

Dhaka: 13 June 2003

## **National Budget FY2004**

### **An Initial Assessment**

#### **1. Growth and Income Distribution**

1.1 *Improved Growth.* According to the BBS, the Bangladesh economy posted a growth of 5.3% during FY03 as against 4.4% in FY02. It may be recalled that economic growth experienced an acceleration during 1990s (linear growth rate – 4.8%) in comparison to 1980s (linear growth rate – 3.6%). In 1990s, the growth momentum was higher during the second half of the decade in comparison to the first half : average growth rate – 4.4% (FY91-95) and 5.2% (FY96-00).

The provisional growth figure for FY03 is marginally above the I-PRSP target rate (5.2%). The improved growth rate still remains below the recent record figure of 5.9% achieved in FY00. According to the I-PRSP, Bangladesh economy is programmed to grow at 5.5% in FY04.

#### 1.2 *Sectoral Contribution to Incremental Growth*

The contribution of the real economic sectors (crop + livestock + forestry + fisheries + mining & quarrying + manufacturing) to incremental growth has jumped from 19.74% during FY02 to 34.43% during FY03. This is largely due to the recovery of the agriculture and forestry sector which recorded negative (-)2.6% growth in FY02.

However, it can be noted that the incremental contribution of the “tradable sectors” remains lower than then its respective sectoral share (40.5% in FY03) implying that the service sector has played the decisive role in the incremental economic growth.

1.3 *Skewed Structural Transformation.* The on-going structural transformation of the Bangladesh economy is characterised by falling share of the agriculture sector with marginal increase of the manufacturing in the backdrop of increasing contribution of the service sector. In FY03, the real economic sector accounted for 40.5% of the

GDP; the said proportion was 43% a decade back. This suggests that in spite of improved growth, the evolution of the Bangladesh economy remains biased against modern, industrial transformation having concomitant implications for sustained growth and equitable income distribution.

*1.4 Deteriorating Income Distribution.* Notwithstanding improved growth, income distribution deteriorated during 1990s coupled with slow pace of poverty alleviation. Population below absolute poverty line (by HCR-DCI method) declined from 47.52% in 1991-92 to 44.33% in 2000. More importantly, the incremental growth had an anti-poor bias which resulted in deterioration in income distribution. For example, between 1995-96 and 2000, national income attributable to the poorest 10% of the population declined further from a miniscule proportion of 2.24% to 1.84%. Conversely, the control on the national income by the richest 10% of the population increased from 34.68% to 40.72%. In other words, the income differential between the poorest and the richest increased from 35.7 times to 53.4 times during the second half of 1990s.

There is no evidence which suggests that this trend has been reversed during the last couple of years.

The bottom line is, incremental growth does not automatically benefit the poor. It is not clear how the budget for FY04, apart from adopting more of the same traditional measures, is going to change the situation. While the I-PRSP do outline a strategy for poverty alleviation, the elements of pro-poor economic growth is not quite obvious from the document.

## **2. Savings and Investment**

*2.1 Stagnating Domestic Savings.* Domestic savings rate continues to stagnate at 18.2%, whereas the national savings rate increased marginally from 23.4% in FY02 to 23.7% in FY03. The marginal increase of the latter is underpinned by increasing flow of foreign remittances from expatriate Bangladeshi workers. The prolonged stagnation of the domestic savings may be largely explained by the deteriorating income distribution scenario in the Bangladesh economy as the poors who demonstrate higher

propensity to save are being deprived of their proportionate share in incremental national income.

One will have to wait in anticipation to see whether the domestic and national savings rates, projected by the I-PRSP for the FY04 at 18.7% and 23.4% respectively – are achieved or not.

*2.2 Declining Private Investment.* The gross investment rate also stagnated during FY03 at 23.2%. More importantly, the role of the private sector, depicted by its share in the GDP, in fact declined from 16.8% in FY02 to 16.5% in FY03. The marginal increment in public investment from 6.4% (FY02) to 6.7% (FY03) sustained the gross investment figure at its preceding year's benchmark. The revealed decline in share of private investment in gross capital formation vindicates CPD's express concern about the continuing investment recession in the economy. Our subsequent analysis of the state of the economy corroborates the above view. One wonders whether the announced fiscal measures are going to ensure the increase of gross investment rate to 24.3% in FY04.

