

# An Analysis of the National Budget for FY2005-06

Venue : Hotel Sheraton  
Date : 19 June 2005  
Time : 10.00 Hours



CENTRE FOR POLICY DIALOGUE (CPD)  
B A N G L A D E S H  
*a c i v i l s o c i e t y t h i n k - t a n k*

House 40C, Road 11, Dhanmondi R/A, Dhaka-1209  
Tel: 9141734, 9141703, 9145090; Fax: 8130951  
E-mail: [cpd@bdonline.com](mailto:cpd@bdonline.com); Website: [www.cpd-bangladesh.org](http://www.cpd-bangladesh.org)

## Credit

Dr. Debapriya Bhattacharya, Executive Director, Centre for Policy Dialogue (CPD) was the principal researcher and was in overall charge of preparing this report.

Lead contributions were obtained from Professor Mustafizur Rahman, Research Director, CPD, Ms Anisatul Fatema Yousuf, Head (Dialogue & Communication), CPD, Dr. Uttam Kumar Deb, Senior Research Fellow, CPD, Dr. Fahmida Khatun, Senior Research Fellow, CPD, and Dr. Khondaker Golam Moazzem, Research Fellow, CPD.

Mr. M. Syeed Ahamed, Senior Research Associate, CPD was responsible for database management and preparation of macroeconomic analysis. Support was provided by Mr. Shubhasish Barua, Research Associate, CPD, Mr. Md Ashiq Iqbal, Programme Associate, CPD, and Mr. M. Shafiqul Islam, Joint Director (Admin and Finance), CPD.

Mr. Wasel Bin Shadat, Senior Research Associate, CPD and Mr. Kazi Mahmudur Rahman, Senior Research Associate, CPD, Mr. Syed Saifuddin Hossain, Research Associate, CPD, Mr. Asif Anwar, Programme Associate, CPD, Mr. Narayan Chandra Das, Programme Associate, CPD, Mr. Md. Masum Billah, Research Associate, CPD, Ms. Nafisa Khaled, Programme Associate, CPD, Ms Farhana Rahman, Programme Associate, CPD, Ms. Dilshad Zaman, Intern, CPD, Ms. Bidowra Tahmin Khan, Intern, Mr. J.M. Abdullah, Programme Associate, CPD, Mr. Kamrul Hasan, Programme Associate, CPD, Mr. Md. Ahsan Habib, Programme Associate, CPD and Mr. Ananta Zakaria Neelim, Intern, CPD prepared drafting notes for the report.

Technical support was provided by Mr. Hamidul Hoque Mondal, Administrative Associate, CPD, Mr. A. H. M. Ashrafuzzaman, Senior System Analyst, CPD, Mr. Rabiul Alam, Word Processor, CPD and Mr Avra Bhattacharjee, Documentation Officer, CPD.

## **Table of Contents**

1	INTRODUCTION .....	4
2	GROWTH, SAVINGS AND INVESTMENT .....	6
2.1	GDP Growth .....	6
2.2	Sources of Growth .....	6
2.3	Per Capita Income .....	8
2.4	Savings .....	8
2.5	Investment .....	9
3	PUBLIC FINANCE .....	11
3.1	Revenue Earnings .....	11
3.2	Public Expenditure .....	12
3.3	Budget Deficit and Financing .....	17
4	FISCAL MEASURES .....	19
4.1	Personal Income Tax .....	19
4.2	Incentives for Investment .....	20
4.3	Export Promotion versus Import Substitution .....	22
4.4	Agriculture .....	23
4.5	Power and Energy .....	28
4.6	SMEs .....	29
4.7	Sectoral Issues .....	30
4.8	Local Government .....	33
5	SOCIAL SECTORS AND SAFETY NET PROGRAMMES .....	34
5.1	Social Sector .....	34
5.2	Social Safety Net .....	36
5.3	Programme for Mitigating Economic Shocks .....	38
5.4	Special Credit Programmes for Employment Generation .....	38
6	CONCLUDING OBSERVATIONS .....	40
	INDEX .....	42

## 1 INTRODUCTION

The Bangladesh economy experienced a respectable growth rate of about 5.5 per cent during the FY05 in spite of having struggle with two exogenous shocks, *viz.* floods of July-August 2004 and phasing-out of apparel quota from 1 January 2005. The economy posted a double digit export growth notwithstanding the challenges emanating from a quota-free global trading regime in apparel. A bumper *Boro* crop, estimated at 13.75 million MT, helped recover from the crop losses due to the flood. A \$2.5 billion worth of foreign direct investment (FDI) proposal from the Tata Group of India transmitted an optimistic signal to the potential investor community. The Privatisation Commission was reactivated with new off-loading mandate. The capital market received a new lease of life, thanks to increased liquidity flow. High import of capital machineries in the wake of robust credit expansion in the private sector and also strong growth of agricultural credit energised the economy in FY05. Off-take of foreign aid improved marginally, and remittance flow continued to be buoyant and is expected to reach about US\$ 3.8 billion by the end of the current fiscal.

However, the macroeconomic achievements could not be translated into overall robust economic development due to a number of weaknesses in the economy. These include failure to implement public investment programmes, coupled with poor revenue collection effort. The macroeconomic correlates are particularly under pressure from the third quarter of FY05 due to stressed balance of payment and stretched fiscal balance. A rising trend in consumer price index created new tensions in the macro-economic stability; a deepening state of weak governance undermined the overall economic management.

In this context, the major challenge before the National Budget for FY06 was to maintain the macroeconomic balances without decelerating the momentum in private investment. In order to sustain the macro-stability in the current context, the budget needed to address the following six major sources of fragility. These are:

- (i) The inability to implement public investment programmes in the face of the runaway growth in recurrent expenditures;

- (ii) Slow progress in domestic revenue mobilisation with continuing dependence on international trade tax, with direct tax collection increasing at a pace that is slower than the domestic VAT;
- (iii) Upsurge in inflation rate underwritten by cost-push factors, such as high global prices of food, fuel, fertiliser and steel;
- (iv) The delicate balance in external payments situation notwithstanding the robust export and remittance growth;
- (v) Failure to undertake complementary reforms to ensure improvement of micro-conditions for private investment, including improvements of governance in public infrastructural facilities and utilities, regulatory framework for capital and debt market, contract enforcement through judicial process and transparency in public expenditure; and
- (vi) Widening disparity in income distribution which is limiting the growth prospect including its sustainability.

The budget of FY06 was placed in the backdrop of the above described macroeconomic scenario. The efficacy of the budgetary measures ought to be looked at from the vantage point of whether it is able to address these concerns or not. On the other hand, the Government of Bangladesh (GOB), for the first time, has prepared a budget ostensibly under the three year framework of the Poverty Reduction Strategy Paper (PRSP). Thus, an added question is whether and to what extent the new budget is in consonance with the Medium Term Macroeconomic Framework (MTMF) of the PRSP and its allocative guidelines.

In the present review, the analysis of the budget for FY06 has been organised under three major blocks of measures: *Public Finance* (Section III), *Fiscal Measures* (Section IV) and *Poverty Alleviation* (Section V). In order to situate the trends in these three areas, the review starts with a discussion of the current state of growth, savings and investment in Bangladesh (Section II). The present analysis of the budget ends with a set of concluding observations.

## **2 GROWTH, SAVINGS AND INVESTMENT**

### **2.1 GDP Growth**

The provisional figures for FY05 suggest that GDP has posted a growth of 5.38 per cent; for which the matching target figure as per the final draft of the PRSP (dated 12 January 2005) was 5.5 per cent. It may be recalled that the BBS has recently revised upward the GDP growth rate for FY04 from 5.52 per cent to 6.27 per cent. *CPD has observed elsewhere that such large upward revision in GDP growth rate has renewed the discussions about the empirical basis, estimation methodology and process transparency of the national income accounts of Bangladesh.*<sup>1</sup>

However, when compared with the major countries in the South Asia region, Bangladesh's growth scenario looks moderate. In FY04, the GDP growth rates of India (8.1 per cent), Pakistan (6.4 per cent) and Sri Lanka (6.5 per cent) have been higher than that of Bangladesh (even with its revised estimate of 6.3 per cent). The GDP growth figures for Bangladesh for FY05 also appears to be restrained when compared with these South Asian countries which have targeted ambitious economic growth of 6.5 per cent (India and Pakistan), and even at 7 per cent (Sri Lanka). India, incidentally, recorded a 7.4 per cent growth during the first quarter of FY05. *It seems South Asia as a whole is going through a spell of relatively high growth.*

According to the PRSP, the economy is expected to grow at 6.2 per cent (6.0 per cent under low case scenario) in FY06.

