**Report No. 56**

# State of the Bangladesh Economy and Budget Responses 2002

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***The Centre for Policy Dialogue (CPD)****, established in 1993, is an innovative initiative to promote an ongoing process of dialogue between the principal partners in the decision-making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such major dialogues at local, regional and national levels. These dialogues have brought together ministers, opposition frontbenchers, MPs, business leaders, NGOs, donors, professionals and other functional groups in civil society within a non-confrontational environment to promote focused discussions. The expectation of the CPD is to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues.*

*In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of CPD include The Independent Review of Bangladesh's Development (IRBD), Governance and Development, Population and Sustainable Development, Trade Policy Analysis and Multilateral Trading System, Corporate Responsibility, Governance, Regional Cooperation for Infrastructure Development and Leadership Programme for the Youth. The CPD also carries out periodic public perception surveys on policy issues and developmental concerns.*

*As part of CPD's publication activities, a CPD Dialogue Report series is brought out in order to widely disseminate the summary of the discussions organised by the Centre. The present report contains the highlights of a dialogue organised by CPD held at* ***CIRDAP Auditorium, Dhaka*** *on* ***June 13, 2002*** *on the theme of* ***State of the Bangladesh Economy and Budget Responses 2002.***

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*Dialogue on*

# State of the Bangladesh Economy and Budget Response 2002

## 1. Introduction

The Centre for Policy Dialogue (CPD) organised a dialogue on *The State of the Bangladesh Economy and Budget Responses 2002* on June 13, 2002 at the CIRDAP Auditorium, Dhaka. *Mr M Saifur Rahman, MP*, Honorable Minister for Finance and Planning, Government of Bangladesh, was present as the Chief Guest and *Mr A M A Muhith*, former Minister for Finance, was the Guest of Honour. Secretary, Finance Division of the Ministry of Finance, *Mr Zakir Ahmed Khan* was the Special Guest. The dialogue was attended by a good number of participants from varied professional groups including academia, NGOs, donor agencies, politics, bureaucracy and members of the civil society.

CPD Chairman *Professor Rehman Sobhan* chaired the dialogue session. He welcomed everyone to the dialogue and pointed out that the national budget was an important document reflecting both the current state of the national economy and an outline of the future goals of the present administration. He believed that it was important that the national budget not remain a technocratic exercise and stated that the dialogue would deal with pre-budget scenarios and post-budget challenges facing Bangladesh today. He concluded his opening remarks with a hope that the dialogue would further enhance discussions among key stakeholders in Bangladesh about various issues of national concern.

## 2. The Keynote Address

*Dr Debapriya Bhattacharya*, Executive Director of the CPD presented the keynote paper. The presentation began with an overview of the benchmark conditions, factors underlying the current state of affairs, and the major concerns facing the Bangladesh economy in fiscal year 2002. At the beginning of FY02, the Bangladesh economy had faced what was possibly the most severe exigency since the macro-economic crisis of the late 1980s. The twin shocks emanating from the yawning fiscal deficit and the deterioration in the balance of payments had exposed Bangladesh to the entrenched vulnerabilities of the economy, he noted. He felt that the two pillars of macroeconomic success, stability and growth, were under considerable pressure. In this context, *Dr Bhattacharya* identified three primary factors contributing to the state of the economy: (i) fundamental structural weaknesses which characterised the economy, (ii) benign neglect in the undertaking of necessary reform measures needed to improve the competitiveness of the economy; and (iii) the confluence of external factors ranging from the global recession and practices of discriminatory trade preferences to terrorist attacks on the USA. *Dr Bhattacharya* argued that these factors have raised two main concerns: (i) whether the emerging negative trends in the macro-economy would precipitate a situation which would threaten the achievements of the 1990s and might possibly lead to an extensive loss of employment and income for a protracted period, or (ii) whether the present predicaments afflicting the economy were a short-run phenomenon to be overcome through prudent management and institutional reforms. He then proceeded to highlight the performance of the Bangladesh economy over the last year under a few key macroeconomic indicators.

*Dr Bhattacharya* noted that the downward trend in GDP growth rate had continued. GDP was down to 4.80 % at the end of current year, down from 5.16% from the previous year. The projected growth rate in GDP for the upcoming year was 6.0%. On the issue of the quantum index of industrial production (manufacturing) *Dr Bhattacharya* observed that in FY02, the QIP manufacturing index is expected to be as low as 3.99% and the production of major industries to be 2.6% (because of the post flood recovery). He mentioned that major gains had been made such sectors as cement, cotton, textiles and tea and that the major losers were fertilizer, paper, matches and garments. Overall investment in Bangladesh was also very low (approx. 0.1%). Even though private investment had increased by 0.02% over the last year, public investment had fallen by 0.2% over the same period. Two thirds of all investment had come from the private sector. In a related vein, the savings rate in Bangladesh had been stagnant over the last decade and this trend seemed to have been continued in the current year (2.01%). He pointed out that the domestic savings growth had surpassed the national savings growth rate (3.35%) and that the former rate has been frozen over the last three years. National savings rate increased only by a small fraction (by 0.10% in FY 2002).

