which reduced the proportion of bad debt to 22.16%, from 28.1% in that of 2002. But the scenario turned a bit sour with a rise in the volume of NPL by another 0.39% or Tk6.89b by March 2004. Total default loans stood at Tk210.08b on 31 March 2004 from Tk203.19b on 31 December 2003.

Though the foreign banks were able to further reduce their classified portfolio, the nationalized commercial banks (NCBs), private banks (PCBs) and state-owned development financial institutions (DFIs) loosened their grip on loan quality. But most of the banks excepting the four NCBs succeeded in reducing provision shortfall. The aggregate provision shortfall receded by Tk11.14b and stood at Tk55.12b, but it grew by Tk1.36b to Tk51.16b for the NCBs as on 31 March 2004. The following table illustrates the total amount of classified loans:

| Banks | March 2004 | December 2003 |
|---|---|---|
| NCB | Tk109.23b | Tk106.68b |
| PCB | Tk.50.78b | Tk 48.61b |
| DFI | Tk.48.05b | Tk 47.27b |
| FCBs | Tk1.40b | Tk 1.71b |
| Total | Tk209.46b | Tk204.27 |

Deposits of the commercial banks have shot up by Tk59.91b to a total of Tk1,125.88b at the end of February 2004, while the total loan disbursement reached at Tk901.83b, registering an increase by Tk69.19b (8.3%). The NCBs have planned to disburse some Tk43.79b for the agriculture sector in 2003-04, of which Tk20.53b (46.9%) has already been provided in the first 8 months. The amount of disbursement was Tk35.61b during the last fiscal year. In the first 6 months of the current fiscal year Tk31.77b was disbursed as industrial term loan, marking a 78.8% growth over the corresponding period of last year. Nonbanking financial institutions, now numbering 28, have commercially invested Tk38.25b in different sectors till February 2004.

## Privatization hits Chinese wall

The proposed budget did not mention any privatization plan, though there was much hullabaloo till last fiscal. Even though there was no declared divestment or retrenchment of jobs, the proposed budget has allocated a paltry Tk0.5b for retraining and creating employment opportunities for early retired labors and employees, which suggests that a golden hand shake will continue silently.

During the outgoing fiscal year there was no new privatization or divestment success. Till April a total of 6 SoEs remained approved for sale by the Privatization Commission (PC), and tender has been called for another 15. Valuation of 30 SoEs for sale has been completed, while work on valuation of another 21 is under various stages of implementation. But the government earlier retarded the privatization process by reverting back some of the SoEs listed for privatization to the respective ministries for liquidation or restart by the ministries themselves. Meanwhile, the cabinet committee also declined to approve the Privatization Regulations that would have empowered the PC with requisite powers and facilitate the process of divestment. It seems that the government is unwilling to proceed with privatization process till the next election, as the resultant retrenchment of jobs draws severe flack from the labor community vote bank.

Privatization cuts a sorry face as the attempts are thwarted by the influential sections of the officials and labors in the SoEs, and some times, in the parent corporation. Besides, valuation of assets, defaulted liabilities, and other legal bottlenecks also pose considerable threat to the process. Thus in the past 11 years only 54 SoEs have been privatized by the PC, of which 26 has been done during the BNP regime in 1993-96 and 2001-04, and 28 by the AL regime in 1996-01. The commitment of the governments over the years towards privatization has never been total or unequivocal. There had been no entry of receipt from SoE divestment shown in any budget ever.

Just to cite an example, the Capital Market Development Program Loan from the ADB had condition for privatization of 17 SoEs. The objective was augmentation of securities in the capital market from the supply side of the paradigm. But the list mostly contained unlisted private limited companies (9 out of 17). Later the list was revised and the government withdrew 3 profit making listed public limited companies from the list which would have contributed most in the supply with least difficulty in divestment, being routed through stock exchanges in market determined prices. In lieu the government added another 8 SoEs on the list and the final list had 22 SoEs. But of them only 10 were listed public limited companies and most had minimal government shares. From the final list, the PC could divest only 12 SoEs. On the other hand the privatization process of 4 among the rest was stopped by the government. All those were listed public limited companies and could have been divested through the stock exchanges at relative ease. The left over 6 SoEs could not be privatized as yet.

## Limping SoEs dip again

Though there was a visible wane in the perennial losses by the SoEs since 2000-01 due to closure of those failing, however, during FY2003-04, the situation turned worse again. While in 2002-03, the SoEs had a paltry profit of Tk775m, the tune of losses this year shot to Tk8.24b. The losses peaked to an all time high of Tk26.59b in 2000-01. During the year, the SoEs have deposited some Tk2.60b as dividend, up from Tk1.68b last year, and have a total debt of Tk9.3b, down from previous year's Tk11.28b.

Among the worst performers were Bangladesh Petroleum Corporation (BPC) with Tk11.31b, Dhaka Electric Supply Authority (DESA) Tk2.55b, Bangladesh Jute Mills Corporation (BJMC) Tk1.54b, Bangladesh Chemical Industries Corporation (BCIC) Tk1.15b, Bangladesh Sugar & Food Industries Corporation (BSFIC) with Tk418m and Bangladesh Textile Mills Corporation (BTMC) with Tk418m. While among the star performers were Bangladesh Oil, Gas & Mineral Corporation (BOGMC) with Tk3.17b, Rural Electrification Board (REB) with Tk1.6b, Chittagong Port Authority (CPA) Tk1.08b, Bangladesh Power Development Board (BPDB) Tk886m, Jamuna Multi-purpose Bridge Authority (JMBA) Tk779m, BPRC Tk347m and Dhaka Wasa Tk326m. The huge loss is attributable to the sudden price hike in oil in the international market due to Iraq invasion, the unabated system loss in power sector and a shrinking jute market.


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Out of the Tk9.29b debt service liabilities owed by these enterprises, BOGMC shares Tk2.74b, BPDB owes Tk2.06b, BCIC Tk1.37b, BPC Tk1.07b, REB Tk798m, and owes DESA Tk550m. Till February 2004 there was an accumulated loan of Tk80.65b by the SoEs, of which Tk9.36b has been defaulted. Among the major defaulters are BTMC (Tk4.49b), BCIC (Tk1.15b), BADC (Tk906m), BSFIC (Tk870m), and BSEC (Tk795m).

In spite of apprehension of labor wrath, which might otherwise turn into political furor, with more loss-making SoEs under axe, accumulated losses in these SoEs are expected to further decline, to 0.4% of the GDP from 1.0% in 1999-2000. Some 223 out of 330 units under the jute, steel, textile and forest industry corporations have already been closed or privatized.