### **2.2 Sources of Growth**

The on-going structural transformation of the Bangladesh economy is characterised by the falling share of the agricultural sector<sup>2</sup>, with marginal increase of the manufacturing, in the

---

<sup>1</sup> CPD. (2005). *State of the Bangladesh Economy in the Fiscal Year 2004-2005 (Second Reading)*. 04 June 2005.

<sup>2</sup> Agriculture sector includes Agriculture (crops and horticulture, animal farmings and forest and related services) and Fisheries subsectors.

backdrop of increasing contribution of the service sector<sup>3</sup>. This trend continued through FY04 and FY05. The share of agricultural sector came down from 23.1 per cent in FY04 (revised) to 21.9 per cent in FY05. On the contrary, the share of Industry<sup>4</sup> and Service sector increased from 27.7 per cent and 50.9 per cent in FY04 to 28.4 per cent and 51.4 per cent respectively.

Subsequent to the adverse impact of flood 2004, Agriculture and Forestry sub sectors experienced a negative growth of (-) 0.73 per cent in FY05. Fisheries sub-sector during this period registered a marginal growth of 4.0 per cent during this period. Thus when the Fisheries sub-sector is included, Agricultural sector shows only a marginal 0.3 per cent growth in FY05. On the other hand, the Industry sector experienced an impressive 8.6 per cent annual growth in FY05. Within the Industry sector, Mining and Quarrying registered an 8.4 per cent growth, while Manufacturing experienced an 8.4 per cent annual growth during FY05. Electricity, gas and manufacturing also showed an impressive 9.1 per cent growth during the period under review.

Overall, the annual growth of the real economic sector<sup>5</sup> was only 3.8 per cent, while the service sector experienced a modest 6 per cent growth in FY05.

The contribution of the agricultural sector in the incremental GDP also experienced a significant decline from 14.8 per cent in FY04 to only 1.3 per cent in FY05, which was largely underwritten by the negative contribution (-7.8 per cent) of the Crop subsector. The incremental contribution of the overall industrial sector increased to 42.3 per cent in FY05, when compared with its matching figure of 31.8 per cent of the previous year.

*On the whole, the contribution of the real economic sectors to incremental growth declined from 33.6 per cent in FY04 to 27.3 per cent in FY05. Incremental contribution of service sector in real GDP growth increased significantly from 44.6 per cent in FY04 to 60.9 per cent in FY05.*

---

<sup>3</sup> Service includes Wholesale & retail trade; Hotel & restaurants; Transport & Communication; Financial intermediaries; Real estate & Housing; Public administration & defence; Education; Health & Social Works; Community, Social & Personal Services.

<sup>4</sup> Industry includes Mining & Quarrying (Gas & non-refined oil, Other mining); Manufacturing ( Large, Medium and Small Scale); Electric, Gas & Water Supply; and Construction.

<sup>5</sup> These include Agriculture (crop, fisheries and livestock), Mining & Quarrying and Manufacturing.

### 2.3 Per Capita Income

In FY04, the per capita GDP and GNI of Bangladesh were recorded at US\$ 421 and US\$ 444 respectively. The annual growth was 8.2 per cent for per capita GDP and 8.0 per cent for per capita GNI, compared to FY03.

Latest data shows that the impact of Floods 2004 and the recent downward revision of exchange rate of Tk have slowed down the growth of real per capita income in FY05. In dollar term, per capita GDP and GNI for FY05 were US\$ 445 (+ \$24) and US\$ 470 (+ \$26) respectively, registering respective annual growths of 6.5 per cent and 6.8 per cent.

It may be mentioned that the government has revised downward the per capita GDP for FY04 from US\$ 421 to US\$ 418, despite the upward revision of GDP for the same year. *This once again underscores our concern about the veracity of national income accounting.*

The per capita income of Bangladesh is still very low when compared with the same of other South Asian countries. For example, Pakistan, India and Sri Lanka in 2004 recorded a per capita GDP of US\$ 538.1, US\$ 602.6 and US\$ 982.5 respectively. In other words, Pakistan, India and Sri Lanka has a per capita GDP which 27.8 per cent, 44.1 per cent and 133.4 per cent more than Bangladesh.<sup>6</sup>

### 2.4 Savings

The economy has experienced some movement in domestic savings during FY05, after almost a half decade of stagnation. Domestic savings increased marginally to 20.16 per cent of the GDP in FY05 from 19.5 per cent in FY04, registering a 0.6 per cent increase as a share of GDP. A comparison with the neighbouring countries shows that the share of domestic savings in GDP was 28.1 per cent in India (i.e. about 40 per cent more than Bangladesh) and 17.6 per cent in Pakistan (i.e. about 13 per cent less than Bangladesh) during FY04.

---

<sup>6</sup> Per capita income for other South Asian countries has been taken from IMF, World Economic Outlook Database, 2004, while the income figure for Bangladesh has been taken from BBS. The comparable figure for Bangladesh in IMF report has been mentioned at US\$ 393.7, which is even lower when compared with other South Asian countries.

The share of national savings to GDP also increased significantly in FY05 to 26.49 per cent of GDP as against 25.4 per cent in FY04, registering an impressive 1.05 per cent enhancement as per cent of GDP.

### *New Data on Savings*

Similar to the GDP figures, the government has also revised the Gross National and Domestic Savings figures of FY04 from 24.5 per cent and 18.3 per cent to 25.4 and 19.5 respectively. *Given the fact that the GDP for FY04 has been increased significantly, these proportions as per cent of GDP are remarkably higher.* However, there may be some problem with the revised data for FY04, as the change in National Savings rate is less than that of the Domestic Savings rate. This could have only happened if there was a *negative* flow of external savings – which empirically is not correct.

**Table 1**  
**Revision in National Savings and Domestic Savings Figures**

<i>Savings as per cent of GDP</i>	FY03			FY04			FY05
	before	after	change	before	after	change	
Gross National Savings	24.45	24.87	0.42	24.49	25.44	0.95	26.49
Gross Domestic Savings	18.21	18.63	0.42	18.27	19.53	1.26	20.16

More curiously, the figures for Gross National and Domestic Savings for FY03 have also been revised in FY05 (an increase by 0.42 per cent of GDP). Revision of savings rate after two years will raise serious questions about credibility of the same.

### **2.5 Investment**

During the last five years (FY01-FY05), the Gross Investment Rate has increased by only 0.3 per cent of the GDP. The ratio was 23.1 per cent in FY01 whilst it crawled only up to 24.4 per cent in FY05. This is significantly low (by – 1.1 per cent of GDP) than the MTMF target of PRSP which was set at 25.5 per cent. It is significantly lower than that of India (26.5 per cent) and Sri Lanka (25.9 per cent), although it is higher than that of Pakistan (18.1 per cent).

Increasing investment continues to remain one of the core challenges of the Bangladesh economy. *In FY05, the country recorded one of the lowest public investment ratio of the last decade, 5.9, a further (-) 0.3 per cent decline from the earlier lowest figure of 6.1 per cent in*

*FY04*. The slack left behind by the public investment was however somewhat picked up by private investment. Private investment as a share of GDP increased from 17.9 per cent in FY04 to 18.5 per cent in FY05. Bangladesh continues to remain an under-invested country, while its national savings rate (26.5 per cent) remains higher than the gross investment rate (24.4 per cent).

### ***New Data on Investment***

Once again, we observe that figures on Gross Investment rate for FY04 has been revised upward from 23.6 per cent to 24.0 per cent of GDP. Similarly, the private and public investment figures have also been correspondingly revised from 17.5 per cent and 6.1 per cent to 17.8 per cent and 6.2 per cent of GDP in FY04.

**Table 2**  
**Revision in Gross, Public and Private Investment Figures**

<b><i>Investment as per cent of GDP</i></b>	<b>FY04</b>			<b>FY05</b>
	before	after	change	
Gross Investment	23.58	24.02	0.44	24.43
Private Investment	17.47	17.83	0.36	18.53
Public Investment	6.11	6.19	0.08	5.9

**Source:** Estimated from CPD Database.

### **Summing Up**

1. Notwithstanding the impact of Flood 2004 and shock in the export market, the GDP for FY05 has been close to the target of PRSP. It will be very interesting to observe whether this figure once again shoots up in the next year by a similar revision in national income accounting. The target for FY06, as was mentioned, is 6.2 per cent.
2. National savings as per cent of GDP has shown a way out from a prolonged stagnation, indicating an 1.0 per cent increase in FY05 over FY04 (2.0 per cent over provisional figure of FY04). Following the recent revision, the Domestic Savings rate is also showing upward trend. There is no comparable target in the PRSP.
3. Gross investment has failed to achieve the PRSP target (by – 1 per cent). The public investment recorded the lowest attainment figure in recent past. Investment attributable to private sector increased by 0.7 per cent of GDP.