The keynote speaker then went on to highlight the revenue situation in Bangladesh. In 2002, revenue earnings as a share of GDP was 10.21%. In the proposed budget the share was expected to increase to 11.09%. Laying out the components of revenue generation, the keynote speaker pointed out that the NBR component of revenue earnings was about 72% while non-NBR revenues were 5.29%. The non-tax component had been 22.92%. In FY 2003, NBR tax revenue was expected to be 14.57%, non-NBR tax revenue was expected to be 45.83% and non-tax revenue was targeted at 32.13%. Dwelling on the decomposition of non-tax revenue, the keynote presenter observed that for FY03, the growth rate (excluding 3 sectors; T & T, railway and portal services) would be 50.59% and (including 3 sectors) would be 32.13%. He also observed that the annual growth of the non-tax revenue for FY02 (excluding 3 sectors) was negative (-0.47%). Moving on to the topic of revenue expenditure, the speaker noted that the size of the revenue expenditure portfolio for the next fiscal year seemed to indicate that the policymakers had exercised great restraint. For the FY03, the interest payment for domestic debt would be decreased and interest payment for foreign debt would be marginally increased. This would result in a rise in contingent liabilities. According to the keynote presenter, the problem was one of marginal allocation for operating and maintaining public assets - the major section of government revenue expenditure was tied up with salaries, allowances and interest payment. *Dr Bhattacharya* commented that the revenue growth targets were very ambitious. He also argued that public expenditure continued to be low. The FY 2003 budget targets public expenditure to increase from 14.57% to 15.04% and for ADP to increase from 5.90% to 6.44%.

*Dr Bhattacharya* then moved on to the issue of ADP implementation. He mentioned that the ADP target in FY03 had been pushed up to Tk. 19200 crore (20% higher than FY02). The ADP implementation was highest in 2000, when it was 99.8% of the original ADP. While dwelling on the ADP implementation, the keynote presenter noted that for the last year, even after slashing down the targets, the ADP implementation target was 60% till third quarter of the FY 2002. *Dr Bhattacharya* commented that the main challenge before the ADP was not financing, but its implementation. The reason for this was the limited absorptive capacity of the line ministries. CPD estimates showed that for FY 2003, the following Ministries/Divisions would continue to remain the traditional large recipients of government funds: Ministry of Communications (17.4%), Local Government Division (15.9%), Primary & Mass Education Division of the Ministry of Education (9.1%) and Ministry of Health & Family Welfare (8.9%). Dr. Bhattacharya expressed his concern that under utilisation of funds would continue in FY 2003. Delving further into the issue, the keynote speaker found a significant rise in ADP allocation among particular ministries: Ministry of Communications 19.6% (Tk. 560 crores), Ministry of Home 51.4% (Tk. 36 crores), Primary & Mass Education Division 45.6% (Tk. 557 crores), Ministry of Chittagong Hill Tracts 36.3% (Tk. 37 crores), and Ministry of Youth & Sports 31.2% (Tk. 34 crores). The growth in ADP had two main focuses: physical infrastructure and social infrastructure. On the issue of financing the ADP, the keynote presenter observed that, the government borrowing in FY 2003 had been contained. In FY03, planned domestic financing was Tk 9029 crores (47%), net foreign financing Tk 8813 crores (46%) and borrowing from banks Tk 1358 crores (7%). On the background of overall aid flow for the FY03, this scenario was quite gloomy. The Project Aid for the fiscal was expected to be at Tk 7540 crores (10.56%), Commodity Aid was Tk 829 crores (-20.82%) and Others was Tk 50 crores (-35.06%).

Regarding the domestic credit expansion, *Dr Bhattacharya* mentioned that in the FY02 government borrowing had been slashed down in comparison to FY01 to Tk 18,920 crores (11.43%) and public borrowing to Tk 6,937 crores (5.32%); however, private borrowing went up to Tk 65,511 crores (17.15%). On the issue of disbursement of term loan the keynote presenter mentioned that total disbursement in FY02 (till Dec'01) was Tk 16.79 Bln with a growth rate of 43%. The highest disbursement was made in FY01 which was Tk 30.57 Bln with the growth rate of 88%. Major gainers were the National Commercial Banks - Tk 2.30 Bln (57%), Private Commercial Banks - Tk 8.11 Bln (58%) and NBFI - Tk 3.84 Bln (56%). He also mentioned that the losers were DFI - Tk 0.16 Bln

(50%) and PCB(F) - Tk 2.30 Bln (0.39%). *Mr Bhattacharya* opined that the robust import growth of capital machinery during FY01 confirmed the term loan off-take figure. Regarding the national inflation rate *Dr Bhattacharya* pointed out that in FY02, there had been a crawling rise in the rate of inflation (2.97%) and significant increase in the context of non-food price (5.91%).

*Dr Bhattacharya* opined that the most disturbing element in the present plan was the optimistic projection of foreign direct disbursement. He argued that CPD had difficulty reconciling the term loan figures with the working capital figures because one could see that working capital had picked up in FY01 but had fallen in FY02. The higher disbursement in FY01 resulted in a total amount of Tk 133.82 Bln with an annual growth of 25%. He also mentioned that low working capital off-take suggests a low capacity utilisation rate, which was confirmed by the QIP.

