State of the Bangladesh Economy and Budget Responses 2008

Paper 63

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The Centre for Policy Dialogue (CPD), established in 1993, is a civil society initiative to promote an ongoing 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 dialogues at local, regional and national levels. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues. These dialogues have brought together ministers, opposition frontbenchers, MPs, business leaders, NGOs, donors, professionals and other functional group in civil society within a non-confrontational environment to promote focused discussions. The CPD seeks 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.

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The present paper titled ***State of the Bangladesh Economy and Budget Responses 2008*** has been prepared under the CPD programme on *Independent Review of Bangladesh's Development (IRBD)*. This programme aims at strengthening institutional capacity in Bangladesh in the area of trade policy analysis, negotiations and implementation. The programme, *inter alia*, seeks to project the civil society's perspectives on the emerging issues emanating from the process of globalisation and liberalisation. The outputs of the programme have been made available to all stakeholder groups including the government and policymakers, entrepreneurs and business leaders, and trade and development partners.

The paper has been prepared by the CPD IRBD Team 2007.

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Acronyms

ADP	Annual Development Programme
AIT	Advance Income Tax
APR	Annual Programme Review
BBS	Bangladesh Bureau of Statistics
BCB	Bangladesh Co-operative Bank
BDR	Bangladesh Rifles
BDT	Bangladesh Taka
BKB	Bangladesh Krishi Bank
BoP	Balance of Payments
BOT	Build, Own and Transfer
BPC	Bangladesh Petroleum Corporation
BRDB	Bangladesh Rural Development Board
CBN	Cost of Basic Needs
CHT	Chittagong Hill Tracts
CNG	Compressed Natural Gas
CPD	Centre for Policy Dialogue
CTG	Caretaker Government
DSL	Digital Subscriber Line
EEF	Equity Entrepreneurship Fund
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FFW	Food for Work
GDP	Gross Domestic Product
HIES	Household Income & Expenditure Survey
HNPSP	Health, Nutrition and Population Sector Programme
ICOR	Incremental Capital-Output Ratio
ICT	Information & Communications Technology
IDSC	Infrastructure Development Surcharge
IPP	Independent Power Producers
IRT	Independent Review Team
LGRD	Local Government Rural Development
LTU	Large Taxpayer Units
MFA	Multi fibre Arrangement
MoC	Ministry of Commerce
MTBF	Medium-Term Budget Framework
MTMF	Medium Term Macroeconomic Framework
MW	Mega Watt
NBR	National Board of Revenue
NCBs	National Commercial Banks
NGO	Non Governmental Organisation
NITTRAD's	National Institutes of Textile Training, Research & Design
NREGS	National Rural Employment Guarantee Scheme
OMS	Open Market Sale
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Papers
RADP	Revised Annual Development Plan
RAKUB	Rajshahi Krishi Unnayan Bank
RMG	Ready made Garments
SECP	Small Enterprises Development Credit Project
SME	Small And Medium Enterprises
SoE	State Owned Enterprises
TCB	Trading Corporation of Bangladesh
TSMU	Textile Strategy Management Unit
US	United States
USD	United States Dollar
VAT	Value Added Tax
VGD	Vulnerable Group Development
VOIP	Voice Over Internet Protocol

I. INTRODUCTION

The National Budget for the fiscal year 2007-08 (FY08) and the Revised Budget of FY07 were placed before the country on 7 June 2007. The Centre for Policy Dialogue (CPD), in continuation of its tradition of presenting its analysis of budgets prepared by successive governments, has prepared the following analysis of the budget for FY08. The CPD analysis draws upon data and information from various ministries, departments and agencies of the government as well as other sources. The CPD also undertakes a thorough examination of the various aspects of the budget for FY08 which was prepared by the Caretaker Government (CTG).

1.1 Distinguishing Features of Budget 2007-08

This is the first time a non-party caretaker government has presented a full year budget. This distinctive feature could be interpreted as an opportunity to prepare a budget that would be free from political bias and pressures which generally tends to be characteristic of budgets prepared during normal times. Some quarters have, however, raised the issue of legality of the present budget that was proposed by a caretaker government. In this context one would be well advised to read **Article 83** *along* with the **Article 93** of the Constitution which stipulates that there is no bar in presenting a full fledged budget under the current circumstances.