Some 44 units under 7 sector corporations have incurred a combined loss of Tk13.877b in the previous fiscal year 2002-03. BPC incurred the highest loss of Tk8.67b, while DESA Tk3.33b, BJMC Tk1.58b, Biman Tk1.01b and BCIC Tk915m. However, Petrobangla has made a profit of Tk2.466b, Dhaka WASA Tk342m, and BIWTC Tk161m.

## Tax reform inventions continue

Tax reform continues to capture the core mindset for revenue improvement. At present only 1.55m individual taxpayers are on the list, another 0.3m are expected to add in the next year, taking the size to only 1.35% of the total population in 2004-05. To compel getting on the tax assessment list, holding a TIN (tax identification number) has been made mandatory for all firms, companies and institutions, individuals seeking certain business or social activities. Submission of return has been made compulsory for all TIN-holders.

Level of tax exempt income has been raised from Tk90,000 to Tk100,000 and application of highest rate raised to Tk900,000 from Tk640,000. However, tax rate of four tiers (10, 15, 20 and 25%) remains unchanged. Requirement to show increase of income by 10% every year has been reduced to 5% for the corporate assessees to avail the self-assessment facility. Earlier, the government had reduced the taxable threshold to Tk75,000 in FY2002 from Tk100,000 at the previous year, which is now being gradually reinstated in the face of public criticism.

Tax evasion remains a persisting problem and various new and novels measures are proposed almost every year in experimentation for curbing the malice. To settle assessment disputes and claims, a Tax Ombudsman office is proposed to be set up soon, the budget proposed. A schedule of tax rate would be provided at the beginning of the assessment year so that the taxpayers can draw up their financial plan in advance and to assess their tax liability at the beginning of a year. Thus the schedule of income tax rates of individuals, local authorities and companies prescribed for the assessment year 2004-05 remains applicable for the next year as well.

To encourage the taxpayers to submit returns on time and discourage delays, the initial penalty has been raised to 10% of the last assessed income with a minimum of Tk2,500 and in case of continued default, Tk250 for each day of default. Through a statutory regulatory order the NBR has lifted the immunity to tax audit that a number of taxpayers used to enjoy by declaring 20% more income than previous year. NBR has been given powers to make audit on any tax files on random sampling basis. The newly created Central Intelligence Cell which previously only did desk base research now could search and seize any documents from any premises of the taxpayers. The increased discretionary powers of tax officials however could severely discourage the genuine taxpayers, while evasion may rise more as such powers are more likely to help the tax officials serve their own interests through harassments and rent seeking, instead of filling the national exchequer.

There is no clear study or intelligent guess regarding impact of tax incentives on the recent resuscitation in the capital market, however, the change in guards at the regulatory body seems to have some positive shifts in public confidence. Keeping the existing 7.5% tax difference between a listed and an unlisted company at work, capital gain tax on sale and transfer of shares has been reduced from 15% to 10%. Tax on textile and jute industries (20 and 37.5% respectively) has been reset at 15%. This might encourage a feeble jute and trouble-struck textile industry, however, the reinstatement of 10% tax (from existing 5%) on registration of immovable property will sure hamper the growth of real estate industry that is already plunged into the VAT net in the proposed budget.

## Savings and investment rise slowly

Despite reduction in bank rates, national savings has increased during 2003-04. National savings-GDP ratio has been estimated at 24.49% and the investment-GDP ratio at 23.58% during the current fiscal, both at their highest levels. The private sector alone contributed 17.47% of the national investment ratio, up from last year's 16.49%, leaving the rest 6.12% by the public sector, down from 6.72%. The revenue-GDP ratio at the end of 2003-04 would reach to 10.5%, much below corresponding government expenditure-GDP ratio of 14.5%. The following table shows the investment-GDP ratio for past 10 years (as percentage of GDP, bTk):

| Year | Total Investment | Public Investment | Private Investment |
|---|---|---|---|
| 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 | 23.09 | 7.25 | 15.84 |
| 2001-02 | 23.15 | 6.37 | 16.78 |
| 2002-03 | 23.41 | 6.20 | 17.21 |
| 2003-04p | 23.58 | 6.12 | 17.47 |

p= provisional, extrapolated on first 10 months' figures

Like the previous year, the credit flow in nationalized and government sectors fell, but increased in the private sector. In the first 9 months of FY2002-03 current account surplus was at $350m (0.62% of GDP). However, overall surplus in the balance of payment stood at $227m.

The banks had an overall excess liquidity of Tk103.53b during January 2004, a slight decrease of 8.57% from Tk113.24b in

November 2003. The central bank had earlier reduced the SLR from 20% to 16% in an attempt to increase investment growth by expanding the lending capacity of the banks. But due to some noneconomic factors like law and order, political uncertainty, cautious assessment and appraisal of projects, requirement of bank syndication for large debt financing, relatively high interest rate etc. investments have been sluggish during the early parts 2004. It is estimated that the excess liquidity in the banking system has grown further since.

### Exports regain gallop

The export sector saw a significant pull at the end of fiscal year 2002-03 after a long slow growth since 9/11, ending up at $5,986m. With a slight boost in the export price index at the end of the year, earnings came to a total of $6,548m in 2003-04. The positive trend encouraged the government to set a target of $7,490m for FY2003-04. The first 9 months of the fiscal year smoothly went by, as each of the sectoral and monthly targets were achieved. The earnings till that period equaled $5,422m exceeding the target of $5,229m by 3.69%, and the earnings of previous year's corresponding period, $4,720m, by 14.8%. Though the readymade garments (RMG) exports faced a major setback in the US market after 9/11, the Canadian market shot up substantially during mid to late months of 2003, as it offered duty-free access of Bangladeshi products in January 2003. Exports to Canada alone shot up by 140%. The sugar industry, for the first time in recent history, has started to export to France and is expected to raise export earnings in future. The export-GDP ratio is likely to reach 12.79% at the end of June, compared to last year's 12.51%.