Regarding the capital market in FY02, the combined market capitalisation of the Dhaka Stock Exchange & Chittagong Stock Exchange was 28% higher than the preceding year, which was still less than the pre-boom benchmark. Market capitalisation for the CSE (April'02) was US$ 1.08 bln, which was 28% higher than FY01. The keynote presenter observed the declining trend of foreign investment flow. Net outflow of portfolio investment (Till Feb'02) was US$(-5) Mln. Only investments in the EPZ were steady (till March'02) which in total was US$ 43 Mln. In considering workers' remittance, the keynote presenter showed a robust growth of 18.05% ($1610.91 Mln) in FY02 (till March). On the issue of export in FY02 (July-March), the gap between actual exports and targeted exports was (-) 17.27%. The export of Woven-RMG declined by (-) 5.60%, Knit-RMG by (-) 2.64% and Frozen Food by (-) 28.82%.

The balance of payments scenario in the FY02 (till December) was not reassuring as the trade balance declined to –$1,276 Mln. Current Account Balance was –$39Mln and overall balance was $46 Mln. *Dr Bhattacharya* said that pressure on the balance of payment was partly contained as trade balances weakened due to export collapse. But the current account is expected to marginally improve due to buoyant remittances. In considering the decomposition of total export growth for the period of FY91-FY02, the keynote presenter mentioned that Bangladesh export growth in recent years had been accounted for, in large measure, by increase in volume rather than average price. He also observed that till March of FY02, decline in both prices (- 1.7%) and volume (-5.3%) had contributed to overall decline (- 6.96%). According to CPD, exports suffered because of the global recession, US TDA2000, preferential treatment of exports from other countries, supply side bottlenecks and import slowdowns in the context of foreign exchange scarcity. Import growth for the FY01 was 12.95% and for FY02 (till Feb) fell to (-) 9.79%. Regarding the opening and settlement of import L/C, *Dr Bhattacharya* mentioned that the settlement of import L/Cs for July-April 2001 declined to (-) 5.01%

and the opening of import L/C for July-April 2001 further declined to (-) 6.66%. There was a severe import shortage in the context of food grains, petroleum and miscellaneous items.

Dwelling on the issue of foreign exchange reserve situation, *Dr Bhattacharya* noted that forex reserve for the FY02 (April'02) stood at $1478.39 million, which was 6.81% higher than the benchmark (FY01); he observed that this was the first positive growth in the last 20 months

After laying out the state of the economy in 2002, *Dr Bhattacharya* moved on to his remarks on the budget 2002-03 and its ramifications. He mentioned that there were five characteristics of the FY03 budget: fiscal consolidation, policy continuity, benchmark contestation, programmatic contention and social compromise. However he pointed out that there was an absence of a mid-term framework anchor, a lack of linkages with the interim PRSP, an absence of a three year rolling plan and a lack of a time-bound reform package.

He then focused on the contribution of incremental revenue collection for FY03. In terms of personal income tax, he pointed out that the tax exemption level was reduced to 75,000 taka from one lakh taka, the four tier tax structure had been replaced by a five tier one and the minimum tax was fixed at Tk. 2400. Overall, higher income groups were getting more relief than the lower income groups. In terms of corporate tax, the tax rate had been lowered to 30% from 35% for listed companies, and for all other companies it had been reduced by 5% from 40% to 35%. *Dr Bhattacharya* argued that this would create a larger investible surplus and will assist in capital markets development. He went onto highlight other tax breaks offered under the new budget: a reduction in the tax on new industries set-up between July 2002 – June 2005 was reduced to 20% for the first five years of operation, a reduction in withholding tax from 10% to 5%, reduced withholding tax on interest of saving certificates from 10% to 5%; and the exemption of foreign remittance through the banking channel for resident Bangladeshis and Bangladeshis working abroad. *Dr Bhattacharya* noted that most of these were positive moves. He also pointed out some new entities that would be taxable in the future: the income of the NGOs was to be brought under taxation barring those arising from micro-credit operations, income of the private English medium schools; colleges and universities were also to be taxed. These too, he believed were right moves.

Stressing the need for export diversification, the keynote presenter noted that the new budget did not provide any concrete blueprint for the clothing and textile section with a strategy to face the post-MFA challenge. Regarding the issue of capital market, off loading of SOE shares would be introduced. 10% tax abatement would be allowed for a 25% dividend declaration instead of 20%. Capital gains tax was fixed at 15% for companies, regardless of the retention period of assets and 5% additional tax was imposed on undistributed profit of listed companies. *Dr Bhattacharya* observed that these measures would not be adequate to rejuvenate capital market. For the protection to local industries in the proposed budget, 20% supplementary duty was imposed on the fish, 30% on various fruits and 20% on dairy products. Supplementary duty had been withdrawn on the raw materials for the manufacturing of soap, shoe, and luggage. Customs and supplementary duty had been readjusted on the import of electrical goods such as accumulator batteries, dry cell batteries, auto bulbs, energy saving lamps, PVC rigid films and PVC resins. Supplementary duty had also been readjusted on biscuit, chewing gum, chocolate, candy and soft drinks. These were positive moves towards the protection of local industries, *Dr Bhattacharaya* observed. He noted that reducing the four-tier tariff structure to three-tier one (10%, 20%, 30%) was a positive initiative by the government. Supplementary duty rates were reduced only to five tiers (10, 20, 30, 50 and 60%) from the existing 31 rates varying from 2.5% to 270%. *Dr Bhattacharya* said that this too was a positive move. The keynote presenter focused on some debatable tax measures on products such as sugar, cement, cement clinker, and full cream milk powder. In the context of computer accessories, 7.5% customs duty and 3% advance income tax were also introduced in the proposed budget. The budget also imposed a ban on the import of reconditioned cars.