### **3. The Expansionary Macroeconomic Stance**

The macroeconomic framework of the budget for FY04 closely follows the Mid-term Macroeconomic Framework (MTMF) agreed under the I-PRSP. The five-year MTMF (FY04-08) has given an apparent predictability to macro-economic policy making.

However, accepting the I-PRSP indicated growth figure of 5.5%, the national budget for FY04 has taken a much more bolder approach by setting higher targets for both total revenue receipts and total public expenditure. In doing so the national budget has settled for a larger budget deficit to be underwritten by greater flow of foreign resources and marginally higher domestic resources.

Thus, the macroeconomic stance of the budget for FY04 is marginally more expansionary than when has been envisaged by the I-PRSP.

In this connection, one may point out that the prevailing inflation rate of about 6% is already above the target rate of 4% for FY04.

#### **4. Three Challenges of the Budget**

A review of the state of the economy prevailing in the fourth quarter of FY03 allows us to identify three fundamental objectives which the national budget for FY04 needs to service. These are:

- a. Further consolidation of the fiscal balance
- b. Strengthening of the balance of payment
- c. Infusing dynamism in the investment scenario.

In the subsequent paragraphs, we seek to trace how these objectives have been addressed in the budget.

#### **5. Fiscal Consolidation**

5.1 *Enhancing Revenue Collection.* The total revenue collection target for FY03 was 19.55% higher than the actual benchmark of FY02. The collection in FY03 was actually 17.07% more, i.e. about 98% of the target. Such a feat was possible thanks to spectacular success in meeting the revenue collection target by the NBR. In contrast, the achievement rate in case of non-NBR taxes was less than 70% and in case of non-tax revenues – a little above 80%.

5.2 *NBR Component.* The impressive overall trend in revenue receipt by the NBR however is underwritten by higher collection rate of total internal trade-related revenue in comparison to total import related revenue. Whatsoever, the underbelly of the NBR's tax portfolio remains to be the income tax.

The guidance given by the Finance Minister regarding the need to increasingly reorient the tax system towards direct taxes and local VAT is very proper. Notwithstanding trade liberalisation, the dependence on import-related taxes is still in the order of 53% of the total revenue intake.

The budget has outlined some important measures for broadening the tax base.

##### Income Tax

Minimum income tax for businessmen and professionals has been proposed at Tk. 12,000/- and for the company directors at Tk. 30,000. This measure will reduce the incidence of tax evasion under the self-assessment scheme. Submission of TIN for the

following categories of people: Practicing professionals (lawyers, doctors, chartered accountant), ISD phone holders and Credit card holders.

Submission of tax returns has been made compulsory for:

- business establishment having a trade license issued by a city corporation, municipality or union council and having a bank account; for all professionals including doctors, dentists, lawyers, chartered accountants, cost and management accountants, engineers and architects who have received practising license from recognised professional bodies;
- for all members of chambers of commerce and industries and trade associations;
- for a person contesting in the elections to National Assembly, City-corporation, Pourashava or Union Council;
- for person or organisation contesting in a tender floated by a government organisation, semi-government or autonomous organisation or a local authority for supply of goods or execution of contract.

These measures will significantly increase the tax base by way of identification of eligible tax payers.

### VAT

Withdrawal of VAT exemption on money exchange business and on use of credit card will increase the VAT net. Introduction of VAT Stamp (like cigarette Band Roll & stamp) on locally produced soft drinks, soap, detergent powder and mineral water from October 2003 will decrease tax evasion. Other measures which will increase the VAT base are: imposition of VAT on all items sold in auction by the government, semi-government and autonomous body, Bank, Insurance and other limited companies at the rate of net 1.5% of the auction value; withdrawal of VAT exemption on Decorators, Caterers and Sweetmeat shop within the metropolitan and the district town areas.