### 3 PUBLIC FINANCE

#### 3.1 Revenue Earnings

*Revenue-GDP Ratio.* The low revenue-GDP ratio remained stagnant at 10.64 per cent in FY05, when compared with the corresponding figure of the pervious year (10.63 per cent). As the humble target of PRSP (i.e. 10.7 per cent) was not achieved in FY05, *the government has set a new target for FY06 at 10.96, which is even (-) 0.24 per cent lower than the PRSP projection.* Both the earnings from tax and non-tax revenue fell short of PRSP target by (-) 0.03 per cent of GDP in FY05. *Government also stepped down from the PRSP targets both in case of tax and non tax revenue earnings.* Without bringing major changes in the tax administration, the government will not be able to achieve the revenue-GDP ratio of 11.7 per cent by FY07, as has been projected in the PRSP.

**Table 3**  
**Revenue –GDP Ratio: PRSP Vs Budget**

Indicator	FY05			FY06			FY07
	MTMF	Actual	Change	MTMF	Target	Change	
Total Revenue	10.70	10.64	-0.06	11.20	10.96	-0.24	11.70
Tax	8.70	8.67	-0.03	9.10	8.95	-0.15	9.60
Non tax	2.00	1.97	-0.03	2.10	2.02	-0.08	2.10

**Source:** Estimated from CPD Database.

*Revenue Target.* The ambitious revenue target for FY05, which was set at 16.7 per cent higher than the realised figure of FY04, ultimately fell short of target by (-) 5.1 per cent. *However, the realisation in FY05 was 10.7 per cent higher than the corresponding figure of previous fiscal year.* Tax component grew by 12.9 per cent during this period while NBR and Non-NBR components grew by 12.8 per cent and 16.0 per cent respectively.

*Incremental Contribution of Sources.* *However, the incremental contribution of VAT in total revenue growth was about 53.4 per cent, while tax on income contributed only 15.3 per cent to the added revenue intake.*

**Table 4**  
**Growth of Revenue Collection FY05-FY06**

Description	Average Annual Growth FY95-05	Growth FY05 over FY04		Growth FY06 (B) over FY05	
		Annual	Incremental	Annual	Incremental
<b>Tax Revenue</b>	<b>11.76</b>	<b>12.90</b>	<b>96.05</b>	<b>16.78</b>	<b>82.21</b>
NBR Component	12.00	12.75	90.79	16.89	78.99
<i>Taxes on Income</i>	12.70	<i>11.01</i>	<i>15.26</i>	<i>18.97</i>	<i>17.02</i>
<i>VAT</i>	13.65	<i>23.67</i>	<i>53.42</i>	<i>19.52</i>	<i>31.74</i>
Custom Duty	9.71	9.59	18.42	13.75	16.87
<b>Non-NBR Component</b>	<b>8.08</b>	<b>16.00</b>	<b>5.26</b>	<b>14.48</b>	<b>3.22</b>
Taxes on Vehicles	16.73	10.79	0.68	22.10	0.90
<b>Non-Tax Revenue</b>	<b>11.45</b>	<b>2.11</b>	<b>3.95</b>	<b>16.00</b>	<b>17.79</b>
Total	11.63	10.73	100.00	16.64	100.00

**Source:** Estimated from CPD Database.

According to the new target of revenue earnings, the government will have to collect 16.6 per cent more revenue in FY06, of which a large portion would come from the non-tax sources. The incremental contribution of NBR revenue would be to 82 per cent of the total revenue growth, while the rest 16 per cent would come from non-tax revenue.

CPD in its earlier reports has repeatedly mentioned that the share of direct tax in total revenue (14.9 per cent) is appallingly low and there is an urgent need for a shift in the composition of revenues away from import tax on goods and services towards direct taxes on income and profit. *If the new revenue target for FY06 is achieved, the incremental contribution of VAT would reduce to 32 per cent, while a marginal increase will occur in direct tax (17 per cent).* Within the non-tax component, a larger share is expected to come from defence receipt, as the government projects have a 6 per cent incremental growth from this sector. However, similar projection in FY05 could not be achieved.

### **3.2 Public Expenditure**

In a pro-poor and redistributive fiscal mechanism, the revenue earnings should grow at a faster rate than the total public expenditure. During the last five years (FY01-05), average

annual growth of revenue earnings has been higher (12.9 per cent) than that of public expenditure (8.2 per cent) – more by default as ADP remained severely under implemented. But in the terminal year (FY05), *for the first time in the recent past, the total revenue earnings grew by only 7.9 per cent as against 12.7 per cent growth in total public expenditure.* For FY06, the government has set the growth of public expenditure at 15.7 per cent, which is lower than the projected growth of revenue earnings (19.5 per cent). It is an open question whether this undesirable trend will be reverted with an approaching electoral frontier.

Within the public expenditure component, the development expenditure should grow at a faster pace than the revenue expenditure to ensure maximum utilisation of resources for building new capital asset base. However, during the FY01-05 period, average annual growth of revenue expenditure was 12.6 per cent, while the average annual growth of development expenditure (ADP) was only 4.8 per cent. In FY05, revenue expenditure registered a whopping 17.4 per cent growth against a 7.9 per cent ADP growth. In this context the government has set a new target for FY06 projecting a faster growth in development expenditure than revenue expenditure.

The government has set a higher target for the FY06 at Tk 64383 crore which is about 15.7 per cent higher than the revised figure of FY04. Target of ADP growth has been set at 19.5 per cent in FY06, as against a 12 per cent growth in revenue expenditure. *If the targeted volume of public expenditure is realised in FY05, the share in GDP will increase to about 15.4 per cent keeping the ADP and non-ADP ratio at 38:62.* However, given the poor capacity to deliver a fuller ADP, it is very doubtful that, by reverting the trend, the growth of development expenditure will be able to surpass the growth of non-development revenue expenditure in FY06.

### ***Overview of Sectoral Allocation***

In terms of total expenditure (development and non-development), education and technology has retained last year's top position with an allocation of Tk 9686 crore which is 15 per cent

of the total expenditure and 33 per cent higher than the revised budget of 2004-05. Public service, with a gigantic growth of 46.2 per cent, has received the highest increment in expenditure (of Tk 2698 crore) stood at Tk 8535 crore (13.3 per cent of total expenditure). The major portion of this expenditure is accounted for by the 54.4 per cent growth or Tk 2149 crore increment in the non-development expenditure of Finance Division which includes allocation for civil pension, parts of subsidy, unexpected expenditure and block allocation for new recruitment.

**Table 5**

**Sector wise Distribution of Total Expenditure (Non Development and Development)**

Sectors	2005-06 (Proposed)		2004-05 (Revised)		Change in FY06 over FY05	
	Amount (crore Tk)	Share (per cent)	Amount (crore Tk)	Share (per cent)	In Crore Tk	Growth (per cent)
Education	9686	15.0	7285	13.1	2401.0	33.0
Public Service*	8535	13.3	5837	10.5	2698.0	46.2
Transport and Communication	6603	10.3	6788	12.2	-185.0	-2.7
LGRD	6383	9.9	5675	10.2	708.0	12.5
Agriculture	4729	7.3	4491	8.1	238.0	5.3
Defence Services	4320	6.7	4115	7.4	205.0	5.0
Fuel and Energy	4293	6.7	4273	7.7	20.0	0.5
Health	4240	6.6	3175	5.7	1065.0	33.5
Public Order and Safety**	3251	5.0	3026	5.4	225.0	7.4
Social Security and Welfare***	3124	4.9	2601	4.7	523.0	20.1
<b>Total Expenditure of the above 10</b>	<b>55164</b>	<b>85.7</b>	<b>47266</b>	<b>85.0</b>	<b>7898.0</b>	<b>16.7</b>
<b>Total Expenditure</b>	<b>64383</b>	<b>100.0</b>	<b>55632</b>	<b>100.0</b>	<b>8751.0</b>	<b>15.7</b>

Notes: \* includes Office of the President, Parliament, Prime Minister's Office, Finance Division, IRD, Planning Division etc.

\*\* includes Ministry of Home Affairs, Ministry of Law, Justice and Parliamentary affairs, Supreme Court, Anti Corruption Commission

\*\*\* includes Ministry of Social welfare, Ministry of Food and disaster Managements, Ministry of Women and Children Affairs

Among others, LGRD, Social Security and welfare and health have posted a significant growth of 12.5 per cent, 20.1 per cent and 33.5 per cent respectively. However, transport and

communication has received Tk 6603 crore in the proposed budget, which is 2.7 per cent lower as compared to the revised budget of FY05.

### ***Revenue Expenditure***

The targeted amount of revenue expenditure for FY05 was Tk 30,518 crores which has since been revised at Tk 33,323 crores. While the revised revenue expenditure for FY05 is only 9.2 per cent higher than its target, it is however 17.4 per cent higher than the revised figure of FY04.