Overall, the budget clearly reflects efforts to sustain reforms and the general direction of the transition taking place in the economy. There are also signs of recognition about the growing structural inequalities in the economy. An attempt has also been made to improve transparency in budgetary accounting. With reaffirmed commitment to the poverty reduction strategy (PRS), a new medium term macroeconomic framework (MTMF) has also been estimated for the next three fiscal years (FY2008-10). This, to some extent, is expected to provide some relief from apprehensions about *plan holiday*, at least for the short term. In line with the PRSP target, a 7 per cent growth of GDP has been projected for FY08. Required performance in the macroeconomic arena to attain this rate of growth will, however, critically hinge on performance in the arena of investment. On the other hand, while it was expected that the proposed resource envelop will define expenditure targets for the upcoming fiscal, there are signs that indicate otherwise.

Built on a fragile fiscal framework stemming from high expenditure targets in the backdrop of lower revenue expectations, the budget proposes a number of thoughtful fiscal measures. It appears that whilst overall, the budget for FY08 does attempt a break off with the past, it falls short of making a real breakthrough.

It may be recalled that CPD had earlier prepared a number of documents which are listed in Box 1. In these documents, CPD analysed the performance of the economy during FY2007 (including certain selected areas such as price), articulated major challenges facing the CTG and undertook an exercise to prepare a set of proposals in view of the Budget FY2008. The present analysis of the Budget builds on these documents and focuses particularly on the major features of the FY2008 budget and their implications in terms of production and investment, distribution and redistribution of incomes.

BOX 1. CPD REPORTS ON MACROECONOMIC SCENARIO FOR THE FISCAL YEAR 2006-07

1. Priorities for the Caretaker Government and an Immediate Action Plan for the Newly Elected Government: A Proposal for Discussion; 27 September, 2006.
2. Economic Programme: CPD's Recommendations for the Caretaker Government (First Reading); 05 November, 2006.
3. State of the Bangladesh Economy in FY07: An "Election Plus" Economic Agenda for the Second Caretaker Government (Second Reading); 25 January, 2007.
4. Price of Daily Essentials: A Diagnostic Study of Recent Trends; 07 May, 2007.
5. Set of Proposals for the National Budget FY2007-08 from the Centre for Policy Dialogue (CPD); 26 May, 2007.
6. State of the Bangladesh Economy in FY2007 and Outlook for FY2008 (Third Reading); 2 June, 2007.

1.2 Benchmarks for FY08

The present analysis begins by establishing the benchmarks for Budget FY08 and identifies several positive and negative features of the Bangladesh economy in FY07.

Notwithstanding a number of internal and external factors afflicting the country's economy, Bangladesh was able to achieve a moderate growth rate 6.71 per cent in the FY07. Impressive disbursement of term loans has led to moderately high growth in the manufacturing sector. Robust export growth, buoyant inflow of remittance and improving port situation have signalled strengthened performance of the external sector. Invigorated capital market and increasingly competitive telecom market stood out as positive outcomes of the economy in FY2007.

On the flip side, the price rise of essential commodities put under threat the impressive achievements during FY2007. Weak overall revenue collection, despite increased income tax collection, and the higher levels of revenue expenditure have exposed fragility of the fiscal framework in existence. Low ADP implementation, poor disbursement of foreign aid and higher levels of government borrowings were viewed as emerging weaknesses in the economy. Acute shortage of electricity, crisis of fertiliser and diesel for irrigation hindered agricultural production. Inadequate enforcement of the new pay scale in the RMG sector remained an issue of concern.

1.3 Challenges for FY08

A number of emerging challenges for the upcoming year have been outlined here in line with the identified characteristics of the Bangladesh economy. These include the issue of addressing some critical structural challenges and maintenance of macroeconomic stability sine these could pose serious threat to continued economic prosperity and needs to be urgently dealt with.

Stabilising Market Price, particularly Food Prices

Arresting the existing high inflationary trends, particularly high prices of essential commodities including food items, ought to be seen as the prime task for the government. Both domestic underperformance and international shocks contributed to the creeping inflation which has been observed for the last one year. It is unlikely that the national inflation will come down below 7 per cent in the near future, particularly in view of the Aman harvest. Various market and non-market interventions together with strong institutional reforms will be required to curb the inflation, keeping in view both short and medium term perspectives.

Achieving Pro-Poor Growth and Addressing Inequality

Translating the continued scaled up growth performance into incremental gains for the poor and disadvantageous groups of the society is the major challenge facing the government. The pace of poverty alleviation accelerated during 2000 to 2005 (on average reducing 1.8 per cent poverty rate per annum). At the same time, regional disparity and income inequality have continued to worsen and threaten to undermine future prospect of poverty alleviation. Income generation through gainful employment for the rural and urban poor, addressing the problems of seasonal unemployment and of people such as those who have lost homes due to river erosion remain critical areas of intervention which would require urgent policy interventions.