## Improvement of Revenue Management

Some positive measures have taken by the government to improve the institutional arrangements for improving efficiency of revenue authority. Among the measures the following are expected to be most effective:

- Reforms in Revenue Administration (RIRA) project for reorganisation of the Large Taxpayer Unit (LTU) and modernisation of the taxes department
- Establishment of a Central Intelligence, Monitoring and Audit Cell at the National Board of Revenue for improving information system and exchange of information among income tax, customs and VAT
- Amendment of Customs Act, 1969 for making it more transparent and suiting to the occasion and with a view to introducing effectiveness in custom administration
- Application of Information technology in customs administration
- Creation of two separate custom houses there instead of the existing one and also for making provision for manpower and logistics
- Establishment of two new VAT Commissionerates at Dhaka, one new VAT Commissionerates at Chittagong, 16 new Divisional Offices and 52 new Circle Offices all over the country and increase required number of manpower and logistics with effect from January 2004
- Fixation of time limit of two working days in the VAT law for issuance of VAT registration certificate after submission of the application
- Making necessary amendments in the VAT Act and Rules to make it simple and at the same time effective

Taking note of the above, it appears that the 12.05% growth in FY04 targeted for the NBR is quite a plausible one. While a large part of the revenue growth will come from the general expansion of the economic activities, a significant portion of it will be contingent upon enhanced investment induced import expansion and expanded local business transactions.

*5.3 Non-NBR Component.* The outlandish 57.7% growth target in FY03 for non-NBR taxes remained miserably unachieved recording less than 10% growth. The modest target of 8.3% for FY04 seems realistic. Shortfall in land revenue and stamp duty

collection is the major reason behind non-fulfilment of the non-NBR targets in FY03; the budget does not spell out any special measure in this regard.

*5.4 Non-Tax Revenue.* Collection of non-tax revenue in FY03 was in fact less than that of the same in FY02 by 7%. The major contributing factors in this regard had been low collection in Dividend and Profit, Administrative Fees and Charges, Rent, Leases and Recovery, and Capital Revenue. Thus, the Ministry of Finance has given a much humbler target of 16.4% for FY04.

To sum up, the budget for FY04 has not spelt out any special initiative to augment revenue collection in the area of non-NBR taxes and non-tax revenues which currently together account for about 23% of the total revenue receipt.

#### *5.5 Public Expenditure*

*Revenue Expenditure.* Revenue expenditure overshoot the target from FY03 and recoded a rise of more than 11.5%. The revenue expenditure is to grow by about 14.5% in FY04.

Economic analysis of the projected revenue expenditure in FY04 reveals that it will continue to be dominated by Pay and Allowances (26.1%), Interest Payment (22.3%) and subsidies and current transfers (27.0%) – together for more than 75%. However, two major features of the revenue expenditure portfolio of the coming year relate to a lump sum lock Allocations of Tk. 1967 crores (6.8%) for inter alia, the declared 10% Dearness Allowance for government employees and significantly enhanced allocation for Repairs and Maintenance.

#### *5.6 Annual Development Programme (ADP)*

The size of the ADP for FY04 has been fixed at Tk. 20,300. Taking note of the development need of the country and public expenditure – GDP ratio in comparable countries, the said size does not seem to be inappropriate. However, question is whether the government is capable of effectively implementing such a portfolio.

The ADP for FY03 has to be reduced to Tk. 17,100 by slashing it by more than 11%. Reports from IMED shows that till March '03, the implementation rate of ADP was

only 45% of the original size and 50.7% of the revised size. These rates are not better than two recorded in the earlier years. In fact, in FY03, even after slashing it by about 16%, the revised size could be implemented only 88%. The budget speech of the Finance Minister does not made any reference to the implementation problem of ADP. No specific measures have been mentioned to increase the accountability of the Ministries in this regard.

The other issue regarding the ADP is the quality of the projects included. The ADP from FY04 includes 174 unapproved investment project against which sectoral block allocation has been provided. Whilst this approach provides flexibility to the policymakers, but it may not encourage allocative discipline.

The ADP has given relative priority to physical infrastructure – 17.4% to transport and 15.9% to electricity (in comparison to 13.3% to education). This seems justified to bring about inter-sectoral balance for economic growth.