Economic analysis of the composition of revenue expenditure indicates that the three heads which account for more than 80 per cent of the total revenue expenditure, accounted a 13 per cent growth in FY05, over the corresponding figures of the previous year. *The share of these three heads increased marginally from 78.3 per cent in FY04 to 79.1 per cent in FY05.*

Within these three heads, “Salary and Allowances” registered a 10.7 per cent annual growth in FY05, of which “Pay of officers” increased by 12.7 per cent. According to the target for FY06, salary and allowances and other would increase by 12.7 per cent over the augmented figures of FY05, largely due to the increase in government salary. Thus, the “pay of officer” is projected to be increased by 27.7 per cent in FY06. “Subsidies and transfers” registered a 27.5 per cent growth in FY05, while “interest payments” accounted an 11.3 per cent growth during this period. Though Interest Payment (domestic) accounts more than 80 per cent share in the total amount, Interest Payment (foreign) during FY05 recorded an 19.9 per cent growth, against a moderate 9.5 per cent growth on account of domestic Interest Payment.

Among others, “Repairs, Maintenance and Rehabilitation” registered a high growth of 43.8 per cent in FY05, largely because of the flood 2004.

The most disturbing feature of revenue expenditure in FY05 has been the high growth of “Block Allocation”. In FY05, block allocation grew by 43.8 per cent over the corresponding figure for FY04. However, the government for FY06 has put a total amount of Tk 1782 crore

as block allocation in the revenue budget, which is 181.1 per cent higher than the revised block allocation for FY05.

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

The size of the Annual Development Programme (ADP) for FY05 was fixed at Tk 22,000 crore, which was 15.8 per cent higher than the revised ADP of FY04 and 30.3 per cent higher than the actual (implemented) ADP of FY04. During FY04 only 83 per cent of the original size of the ADP, i.e. 89 per cent of the revised size was implemented. The government has set the revised ADP target for FY05 at Tk 20,500 crore, reducing it by 7 per cent from the original target.

The government has set the new ADP target for FY06 at Tk 24,500 crore, which is respectively 11.4 per cent and 19.5 per cent higher than the original and revised ADP of FY05. CPD in its post-budget reflection pointed out that this so-called ambitious ADP target needs to be seen from the perspective that Bangladesh remains an under invested economy and as such a large ADP target is worth chasing for. Thus, implementation of a fuller ADP became a major challenge compared to targeting a bigger ADP. The second aspect, which needs to be underscored in this respect, is that the issue of quality is no less important than the issue of size of the ADP.

According to the new ADP, education and religion followed by power (electricity) and local government got the most allocation for FY06. Within the top gainers in ADP of FY06, local government experienced the highest increase (28.4 per cent) in allocation compared to the previous years. While other major sectors lost their respective sectoral share in ADP of FY06, sectoral share of local government increased by 1.6 per cent.

Similar to the revenue expenditure, the share of “Block Allocation” increased significantly in the new ADP. An amount of Tk 4838 crore has been allocated as Block Allocation (including sectoral allocation), which is more than 4 times (410.9 per cent) higher than the revised ADP for FY04.

The government is aiming to finance 52 per cent of total ADP of FY06 from the domestic resources. In the context of low revenue earnings following the Flood 2004, this share was 49.1 per cent in the revised ADP of FY05.

A number of 29 new projects have been included in the new ADP, of which 5 are investment project, 11 TA projects and 13 are Japanese project. Another 124 unapproved projects have been included in the ADP. As a number of 189 projects were completed during FY05, with the new projects in FY06, the total number of projects now stood at 838.

### 3.3 Budget Deficit and Financing

After a systematic fall in budget deficit, as percentage of GDP, during the previous years from (-) 7.0 per cent in FY01 to (-) 4.2 per cent per cent in FY04, the economy has once again experienced a rise in budget deficit as it stood at 4.5 per cent in FY05, which is however lower than the PRSP target of (-) 4.7 per cent of the GDP. Low domestic resource mobilisation following the flood 2004 has led the economy towards an increased budget deficit in FY05.

**Table 6**  
**Budget Deficit: MTMF Vs Budget**

As per cent of GDP	FY05			FY06			FY07
	MTMF	Actual	Change	MTMF	Target	Change	
Domestic Borrowing	1.90 (40.43)	2.06 (46.19)	0.16	1.90 (41.30)	2.00 (44.74)	0.10	1.90 (42.22)
External Loans and Grants	2.80 (59.57)	2.40 (53.81)	-0.40	2.70 (58.70)	2.47 (55.26)	-0.23	2.60 (57.78)
Overall Balance	-4.70 (100.00)	-4.46 (100.00)	0.24	-4.60 (100.00)	-4.47 (100.00)	0.13	-4.50 (100.00)

**Note:** Figures in the parentheses indicates share of each items in total fiscal financing.

**Source:** Estimated from CPD Database.

Despite the shortfall in revenue collection, domestic financing contributed to 46 per cent of total deficit financing in FY05, when compared with its 43 per cent share for the period of FY04. The share foreign financing has decreased from 57 per cent in FY04 to 54 per cent in FY05.

Within the domestic resources part – the major source was net borrowing through non-bank instruments that accounted for Tk 4000 crore, which is, however, (-) 10.6 per cent less than

the corresponding figure of FY04. Another Tk 3601 crore was borrowed from the banking source, which is about 2.4 times higher than the matched period of FY04. Share of bank borrowing in total deficit financing has increased from 11 per cent during the FY04 to 22 per cent during the FY05. On the other hand, share of non-bank borrowing has reduced from 32 per cent in FY04 to 24 per cent in FY05. The budget deficit is projected to remain same (at 4.5 per cent of GDP) in the new budget for FY06, which is marginally lower than the PRSP projection (-4.6 per cent).

### **Summing Up**

- Revenue earnings have fallen short of the budget target (by -5.2 per cent) and PRSP projection (by -0.1 per cent of GDP) in FY05; which has made the government to go for a modest target in FY06 (below PRSP target). The incremental contribution of VAT is still too high when compared with the low share of direct tax (14.9 per cent) in total revenue.
- During the FY01-05, the growth of revenue earnings (12.9 per cent) has been higher than the growth of public expenditure (8.2 per cent). However, this redistributive approach of fiscal mechanism was distorted in FY05, as the growth of revenue expenditure (12.7 per cent) surpassed the growth of revenue earnings (10.7 per cent).
- The growth of development expenditure in recent years has been undermined by the faster growth of revenue expenditure. FY05 was no exception to that as the growth of revenue expenditure (17.4 per cent) surpassed the growth of development expenditure (7.9 per cent).
- Budget deficit is again on rise after the systematic fall for about five years. At this moment, the fiscal balance will largely depend on how the government manages this deficit. The ideal approach would be to increase the share of foreign resources in deficit financing, while keeping the loan and bank borrowing at a minimum level respectively for foreign and domestic sources. However, existing scenario is showing a totally opposite trend with high borrowing from banking sources and incremental contribution from foreign loan. This might result in a double jeopardy for the fiscal balance with liquidity crisis and increasing expenditure on interest payments.

- Overall, the fiscal sector of the economy in FY05 has been a deviation from the PRSP targets.

## **4 FISCAL MEASURES**

### **4.1 Personal Income Tax**

- Budget FY 2006 has proposed to increase the limit of tax-free income from Tk1 lakh to Tk1.20 lakh, while restructuring the upper limits of taxable income for each of the four slabs. It can be mentioned that in India, the income tax exemption threshold is Tk 1.45 lakh (i.e. Rs. 1 lakh).
- Comparing the proposed income tax structure and that of FY05, it is found that salaried income tax payers will pay relatively less in income year FY06 than they did in FY05. However, people in the high income brackets will pay relatively less than the people in the relatively low income brackets. For example, a person with Tk 10001 monthly salary will pay 10 per cent less than what s/he paid in FY05, whereas, a person with Tk 30833 or Tk 55833 monthly salary will pay 18 percent and 14 percent less tax respectively.
- It is however unfortunate that people having income of an amount of Tk120001 will pay an income tax at a rate of 10 per cent, while people having black money will pay at a rate of 7.5 per cent, much lower than the poor tax payers (See Table 7).