Investment Augmentation and Improved Domestic Savings

For policymakers in Bangladesh the challenge is to revert the image as an "underinvested country" and enhance domestic savings. Practical measures will have to be devised to transform savings into investment for the purpose of accelerating the growth prospect of the economy

Expanding Domestic Tax Base

Historically, Bangladesh has the lowest revenue-GDP ratio among all her counterparts in the South Asian region. Intensifying domestic resource mobilisation through an active revenue collection drive, extending the coverage of revenue collection and improving auditing system for augmenting more transparent corporate governance persist to be a challenge in terms of attaining a stable fiscal situation in the coming fiscal year.

Greater Foreign Aid Flow

Low disbursement of foreign aid has been a major concern in recent years. Although the importance of foreign aid in the overall economy has been on the decline in recent years, the importance of more foreign aid flow for the development of infrastructure and human resources cannot be overemphasised. Even though the situation has somewhat improved with the installation of the present caretaker government, meeting the targets for foreign aid will remain a major challenge for Bangladesh.

Improving the Quality of ADP Implementation

Allocation and implementation of ADP has always been a challenge for successive governments in Bangladesh. Declining trend in ADP-GDP ratio is acting as a limiting factor to the future economic growth of the country. Selection of demand driven projects and their effective implementation are basic requirements for better management of public expenditure programmes and Bangladesh has a long way to go in this respect.

Improving Investment in Agriculture

Gross disbursement of agricultural credit recorded a fall during FY07. With an improved recovery net disbursement had been even worse. In view of the rising production cost and stagnant production, the negative growth of agricultural credit may have adverse impact on future agricultural production. In FY08 improving investment in agriculture will be a major challenge for maintaining the overall development process.

Proper Utilisation of Allocation in Power, Education and Health

The challenge for the government will be to go for immediate and provisional measures to address the existing acute power shortages. An absence of urgent and decisive decision as regards power projects is having an adverse impact on the situation.

Providing qualitative education and basic health services to all continue to remain a major task for Bangladesh. The slow down in the utilisation of allocation in education and health in recent times will affect development of human capital in the long term. Proper utilisation of allocation in these two key areas should be given the highest priority.

Sustaining Export Growth

The narrow export basket of Bangladesh is likely to face heightened competition as the EU and US restrictions on RMG export from China is withdrawn in the coming fiscal year. In this new competitive scenario, sustaining the current high export growth will be an uphill challenge in FY08.

Improving the FDI Flow

FDI inflow to Bangladesh has been on the decline in the past year and the country is falling behind compared to other developing countries in terms of attracting FDI. Apart from taking immediate decisions on large scale FDIs such as Tata and Asia Energy, ensuring greater net inflow of FDIs is crucial for Bangladesh. This may help to concentrate attention on other large scale proposals (such as Mittal and Dhabi) for final decision. Diversifying the FDI basket is also emerging as a major challenge.

Greater Mobilisation of Equity Capital

The capital market in Bangladesh has improved remarkably during the recent times thanks to political stability. Investors' confidence is on the rise and as a result the market is gaining momentum in recent years. With stronger monitoring mechanism against market manipulation in place, this is perhaps the most opportune time for further consolidation and strengthening of the equity market. This will have to be done both by providing more investment opportunities as well as by catering to more investors, especially NRBs and foreign investors. To this end, bringing more SoEs into the capital market with a view to mobilising larger capital will be the major task in hand for the CTG.

Keeping up Remittance Flow

Remittance inflow has certainly provided a cushion to the BoP situation of Bangladesh economy in FY07. Improving the quality of manpower, enhancing their earnings power and effective negotiation for greater market access for Bangladeshi workers going abroad will stand out as the major challenges to sustain this remittance flow in the next fiscal year.

Pushing Forward Structural Reforms

Stagnation in structural reforms has finally started to break the shackles and needs to be further strengthened. These have to be carried out effectively and energetically. This will require bringing about major legal and institutional changes in several key areas. Accomplishment of these reforms is thus one of the crucial priorities in FY08.