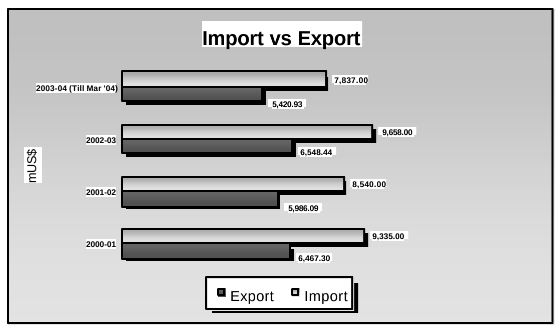
Knitwear and woven garments, frozen foods, textile fabrics, ceramic tableware, agricultural products, home textiles and footwear performed quite well during the first 10 months of FY2003-04. Jute goods, raw jute, bicycle, chemical products, electronics, petroleum by-products and handicrafts could not achieve their respective targets during the period and some of those are showing declining trend over the past few months. Major exports after the first 9 months are as follows:

| Item | Export m$ | Target m$ | Change on target | Change on last year |
|---|---|---|---|---|
| RMG | 2,570 | 2,540 | 1.18%+ | 9.79%+ |
| Knitwear | 1,480 | 1,372 | 7.87%+ | 25.42%+ |
| Frozen food | 274 | 270 | 1.51%+ | 13.11%+ |
| Leather | 147 | 146 | 1.01%+ | 7.80%+ |
| Jute goods | 186 | NA | NA | 3.84% - |
| Raw jute | 52 | 78 | 50.0% - | 9.54% - |

Although the multi-fiber agreement (MFA) is inching on to end by the coming December, there seems to be no strong strategic plan by the government visible as yet to take on the enormous impact on the export sector. Though the garment sector provides about 76% of the $6.5b export earnings, there has been little done by the government to help mitigate the exporters' apprehension over losing global market share in the post-MFA era. This might take a toll on the economy, by also shredding a large number of jobs, especially for women. The budget makes a special allocation of Tk200m for retraining and creating employment opportunities for the laborers of garment industries, who might face retrenchment in the wake of post-MFA eventualities. Though the fund is small compared to the 1.8m-strong workforce, this however, at least manifests the government's concern for the sector.

Corporate tax rate for the textile sector has been further cut to 15% from the existing 20%, which will help integration with the other linkage industries of the readymade garments industry that has been enjoying a lower rate of 10% since last year, drastically slashed from previous year's 30%. Intense global competition, poised to intensify in the next year, has been in the government's mind, which was manifested in a number of measures taken in recent years. However, the exporters still feel that there is not enough done to help the industry sustain, as declining law and order, infrastructure and other fiscal facilities are yet to be mused.

Defying domestic exporters' apprehension regarding the post-MFA scenario, the foreign investors already made 33% more investment in the textile sector during the first last half of FY2002-03 compared to the previous year. Earlier the government signed the Trade and Investment Framework Agreement (TIFA) with the US that allows duty-free access of Bangladeshi goods to the US market and act as a basis for all other future trade and investment deals between the two countries. This might hopefully help absorb the shock in export earnings from 2005 on, as well as increase investment relations with USA. A similar agreement has been made with Canada and Australia has also provided duty-free access of Bangladeshi produce.




The garments export is now tangled in a tug of war between the fabric manufacturers and RMG producers. While the RMG exporters strongly suggest the government to set up a central bonded warehouse for fabrics and liberal import of yarn and fabric from the neighboring India at cheaper price accepting an EU prescribed SAARC cumulation offer for GSP facilities, the textile producers warn that this would not only destroy the burgeoning local textile industry, but also make the RMG exports totally depended on imports, leading to increased lead time for exporters and lower value addition to the sector. So far no step has been proved effective enough to settle the dispute. Non-resolution of this dispute nurtures uncertainty for exports in the coming years, as it concerns the largest component of export.

### Imports on joy ride

The Cabinet Committee on Economic Affairs has approved a 3-year export-import policy with limited safeguard for import, focusing diversification and value addition in export. The new import policy for 2004-06 envisages limited restrictions on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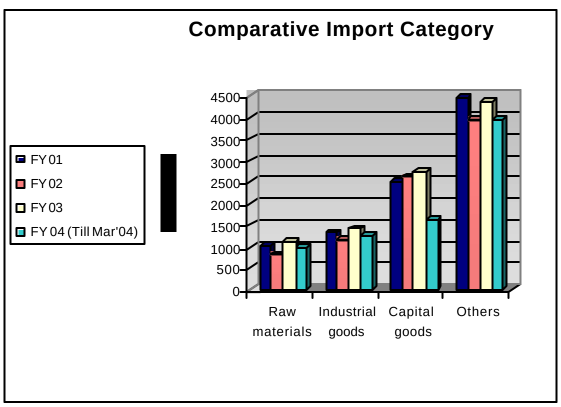
import of CI sheet, cement, coconut oil, medicine, medical equipment, soybean and palm oil, reconditioned vehicle and electric meter for ensuring quality as well as healthcare and environmental safety. As Bangladesh Bank had withdrawn the mandatory letter of credit (LC) margin requirement from all imports in line with policy of further liberalization in November 2003, imports grew by 15.4% during the first 9 months of the current fiscal compared to the same period of last fiscal year. Owing to the proposed budget's further relaxation of duties, import is likely to grow faster than previous years. Till April last, the quantum of LC has soared by 19%, and by the end of this June the figure might shoot further.

The budget for 2004-05 proposed lessening the tiers of customs and supplementary duties as well as substantial cut in the maximum rate of duties. The restructuring will reduce revenue by Tk7.75b. Custom duties has been proposed to be reduced from a 4-tier system to a 3-tier one standing at 7.5% on raw materials, 15% on intermediate goods and 25% on finished goods from the existing 7.5%, 15%, 22.5% and 30%. For supplementary duties (SDs) the maximum rate has been cut down to 30%, from the present 75%. However, the 5% reduction in the highest import duty slab, purportedly in compliance with IMF loan tranche condition and without reduction on raw material and semi-processed/manufactured goods, raises controversy and apprehensions on several counts. Many import substituting as well as export oriented industries will be adversely affected due to increased competition with imported products, which will be brought into the country at lower duties. Local assembling, manufacturing and backward linkage industries, particularly textile, ceramic, footwear, electronics, toiletries, agro-based and food-processing industries will suffer. Most of such units are either small or medium enterprises (SMEs).




It is also genuinely feared that the autonomous import liberalization through budgetary means will reduce bargaining opportunity in the bilateral and multilateral negotiations of tariff reductions in which Bangladesh is involved. The average tariff in Bangladesh is 21.9% (2002) which is lower than India by 9.1%, while Bangladesh exports to India continue to face tariff, non-tariff and para-tariff barriers and even antidumping or countervailing duty.

### Reserves on loan and remittance tower

During the first 10 months of FY2003-04 remittance reached $2.78b, registering a 9.88% growth over last year's $2.53b for the same period. Earlier, remittances hit a record high in FY2002-03 with $3.06b. At this pace the year may evidence another new high at the end of June.