**Table 7**  
**Implications of Revised Income Tax Rate for Individual**  
**Assesses for the Income Year 2005-2006**  
**(Tax Assessment Year 2006-07)**

(Amount in Tk)

Income	Rate	Per month salary	Tax		Difference	
			2004-05	2005-06	Amount	per cent
Tk 120,001		10,000	2,000	1,800	(200)	-10 per cent
Tk 370,000	10 per cent	30,833	30,500	25,000	(5,500)	-18 per cent
Tk 670,000	15 per cent	55,833	81,500	70,000	(11,500)	-14 per cent
Tk 1020,000	20 per cent	85,000	157,500	140,000	(17,500)	-11 per cent
Above	25 per cent	-				
Minimum Taxable Monthly Income			8,333	10,001	1,668	
Minimum Tax			1,500	1,800	300	
Exemption			100,000	120,000	20,000	

**Note:** Tax rate table for the income year 2005-06, for which the Tax Assessment year is 2006-07.

**Source:** Estimated from CPD Database.

- Budget will allow the banks to make provisions for bad and doubtful debts up to 1 per cent in place of 2 per cent of the total outstanding loans till assessment year 2006-07.
- The budget proposes to withhold advance income tax @ 10 per cent on dividends making it taxable for shareholders.
- Rate of advance income tax applicable to profits from approved Securities and Bonds are proposed to be reduced to 10 per cent from the prevailing 20 per cent.
- Reduced rate of tax @ 10 per cent on income from computer software business will be continued up to 30 June 2008.
- To encourage donations to philanthropic and educational institutions by any individual or industrial enterprise, it is proposed to allow the donors tax-rebate for such donations. *However, caution should be exercised against any abuse of such rebate.*

## 4.2 Incentives for Investment

To encourage investment, the budget has proposed a number of steps: (a) recasted tax holiday facility for selected industries, (b) continuation of cash compensation scheme, (c) provision for investing for undeclared income, (d) widening the gap between listed and

unlisted companies, (e) preferential treatment for import of raw materials, (f) consideration of tax deduction at source as final settlement of tax.

### ***Tax holiday***

Misuse of tax holiday facility gave rise to the apprehension of its total discontinuation from this fiscal year when on 30 June, 2005 the duration of the facility was supposed to expire. Instead, the government went for continuation of this facility for 18 selected sectors. The facility was extended up to 30 June, 2008. The duration of the facility was however, brought down from 5 and 7 years to 4 and 6 years depending on location. Sectors which will enjoy this facility included a number of important activities such as textiles, pharmaceuticals, petrochemicals, fertilisers, steel, and agri-machineries. *This is likely to have positive impact on investment, although the government could have taken additional measures to plug the loopholes (which encouraged misuse and abuse of the facilities). Extending the facility of accelerated depreciation up to 30 June 2008 is also expected to encourage new investment.*

### ***Investment of Undeclared Money***

The opportunity to allow whitening the black money has always been controversial. It provides incentive to tax dodgers, encourages income concealment, and is a disincentive for honest taxpayers. This facility was supposed to end on 30 June, 2005. The Finance Minister is on record as saying that he is against any extension of this facility, perhaps also because of the weak response to this facility. However, it appears that he has succumbed to pressures, and has now proposed the extension of the provision of whitening undisclosed income, on payment of a 7.5 per cent tax, till 30 June, 2006. *We think that such backtracking by the Finance Minister will send a wrong signal to the tax payers and undercut credibility of other fiscal measures.*

### ***Enhancing the Dispersion between Listed and Non-listed Company***

The budget has proposed to increase tax rate for non-listed companies from 37.5 per cent to 40 per cent. This will further increase the difference between tax rates for listed and non-listed companies. *Although the intention to encourage companies to go public and be listed*

*in the stock exchange is understood, such high level of taxation for non-listed companies is likely to harm small and medium enterprises whose scale is not favourable for them to go public.*

### ***Investment in Real Estate***

The budget proposes taxing of investment in real estate at a flat rate of 175 Tk/M<sup>2</sup> and imposition of 2.5 per cent tax on the price of land to be deducted at source at the time of registration. Such payments are to be recognised as final settlement for the purpose of taxation. *This new proposal is expected to make payment of taxes convenient for potential investors; however, this may also create an opportunity to whiten black money. This may lead to increase in apartment price as well.*

## **4.3 Export Promotion versus Import Substitution**

### ***Export Promotion***

The budget has proposed a number of steps to promote exports including (a) tax holiday for selected export-oriented industries, (b) continuation of cash compensation scheme (notably for agro-based industries and continuation for backward linkage textile sector), (c) income tax rebate on export earnings (d) concessional import duty on raw materials for export-oriented industries. *However, a comprehensive initiative to promote export diversification is not seen in the budget.*

*All the incentives proposed in the budget are more or less continuation of old incentives carried from earlier budgets, barring inclusion of some items for zero-tariff treatment (such as spare parts for export-oriented industries). The budget proposed no new subsidy or any initiative to encourage technological upgradation of export-oriented industries.*

### ***Domestic Protection***

To provide protection to domestic industries the budget has proposed a number of fiscal measures including (a) imposition of taxes on items that were previously zero-tariffed, (b) raising tariffs, (c) imposition of supplementary duties (SD).

Although the three-tier import structure has been essentially retained, *for ten items the zero-tariff has been raised to between 7.5 per cent and 15.0 per cent. For another 30 items existing tariff rates has been further raised.* For 24 items supplementary duties ranging from 20.0 per cent to 65.0 per cent have been imposed (for 31 items the SD has been withdrawn). *Some of the positive initiatives in this context are the followings:*

- In order to provide protection to the industries engaged in the production of mineral water, the budget has proposed to impose 35 per cent supplementary duty on mineral water at the import stage.
- Imposition of 20 per cent supplementary duty on imported detergents has been proposed in the budget.
- The budget has proposed to impose 20 per cent supplementary duty on all imported Lamps and Light fittings.
- The budget proposes to enhance supplementary duty from 25 per cent to 35 per cent on some items of processed food and fruit juice.
- Supplementary duty was enhanced from 25 per cent to 35 per cent for all kinds of imported furniture.

The restructuring of the SDs has necessitated moving of a large number of items from existing slabs and putting these into the three slabs. The actual impact of this at the consumer level will need to be carefully assessed.

*Increased duties on items such as billets and related construction materials are likely to further increase the cost of construction.*

## **4.4 Agriculture**

### ***Crop Sector***

#### ***Positive Measures***

- Total allocation (revenue and development) for Ministry of Agriculture in FY06 is Tk 2,213 crore (24.5 per cent more than the original budget of FY05, but 6.7 per cent less than revised allocation in FY05).

- It is promised in the budget that in FY06, agricultural extension, research, field training, production, preservation and distribution of improved seeds, storage and marketing of agriculture produce and irrigation activities will be strengthened. Bangladesh Agricultural Development Corporation (BADC) would be restructured and the Corporation's work involved in seed production, preservation and distribution will be further expanded. *This is a pragmatic proposal considering the fact that BADC delivers only about 5 per cent of seed requirement.*
- From 1 July 2005 interest on agricultural loan provided for production of pulses, mustard seeds, spices and maize will be reduced to 2 per cent from the existing 8 per cent. *This is a welcome measure for promoting agricultural diversification. However, proper utilisation of credit need to be ensured.*
- The budget proposed complete withdrawal of all duties and taxes on some varieties of fertilizer (Magnesium Sulphates, Zinc Sulphates, Disodium Tetraborates). It has also proposed reduction of customs duty from 15 per cent to 7.5 per cent on raw materials needed for the manufacture of parts and accessories of rice and wheat mills. *This will be helpful to reduce micro-nutrient deficiency in soil and increase competitiveness of concerned manufacturers..*
- The Government has waived interest on classified agricultural loan up to Tk 5,000 as of 31 December 2003. The repayment period of principal amount will be extended from 30 March 2005, as fixed earlier, to 30 March 2006. *This will help small loanees.*
- The budget has proposed continuation of 20 per cent subsidy on electricity bills of *Palli Bidyut Samities (PBS)* for electricity and waiver of minimum charge for all electricity connections throughout the country for irrigation with effect from 1 July 2005. *This measure will surely have some positive effect, but this is expected to be limited considering the fact that 83 per cent of the total irrigated area is under diesel operated engines. It is to be noted that in spite of demands from various quarters no support has been given to diesel used for irrigation.*

### *Grey Measures*

- The Budget proposed increase of agricultural subsidy from Tk 600 crore in the original budget of FY05 to Tk 1200 crore in FY06. Subsidy for agriculture will be spent on different types of fertilizers (Urea, DAP, MoP and TSP). It may be noted that *total allocation for agricultural subsidy and other assistance in the revised budget of FY05 was Tk 1315 crore. Thus, it is not clear whether total assistance for agriculture has been increased or reduced.*
- Cash incentive for export of agricultural products, fruits and vegetables will be continued at 30 per cent. *Earlier experience with disbursement of cash incentive indicates that due to absence of clearly spelt out and realistic procedures allocated amount could not be spent. Hopefully, proper mechanism would be in place and steps for awareness building among potential exporters would be undertaken to promote export of agro-products.*
- Bangladesh Bank will provide refinancing at 5 per cent rate of interest to relevant banks to enhance the agricultural credit flow. *It is not clear from the budget speech whether Bangladesh Bank will also ensure that the banks provide loans to farmers at 8 per cent as was stipulated in FY05.*

### *Concern(s)*

- *Bangladesh needs a comprehensive road map and action plan for promotion of agricultural diversification which must focus on pulses, oilseeds, spices, vegetables, new crops with export potentials (such as maize), fruits, flowers, dairy, poultry and fisheries. Without integrated road map, agricultural diversification will not be possible.*

### ***Fisheries and Livestock Sector***

#### *Positive Measures*

- The budget has proposed a total allocation (development and revenue budget) of Tk 549 crore in FY06 (0.48 per cent more than original budget of FY05).