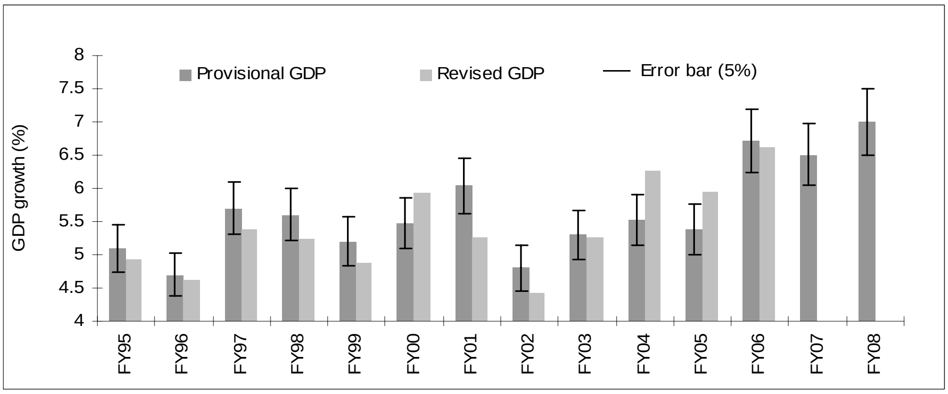
The present review examines the proposed budget in the context of prevailing trends in the Bangladesh economy. In this introductory section the review establishes the benchmark conditions for the budget FY08 and the challenges ahead facing the Bangladesh economy over the next fiscal year. The review analysis some key features of the budget FY2008 with a view to examining their impact on the economy. Economic growth and income, saving and investment trends along with an overview of possible employment scenario are discussed in Section 2. The section also portrays a brief assessment of the delivery of the Poverty Reduction Strategy (PRS) and the new medium term outlook. Issues related to public finances have been discussed in Section 3. Fiscal and price stabilisation measures proposed in the budget for FY08 have also been analysed in Sections 4 and 5 respectively. Section 6 presents sectoral and regional measures while Section 7 explores social safety net programmes. The review ends with a discussion on a number of challenges standing in the way of implementation of various measures to be undertaken by the current government.

II. GROWTH, SAVINGS, INVESTMENT AND EMPLOYMENT

2.1 Growth Performance in FY07

As expected, the GDP growth estimates for FY06 have been revised downward from 6.71 per cent to 6.62 per cent. Downward revision of preliminary GDP growth has now become a common practice in Bangladesh for quite some time. This is the ninth time GDP estimates have faced this fate in the last twelve years.

FIGURE 1. PROVISIONAL AND REVISED GDP (FY95-FY08)



Source: CPD-IRBD Database.

Bangladesh economy has passed through an extraordinary developments in FY07. Macroeconomic management during the year, carried out by three different sets of government, was marked by high level of violent political agitation, aborted election and declaration of emergency. Preliminary estimate from BBS suggests that the economy posted 6.51 per cent GDP growth in FY07. Proxy indictors tend to suggest that the economy had experienced some slow down during the elapsing year for a variety of reasons. These include, inter alia, indifferent agricultural production (particularly average crop output, and adverse effect of Avian Flu in poultry industry), modest progress in industry and sluggish growth in service sector. Recent upward revision of energy prices and the mounting pressure of rising inflation will also possibly militate against achieving the provisional growth rate.

Taking note of the above, it is being suggested here that the provisional growth estimate may have to be further revised downward, once data for the full fiscal year becomes available. The revised GDP growth in FY07 may finally settle at around 6.0 per cent.

2.2 Growth Outlook for FY08

The Caretaker Government (CTG) has set a growth target of 7.0 per cent for the coming FY2007-08. Taking note of the performance in FY07, it is maintained that all the three major components of GDP, *viz.* Agriculture, Industry and Service will have to enhance their contribution further to attain this optimistic growth target. The agricultural sector has to post a robust growth since crop and livestock slowed down considerably in FY07. The crop sub-sector has to significantly increase its growth rate (say + 4 per cent) while livestock sub-sector must regain the momentum it lost after the Avian Flu. Manufacturing sub-sectors will need to sustain its impressive growth which it recorded in FY07 notwithstanding the prevailing situation. Manufacturing, both large and small scale, has to score a moderate increase in its growth rate and the construction sub-sector ought to reclaim the lost momentum. The other components of the Industry sector i.e. Electricity, Water and Gas Supply along with Mining and Quarrying must retain its pace of growth. Since service sector alone accounts for half of the national income, at least it has to moderately accelerate its growth on FY07's benchmark. On one hand, Real Estate, Renting and Business Activities have to revert back to higher growth path, whereas sectors like Education and Health and Social Works must significantly improve their performance. It is anticipated that Public Administration and Defence would experience accelerated growth in FY08. Import Duty has to break free from negative growth rate as was recorded in FY07 and has to increase its incremental contribution in realising the targeted growth rate. In fine, attainment of the projected 7 per cent economic growth would demand an energetic performance by all the major sectors of the economy. However, for this to happen, the flow of investment will have to play a defining and definitive role.

2.3 Growth – Investment Nexus

Figures from the budget documents' (2007-08) suggest that the incremental capital-output ratio (ICOR) *improved* during FY06 by 0.37 per cent with the ICOR coming down from 4.09 in FY05 to 3.72 in FY06. Conversely in FY07, the ICOR registered a marginal increase implying a fall in capital productivity. Estimates of gross investment in FY07 suggest a substantial improvement with the ICOR rising from 3.72 in FY06 to 3.89 in FY07.