It is not clear how the implementation of the projects scheduled for completion in FY04 and the priority projects will be expedited. Discontinuation of projects after significant incurred expenditures also raises concern.

### *5.7 Fiscal Deficit and Financing*

The total public expenditure is to grow in FY04 by 18.4% in comparison to 16.4% growth in total revenue recipient during the same period. This has led to a programmed increase of the overall budget deficit (without grants) from 4.25% in FY03 to 4.81% in FY04. Once foreign grants are accounted for, the budget deficit figure comes down to a sustainable level of 3.4%.

The overall budget deficit in FY04 will be 59% financed by external sources. However, the share of grant will be only 16.4% in comparison to 19.1% in FY03. Whereas foreign loans will account for 42.5% as against 35.5% in FY03.

On the other hand, contribution of term debt-will increase in domestic sources. More importantly, in spite of significant increase in foreign aid prospect and satisfactory revenue collection, the financing need has to be balanced by borrowing from the

banking system to the time of Tk. 2603 crores (which is 42% more than that of in FY03).

## **6. Infusing Dynamism in Investment Scenario**

### *6.1 Promoting Agriculture Sector*

Growth in agriculture in FY03 is projected to be 3.6 %. According to the Economic Survey of Bangladesh 2003, crop and horticulture sector has grown at 3.21% while livestock and forestry have grown at 4.51% and 4.97%, respectively. Growth in the fishery sector is estimated to be 2.33%. Performance of different sub-sectors of agriculture, underlying reasons for such performance and new measures proposed for promoting growth of the sector is discussed below.

Foodgrain Production: Less than Full Delivery of Boro. According to the Bangladesh Bureau of Statistics (BBS), production of Aus rice in FY03 is 1.85 million metric ton and that of Aman rice is 11.11 million metric tons. Farmers are now harvesting Boro paddy, so, production data for Boro rice is not yet available. CPD estimate suggests that Boro production is expected to be about 11.6 million metric tons. Preliminary estimates show that wheat production in FY03 is 1.4 million metric tons. Thus, total foodgrain production in FY03 is expected to be 24.56 million metric tons. Food grain production target for FY03 was set at 28.08 million metric tons. Aus production is slightly more than the targeted production while Aman production is 3% less than the targeted production. In other words, Aus and Aman production in FY03 are 2.20% and 3.54% higher than that of FY02. On the other hand, wheat production in FY03 has been less by 20% than that of the targeted amount of 1.75 million metric ton. Total food grain production in FY03 is expected to increase by only 0.15%. It may be noted that food grain production in FY02 was 3.14% less than that of FY01.

Cultivation of Boro was delayed in some areas due to cold and Boro seedlings faced cold injury in the seedbed. There was also serious crisis of HYV Boro seed in many areas of the country. Furthermore, government has increased the price of diesel from Tk.17 to Tk 20 in January 2003. All these factors probably have contributed to the likely decline in Boro production.

Rising Import of Foodgrain: Foodgrain import has increased significantly during FY03 and particularly in recent months. In FY03 (July-February), import of food grains amounted to Taka 877 crores, the matching figure for FY02 was Taka 659 crores, recording about 33% per cent increase. Information on opening of new letters of credit (L/C) indicates that import of food grains is going to increase further in the coming months. During the period July-February FY03, value of new L/Cs opened for importing food grains amounted to about \$335.2 million recording a 185 per cent growth over the comparable figure for FY02. Increase in import of food grain was encouraged by low import duty of rice (decreased to 7.5% from 34% in July 2002) and low production of wheat and also by subsidised export of food grain by India. Food Corporation of India (FCI) off loaded rice and wheat for export purpose at half of their economic cost.

Increased Fisheries Production and Decrease in Import of Milk and Dairy Products:

Number of poultry farms, dairy farms, beef and goat fattening farms, fish farms and hatcheries have increased during the last decade or so. There is substantial increase in production of milk and import of powder milk has significantly reduced.

The import of milk and dairy products has reduced by 2%. Decrease in import of milk and dairy products are due to the increase in domestic production and also because of increase in import duty during FY2002-03.