Foreign exchange reserve has been steadily increasing from a low point of $1.05b in mid 2001 to $2.0b in June of 2003 and then to an 8-year high of $2.81b last March. The steady growth is largely due to an increased flow of remittance, good export performance and increased borrowing from multilateral agencies like the IMF, WB and ADB. As of early June 2004 the balance stood at $2.6b. The country had the highest foreign exchange reserves in June 1995 with $3.07b.

As import duties have been reduced substantially, import of both essential and luxury goods are likely to shoot up in near future, and at the same time, exports may retard thanks to price cut and stiffer competition, which would together gnaw on the foreign exchange reserve. The first onslaught of quota-free RMG may take on the reserves.

### Currency floats flat

Despite apprehension by the economists, currency on the current account that was floated free since 31 May 2003, remains stable, albeit at a subtler intervention. Taka lost its value by only a few poisa during the first 10 months, however, recently it has become a little weaker against US dollar and now trading within the range of Tk60.10 to Tk62.15 to the dollar against an average mid-rate of Tk 58.60 in June 2003.

As predicted earlier, since US dollar was soft in the global market, the Taka survived a likely adverse impact during the year. However, with the next president election in USA in November and likely pullout of occupation forces from Iraq with positive growth of the US economy may lead to a resounding convalescence of dollar, which might invite pressures on Taka that may not be overcome by intervention from central bank in the long run. Since import has been further liberalized for the next year, demand for imported goods and thus dollars might rise significantly.

Irregular monitoring and supervision, inadequate training for dealers, absence of technology and separate front and back office dealing rooms, nontransparent accounting policy also are likely to turn the exchange transactions more vulnerable. Recently the FCBs alleged that the government was trying to intervene in the currency market by supplying dollars at a lower price through NCBs, apparently to cool a heated market. This might thwart a depreciation of taka for the time being, but taka may not escape an eventual decline in value once the market is dried out of cheap dollars. This practice has also eventuated the creation of a two rate market which is artificial and could result to diversion of inward remittance by the expatriate Bangladeshis, most of whom use the channel of the low rate paying NCBs in sending money home.

### Stagnant FDI with no sunshine

Over the past few years there have been some disputes over the amount of actual foreign direct investments. The Board of Investments (BoI) seems to overestimate the amount always out of an urge to its performance, while Bangladesh Bank cuts it down to a credible size. During the second half of FY2002-03 BoI claimed $287.67m in FDI, while BB booked the figure at $186m. Later the actual figure turned out to be $275.58m, and it was found that the investing companies failed to provide figures to both BB and BoI at the same time.

By the end of 2003 foreign direct investment had increased by 32% over last year to a total of $475m. Only $360m was recorded in 2002. This extensive growth continued up to December 2003 when FDI unexpectedly started to fall and kept on declining into the early part of 2004. This was largely due to frequent hartals (general strikes) and a report finding of high costs of utilities, services, telecommunication, transport and taxation in Bangladesh compared to other Asian countries. These high costs have turned away many investors, even though Bangladesh has the second cheapest labor market in Asia. Infrastructure problems like inadequate and insecure port facilities, intermittent power outage and disruption in gas supply has bedeviled compounding difficulties of investors, both local and foreign, without any respite at sight. Bangladesh is in danger of loosing out to regional competitive destinations of FDIs. Incidentally, the chief of the BoI has pleaded for intervention from the Prime Minister's Office in emergency and long-term mitigation of the bottlenecks.

### Agriculture: subsidy increased but not enough

The budget proposed a total of Tk17.77b in both development and revenue head allocation for the agriculture sector. This includes an increased amount of subsidy, Tk6.0b from last year's Tk3.0b. However, the largest part of the facility will go in power, used mainly for irrigation, which again primarily serves the relatively rich as power pumps are owned by the well-to-do section in the rural areas, who are less likely to reduce the rent charged to the poor farmers. Though there is significant subsidy on fertilizer, the evil nexus of distributors and dealers gobbles the major incentive by creating artificial crisis during the high time of crops. Thus the raised subsidy may not help mitigate poverty or narrow rich-poor gap if not implemented judiciously. The budget raised cash incentive for exports of agro products to 30% from the existing 25%, which will also benefit the relatively rich middlemen and exporters, as producers barely get their rightful share from the incentive. Without devising a sound channel to reach the grassroots farmers, the well intended subsidy or incentive to agriculture could be squandered and might fail to create the desired impact. But the realization that the sector needs attention is manifestation of growing consciousness that too little has been done for the sector which still remains the back bone of the economy.

Agriculture sector has been offered credit at 8%, the lowest lending rate bracket. In recent months agriculture credit has been on the rise. Eight NCBs and DFIs have increased the flow of agro-credit by 18.68%, from Tk38.53b to Tk45.73b, by revising their previous disbursement target during the 2004-05, against last year's Tk35.6b.

The sector's contribution to GDP during the current fiscal year has been estimated to be 22.83% (crop 12.94%, livestock 2.90% and forest resources 1.84%), down from last year's 23.46%. Agriculture is increasingly being a knowledge-intensive industry where knowledge of modern farming assumes more importance than the size of the land endowments. Economists believe Bangladesh could produce an extra 2.4m tons of rice if proper training and incentives are provided to the farmers.

Interest on classified agricultural loans up to Tk5,000 till 31 December 2003 has been waived by the government and all Certificate Cases against the defaulted borrowers has been withdrawn. This would free as many as 1.5m farmers of the interest burden amounting to about Tk4.18b, who will also remain eligible for fresh loan in the future. The government shared Tk1.67b or 40% of the waived amount, while the respective NCBs and specialized banks shared the rest. The step would enable the farmers to raise the crop volume, who have produced an estimated 27.3m tons of food grains in 2003-04, against a targeted 28.12m tons, registering a 2.25% growth against the backdrop of an ever waning arable land.

### Social safety net widens

The seemingly facelift attempt to help the destitute old poor by offering an allowance of Tk100 per capita per month in 1998-99 now gets wing as number of recipients of the old age allowance shot from 0.26m to 1.0m in 2003-04, and now is expected to reach 1.2m in the next year. Recipient of destitute women allowance has been raised to 0.6m from 0.5m. Besides, some Tk4.05b in cash and 0.844m tons of food grains have been earmarked for various vulnerable group assistance programs and Tk1.0b as emergency fund for retraining and creation of employment opportunities for voluntarily retired or retrenched workers of public enterprises and private garment industries. Tk3.15b has been allocated, in addition to last year's Tk3.45b, for microcredit program, which government agencies under different departments had launched last year under a poverty reduction program. Another Tk2.19b has been proposed to be provided to the PKSF for microcredit programs through NGOs. Though these programs are targeted to reduce poverty, however, the nature and tune of assistance each individual receives rather smack of political appeasement with a view to win votes in the coming election. But again, the fact that some vulnerable groups are receiving attention is in itself a development to recon with.