In the case of VAT, the net was broadened. Minimum annual payment for small shops in city corporation locality would be Tk. 5400 and for small shops in other areas to be Tk. 3600 annually. The retail VAT rate increased from the existing 1.5% to 2.25%. CPD has suggested that VAT net needs to be broadened further. Withdrawn of VAT from tractors, power-tillers, aerator and full fat soya-beans both at the import and local production stage and electricity used for irrigation were right moves for coverage & support of the agricultural industry. On the issue of tax administration, use of TIN had been broadened in the proposed budget. Downsing discretionary power of the tax authorities and measures to limit the ability to appeal to the Appellate Tribunal were also introduced as was the creation of four new Tribunal Benches.

In his summary observations, *Dr Bhattacharya* noted that the tax relief had been given in the current budget to various segments to encourage investment and export diversification. Furthermore, various types of import duties were rationalised to make intermediate inputs cheaper and to provide protection to local industries. In addition, the trade tax has been lowered, trade liberalisation made more predictable, tax administration was being reformed and efforts were being made to broaden the tax net. *Dr Bhattacharya* concluded by stating that despite the positive measures taken in the budget in 2003, investment will still remain constrained by the lack of reforms (particularly in trade-supportive infrastructure, public domination and the law & order situation).

## 3. Discussion

Before declaring the floor open for discussion *Professor Rehman Sobhan*, the chairman of the session, expressed his hope that an informal exchange of views among the participants would provide newer insights for the policy makers as well as the analysts and pave the way for a better conceptualisation of the issues discussed.

### *Overview of the Budget & the Key Economic Indicators*

Former Finance Minister and member of the CPD Board of Trustees, *Mr M Syeduzzaman* said that a serious mid-term review would help tighten the grip on the overall budget management situation. He pointed out that in the second half of 1990, the real economy was doing better than anytime before, but that the balance of trade and fiscal balance as a whole had been much worse. However, he did acknowledge that over the last four months the government had taken some measures to improve these balances. He argued that the main challenge was to stimulate the economy from the growth rate that it had been experiencing over the last few years. He concluded however, by questioning the revenue projection numbers and the size of the ADP proposed by the Finance Minister in the current budget and wondered if they were realistic. The speaker acknowledged the difficulty in preparing the yearly budget but found that the revenue proposals put forth here were a little shaky and wondered how the parliament and the ministers would respond to it.

Picking up where *Mr Syeduzzaman* left off, *Professor Masum*, Dept. of Economics, Jahangirnagar University felt the need for proper identification and evaluation of the factors that contributed to the revised GDP growth rate. He questioned the validity of projecting GDP growth rate at 6.0% for FY 2003 given the downward trends over the past few years. *Professor Masum* however congratulated the Finance Minister for guiding the Bangladesh economy in the appropriate direction despite the multifarious difficulties that had resulted from the global recession.

In line with *Professor Masum's* observation, *Dr Mirza Azizul Islam*, former Director of UN-ESCAP believed that the projection of GDP growth rate for FY2003 was unrealistic. In addition, he was curious to know the assumptions underlying the current budget – more specifically he wished to know if the investment numbers mentioned in the budget were included in the non-tax revenue or whether they were a way to finance a deficit. Money does not buy quality and he believed there should be a linkage between expenditures in this sector and the quality of education.

However, Former Secretary of Economic Relations Division (ERD), *Dr Mashiur Rahman* was more optimistic. He said, "The increase projected for the next year in the revenue financing was a little challenging but the economy can absorb it - even if there is a shortfall in revenue." In this regard he was supportive of the Government's tax reform strategy.

Taking a more cautious approach, Former Finance Minister, *Mr A M A Muhith* commented that the Finance Minister has opted for an "ambitious budget" at a time when there is recessional trend in the economy. He too was skeptical about the growth rate in revenue expenditure projected in the budget. He also commented that the economy needed to come out of the "black-hole" of underground economy, smuggling and high levels of corruption.

***Corruption and Social Accountability***

*Dr Atiur Rahman* of BIDS was the first to point out that the new budget did not do anything to address issues related to social justice. Social justice was a key issue for any developing country and Bangladesh was no exception. Without the presence of social justice, governance and ethics in this country would never really improve. Given the fact that Bangladesh was considered the most corrupt country in the world, this issue was more important that ever before.

Taking up this thread of questioning in a different vein, *Mr Waliur Rahman Bhuiyan*, President of the Foreign Investors Chambers mentioned that, "Whenever we talk about corruption, we assume or we indicate that only the government officials are corrupt". He argued that it was not only the government officials that were corrupt but other elements of society as well. This issue needed to be addressed on an urgent basis. He believed that an underlying reason for the rampant corruption within the government was its size. Given the fact that the governmental institutions were over-manned, average pay per civil servant was low. A possible solution would be to perhaps reduce the size of the bureaucracy and increase the average pay. That may somewhat help stem the problem of corruption. Until pay was increased to a respectable level, government civil servants would find it economically feasible to consider corruption as a viable alternative. He pointed out that this topic had been often discussed in the past, both inside parliament and in civil society, but more concrete measures were needed. *Mr Bhuiyan* also argued that the government needs to institute some sort of performance based pay scheme. That would provide an incentive for government officials to work more efficiently and would reward hard work and merit.