Proposed Budgetary Measures to Promote Agriculture: Measures related to promotion of agriculture include the following:

- Increase of agricultural subsidy from Taka 200 crore in FY2002-03 to Taka 300 crore in FY 2003-04. *Subsidies for agriculture should be used for production of “breeders seed” to cater the need of BADC, private seed sector and NGOs who are producing quality seeds for farmers. It may be recalled that crisis of quality seed was one major problem of Boro rice production this year and lack of availability of quality seed is a problem of agricultural production. Studies showed that supply of quality rice seed alone could increase rice production in Bangladesh by 2.1 million metric tons from the existing rice fields and from same varieties.*

- In addition to the subsidies, a fund amounting to Taka 50 crore is proposed to help develop agro-based industries. *This year government was able to utilise cash support of Tk. 31.5 crore only out of declared Tk. 100 crore for this purpose. In this context, it would be realistic to also include plant nurseries using biotechnologies for regeneration of plants, and establishment of cold storages, seed processing and storage facilities using subsidised credit. Support should also be provided to strengthen public-private research partnership.*
- The budget proposed to increase the customs duty for rice from existing 7.5% to 22.5%. Though there is rise in price of foodgrain in the market but the budget has to make a balance between the interest of rice producers and rice consumers. It may be noted that rice provides nearly 40% of total national employment (48% of rural employment) and also low-lying paddy fields cannot be profitably used for other purposes. Therefore, to encourage growth in rice production increase in customs duty is justifiable.
- The Barind Authority has been implementing integrated programmes for development of the Barind areas in the northern part of the country since 1992. The budget proposes an allocation of Taka 935 crore for development of the Barind areas, against an allocation of Taka 757 crore in the revised budget of FY 2002-03. *Experience show that availability of irrigation facility leads to cultivation of irrigated rice and reducing the diversity in crop cultivation. Considering the fact that Barind region is suitable for fruit crops like mango, litchi, etc. and also for pulses in Rabi season, special measures should be taken to increase rice production through supplementary irrigation in Aman season, expansion of Chickpea and other pulses by providing quality seeds in Rabi season. Encourage cultivation of fruit crops and trees using irrigation facilities.*
- The budget proposes to continue existing support to milk production. It has also proposed to extend tax exemption from all agricultural activities up to June 2006. Besides, special tax exemptions will be continued for preservation of environment, for helping agro-based industry and medium and small industries. Supplementary duty for import of milk powder will be increased from existing 20% to 25%. *These are welcome steps for growth of this sector.*

- The existing customs duty on agricultural equipment, irrigation pump, fertilizer, poultry equipment including few other item is zero. But fish 'pona', breeding animal, poultry parent stock, seeds and on certain types of fertilizer AIT & IDSC together being 6.5% is applicable at import stage. In order to give support to such agriculture related sector, the budget proposes to withdraw this AIT & IDSC completely besides maintaining the existing 'zero' customs duty.
- Proposal has been made to fix customs duty rate at 7.5% on all types of pump except in certain cases (irrigation pumps & hand pumps). In case of irrigation pump the existing 'zero' rate will continue.
- With the present leviable duty of 32.5% the total incidence of taxes is 89.35% on import of sugar. Despite prevalence of such high duty rates the sugar manufactured locally is losing market and not in a position to compete with the imported sugar. To give further protection to local sugar industry the budget proposes to impose 40% supplementary instead of existing 20%. *Studies with recent data show that Bangladesh does not have any comparative advantage in production of sugarcane and sugar. Without addressing the core inefficiency of the sugar industry, such measures will only penalise the consumers and encourage smuggling.*
- The budget proposes to increase supplementary duty from 30% to 40% on import of various types of fruits. In the same manner, the budget proposes to impose 25% supplementary duty on import of spices like cardamom, 'daruchini', cloves, jeera', black pepper which are consumed by comparatively the well to do class.