- The budget proposed withdrawal of all duties and taxes on the raw materials of dairy and poultry feed, medicine, other medical inputs and capital machinery required by the livestock sector. *These are expected to reduce the cost of importing such items and would be beneficial to the poultry industry by reducing cost of production and enhancing competitiveness.*
- The budget has proposed extension of tax exemption period on income from fish farming, poultry and dairy farms, poultry feed production, etc. from the prevailing 30 June, 2006 to 30 June, 2008. *This is a welcome measure to encourage investment, employment and growth in livestock and fisheries sector.*

### ***Rural Development***

#### ***Positive Measures***

- Allocation to the tune of Tk 100 crore in the revised budget of FY05 and Tk 120 crore in FY06 budget were made to the *Union Parishads*. *Though the amount of allocated money is highly limited compared to the need of resources by the Union Parishads, allocation of resources undoubtedly gives a positive impression about government's willingness to support rural development*
- The budget has proposed a total allocation of Tk 2,214 crore, from revenue and development budget, to the Ministry of Fisheries and Livestock, Ministry of Social Welfare, Ministry of Women and Children Affairs, Ministry of Labour and Manpower and Ministry of Youth and Sports in order to implement 113 projects to accelerate development of the rural non-farm sector and to create additional employment opportunities in the rural areas.
- A 'Char Livelihood Project' in 5 districts with an outlay of Tk 475 crore is being implemented to raise the living standards of extreme poor people living in disaster prone districts.
- The '*Abashan Project*' (with an outlay of Tk 447 crore) is being implemented by the Office of the Prime Minister to provide land, houses, credit facility, education, health,

family planning services and employment opportunities to 65 thousand landless and extreme poor people.

#### *Grey Measures*

- Under Rural Infrastructure Programme, the Local Government Engineering Department (LGED) will construct 10,000 km paved roads, 9,500 km of kutchra (earthen) roads, 346 Union Parishad complexes and 20 cyclone centres, and develop 435 growth centres/hat-bazzars. *Theoretically, these are expected to provide a boost to the rural economy by increasing mobility of inputs to and outputs from the rural area. On the other hand, these projects are much vulnerable in terms of implementation. Major challenge would be timely implementation without sacrificing quality.*
- The Budget proposed to rejuvenate Upazilla Central Cooperative Societies under Bangladesh Rural Development Board (BRDB) by providing agricultural credit fund and inject fresh capital to the Samabaya Bank (co-operative bank).
- The budget allocated Tk 60 crore for newly introduced special programme titled “Development Support through Gram Sarkar”. *In view of the debate around the way these Gram Sarkars have been formed, it is doubtful whether this money will be appropriately targetted and properly used.*
- The budget reiterated commitments to provide safe-drinking water to the rural areas and the budget has proposed to provide sanitation facilities for all families by 2010. *However, the budget failed to mention indicators to monitor the implementation of such facilities.*

#### *Concern(s)*

- *The above-mentioned projects give some indication that the government is aware about its rural inhabitants but does not necessarily ensure us that it has effectively undertaken pro-rural and pro-poor policies. The budget lacks visionary projects for rural development (such as special programmes for backward or poverty stricken areas, a knowledge centre or ICT kiosks in villages) initiative which our neighbouring countries have been successfully promoting.*

### ***Agro-Processing and Agro-based Industry***

- ***Equity Entrepreneurship Fund:*** The government is continuing the allocation in EEF and in FY06 an additional allocation of Tk 150 crore has been proposed. This fund is reserved for providing equity support to computer software, food processing and agro-based industries. As of now a total of Tk 668.9 crore as EEF has been approved for 181 agro-based and food processing industries which has a project value amounting to Tk 1708 crore. Tk 149.5 crore has so far been disbursed to 55 agro-based and food processing projects under EEF. *It appears that the revised system of granting support from the EEF is working well (it may be noted here that CPD has earlier prepared a policy brief to raise effectiveness of the EEF facilities which was submitted to the Bangladesh Bank). The demand for EEF fund has been increased not only in traditional industries such as poultry and fish feed, fruit processing, hatchery and fish production, software development, but also in non-traditional industries such as crocodile farming etc. This support needs to be extended and enhanced.*
- Tax holiday for agricultural machinery industry has been proposed. *This is expected to have positive impact.*
- The budget has proposed increase in supplementary duty from 25 per cent to 35 per cent on some of the items of processed food and fruit juice. *This is expected to give some protection to processed food and fruit juice sector.*
- *Continuation of 20 per cent subsidy on electricity used in agro-based industries has been proposed in the budget. This will be helpful in reducing cost of agro-based industry.*

### **4.5 Power and Energy**

- In FY 2006, an allocation of Tk 4,293 crore was made in the power and energy sector under the revenue and development budget. This was only 0.47 per cent higher than the revised allocation of FY05 (Tk4273 crore). This appears to be on the low side considering the demand. To compare, India has increased the allocation for energy and power by 33.4 per cent in FY06.

- In power sector, a total of 51 projects are on stream under seven organisations. Of these, only 22 per cent fund was allocated for generation, 17 per cent for transmission and the rest 56 per cent for distribution. *This lower share of generation-related projects indicates that hardly any substantial improvement in the power situation could be expected in near future.*
  
- Although power generating companies enjoy tax exemption on income for 15 years, it is to be noted *that the sector has not been in the tax holiday list as proposed in the budget FY06.*
  
- Proposed reduction of customs duty on crude petroleum (from 25 per cent to 7.5 per cent) and customs duty on refined POL products (from 25 per cent to 15 per cent) and withdrawal of supplementary duty of 15 per cent on refined petroleum product will help to reduce the burden of loss that BPC incurs, to some extent. It has no implication for consumers as the price is regulated by the government. However, without rationalizing the tariff on POL products as mentioned in PRSP, recent changes will hardly have any positive impact for the rural poor.

#### **4.6 SMEs**

- Under the proposed tax holiday facility, major SME oriented industries such as plastic, melamine, ceramic and sanitary ware, insecticide & pesticide, computer hardware, agricultural machineries, boilers & compressors, textile machinery etc. have been included. *This will have positive impact on investment in these sectors.*
  
- There is no new budgetary allocation to finance small and medium enterprises as government did in the last fiscal year (FY05). Under ‘Refinancing SME Scheme’ the government had earlier allocated an amount of Tk .250 crore at 5 per cent interest to financial institutions for extending credit, which was fully utilized. In view of the huge demand for this type of credit, the lack of support in the present budget is worth mentioning.

- Proposed tax rate for non-listed companies at 40 per cent instead of 37.5 per cent is likely to negatively impact on the growth of small and medium enterprises. If it is an attempt to push non-listed companies to be listed, this could not be achieved easily, since most of the non-listed companies do not comply with the required terms and conditions necessary for enlisting. A large difference of 10 per cent in corporate tax between large and small enterprises is against the spirit of the PRSP.

#### **4.7 Sectoral Issues**

##### ***Ready Made Garments***

- In view of the challenges faced by the RMG in the context of the quota-phase out, the support for RMG sector was rather weak. One positive move is that imports of spare parts, dyes and chemicals for RMG have been zero-tariffed. An initiative has been taken to formulate a programme titled “*Post-MFA Action Programme*” at a cost of US\$ 40 million with the assistance from development partners. In FY 2005, the government allocated Tk 30 crore for the purposes of retraining of retrenched garment workers. Only high value RMG has been awarded tax holiday facility, but there is no particular criteria proposed to identify such industries.
- The budget has proposed setting up of a special fund of Tk 20 crore for retraining and creating employment opportunities for employees/labourers of garment industries.
- In Sri Lanka, government has proposed establishment of a SME Bank by this year to enable banking and financial institutions to provide for required working capital and investment needs of the apparel industry, and to modernize the factories. A total sum earmarked for the issuance of this guarantee will be Rs. 600 million (Tk 348 million) so that the industry will be able to raise Rs. 2,000 million (Tk 1160 million) from the banking system and other financial institutions. It has also allocated support for productivity improvement measures and promotion of markets for apparel exports.