*Professor Abu Ahmed* of University of Dhaka brought up the issue of income tax for the government officials. In the budget the government officials were taxed for their income. Given the generally low levels of salary in these governmental institutions, perhaps the government could install some form of a social security system. He further suggested that government spend more money in the education section.

Taking this one step further, *Mr Muhith* felt that some of the budgetary provisions had created a scope for corruption. According to him, the tax proposals which have been made with regard to imports of essential commodities would facilitate smuggling; he thought that these should be reevaluated in view of their negative implications for the the poor of this country and also the middle class." He wondered what the government would do about this issue.

### *Environment and Reconditioned Cars*

*Dr Atiur Rahman* felt that current measures were not enough to deal with the environmental problems of this country. He said that the current budget did not do enough to address the issue of the environment and that the business community could do more to further this cause. He highlighted the link between environmental upkeep and the exports that Bangladesh ships abroad, pointing out that export plants in this county need to be more careful, as the developed world is very environment conscious and if matters were not addressed, it could have adverse consequences for our goods abroad.

*Mr Enaytullah Khan*, Editor of the Holiday, seemed to agree with this perspective. He argued that it was indeed an important criterion for exports and he strongly suggested taking appropriate measures to deal with the issue because he had already received warnings from his overseas customers regarding this issue. He said, "If our products do not have the environmental safety features built into production plants, then in future they (the foreign buyers) will not buy our product." He asked the government whether they could consider the accelerated depreciation of polluting plants.

*Dr Atiur* felt that the ban on reconditioned cars was unfair. He disagreed with the views put forth above and said that there is a need to revise this policy. He pointed out that the only people who could afford new cars are the rich in Bangladesh, and that a ban on reconditioned cars hurts only the middle class people who were unable to afford new cars. There were a number of other speakers who agreed with him on this issue and felt that the policy had been implemented too abruptly.

*Mr G M Quader Chowdhury, MP* of Jatiya Party expressed his support of the government decision to ban the import of reconditioned vehicles. He suggested that an alternative strategy that the government could follow was to impose a tax on the import of reconditioned cars that would put them at price parity with new cars. He also suggested the government introduce a scheme whereby reconditioned car salesrooms and firms be slowly phased out.

### *Issues Related to NGOs and their Taxation*

*Dr Atiur Rahman* raised the question of NGOs and their linkage efforts. He felt that there needs to be greater initiative in this area, not only from the NGOs but also from government agencies. He suggested that the Bangladesh Bank should come forward with some sort of statutory fund for poverty reduction. This fund could be used to further strengthen the linkages that had been established by the NGOs and could be used discretionarily for this purpose. He believed that the source of financing for this fund should not come directly from the government but could be raised in other ways. One suggestion he had was carrying out a national lottery and using the proceeds from it to fund this idea.

*Ms Khushi Kabir* of Nijera Kori commented on the changing face of the NGO environment in Bangladesh. She pointed out that the new budget only provided for tax exemptions to those NGOs that were registered with the NGO Affairs Bureau whereas before there had been a tax exemption for all NGOs. She also said that NGOs were now beginning to have to compete with commercial banks that were giving out micro-credit loans as well. Given the fact that these new banks were entering the world of micro-finance, she thought it was a little unfair that NGOs were to be taxed for their activities in a manner similar to these banks, given the fact that the NGOs did not have the balance sheet power that the banks had.

Former Secretary, *Dr Mashiur Rahman*, disagreed with her and pointed out that NGOs were no longer purely non-profit businesses. Rather they were slowly evolving into multi-faceted conglomerates that were involved in various commercial activities. He felt that there needs to be a distinction between the commercial and non-profit segments of the NGOs and that the commercial ventures should be taxed and subject to the law in a similar fashion as any other profit making enterprise in Bangladesh. He felt that this was only fair, since otherwise the commercial ventures of the NGOs would have an unfair competitive edge over other commercial businesses in this country.

### *Taxation: Issues, Concerns and Strategies*

*Dr Atiur Rahman* of BIDS felt that the changes to the structure of the income tax was an unfair change for the majority of the people in this country. He felt that the Finance Minister needed to seriously reconsider this move. He argued that the taxable level of income is lower in India compared to Bangladesh, although it was a fact that the cost of living in this country is significantly different than that of India. Former lawmaker and BNP leader *Maj (Rtd) Akhtaruzzaman* agreed with this view in his comments. He argued that the poor in this country did not earn enough to contribute in a meaningful way to the tax revenues of the state and squeezing them for more money, by increasing the tax burden on them, does little to alleviate their own problems.

*Professor Abu Ahmed* of University of Dhaka disagreed with this view. He thought that it was the right decision, because the more people the government can bring into the tax net, the more successful will be the domestic resource mobilisation. He also did not believe that the tax system proposed was unfair because he thought that the higher income groups in Bangladesh paid a significantly larger amount in indirect taxes (house tax, road tax) but that the middle class people did not pay any tax, though they received all the services from the Government. He stated that Bangladesh suffered from a severe case of the free rider problem present in market economies where the state provided benefits that not everyone in society has paid for. This was an anomaly that needed to be corrected.