TABLE 1. RECENT ICOR TRENDS IN BANGLADESH

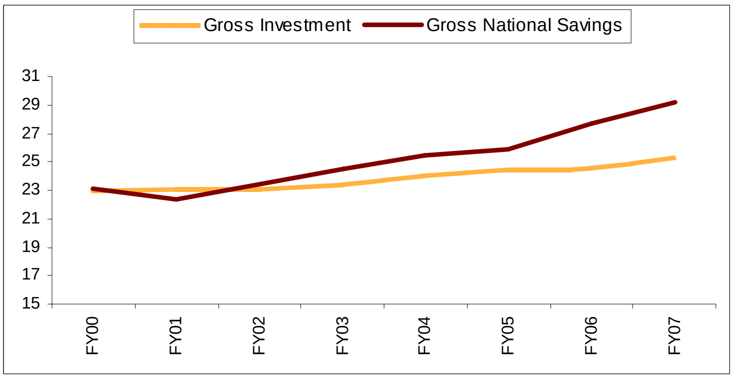
Indicators	**FY05**	**FY06**	**FY07**	**FY08**
Growth rate of GDP at constant price (%)	6.00	6.62	6.51	**7.00**
Investment as % of GDP	24.53	24.65	25.30	**26.20**
ICOR	4.09	3.72	3.89	**3.70**

Note: Earlier estimate by BBS shows that the investment-GDP ratio in FY07 is at 24.3 per cent, with a similar growth of 6.5, the ICOR was 3.74

Source: CPD-IRBD Database.

To achieve the targeted growth rate of 7 per cent in FY08, it would require either a considerable increase in investment rate or a much improved ICOR, or a combination of both (say investment equivalent to 26.20 per cent of GDP and an ICOR of 3.70). Implied investment target for FY08 would require an additional investment of Tk 20,930 crore (worth almost an extra 1 per cent of GDP) over last year's benchmark. This would mean investment rate has to score a record high compared to last two decades, coupled with regaining the lost capital productivity. Recent slowdown in the growth of gross capital formation and stagnant public investment, however, do not invoke much optimism in this regard.

FIGURE 2. WIDENING SAVINGS-INVESTMENT GAP



Source: CPD-IRBD Database.

One of the major issues in this connection would be resource mobilisation for underwriting the required investment. Greater revenue earnings, improved flow of foreign aid (particularly grants) as well as increased foreign and domestic investment may address the need for incremental investment demand. Higher government borrowings may partly substitute these sources. However, in the final analysis one would need to strengthen the national (domestic) savings rate through enhanced household savings, accelerated corporate savings and improved government savings to sustain this additional flow of resources.

Curiously, Bangladesh has remained an underinvested country for a long period. The gap between national savings rate and gross investment rate is fairly large (more than 3 per cent of GDP). Thus, arguably, it is not the availability of resources, rather its effective utilisation which constitute the major challenge.

2.4 Outlook for Pro-Poor Growth

According to the Preliminary Report on the Household Income & Expenditure Survey (HIES 2005), Bangladesh has achieved remarkable progress in poverty alleviation, with the poverty incidence being reduced by 8.9 per cent between 2000 and 2005 (as per CBN method) at the national level (i.e. 1.8 per cent per annum compared to 1.0 per cent per annum between 1996-2000). Without doubt an impressive growth performance during this period had contributed definingly to this impressive outcome.

Reduction of poverty incidence (on head count basis) accompanied by moderate economic growth does not necessarily mean *pro-poor growth*. A deepening of regional disparity and aggravation of income inequality has indeed dampened the potential impact of poverty reduction and also its sustainability in the future. Between 2000 and 2005, the income Gini coefficient increased from 0.45 to 0.47 in Bangladesh at the national level. In this connection it is pertinent to refer to the underlying sources of inequality in rural and urban Bangladesh based on HIES 2005 unit level data examined by Bhattacharya and Khan (2007)[1]. The authors suggest that policies to raise the share of wage income, income from farm, inland remittance and formal transfers could help address the issue of rising inequality and reduce it.

In the budget for FY08, about 57 per cent of total public expenditure or 73.42 per cent of ADP is allocated for "poverty reduction". The corresponding figures for revised budget of FY07 were 56.11 per cent and 74.77 per cent respectively. "Poverty reducing expenditures" increased from 8.0 per cent in the revised budget of FY06 to 8.6 per cent in the budget for FY07. A special feature of this budget is that figures on poverty-related, regional and gender equity-related allocation were made available to the general public for the first time. However, further clarity on the estimation of these figures is desirable.