## 6.2 Manufacturing Production

According to the provisional estimates provided by the BBS, the manufacturing sector grew at the rate of 6.6% in FY03, against the growth rate of 5.5% in FY02. Vision in industrailisation is to increase the share of the manufacturing sector to 25% of GDP having employment for 20% of work force. The *Quantum Index of Production* (QIP) during July-February FY03 grew by 5.15 per cent over the matching period of the previous year. Although the QIP of February 2003 is 3.82 per cent lower than that of the preceding month, it is however 7.28 per cent higher on point-to-point basis.

Production data for the period July-February FY03 suggest that the manufacturing growth rate is less than 3%. The frontrunners in terms of production growth are pharmaceuticals (23.7 per cent), garments (14.6 percent), cotton fabric (7.9 per cent), and petroleum products (6.4 per cent). Fertiliser sector, with 28.8 per cent production growth, seems to have recovered. The paper industry continues to be in a state of doldrums as its production fell by another 18.8 per cent during July-February FY03.

Budgetary Measures Proposed: Following measures are proposed in the budget to promote manufacturing growth:

- To promote growth of agro-processing industries, the budget proposes full exemption of VAT on locally produced and packed items such as rice, pulses, wheat, maize, garlic, onion, chilli, ginger, corriander seed, vegetables, fresh fish and meat.
- Reduction of the corporate rate of income tax for readymade garments industries from 30% to 10% only for the period upto June 30, 2006.
- For textile sector corporate tax will be reduced from current 30% and 35% to 20% for the period upto June 30, 2006.
- To solve the problem arised due to the recently introduced provision for some irregularity-prone deemed-export sectors to submit bank guarantee covering the whole amount of duty & taxes applicable to the imported raw materials at the customs clearance stage, the budget proposed a new provision. Under this proposed provision, irregularity-prone deemed export sectors shall submit bank guarantee covering only 25% (one fourth) of the duty & taxes applicable at import stage.
- Currently, particle board, plywood and carpet of international quality is being manufactured within the country along with assembling of refrigerator and colour television. In order to discourage import of these items in CBU condition, the budget proposes to impose 15% supplementary duty on these goods. In addition, it proposes to increase the existing rate of supplementary duty on glass sheet from 30% to 40% and impose 40% supplementary duty on glass mirror at import stage.

- The proposal for reduction of import duty on fuel (kerosene, furnace oil, jet fuel) from 30% to 20% will affect positively the industrial production and service sector.
- The duties & tax rate on raw materials which are used in various local industries like linseed oil, tung oil, dolomite, blended powder/flux, grinding ball and nickel coated copper wire (a raw material of spectacle frame) will be lowered to the existing rates of custom duty on the above goods to the next lower stage. The budget also proposed to withdraw the existing 20% supplementary duty on aluminum or iron base cap for filament lamp.

### *6.3 Foreign Investment*

Available data indicate that a meagre \$16 million was received by Bangladesh as net FDI inflow during the months of July-December FY03, which is 55.6 per cent less than the comparable figure for FY02 (which itself was disappointingly low). FDI flow in July-March, 2003 was only USD 28 million. Thus, in spite of all the proactive policy procurements and expensive road-shows, foreign investment continues to shy away from Bangladesh. No targeted measures to encourage and support foreign input has been arrested among the budgetary measures.

Proposed Measures Related to Investment: From the L/C opening and settlement figures it is observed that the investment stagnancy continues whilst there are disparate signs of recovery. The textile sector received less inflow of capital due to uncertainty of policies regarding the SAARC cumulation for RMG and certain level of saturation. The import of textile machineries has been reduced for July-Mar 2003 by 11.2% and 36.5% according to the data of L/C opening and L/C settlement. The investment in leather increased significantly, the import of leather machinery increased by 150.8% (L/C opening) and 537% (L/C settlement) for the same period. The incentives provided in the last budget for the leather industry played a positive role. The import of RMG machinery experienced a marginal growth both for L/C opening and settlement. The BOP figures show gradual improvement of foreign portfolio investment, most of which came from the NRBs.

- Reduction of corporate tax rate of listed companies to 30% from 35% and for others to 35 % from 40% and for bank, insurance company and financial institution 40% may play a positive role for investment in domestic business.