## ***Textile***

- In view of the MFA phase out and the need for strengthening local backward linkage industry, the decision to continue with the current provision of *5 per cent cash subsidy in the next fiscal year for textile sector is a positive step. However, support to the textile sector needs to be further strengthened in view of the MFA phase-out.*
- Withdrawal of duties from machines, spare parts, some dyes and chemicals essential for textile, terry towel, hosiery and label *is expected to reduce cost of production in this sector.*
- Consideration of tax deduction at source (at 0.25 per cent of export income) as final settlement for the purpose of tax is expected to have positive impact.
- Although high value RMG have been provided with tax holiday facility, there was a need for further tax-breaks to stimulate backward linkage activities in the textile particularly in view of the challenges of a quota-free regime.
- *A textile technology upgradation fund would have encouraged the sector to undertake the necessary restructuring and upgradation.* The Indian Budget FY 2006 had not only proposed a budgetary allocation of Tk 4350 crore (Rs.30000 crore) (5.83 per cent of total Revenue Expenditure) but also granted Tk 631 crore (Rs.435 crore) for the purpose of setting up a Technology Upgradation Fund (TUF). Though India already has a strong textile infrastructure, they have introduced a 10 per cent capital subsidy scheme for the textile industry.
- There is no special allocation for handloom industry which is a large rural employer. On the other hand, the Indian Budget FY 2006 has taken initiatives to adopt and promote cluster development approach for production and marketing of handloom products. Indian budget has allocated Tk 58 crore (Rs. 40 crore) towards this. Besides, a life insurance scheme for handloom weavers has been taken by the

Indian government, which will provide insurance coverage of up to Tk .72,500 (Rs. 50,000).

### ***Leather and Leather goods industries***

- Investment in leather manufacturing products has increased in recent times. Proposed concessionary rate of customs duty for dyes and chemicals for this sector is likely to have positive impact on investment in this sector.

### ***Telecommunication***

- Investment in the telecommunication sector will be encouraged in the next fiscal year as a result of because of reduction of import duty on telephonic machinery (from 15 per cent to 7.5 per cent) and reduction of supplementary duty (15 per cent to 0 per cent) on telephone answering machines and dictating machines.
- Local mobile phone battery producers will be benefited because of the increase in the import duty from 7.5 per cent to 15 per cent.
- Imposition of a tax of Tk 1200 for connection of each SIM/RIM Card, or for the same purpose CDMA technology, at local stage is likely to create distortions in the mobile telephone market.
- Firstly, this would create a disincentive for lower income groups since clients will be required to pay same amount (i.e. Tk 1200 for connection + Tk 300 for the set) irrespective of income levels. Secondly, there is an apprehension that this will create entry barrier for new entrants and may encourage anti-competitive behaviour.
- Surprisingly the National Board of Revenue (NBR) has circulated a notice to implement this tax structure with effect from June 09, 2005. Since this is only a budget proposal and the budget has not been discussed and passed in the parliament, such advance implementation undermines the participation of legislature in the national policy making.

### ***Manufacturing Items (MIs)***

- The current budget proposes to reduce customs duty on some raw materials needed for the manufacture of transformer. *At present Bangladesh is manufacturing quality transformers. After fulfilling the local requirements, it is also exporting. Reduction of customs duty on raw materials for transformer manufacturing could not only help meet the demand of the local need but also stimulate export.*
- Reduction of customs duty on some raw materials for *local Bicycle Industries* has been proposed in the budget. *This is a positive move towards diversifying export basket as light engineering (bicycle) is an emerging potential export sector.*

### ***Vehicle***

Customs Duty of vehicles within the range of 1500cc – 1649cc in CKD has been raised from 15 per cent to 25 per cent; also for vehicles exceeding 1649CC in CKD. *A positive approach by the government to tax the urban rich.*

### ***Tax Base under VAT***

Instead of expanding the existing tax base, the government emphasized the need to consolidate the present VAT system and has tried to make it more transparent. For this reason, the current budget didn't propose any major change in the existing tax regime. It is firmly believed that government needs to further simplify the collection procedures and ensure proper enforcement of the law and regulations. *CPD has earlier proposed broadening of the VAT net to include the professionals; however, this has not been done.*

## **4.8 Local Government**

Under 11 heads in the ADP, a total of block allocation accounting Tk 826.5 crores have been allocated for various local government institutions – this amount is 5.3 per cent more than that of the comparable figure in FY04 (revised). Interestingly, the largest increase to place

under the head of Gram Sharkar (50 per cent more) and allocation for various Chittagong Hill Tract (CHT) related heads did not experience any growth (Tk 115 crores).

However, Tk 244 cores has been earmarked for the CHT as investment project in the proposed development budget of FY06 which 31.1 per cent higher than the allocation in the revised budget of FY05.

Under the revenue budget, CHT Ministry received Tk 126 crores in FY06 compared to Tk 114 crores in FY05 (revised).

## **5 SOCIAL SECTORS AND SAFETY NET PROGRAMMES**

Towards targetted poverty reduction, social safety-net and employment generation programmes, the budget for FY06 proposed an additional allocation of Tk 4,600 crore from the non-development budget. This allocation is about 12.1 per cent of the total non-development budget. This allocation (besides ADP) for Social Safety Net include the following: (a) Continuation of Existing Programmes, (b) New Programmes Introduced, (c) Special Programme for Mitigating Economic Shocks, (d) Special Credit Programmes for Employment Generation.

### **5.1 Social Sector**

#### ***Education***

- As in the last budget, education has received the highest allocation of Tk 9487 crore which is 14.94 per cent of the total budget. Out of this Tk 3227 crore will be spent from development budget for implementing 61 projects.
  
- This allocation is Tk 2366 crore (33.23 per cent) more than last year's revised budget and 23.53 per cent more than that of the proposed budget.

- Development budget this year is 57.49 per cent more than revised budget of the previous year and 5.08 per cent more than the proposed budget. Increase in revenue budget is 296 crores (23.4 per cent) from revised budget and 35.82 per cent more than that of the proposed budget.
- Share in total GDP allocation is 2.27 per cent which was 1.93 per cent in FY05 revised budget and 1.84 per cent in the proposed budget.
- In line with PRSP, budget has put a lot of emphasis on girls' education. The budget will bring 29 lakh more students under the stipend programme. In addition the budget has increased the number of scholarships at various levels.
- Expenditure upto March was 44 per cent. Number of projects in ADP is 51 of which 13 were targeted to be completed but none was complete. In FY 04 budget 39.1 per cent was spent upto March which went up to 88 per cent in June.
- No new project was included in education sector.
- Ministry of education has been brought under the Medium Term Budgetary Framework (MTBF) which is a new initiative of the Government. Indicators of attainment of targets and out put target of those indicators are specified under this new initiative. So hopefully the targets can be better monitored.

### ***Health***

- Combined allocation in Health is Tk 4240 crore which is 6.6 per cent of the total budget. This allocation is Tk 1065 crore (33.5 per cent) more than last year's revised budget and 31.6 per cent more than the proposed budget.
- Development budget increased by 58.7 per cent compared to the revised and only by 4.7 per cent compared to the proposed budget. Revenue allocation increased by 14.4 per cent from the revised and by 24.9 per cent from the proposed budget.

- Share in GDP allocation is 1.0 per cent as against 0.9 per cent of the last revised budget. This share is 0.9 per cent of the FY 05 proposed budget.
- Expenditure up to March '05 has been only 33 per cent of the allocated amount. Number of projects in the ADP was 16. One was targeted to be completed but was not completed by March '05. In FY 04 budget 34.4 per cent was spent upto March '05 which went upto 71 per cent in June.
- Only one new project has been included but this was under the local government division.

On the whole, allocation in social sector in FY 06 as percentage of total budget has increased by 1.39 per cent.

## **5.2 Social Safety Net**

### ***Continuation of Existing Programmes***

Some these were launched in earlier regime, and retained and expand under the current one. This is a very welcome trend.

- Increased monthly allowance under Old-age Allowance and Allowances for the Widowed, Deserted and Destitute Women, from Tk 165 to Tk 180, and increased number of beneficiary coverage, from 19.15 lakhs to 21.25 lakhs.
- Increased number of beneficiaries under Honorarium for Insolvent Freedom Fighters, from 60 thousand to 70 thousand.
- The budget proposed an additional allocation of Tk 75 crore to the Fund for Mitigating Risks due to Natural Disasters.

- The budget proposed an additional allocation of Tk 20 crore to the Fund for Rehabilitation of the Acid-burnt and the Physically Handicapped and an additional allocation of Tk 75 crore to the Fund for Housing the Homeless.
- The budget proposed allocation of 10.32 lakh tons of food grains for VGD, VGF, Food for Works Programmes, Test Relief and Gratuitous Relief (GR) in FY06 which is *18.6 per cent higher than the revised budget of FY05 but 22.3 per cent lower than original budget in FY05*. In addition, it proposed an allocation of Tk 300 crore in FY06 as Food for Works Programme (Cash) which is *13.6 per cent more than the revised budget of FY05*.
- The budget made a lumpsum allocation of Tk 100 crore to the Ministry of Flood and Disaster Management to meet the emergencies due to natural disaster.