2.5 Assessment of the MTMF

The budget for FY08 and those of the preceding two years were supposed to have been prepared within a Mid-Term Macroeconomic Framework, as contained in the national PRS document.[2] Table 2 depicts a comparison of MTMF targets and actual performances achieved during the period under review. As may be observed from the table, the GDP growth rate compares favourably for FY06 and was reasonably within target limits for FY07 (it is expected to be scaled down however), but the actual inflation rates were above the target and the gross domestic investment rates were below the target.

[1] Bhattacharya and Khan (2007), Growth and Inequality Linkages to Poverty in Bangladesh, in *New Issues in Bangladesh Economy*. Dhaka: CPD.

[2] The Ministry of Finance has recently updated the MTMF providing a new set of projections for FY08, FY09 & FY10.

TABLE 2. MEASURING BUDGET PERFORMANCE WITH PRSP TARGETS (OUTPUT)

Macroeconomic indicators	FY06 (PRSP)	FY06 (Actual)	FY07 (PRSP)	FY07 (Revised)	FY08 (PRSP)	FY08 (Budget)
Output						
Real GDP growth (%)	**6.5**	**6.6**	**6.8**	**6.5**	**6.9**	**7.0**
Consumer Price Index	**6.5**	**7.2**	**6.0**	**7.0**	**5.5**	**6.5**
Gross Domestic Investment (% GDP)	**25.0**	**24.7**	**24.5**	**25.3**	**24.8**	**26.2**
ICOR	**3.8**	**3.7**	**3.6**	**3.9**	**3.6**	**3.7**

Source: PRSP, MTBF and Budget Documents.

As we have commented earlier on the growth and investment targets for FY08, one would like to point out here that the inflation target for the upcoming year has been realistically put between the benchmark of FY07 (7 per cent) and the PRSP target (5.5 per cent).

TABLE 3. MEASURING BUDGET PERFORMANCE WITH PRSP TARGETS (GOVERNMENT ACCOUNTS)

Macroeconomic indicators	FY06 (PRSP)	FY06 (Actual)	FY07 (PRSP)	FY07 (Revised)	FY08 (PRSP)	FY08 (Budget)
Government Accounts (% of GDP)						
Total Revenue	11.0	10.8	11.3	10.6	11.6	10.8
Tax	9.0	8.7	9.2	8.4	9.6	8.6
Non-Tax	2.0	2.1	2.1	2.2	2.0	2.2
Total Expenditure	15.5	14.2	15.0	14.3	15.3	16.4
Current Expenditure	8.6	8.4	8.7	9.2	8.6	9.4
Of which: Interest Payments	1.7	1.9	1.6	2.0	1.7	2.0
ADP	5.9	4.7	5.6	4.6	6.0	5.0
Overall Balance (excl.Grants)	-4.5	-3	-3.7	-3.7	-3.7	-5.6
Financing (net)	4.5	3.0	3.7	3.7	3.7	5.6
Domestic financing	2.0	2.2	1.9	2.1	1.7	3.6
Borrowing from the Banking System	0.9	1.6	1.2	1.4	1.1	1.2
Non-bank borrowing	1.1	0.6	0.7	1.0	0.6	0.8
Foreign financing	2.5	0.8	1.8	1.6	2.0	2.0

Source: PRSP, MTBF and Budget Documents.

Table 3 continues with the comparison of PRSP's macroeconomic targets with corresponding achievements, particularly with respect to government accounts.

The revenue targets (as per cent of GDP as mentioned in the PRSP) were not met in FY06 and FY07 and have been slashed down in the budget for FY08. Total public expenditures (as per cent of GDP) were lower than targets in FY06 and FY07 mainly due to slack implementation of ADP, whereas for FY08 the target has been put at a higher level, however, the incremental government outlay is going to take place as revenue expenditures, rather development expenditures. The overall deficit in FY06 and FY07 remained within the PRSP targets due to serious shortfall in development expenditure, although the fiscal deficit would increase by more than 1.5 times in FY08[3]. Domestic financing overshot the target due to lack of adequate foreign financing. Bank borrowing emerged as the major source of domestic financing surpassing the targets in each year. Conversely, foreign financing steadily underperformed, putting pressure on domestic sources.

2.6 Medium Term Outlook

The new MTMF (FY2008-2010) medium term outlook for FY09 and FY10 makes the projection that the economy will grow at 7 per cent and 7.2 per cent in FY09 and FY10 respectively. The projections also depict optimism about harnessing the inflationary trend, setting the target at 5.5 per cent for FY09 and 5.0 per cent for FY10.