- VAT withdrawn at import stage on import of gas cylinder, regulator, valve & hose pipe and reduction of customs duty from 32.5% to 15% on hose pipe used with gas cylinder, and exemption of VAT on bulk purchase by the enterprises bottling gas may boost further investment in this sector.
- Zero duty and exemption form AIT & IDSC will boost up further the agro-based industry, thus attract more investment.

#### *6.4 Capital Market*

The capital market in Bangladesh remains shallow, and is yet to emerge as a major source of equity financing in the industrialisation process. New investment through Initial Public Offer (IPO) up to February 2003 is Taka 146.00 million. The amount of total market capitalisation at the Dhaka Stock Exchange (DSE) in March 2003 (Taka 61025 million) was 1.87% lower than that of end of February 2002 (Taka 62189.7 million). On the other hand, amount of total market capitalisation at the Chittagong Stock Exchange (CSE) has increased by 3.04%, from Taka 53814 million in February 2002 to Taka 55452.5 million in March 2003. The discrete benefits offered in the budget for FY03 along with cuts in the interest rates of the NSD certificates have yet failed to bring back the small investors to the secondary market of shares and securities.

Measures proposed in the Budget for investment promotion and capital market include: (i) investment in purchase of shares of a listed company during the period from 1<sup>st</sup> July 2003 to 30<sup>th</sup> June 2005 be accepted without explanation by the taxes department. However, if the shares are sold or transferred within two years of purchase, this facility will not be allowed. (ii) Dividend income by investors from company will be non-taxable, however company will have to pay a 10% dividend tax.

### **7. Strengthening Balance of Payments**

The external sector in FY 2002-03 performed comparatively better than in the previous fiscal, although the price of Bangladeshi exportables continued to fall in FY 03. With 6.14 per cent of growth the export was back to a positive trend. According to the statistics for July-March, FY 2003 the woven RMG export growth was still negative, which was registered at -0.89 per cent. However, the knit-RMG recovered and had shown strong growth, 12.58 percent for the first nine months of the FY 03.

The frozen food export growth was also positive (19.92%). Handicrafts and computer software export increased during this period. The positive volume index (13.76 percent) contributed to a positive export growth, whereas the price index dipped further in this fiscal (-9.34 per cent).

The import growth arrested also a positive tone during the first 9 months of FY 2003. The actual import growth was 3.82 percent for this period. According to the statistics of L/C opening, the import of consumer items had a robust growth ( 82.1 percent), while the import of intermediate goods was negative (-9.6 percent). The import of capital machinery experienced a positive growth (40.6 per cent) except textiles machinery (-11.2 per cent). Import of motor vehicles, computer and electronic equipments also registered a positive growth during the period.

The balance of payments consolidated further during FY 03. The positive current account balance reached USD 597 million, which was more than 4 times higher of the balance at the same period. The positive current account balance owed to the robust growth of remittance during this period of the FY 02. The remittance flow was USD 2787.17 for the period of July-May, 2003, which was 22.84 per cent higher than it was in the previous period. However, the capital account was not in a good shape, with a pale USD 28 million direct investment. The direct investment during the July-March, 03 period was USD 17 million less than it was in previous period. The suppliers' credit weakened the composition of the capital account, where the outflow amounted USD 270 million. The foreign reserve situation improved strongly during the July-May, 2003 period. The foreign reserve on June 10, 2003 was USD 1929.63 million, which was equivalent to 87 days of import. For the same period in FY 02, the import equivalent was only for 50 days. As a whole, the balance of payments situation was under control.

Proposed measures related to external sector: As the RMG is the largest sector of the economy, the continuity of the positive growth of the sector is crucial. As the competition became steeper during the last couple of years, the government had to be innovative to provide further support to the sector. In FY 2004 the government proposed reduction of corporate tax from 30 per cent to 10 percent up to June, 2006. This measure will provide some breathing space to the sector, however, the

sustainability of the growth in the sector will depend on improvement of productivity and diversification of the market and products within the sector. The corporate tax for textile sector has been proposed to be reduced to 20 percent for the same period as for the RMG. This reduction may facilitate to compete with imported fabrics and improve scope for preferential market access for the RMG in the EU and other markets with better compliance of Rules of Origin. For the time being a new provision has been proposed under which irregularity-prone deemed export sectors shall submit bank guarantee covering only 25% (one fourth) of the duty & taxes applicable at import stage. The impact of this measure is not clear. Other than these measures the budget for FY 2004 provided more fiscal measures for import substituting industries and provided domestic protection supports to many sectors.