Disagreeing with him, *Mr Waliur Rahman Bhuiyan*, President of FICCI said, "I do not mind paying taxes. But I do not want to see my driver bearing the tax burden as well." He believed that the poor in this country simply did not make enough to warrant their shouldering more of the tax burden. Former Deputy Speaker *Professor Ali Ashraf* said, that people in Bangladesh, in general, are happy to pay taxes but they would like some sort of assurance of security of their life and their property if they do.

*Ambassador Farooq Sobhan*, President, Bangladesh Enterprise Institute, asked whether the Finance Minister would be able to ensure efficiency and transparency in the tax collection process. He was particularly concerned about the government's institutional capabilities in widening the income tax and VAT nets to ensure more revenue mobilisation in the future. He wanted to know what would be done to strengthen and accelerate this process.

*Mr Enaytullah Khan*, Editor of Holiday, wondered what were the ramifications of the government policy on untaxed income. He felt that there needed to be a greater government scrutiny on this matter and it needed to be determined whether black money was being whitened in this case or whether it was being invested. He believed that this policy offered an extraordinary opportunity for smugglers and tax evaders to bypass the law and legitimise their unethically earned income. An overwhelming majority of the attendees agreed with this view and criticised the government for accepting investment of untaxed money "unconditionally". They felt that the government needed to set a more ethical standard in this country.

Former MCCI President *Mr Latifur Rahman*, felt that a problem of greater significance for the government was to stop the evasion of the VAT. He pointed out that there were many businesses in this country that did not pay the VAT, and as a result they often have an uncompetitive advantage over businesses that did pay VAT.

*Dr Mashiur Rahman*, noted that in the present set up, the estimated tax including income tax, VAT et al would not be enough to achieve the estimated target of the revenue earnings. Given this rather disturbing fact he wondered how the Finance Minister had planned to make up the hole.

### *The Law and Order Situation*

Many of the dialogue participants pointed out that improvement in the law and order situation was vital for increasing investment and improving governance in Bangladesh . Others stated that they would be happy to pay for the implementation of law and order as long as it ensured their safety and security.

### *The Balance of Payments: Exports and Imports*

*Dr Mirza Azizul Islam*, a former Director of UN-ESCAP, believed that the projection for annual growth in the collection of custom duty in FY2003 was unrealistic. He noted that there was a substantial reduction in the trade weighted average tariff rate in the new budget. The implications for these two disparate numbers was troubling for the country. The reduction in the tariff rate and subsequent projection rate of custom duty seemed to imply that imports had to increase substantially. However, given the current predicament with imports in general, and the poor state of the financial sector, he could not see how the government intended to finance the incremental imports which was implicit in the budget. He thought that the only way we could possibly finance these additional imports is through increased remittances. He questioned the government on the viability of this option.

*Dr Atiur Rahman* commented that the Finance Minister was constrained by the high level of non-performing assets in the bank. The Minister had promised a high-level committee to tackle the matter, but nothing substantial had materialised. *Ambassador Farooq Sobhan* drew the Minister’s attention toward some comments and suggestions he (the Minister) had made in the past. He pointed out that the Finance Minister had said at some time in the past that in order to further boost remittance it would be necessary to encourage Bangladeshi private sector banks to compete with the national ones. *Mr Sobhan* wondered if any headway had been made in this regard. He also questioned whether Bangladesh would set tax holidays for foreign investors.

*Dr Mashiur Rahman* raised the issue of bank interest for export oriented industries. He thought that it should come down because the country was facing competitive pressures from countries like Vietnam and China (where the bank interest is relatively low). In a similar vein, *Mr A M A Muhith* underscored the need to restore zero tariffs on the import of computers and accessories to help develop the information and communication technology (ICT) sector in the country. A number of the other dialogue participants raised questions regarding Bangladesh’s policy going forward and asked whether the government would be using it as a source of foreign exchange.

## 4. Comments by the Finance Minister

The Finance and Planning Minister *Mr Saifur Rahman* thanked *Dr Debapriya Bhattacharya* for his analytical presentation. He said, “It is not an easy task to frame a budget, I cannot satisfy everybody." He pointed out that the budget is a document that reflects the politics of regulating social conflict and that any social conflict is hard to dispel through just the budget. "It is very difficult to rely only on the budget to provide the solution to social conflicts."

Commenting on the overall budget, *Mr Saifur Rahman* pointed out that the government had prepared this budget under two severe constraints: (i) the lack of macroeconomic stability and (ii) the inadequate supply of foreign reserves. He was quick to point out that due to this foreign exchange crisis, talks with donor countries for foreign aid had been difficult and inconclusive.

Moving on to the key economic indicators, the Finance Minister expressed his firm conviction that the revenue earning target projected in the national budget of FY2002-2003 'would certainly be achieved'. With the current state of the economy, he was confident that the government would be able to attain revenue earnings targets in spite of whatever may happen in the country. He believed that the budget did much to strengthen the revenue management system and he was thus confident that the targets could be met.

The Finance Minister explained the rationale behind his decision to ban the import of reconditioned cars. He argued that these imported cars were old relics that did nothing but ruin the environment in this country. However, he did acknowledge that perhaps an outright ban was not the best strategy and it perhaps would have made more sense to carry out a gradual phase out. He indicated that he might review the matter.