### Energy and power get an extra pole

The government decided to continue the ongoing drive for infrastructure development emphasizing on the energy and power sector. Some Tk43.51b, 19.2% of the total ADP, has been allocated for the sector in the proposed budget against last year's Tk40.67b. As per a recent World Bank estimation, industrial output worth $1.0b, equivalent to about 0.5% of the GDP, is lost annually due to power outage. Per capita energy consumption in the country is abnormally low, only at 110kwh compared to 400kwh in India. Some 20% of the population has access to power, with less than 10% in the rural areas. Shortage of power is still at a staggering level and mostly attributable to system loss, improper distribution system, corruption and lack of maintenance. Government has allowed participation of private enterprises in this sector and a number of power generation projects have been undertaken. Currently, 15 new power stations are under construction in the public sector to produce 2,610mw of electricity. In addition, several projects are being implemented in the private sector to produce 1,390mw. Total installed power generation capacity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including in private sector is now 4,710mw of which 3,700mw can reliably be generated.

To meet the growing demand for gas, the existing drilling projects will be continued and more new ones undertaken. To make electricity available in outlying rural areas at low cost the budget has suggested withdrawal of customs duty and VAT on the machinery, parts, and components needed for solar energy. However, bringing the LP gas cylinders under the VAT net (15%) would increase sufferings to the low- and medium-income consumers.

Power generation output must be doubled from present level by 2010 to match the projected demand during that period. But barely any realistic step has so far been taken to achieve the target. The establishment of new generation units is taking too long and in most cases remains confined to plans on paper. Lengthy decision-making process, inefficient management and absence of commercial and corporate cultures are among the main reasons for bleak investments in the country's power sector.

To achieve the power target by 2020, the government requires a total of $15.10b in phases, but only a paltry amount has been invested. Of late power sector has started receiving due attention from the multilateral lenders. ADB approved $286m loan package to assist reforms in the sector and improve quality of power supply. This covers 57% of the total project cost of $328.5m, while Nordic Development Fund provides $9.6m, the government and executing agencies $98.7m and domestic borrowing the rest $34.2m.

The proposed budget has suggested withdrawal of existing advance income tax on all types of petroleum products and reducing supplementary duty on kerosene from 25% to 15%, which will reduce the import cost of crude oil, kerosene and all other fuel oils significantly. Ordinary consumers might receive the benefit, if however, concerned business entities reflect the real situation in pricing. But gas is poised to experience an about 5% hike in the next few months, in line with the new pricing policy.

An energy regulatory commission, tasked with pricing and policy is in the offing at the behest of IMF-WB loan tranché condition. Necessary legislation has been enacted in this regard and the recruitment process is on going.

### Education outlay down, still highest

Education receives 13.4% of total budget proposed for the FY2004-05, with Tk76.80b, up by 13.95% from the previous fiscal, and remains the single largest allocation in the budget. A 6-year 'Primary Education Development Program-2' with an outlay of about Tk50.0b is now under implementation for the expansion and qualitative improvement of primary education. Recruitment of 35,000 new teachers, construction of 30,000 alongside maintenance work of primary schools and training institutions, training 90,000 teachers and supplying 400m books are major steps under this program. A new project is to be undertaken with an outlay of about Tk 4.0b to create scope for primary education for children who are deprived of this opportunity. About 2.0m children of 600 unions of 60 upazilas will be brought under the primary education net and given various amounts of financial incentives.

Foreign assistance for education continued during the year. The UK government has approved grants worth Tk16.15b to facilitate providing quality education to 17m children per year and to improve livelihood in *shoal* areas. Earlier the National Education Commission has proposed for radical educational reforms that includes launching a single-discipline secondary education system, raising the teacher-student ratio, create an updated pay structure for teachers, and decentralization of administration and constitution of a regulatory body for private universities.

Despite the largest chunk allocated for, education fails to yield desired result, as much of the government funds fails to reach the targeted and most vulnerable group. On average annually Tk6.0b is spent as stipend for the primary students and for the girls of the secondary level schools, but Public Expenditure Review Commission (PERC) has found that the money failed to stop the dropout rate (48% belonging to the absolute poor families) in the primary schools and improve the standard of education of recipient girls in the higher secondary schools, suggesting that the amount had in fact never reached in substantial portion. Identifying a 12% outright wastage in cash incentive extended to the education sector, the PERC suggest total restructuring of the education system, including handing over schools to the local government, increasing standard of the textbooks and ensuring better governance in the schools. But the budget has offered no directive or plan to implement any of the PERC suggestions.

### Health sector renewed pledge

Despite a hefty allocation every year, health remains one of the less analyzed sectors in the budget. Like all previous years, the sector received considerable attention, as allocation has been raised from last year's Tk29.22b to Tk37.32b in 2004-05 along with no taxes and duties on medical and hospital equipment and accessories. This should expedite setting up hospitals of international standards, two of which are already in near completion. Steps have been proposed to establish more new hospitals, increase beds in the existing hospitals, filling up all vacant posts of doctors, nurses, medical technologists and health assistants and other staff; create new posts and increase supply of medicine and medical equipment to the hospitals. The government mused on setting up a Medical University at the national level, while 7 new medical colleges and 8 health institutes in the private sector are on the way.

The government decided to implement a 3-year Health, Nutrition, Population Sector Program (HNPSP) with an outlay of Tk94.10b to provide health service to the doorsteps of the people and aiming at overall improvement of the sector. Earlier a 5-year Health, Population Program Project (HPSP) was launched in 1998 by the World Bank involving $2.1b. The project fell out of favor by the WB later in early 2002, but however, received emphasis again in June 2003 and has been extended for another year. The government decided to run both the HNPSP and HPSP simultaneously for one year.

### Infrastructure to get the prop

The budget proposed an increased allocation for infrastructure development including road, transport and telecommunication sectors. An amount of Tk44.80b against the previous year's original outlay of Tk43.20b has been earmarked for roads and railways, and Tk13.51b for post and telecommunications. The government has duly emphasized on gradual rehabilitation of railway tracks and bridges, remodeling and modernization of railway stations instead of previous years' customary repair and maintenance of roads and highways.

The road link over the country's large rivers has already been established with the large bridges over Padma and Rupsha this year. By establishing road networks with the neighboring Myanmar and Thailand, the government decided to improve regional cooperation and economic and commercial relations.