[3] This also includes the liabilities of Bangladesh Petroleum Corporation. An analysis on financing of budget deficit has been provided in Section III.

TABLE 4. MEDIUM TERM OUTLOOK OF BANGLADESH ECONOMY

Indicators	Budget	Projected	
	2007-08	2008-09	2009-10
Output (%)			
Real GDP growth (%)	7.0	7.0	7.2
CPI inflation	6.5	5.5	5.0
GDP deflator (% change)	6.0	5.2	4.9
Gross Domestic Investment (% GDP)	26.2	27.4	28.1
Government Accounts (% of GDP)			
Total Revenue	10.8	11.1	11.2
Tax	8.6	9.1	9.2
Non-Tax	2.2	2.0	2.0
Total Expenditure	16.4	14.9	15.0
Current Expenditure	9.4	9.0	9.1
Of which: Interest Payments	2.0	1.9	1.9
Overall Balance (excl.Grants)	-5.6	-3.8	-3.8
Financing (net)	5.6	3.8	3.8
Domestic Borrowing	3.6	2.0	2.1
External Borrowing	2.0	1.8	1.7
Money and Credit (% change)			
Net Domestic Assets	13.6	14.7	14.1
Private Sector	14.5	15.5	15.0
Broad Money	15.0	14.0	13.0
Balance of Payments			
Exports, f.o.b (% change)	18.5	18.0	18.0
Imports, c.i.f (% change)	19.0	18.5	17.0
Remittances (US$ million)	6600.0	7400.0	8200.0
Current Account Balance (% of GDP)	0.7	0.1	-0.4
Gross Official Reserve (US$ million)	5300.0	6112.0	7151.0

Source: PRSP, MTBF and Budget Documents.

In the revised medium term outlook revenue collection is programmed to grow at a slow pace, whereas total expenditures are to fall drastically in FY09. As a result, fiscal deficit is expected to improve leading to an improvement in the overall balance. This sudden shift may be explained by the disclosure of BPC debts and its adjustment amounting to about 1.42 per cent of GDP in FY08.

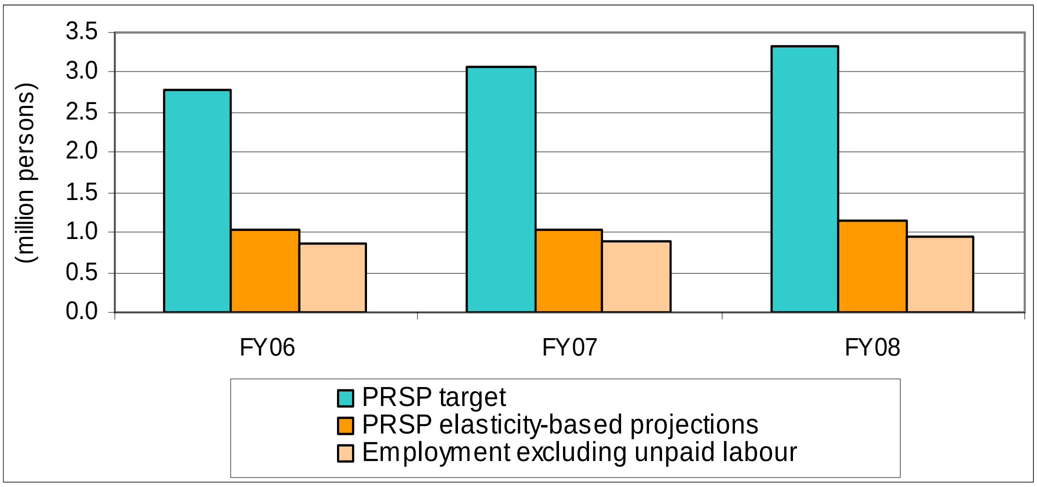
In the monetary sector, Broad Money Growth was projected to slowdown over the years from 15 per cent in FY08 to 13 per cent in FY10. It is expected that private credit flow will sustain high expansion despite reduction in aggregate growth.

The BOP components are expected to experience robust growth in the coming years. These include steady export growth and import performance as well as improvement in foreign exchange reserves situation. Remittance flow is also expected to continue the current momentum.

2.7 Employment

Neither the budget speech of FY08 nor any other budget document refers to the employment scenario of the country. A labour market analysis done at CPD indicates that there is a gap between the employment projections mentioned in the PRSP and projections based on PRSP-indicated employment-GDP elasticity. See Figure 3 for the component.