## **8. Social Safety Net**

- Increase of amount of old-age Allowance and Widowed and Deserted Women Allowance to Taka 150 per month (from the existing Taka 125) is a welcome continuation of the programme started during previous regime.
- Increase of allocation for the “Fund for Acid-burnt Women and Rehabilitation of Physically Handicapped” to Taka 40 crore and for the “Fund for Mitigation of Risks from Natural Disasters” to Taka 75 crore deserves appreciation. However, the underlying causes of such social evil must be addressed.
- The budget proposed a combined allocation of Taka 4353 crore for various kinds of programmes related to poverty alleviation including expansion of microcredit programme. Through its *Abashon Programme* the government plans to rehabilitate 65,000 landless and homeless families for self-employment.

## **9. Debatable Tax Measures**

- Increase of customs duty and supplementary duty on sugar will increase price of sugar in the domestic market and enhance smuggling
- Increase in supplementary duty on powder milk and salt will tax the general citizens
- Extension of concession to import of reconditioned taxi-cab similar to new cars will deteriorate the urban pollution situation

- Withdrawal of VAT exemption on use of credit card must not be applied on the consumers.
- It is difficult to explain the reduction of supplementary duty on spirits, wine and other alcoholic drinks
- Withdrawal of VAT on travel agency will not boost the tourism sector, as the sector development largely depends on infrastructure, law and order and other factors
- Imposition of differential specific duty on mobile set will hamper the growth of mobile telecom market.

## **10. Summing up**

- The budget for FY04 is premised on high foreign aid flow and enhanced revenue collection. But it does not bring any significant clarity regarding the problems of ADP implementation. Given the apprehension regarding quality of the ADP projects, expanded financing by debt creating foreign loan is a major concern.
- It is not immediately obvious about the distributive impact of the fiscal measures as such they lack transparency.
- The balance of payment situation continues to remain fragile as the export is faltering in the face of deteriorating terms of trade. Weak export growth of the RMG (particularly woven RMG) portends emerging problem in the sector. FDI has virtually dried up. Slight recovery in imports is going to put fresh pressure on the BOP. Sustaining buoyant flow of remittance remains a major challenge. Without the disbursement of the negotiated foreign aid the situation may aggravate. Maintaining stability of the exchange rate will be also a major issue.
- The budget has provided a set of discrete supports to agro-based industries, textile and RMG sector, equity market etc. However, no comprehensive road map for improving investment has been put up. More importantly, the budget speech does not recognise any micro level impediments to investment which are enhancing cost of doing business in Bangladesh and undercutting competitiveness.

- The budget does not sketch any plan for institutional reforms in investment supportive or trade-supportive activities. The Minister even did not fully reveal the reform plan agreed by the government with the development partners during the recent loan negotiations. If the planned expenditures do not lead to quality investment leading to gainful employment generation and, desirably, productivity growth, the inflation rate may increase further. The budget speech does not take cognisance of the creeping cost push inflation.
  
- It needs to be reemphasised that effective participation of the poor in the growth process means much more for poverty alleviation than symbolic allocation for social safety net programmes. Thus, Bangladesh economy has to shift to higher gear to accelerate the pro-poor growth process and thus reaching a higher equilibrium. Guiding the economy to that equilibrium will be the fundamental challenge of this year's budget implementation. The major impacts will define the success:
  - Increased flow of private investment
  - Resurgence of Exports
  - Implementation of the ADP

The present initial assessment of the National Budget for the fiscal year 2003-2004 (FY04) has been prepared at the Centre for Policy Dialogue (CPD) under its Independent Review of Bangladesh's Development (IRBD) programme by a team led by *Dr. Debapriya Bhattacharya*, Executive Director, CPD. The other members of the team are:

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