Bangladesh has experienced a boom in telecommunications sector in recent years. Bangladesh Telegraph & Telephone Board (BTTB) has taken initiatives to provide mobile phone connections to 1.0m subscribers, with 0.25m right in this year. The number of land telephone connections has now increased to 0.95m from 0.564m in late 2001. The government has also reduced the call charges (NWD by 72% and ISD by 46%) to enhance communication frequency and revenue.

The government has kept the National Telecommunication Policy of 1998 at work, and replaced the outdated Telegraph Act and Wireless Act by enacting the Telecommunication Act in 2001 that gaped door wide ajar for private participation. Responding to a recent government initiative some 3 private companies have already come forward with the proposal to set up 1.4m land phone connections at different zones in the country. The entire mobile phone system is now under the private sector, which has provided some 2.0m connections. With the BTTB's 1.0m, the total telephone connections would reach as much as 3.5m by the end of the next fiscal, taking the teledensity to 3.28%, quite close to the 1998 policy's target of 3.3% by 2004-05. However, delay in restructuring BTTB, lack of interconnection capacity between BTTB and private cell phone service providers, etc may pose significant challenge to attaining the result.

Meanwhile, steps have been launched to take Bangladesh to the information super highway through the 14-country club of SEA-ME-WE-4 submarine cable, which will enhance its data transfer capability. ISP fee has been reduced during the year to increase Internet usage, and Internet telephony has been set free. Already 35% of the country has been covered by Internet connection and more areas have been targeted for the next year.

## Capital market smells revival

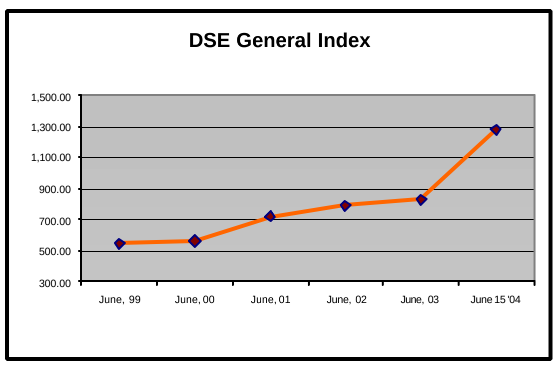
The capital market appears to have at long last discovered its beaten track again after the 1996 painful bubble and burst, riding on incentives provided during the past few years. The present government soon after taking power undertook some positive budgetary measures to rebuild the shattered public confidence. A new Chairman was appointed at the SEC, who also took some pro-market measures that in the past 8 months yielded in gradual rise of the all share price index, crossing the 1000-mark on 04 April, first time since 28 July 1997, and then 1100 on 27 April, 1200 on 03 June and now, poised to cross the 1300 barrier. The market capitalization has crossed the $2.0b on 02 May last, also another first time after the 1996 debacle. The following table shows the capital market performance scenario for past 5 years:

| | 2000-01 | 2001-02 | 2002-03 | 2003-04 |
|---|---|---|---|---|
| General index (DSE) | 716.06 | 792.56 | 830.46 | 1299.98 |
| Total no of securities | 244 | 257 | 260 | 267 |
| Total no of cos. | 224 | 238 | 241 | 248 |
| Tot. issued cap (mTk) | 32,227 | 34,968 | 36,081 | 46,304 |
| Tot. mkt cap (mTk) | 70,698 | 63,135 | 69,201 | 134,141 |
| No of IPOs | 10 | 9 | 8 | 10 |
| Capital injected (mTk) | 942 | 1,859 | 240 | 9,613 |
| Trading volume (mTk) | 49,094 | 35,936 | 30,597 | 20,308 |

*2003-04 figures are updated till 21 June 2004*

The new chairman started with relaxing SEC grip over the trading mechanisms. At the same time he also emphasized on disciplining the renegade listed companies. Of late a standing committee has been established to review existing rules, regulation and practices and some of its recommendations have been implemented. The circuit breaker restrictions on price movement of well-performing category 'A' shares were withdrawn effective from 19 June 2004. Earlier, limits on 'B', 'G' and 'Z' categories were relaxed in May. But no new IPO was floated during the last 8 months. There was no divestment of government held shares in listed companies during the last fiscal year. The budget also has no receipt provisioned on this account.

The government introduced two new bonds having 5- and 10-years maturity with interest rate of 7.5 and 8.5% in December last, which may not have any immediate impact of the capital market, but would improve the government securities market, that may eventuate to the development of a debt securities market. The government is striving to create a vibrant secondary debt securities market by ensuring participation of the public and corporate bodies in transactions of government bonds and money market securities. Currently the only active investors in such markets are the banks in fulfillment of statutory liquidity obligations. If the plans are effective hopefully more investors will enter both the primary and the secondary bond market. In this regard the Finance Minister has in the budget announced the lowering of withholding taxes on the approved securities and bonds to a flat rate of 20% for both individuals and institutional investors.




Previously tax rates were at 25, 37.5 and 45% for individuals, corporations, and banks and financial institutions respectively. Earlier such tax rate for approved zero coupon bonds was fixed at 10% only. Facilitating tax treatment and determination have also been made for asset securitization by non-bank financial institutions (NBFIs). It is expected that the measures will see NBFIs under cash crunch increasingly tapping the public market to raise funds, especially for equipment lease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and housing finance. In view of the dwindling IPO market of equities, where there has been not a single public float for the past 7 months and also with the reduction of bank interest rates and that of the popular non-transferable government securities under the National Saving Certificates and cap and restrictions in such investments, funds should gradually flow to a government and corporate debt securities market.

Meanwhile the Bangladesh Bank has selected 8 banks (3 NCBs and 5 PCBs) and one NBFI as primary dealers (PD) to handle the secondary market for T-bills and other government bonds. The PDs will subscribe and underwrite primary issues and make secondary trading deals with two-way price quotes. However, they will not short-sell or act as inter-bank or inter-dealer brokers. Once the PDs are fully operational, as almost all procedures are already completed, this would activate the secondary bond market shortly.

There is a discriminatory tax policy to encourage private companies to be converted into public limited and unlisted public limited companies to float public shares. Currently there is a 7.5% income tax rate differential between a listed and an unlisted company. The current income tax rate for listed companies is 30% with a condition that they declare 10% dividend for the shareholders. On the other hand, it is 37.5% for non-listed companies and those listed companies other than banks, insurance, leasing and finance companies that do not declare 10% or more dividend in a year or fail to distribute declared dividend to the shareholders within 60 days from such declaration. Listed companies other than banks, insurance, leasing and finance companies declaring 20% or more dividends receive a 10% tax rebate provided such declared dividends are paid out within the stipulated 60 days from declaration. However, the financial companies, including bank, leasing and finance, and insurance companies are being taxed at a different higher slab of 45%, though all of those are public limited companies and most are listed under statutory compulsions. Furthermore, these companies are also levied 'excess profit tax' at 15% on the portion of profit which in a year exceeds 50% of the aggregate sum of capital and reserve of that company.