### ***New Programmes Introduced***

The budget has proposed introduction of two new programmes in the next fiscal year in addition to the ongoing social safety-net programmes:

- ***Allowance for the Fully Retarded:*** The budget has proposed to provide a monthly subsistence of Tk 200 to 1 lakh 4 thousand fully retarded persons; the budget allocated an amount of Tk 25 crore towards this programme.
- ***Seasonal Unemployment Reduction Fund:*** The budget proposed to create a fund of Tk 50 crore for the marginalized poor of some selected areas in Bangladesh where remain unemployed per force for certain periods in a year owing to natural and geographical constraints. This is expected to mitigate their miseries by creating employment opportunities for them.

It can be mentioned that, prior to budget announcement, CPD suggested these two proposals to the Finance Ministry.

### **5.3 Programme for Mitigating Economic Shocks**

This nominal allocation only gives indication of the problem, not the solution.

- The budget has proposed to allocate Tk 30 crore to the special funds introduced in FY 2004-05 for Retraining and Employment of the Voluntarily Retired/Retrenched Employees/Labourers.
- The budget has also earmarked Tk 20 crores for retraining and Employment of Workers/Employees of the Readymade Garment Industries.

### **5.4 Special Credit Programmes for Employment Generation**

The government has taken up a number of special credit programmes (Tk 831 crore) under both revenue and development budget for creation of employment opportunities for the poor:

- Up to December 2004, within the purview of different development programmes micro-credit amounting to Tk 6,000 crore has been disbursed from Government's own resources through different ministries /divisions/ departments. The budget has proposed a further allocation of Tk 200 crore from the revenue budget to the micro-credit fund which has already been created under the Rural Development and Cooperative Division, Ministry of Fisheries and Livestock, Ministry of Youth and Sports, Ministry of Liberation War Affairs and Ministry of Women and Children Affairs.
- The budget has allocated Tk 281 crore to PKSF (Palli Karma Shahayak Foundation) to implement micro-credit programmes through NGOs in FY06.
- Increased allocation of funds for the Bangladesh NGO Foundation from Tk 50 Crore in FY05 to Tk 100 crore in FY06.
- Allocated additional amount of Tk 100 crore in FY06 as Special Fund for Employment Generation of the Hard-Core Poor.

- The budget has increased allocation of Tk 50 crore for development of micro-enterprises in the rural areas. PKSf is implementing this programme through 70 NGOs.
- The budget is going to provide credit support of Tk 100 crore through Bangladesh Krishi Bank, Rajshahi Krishi Unnayan Bank, BASIC Bank and Karma Sangsthan Bank to promote agro-based industries.

*Hopefully, these programmes will benefit the poor. The test of the actual efficacy of these allocations will be in their implementation and capacity to reach the target groups.*

### **Comment**

An analysis of actual expenditure of money allocated as special block allocation for poverty reduction in FY05 (Tk 230 crore) under ADP revealed that not a single Tk was spent until March 2005. On the other hand, data on utilisation level of targeted programmes for poverty eradication and employment creation during the FY05 are not available. In the absence of utilisation level, it is not known how far they were implemented in FY05 and what will be the fate of these allocations in FY06.

Finance Minister in his budget speech mentioned, “Fifty-four per cent of revenue and development budget will be spent to finance direct and indirect poverty reduction programmes in next fiscal (FY06)”. However, he does not mention how he has derived these figures and which ministries/agencies/programmes/projects are included in this. A separate annex at the end of the speech could have resolved this problem. *Currently, the most important public development document of the country lacks transparency regarding resource allocation to its most important objective, i.e. poverty alleviation.*

## 6 CONCLUDING OBSERVATIONS

Three major trends may be observed from the proposed budget for FY06.

- First, *care* has been taken to upgrade some sectors in terms of allocative priority from poverty alleviation consideration. These include the initiatives in the area of health and education. Other initiatives belonging to this category are those contributing to agriculture and rural development. There had also been a conscious effort to expand and deepen the social safety net programmes. However, without a proper poverty audit, it will be difficult to say what is the actual pro-poor intensity of the budget FY06.
- Second, with a view to provide support to investment and employment generation in the backdrop of limitation of available resources, the budget for FY06 has made a number of *compromises*. This has been reflected through recasting of tax holiday provisions, continuation of a number of cash incentive schemes for selected export sector, and rationalisation of tariff and para-tariff structure.
- The third trend in the proposed budget for FY06 suggests that the fiscal measures were in fact generated through *collusive* behaviour. The extreme manifestation of this was the extension of the time period for tax amnesty for undisclosed income. Some other fiscal measures would also invoke such suspicion (for example, tax on SIM card).

At the end of the day, the “reality check” of the budget for FY06 will be in its implementation. If the implementation behaviour pursues its earlier track record, then both the fiscal and external balance will be in jeopardy, ultimately undermining the savings-investment prospect. Admittedly, under such a scenario, the poor will be affected more than the rich.

Some of the “not so pro-poor trends” in the public finance basket are the following. *First*, revenue expenditure increasing at a rate faster than that of revenue earnings and development expenditure. *Second*, increased contribution of the VAT in incremental contribution to the total revenue intake. *Third*, extremely poor level of utilisation of resources allocated to some

of the social sectors (e.g. primary health care and education sectors) which essentially benefit the rural poor.

As a result of the above, the economy is already under performing in contrast to the targets set by the MTMF.

The concern for such a grim possibility increases as the government's<sup>7</sup> inclination to commit one by one all the "eight sins" identified by the CPD earlier. These were:

- (i) *Bloated Public Investment Programme*
- (ii) *Adverse Selection of Projects and Programmes*
- (iii) *Tendentious Award of Tax and Tariff Relief*
- (iv) *Contracting of Questionable Suppliers Credit*
- (v) *Patronage Distribution through Public Procurement*
- (vi) *Patronage Distribution through Privatisation of State-Owned Enterprises*
- (vii) *Issuance of New Bank Licences*
- (viii) *Issuance of New Insurance Licences*

We regretfully observe that the tally has reached three through the budget for FY06. Will the rest follow as well?

---

<sup>7</sup> See for details – IRBD 2005 Second Reading.

## INDEX

---

### A

ADP · *See* Annual Development Programme  
Agriculture · 7, 14, 23  
Agro-Processing · 28  
Annual Development Programme · 16

---

### B

Bangladesh economy · 4, 6, 9  
Budget Deficit · 17

---

### C

CONCLUDING OBSERVATIONS · 40  
Crop Sector · 23

---

### D

Domestic Protection · 22

---

### E

Education · 14, 34  
*Equity Entrepreneurship Fund* · 28  
Existing Programmes · 34, 36  
Export Promotion · 22

---

### F

FISCAL MEASURES · 19  
Fisheries and Livestock Sector · 25

---

### G

GROWTH, SAVINGS AND INVESTMENT · 6

---

### H

Health · 14, 35

---

### I

Import Substitution · 22  
Incentives for Investment · 20  
*Incremental Contribution* · 11  
INTRODUCTION · 4  
Investment · 9  
Investment in Real Estate · 22

---

### L

Leather · 32  
Local Government · 27, 33

---

### M

Manufacturing Items · 33  
MTMF · 5, 9, 11, 17, 41

---

### N

*New Bank Licences* · 41  
New Data on Investment · 10  
New Data on Savings · *See*  
New Programmes · 37  
Non-listed Company · 21

---

### P

Per Capita Income · 8  
Personal Income Tax · 19  
Power and Energy · 28  
*Privatisation* · 4, 41  
Public Expenditure · 12  
PUBLIC FINANCE · 11  
*Public Procurement* · 41

---

### R

Ready Made Garments · 30  
Revenue Earnings · 11  
Revenue Expenditure · 15, 31  
**Revenue –GDP Ratio** · 11  
*Revenue Target* · 11  
*Revenue-GDP Ratio* · 11  
Rural Development · 26, 27, 38

---

## **S**

**Savings** · 8

**Seasonal Unemployment** · 37

Sectoral Allocation · 13

Sectoral Issues · 30

SMEs · 29

Social Safety Net · 34, 36

Social Sector · 34

sources of fragility · 4

Sources of Growth · 6

Special Credit Programmes · 38

*Suppliers Credit* · 41

---

## **T**

*Tariff Relief* · 41

Tax holiday · 21, 28

Telecommunication · 32

Textile · 31

---

## **U**

Undeclared Money · 21

---

## **V**

VAT · 5, 11, 12, 18, 33, 40

Vehicle · 33