Commenting on the Poverty Reduction Strategy Paper (PRSP), Finance Minister *Mr Saifur Rahman* informed the audience that a draft PRSP has already been prepared which would be launched next week. He also informed the audience that a month-long discussion with all the stakeholders in society on the draft PRSP would take place. He mentioned that the interim poverty reduction strategy might be integrated with three-year rolling plan to achieve the best results. In this regard, he also expressed his hope that Bangladesh would receive the desired commitments from the World Bank and International Monetary Fund (IMF) for the preparation of a final PRSP.

Given the emphasis on taxation and the changes made to the tax policy in this budget, the Finance Minister spent a considerable amount of time defending his choices. He argued that the changes he had proposed were necessary to reduce the budget deficits that this country was facing and also to finance essential development schemes. Focusing on the specifics, he defended the introduction of new minimum ceiling of income tax which was reduced from Tk. 100 thousand of annual earnings to Tk. 75 thousand by stating that the "state cannot function" by collecting taxes from less than one million people in a country of 130 million. He was quick to dismiss the allegations that the reforms he had suggested were "ambitious" and rather stated that they were "incremental." He also vigorously defended the allegations that his policies had created an opportunity for the legalisation of black money.

The Finance Minister observed that the government needed to pay attention to ensure social justice, institutionalise democracy and strengthen the oversight system to ensure that the benefits of its programs reach the people. The Minister said that the law and order situation could not be properly managed through the budgetary process. However he did point out that, "I have increased the monetary allocation for the Home Ministry and in addition given them money for new recruits. But I do not know whether these measures will do the trick."

The Finance Minister expressed his strong confidence regarding the country's investment scenario that the investment would pick up soon. He stated: "We have already received a number of investment proposals in the textile sector. In fact, around 15/20 textile industries are in the process of supplying high grade fabrics for the export-oriented ready-made garment sector". However, he also noted that unless good governance, accountability and transparency could be ensured, no foreign investment would come into the country.

## 5. Concluding Remarks by the Chairman

*Professor Rehman Sobhan* concluded the session by underpinning the importance of fiscal and financial discipline and good governance in the management of the economy. In the absence of such disciplines the underlying tensions in the economy discussed during the dialogue could manifest in the form of serious macroeconomic instability and also social tensions. The CPD chairperson thanked the participants for their active participation in the dialogue.

***List of Participants***
*( In alphabetical order)*

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| *Mr Salehuddin Ahmed* | Deputy Executive Director, BRAC |
| *Professor Momtaz Uddin Ahmed* | Member, GED, Planning Commission |
| *Professor Abu Ahmed* | Department of Economics, Dhaka University |
| *Dr Fakhruddin Ahmed* | Governor, Bangladesh Bank |
| *Mr Abdul Matlub Ahmed* | Chairman, Nitol Group |
| *Mr Mohiuddin Ahmed* | Former Secretary to the Government |
| *Mr Major (Rtd.) Md Akhtaruzzaman* | Former Member of Parliament |
| *Mr Rafat Alam* | Visiting Researcher, CPD |
| *Maj Gen A M S A Amin* | Former Ambassador |
| *Mr Mahfuz Anam* | Editor, The Daily Star |
| *H E Mr Dietrich Andreas* | Ambassador, Embassy of the Federal Republic of Germany |
| *Ms Naoko Anzai* | Assistant Resident Representative, UNDP |
| *Ms Ferdous Nurun Ara* | Director in Charge, Bangladesh Bureau of Statistics |
| *Ms Ferdous Ara* | Secretary, DCCI |
| *Professor Mr Ali Ashraf* | Former Deputy Speaker of the Parliament |
| *Mr Qazi Humayun Azad Baksh* | Chairman (a.i), Bangladesh Tariff Commission |
| *Ms Irina Bhattacharya* | Independent Consultant |
| *Mr Waliur Rahman Bhuiyan* | President, FICCI |