As per tranché condition under the Capital Market Development Program Loan (CMDP) of the Asian Development Bank (ADB), the government was to introduce legislation to further reduce corporate tax rate for all listed banks, insurance companies, financial institutions, and nonresident companies to 35%, to make the rate uniform with the rate then applicable to listed industrial companies. But it was only reduced to 40% in 1998-99 and then again raised to 45% in 2003-04. On the other hand corporate income tax for non-listed companies has since been enhanced to 37.5% from the then 35%.

The action plan was initially complied with partially, but then reversed, since in Finance Act 2000, the applicable rate of tax on total income of publicly traded (listed) companies that had registered offices in Bangladesh, was 35%, in compliance with the second tranché release condition of the loan.

Finance Act 2002 also introduced the excess profit tax. The tax rate for listed and nonlisted industrial companies was also set at 30% and 35%, respectively. In FY2004, the tax rate for listed companies was kept at 30% while the rate for nonlisted companies was raised to 37.5% and the rate for financial institutions (listed or not) was increased to 45%. Therefore, it appears that the tax rate for financial companies was initially reduced a bit to qualify with tranché release condition of CMDP but was reversed thereafter. The rates have been kept the same for the next fiscal year. The banking sector now account for 34% of the market capitalization with 23 listed companies under statutory compulsion. Reducing tax rate would increase distributable income of the banking companies with positive impact on the market. But there is a counter argument that banks are making excess profit through burdening the economy with unusually high interest rate spreads.

The table below shows the corporate tax rate scenario for past 10 years:

| Fiscal year | Private | Public | | Listed Banks/ Insurance |
|---|---|---|---|---|
| | | Listed | Nonlisted | |
| 1996-97 | 40.0% | 35.0% | 40.0% | 45.0% |
| 1997-98 | 40.0% | 35.0% | 40.0% | 35.0% |
| 1998-99 | 40.0% | 35.0% | 40.0% | 40.0% |
| 1999-00 | 40.0% | 35.0% | 40.0% | 40.0% |
| 2000-01 | 40.0% | 35.0% | 40.0% | 40.0% |
| 2001-02 | 40.0% | 35.0% | 40.0% | 40.0% |
| 2002-03 | 35.0% | 30.0% | 35.0% | 40.0% |
| 2003-04 | 37.5% | 30.0% | 37.5% | 45.0% |
| 2004-05 | 37.5% | 30.0% | 37.5% | 45.0% |

However, the tax cut on textile industries should have greater impact on the capital market, as it is the largest sector in the bourses with 45 listed companies that have 6% share in the market capitalization. The listed textile companies on average offer dividends at 7.16%, which could substantially be raised if they get the tax cut. Moreover, the 11 loss-making companies might find some incentives to show better performance in their balance sheets.

### Items to be costlier

- Imported new cars will go up as supplementary duty (SD) on cars and jeeps with cylinder capacity up to 1649cc to be refixed at 30% in place of the existing 15%, and with 1649cc to 3000cc enhanced to 60% from 40%, and over 3000cc, to be 90% from 75%.
- Cigarettes priced at Tk 20 and above will go up with SD raised from 55% to 57%.
- Entertainment business (such as amusement and theme parks, picnic spots, etc) house cleaning and maintenance agencies, lease-financing institutions, express mail service providers, film distributors, commercial building and living apartment builders, upper grade tailoring shops of Dhaka and Chittagong to be under the VAT net.
- VAT on foods at community centers in social gatherings (such as marriage ceremony, birthday, etc.) introduced.
- Pressure cookers, LP gas cylinders, silk and lottery tickets were also proposed to be brought under the VAT net.
- The 2-stroke motorcycles (both fully built and completely knocked down) will go up as SD to rise from 40 to 250%. However, 15% SD on 4-stroke motorcycle has been kept unchanged.


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- Domestic air travel will go up as air tickets to be brought under ED.

### Items to be cheaper

- Kerosene should come down as SD on the fuel reduced from 25% to 15%, crude oil to 9% and other fuel oils to 9%.
- Paper should come down as SD has reduced to 25% from 30%.
- The SD on sugar has been proposed to be reduced from 30% to 15%.
- Mobile set to get cheaper as a fixed duty of Tk1,500 per set has been refixed instead of the existing varied rates between Tk3,000 and Tk4,000.
- Agriculture and poultry machinery should be cheaper as their customs duties (CD) and VAT have been withdrawn.
- Capital machinery of dairy and poultry industries should be cheaper as CD and VAT have been withdrawn on them.
- Solar energy should be cheaper as CD and VAT leviable on the machinery, parts and components are withdrawn.
- Textile machinery and raw materials should be cheaper as duties on them have been reduced.
- Medical and hospital equipment and accessories should be cheaper as all duties on them have been withdrawn.

### Reforms and reinstatements

#### Revenue and administration

- Lowest taxable income has been raised to Tk.100,000 from the existing Tk90,000 with the ceiling of highest rate to be applied on raised to Tk.900,000 from the existing Tk.640,000.
- A new separate directorate under the Taxes Department to go after the tax dodgers. Tax collecting officials will get more power to deal with taxpayers, which is likely to reduce revenue as it would create more troubles for the taxpayers who would compelled to evade more.
- Submission of tax returns by all TIN holders are now made mandatory.
- All individual assesses are now required to submit their expenditure statements on lifestyle.
- Tax on income from capital gains arising out of transfer of stocks and shares of private limited companies has been reduced to 10% from the existing 15%.
- Rate of advance deduction of income tax for registration of transfer deeds of immovable property has been raised to 10% from the existing 5%.
- Rate of deduction of tax on approved securities and bonds has been reduced to 20% from the existing 25% and 40% respectively to encourage secondary market for securities and bonds.
- To avail the company of the self-assessment facility, the requirement to show increase of income by 10% has been reduced to 5% .
- 300,000 more persons would be brought under the tax net in this fiscal.
- Rewards introduced for the highest VAT paying business and establishments in each district.
- The spinning and weaving industries, under excise duty (ED) for the last few years, have been brought under VAT and, ED leviable on their products has been withdrawn.

#### Banking and finance

- Bangladesh Bank slashed bank rate by 1% to 5% and statutory liquidity reserve to 12% from existing 16%, with additional cash reserve requirement remaining at 4%.
- BB amended rules on capital adequacy to enable the banks to meet the requirement easily, which now can compute risk-weighted asset-based capital adequacy without taking into consideration the amount in interest suspense account.
- The Enterprise Growth and Bank Modernization Project will receive $250m interest free loan from the WB to reform NCBs (Rupali, Agrani, Janata, and Sonali Bank) and encourage SME development while strengthening institutions like the Board of Investment, Privatization Commission, and Export Processing Zones Authority.
- BB has introduced a refinancing scheme of Tk1.0b with its own fund for development of SMEs, effective from 02 May 2004.
- BB has enforced middle rate system in fixation of lending rates replacing the existing bands to prevent unhealthy competition among banks and check anomalies in fixing lending rates.
- BB has inquired on debt repayment status of directors of NBFIs with the banks, which are now required to submit information every 3 months to BB from 30 June 2004.
- As part of the World Bank-IMF reform initiative for NCBs, US-based International Business & Technical Consultant (IBTC) has been appointed as consultant firm for Sonali Bank, the largest NCB, for 2 years, and will receive $4.85m. PricewaterhouseCoopers was appointed to run Agrani Bank management on December 2003.
- BB and SEC have decided to find out appropriate ways to discipline the AGM-defaulting companies for the interim period. SEC instead of the High Court (HC), could be empowered to deal with AGM-default cases for the interim period, under the proposal.

#### Privatization

- No new policy or directive on privatization.
- Powers of Privatization Commission has been cut in a policy reversal by taking back a number of SoEs to the ministries for privatization, which were earlier entrusted with the PC.
- Tk0.5b earmarked for training and rehabilitation of the retrenched workers.

#### Trade and tariff

- 3 slabs of customs duties of 7.5% for raw materials, 15% for intermediate goods and 25% for finished goods to be at work instead of the existing 4. The duty slab of 22.5% for semi-finished goods has been abolished. The new duty structure defies the demand of the country's apex trade


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body FBCCI, which wanted a 4-tier duty structure with the lowest rate at 2.5% and the highest at 30%.

- The number of zero-duty items would be 519 against the existing 541, number of items at 7.5% would be 1,510 in place of the existing 1,431, items at 15% would be 1,879 in place of 1,305 and items at 25% would be 2,891.
- The 1,117 items falling under the now abolished 22.5% import duty have been distributed to 15% and 25%, with 569 items to have an increase of 2.5% CD. Some 3,150 items would get reduction of customs duty in 2004-05. Some 131 items would come down to 7.5% from the existing 15%, and 572 items to 15% from 22.5%.
- The highest ceiling of customs duty has been proposed in the budget as 25% against the present 30%.
- The taxes on the government approved securities and bonds are charges at 25%, 37.5% and 45% for individual, corporate entities and banks and financial institutions respectively.
- VAT net to cover 6 new products and 12 new services that include amusement and theme parks, picnic spots, house cleaning and maintenance agencies, express mail service providers, lottery ticket-sellers, tourist and shooting spots, historical places, film distributors, commercial building and apartment builders, lease finance institutions, upper grade tailoring shops of Dhaka and Chittagong.
- The VAT levied on insurance premiums and shipping bills and C&F agents' commission on 100% exports industries including RMG industries at source have been withdrawn.
- In contradiction with the latest Industrial Policy, the newly set up industries would now be taxed at a reasonably discounted rate, while the existing tax holiday for them would be lifted.

## Concluding thoughts

The budget despite attempts to infuse some flavors of rural development remains largely a traditionally pro-rich pro-urban and trade-friendly one, like all previous years. Significant rise in expenditure and concomitant revenue income mark the new budget, but the quality of the spending and achievability of the earning belies imagination and remains a burning question.

The government has apparently tried to portray its concern for the rural development through increased allocation for rural infrastructure development, agriculture, and social benefits for the poverty-struck ultra-poor, but since no details of a well thought out plan has been chalked out, the performance remains largely dubious. Historically, such allocations eventually fell in gray areas of the political cauldron.

The budget proposes some measures to contain inflationary pressures on the large middle class and poor, but the existing imperfect market mechanism might not help cool the already heated price indices. Liberalization of imports, especially of finished goods, and at the same time imposing duties on some raw materials, allegedly under the IMF duress, would rather plunge the domestic industries on the precipice. The country has slowly been becoming a trade-prone economy instead of an industrialized one, the most cherished goal for all nations.

Seemingly the new ADP has less politically considered projects than previous years, but the proposed budget did not review the performance of many such projects taken last fiscal year. For example, the impact of goat development project was not studied or discussed. However, the proposed budget also has some gray allocations in some areas like education, disaster management, microcredit through ministries, etc. There is a general apprehension that much of the fund may be drained to gain parochial political gains in the face of a forthcoming election in a couple of years.

The capital market has got less attention than needed in the proposed budget. Though tax on capital gain has been cut and textile sector got some incentives, the largest sector with banks and financial institutions and pharmaceuticals industry remained missing. However, since the general reaction to the proposed budget was somewhat positive, the market seems to be moving on the upward track for few more months in the next fiscal.

## Points to ponder

- Projected GDP for the next fiscal appears to be realistic, but tumultuous political climate and the poor law and order situation may not allow the expected economic course of action to live up to it.
- No political reform to curb the nexus of police-politician-criminal has been proposed in the budget, without which the issue of meaningful good governance can never be addressed.
- Reduction and withdrawal of protection duty on domestic goods and imposition of duty on some raw materials may backfire the ongoing industrialization process, as domestic small and medium industries would fall under fierce competition with global producers.
- Agriculture got more support with a Tk6.0b subsidy, but without detailed plan for its institutionalized protection, the money may encourage only intermediaries and suddenly born middlemen.
- Increase of power of the tax administration officials would only add to the woes of the taxpayers, as there was no concomitant attempt to check corruption among those officials, there may not be any significant rise in income tax, while increasing likelihood of more evasive attempts by the troubled taxpayers.
- Despite rationalization in income tax, the incidence would fall more on people of the lower income group than the upper income, widening the rich poor gap.
- Banking and financial institutions get no incentive in the proposed tax regime, which might discourage the capital market.
- ADP size is bloated, highly ambitious, dependent much on popped up revenue and foreign aids, and the past history casts strong doubt on their implementation.
- The stray attempts to reduce poverty by providing social safety measures in tiny amounts, and without creating any jobs in the underprivileged rural areas may not make any meaningful dent to the whole poverty fabric.