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| *Mr Cleaveland Charles* | Chief Commercial & Economic Officer, American Embassy |
| *Mr Toufic Ahmad Choudhury* | Professor and Director, BIBM |
| *Mr Abdul Muyeed Chowdhury* | Executive Director, BRAC |
| *Mr Abdul Quiyum Chowdhury* | APS to Hon'ble Minister for Finance |
| *Mr Syed Manzur Elahi* | Chairman, APEX Group of Industries |
| *Dr Omar Faruque* | Senior Development Advisor, CIDA |
| *Ms Berit Fladby* | Counsellor, Norwegian Embassy |
| *Mr A Gafur* | Executive Director, American Chamber of Commerce in Bangladesh |
| *Mr Abdul Haque* | Member, Executive Committee, FBCCI |
| *Mr Zafrul Hasan* | Joint Secretary General, BILS |
| *Dr Abul Hashem* | Former Section Chief, UN- ESCAP |
| *Mr Md Altaf Hossain* | Deputy Chief, ERD, Ministry of Finance & Planning |
| *Mr Tom Hunstol* | Norwegian Embassy |
| *Mr Iyanatul Islam* | Assistant Professor, Griffith University, Australia |
| *Dr Mirza Azizul Islam* | Former Director, UN-ESCAP |
| *Professor Rounaq Jahan* | Columbia University, NY, USA |
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| *Ms Khushi Kabir* | Coordinator, Nijera Kori |
| *Dr Wazedul Islam Khan* | General Secretary, Bangladesh Trade Union Kendra |
| *Mr Zakir Ahmed Khan* | Secretary, Finance Divn, Ministry of Finance |
| *Mr Enayetullah Khan* | Editor-in-Chief, Holiday |
| *Mr Milon Khan* | Media & Communication Officer, DFID |
| *Lt Col Mohammed Faruk Khan, MP* | Chairman, SUMMIT Properties & Construction Company |
| *Dr Fahmida Akter Khatun* | Research Fellow, BIDS |
| *Dr M A Latif* | Senior Research Fellow, BIDS |
| *Mr Jan Maas* | Charge de Affairs, Royal Netherlands Embassy |
| *Mr Goutam C Majumder* | Programme Officer, Democracy Watch |
| *Ms Anne Marchal* | Second Secretary, European Commission |
| *Mr Ahsan Ullah Master, MP* | Chairman, BILS |
| *Dr Md Masum* | Department of Economics, Jahangirnagar University |
| *Ms Nasreen Awal Mintoo* | President, Women Entrepreneurs' Association |
| *Mr Mohiuddin Monir* | Executive (Accounts), Haq's Bay |
| *Mr Anwar Hossain Monju, MP* | Former Minister for Communications |
| *Mr A M A Muhith* | Former Finance Minister and President, POROSH |
| *Mr Alexander A Nemov* | First Secretary, Embassy of Russian Federation |
| *Mr Asaduzzaman Noor* | Hon'ble Member of Parliament |
| *Mr Md Nuruzzaman* | Deputy Director, BARD, Comilla |
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| *Mr G M Quader* | Hon'ble Member of Parliament |
| *Mr A S M Quasem* | Vice President, ICC- Bangladesh |
| *Mr Fazle Rabbi* | Senior Information Officer, Ministry of Finance |
| *Dr A K M Masihur Rahman* | Former Secretary, GOB |
| *Dr A K M Atiqur Rahman* | Associate Professor, Economics Department, NSU |
| *Mr Shamsur Rahman* | Senior Research Fellow, BIISS |
| *Dr Atiur Rahman* | Chairman, Unnayan Shamannya |
| *Mr Mahbubur Rahman* | President, ICC Bangladesh |
| *Mr A K M Mahbubur Rahman* | Chief Accounts & Finance Officer, BEPZA |
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| *Brig Gen M Mofizur Rahman psc(Rtd)* | Executive Chairman, BEPZA |
| *Mr Mamun Rashid* | Chief Executive Officer, Citibank N.A. |
| *Mr Mostafizur Rahman Sarder* | Joint Director, Foreign Exchange Policy Department, Bangladesh Bank |
| *Dr Binayak Sen* | Senior Research Fellow, BIDS |
| *Mr A K M Shameem* | DGM, Agrani Bank, Gajipur |
| *Ambassador Farooq Sobhan* | President, Bangladesh Enterprise Institute |
| *Mr M Syeduzzaman* | Member, Board of Trustees, CPD |
| *Dr R K Talukder* | Professor, Department of Agricultural Economics Bangladesh Agriculture University |
| *Mr Paul Zwetsloot* | First Secretary & Head of Development Embassy of Royal Netherlands |

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*( In alphabetical order)*

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| *Mr Syed Zahirul Abedin* | The New Nation |
| *Mr Faruque Ahmad* | BSS |
| *Mr Babu Ahmed* | The Daily Prothom Alo |
| *Mr Mahbub Alam* | ATN Bangla |
| *Mr Shofiqul Alom* | The Daily Arthanitee |
| *Mr Rezaul Karim Byron* | The Daily Sangbad |
| *Mr Mustofa Feroz* | The Ekushey TV |
| *Mr Pulock Ghatack* | The Banglabazar Patrika |
| *Mr Titu D Gupta* | The UNB |
| *Mr Mahtab Haider* | The Weekly Holiday |
| *Mr Sadrul Hossain* | The Daily News Today |
| *Mr Delwar Hossain* | The Daily Dinkal |
| *Mr Rahim Hermachi* | The Daily Bhorer Kagoj |
| *Mr A T M Ishaque* | The Ajker Kagoj |
| *Mr N Islam* | The Bangladesh Observer |
| *Mr Shahriar Karim* | The Daily Star |
| *Mr Nurul Hasan Khan* | The Daily Dinkal |
| *Mr Humayun Kabir Khan* | The Bangladesh Betar |
| *Mr Subir Kumar* | The Daily Ajker Kagoj |
| *Mr Minhaz Moslem* | The ETV |
| *Mr Kawser Rahman* | The Daily Janakantha |
| *Mr M Azizur Rahman* | The Financial Express |

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| *Mr Shaugat Ali Sagor* | The Daily Prothom Alo |
| *Mr Asif Showkat* | The Daily Matribhumi |
| *Mr Ziaur Rahman Sohel* | The Daily Arthaneeti |
| *Mr A Tanchangya* | The Weekly Citizen |
| *Mr Khawaza Moin Uddin* | The Bangladesh Observer |
| *Mr Jamal Uddin* | The Daily Ittefaq |
| *Mr Shafiqul Islam Zibon* | The Daily Manavzamin |