FIGURE 3. TOTAL EMPLOYMENT: FY06-FY08

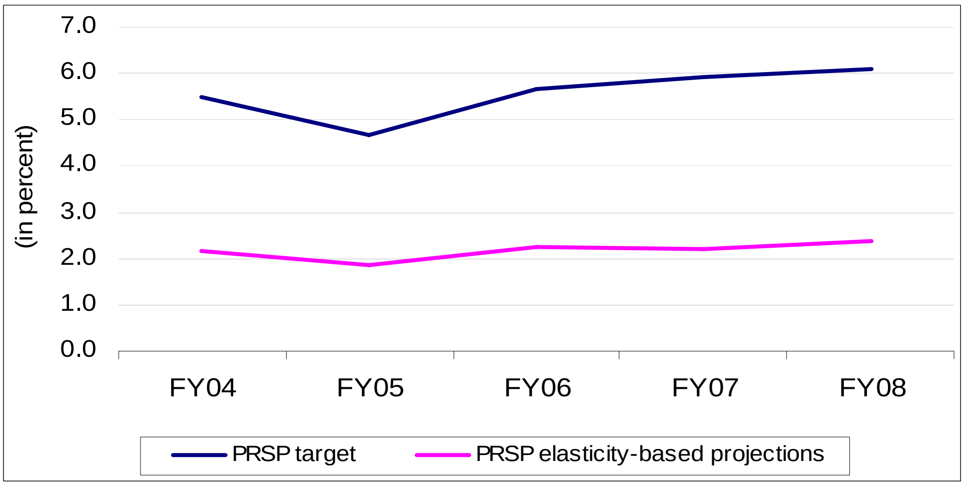


Source: CPD's calculation based on PRSP.

According to the PRS estimates, 30.6 lakh new employment opportunities were to be created in FY07. Estimation from PRS-based elasticity approach suggests that only 10.4 lakh jobs may have been created in FY07 resulting in a shortfall of 20.2 lakh. It may be recalled here that 12 lakh new job seekers annually enter the labour market in Bangladesh.

PRS targets imply that more than 30 lakh jobs are to be created in FY08. But our analysis suggests that, given the macro-correlates, it will be challenging to meet the 12 lakh mark. Accordingly, a wide gap is observed between the two projects on growth rate of employment. As per the PRSP projection, the growth rate of employment will be around 5.7 per cent in FY08, whereas it is only 2.4 per cent according to the elasticity approach. In both cases, it is observed that PRSP employment projections and its growth rates are over-estimated when one considers an employment-GDP elasticity of 0.34 as the "base case" indicated in PRSP[4].

FIGURE 4. GROWTH RATE OF TOTAL EMPLOYMENT: FY04-FY08



Source: CPD's calculation based on PRSP.

[4] Bangladesh, Government of (2005). Unlocking the Potentials: National Strategy for Accelerated Poverty Reduction. Dhaka: General Economics Division (page 47).

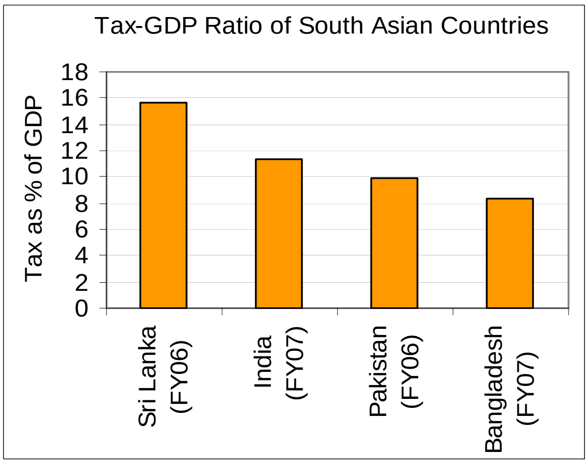
III. PUBLIC FINANCE FRAMEWORK

Proposed fiscal structure for FY2008 demonstrates a certain degree of fragility on different counts. In the backdrop of a comparatively low revenue growth target, a much higher growth in expenditure has been targeted. At the same time, within public expenditure, marginalisation of development expenditure is taking place with lowest ever targeted annual development programme (in terms of share of GDP). Mobilising resources to finance the formidable deficit of 5.6 per cent of GDP might turn into a major challenge for the government during the upcoming fiscal year. With obvious pressure building on the domestic sources, higher borrowing from the banking and non-banking sources will be required. Over ambitious target of foreign financing (both grants and loans) may also make the ADP financing tricky. About 49 per cent of the ADP outlay is to be foreign sourced.

3.1 Revenue Earnings

A target of Tk 57,301 crore in revenue collection has been set for FY2008, which is Tk 7,829 crore or 15.8 per cent higher than the revised figure for FY2007. On the other hand, revenue-GDP ratio and tax-GDP ratio are targeted at 10.8 per cent and 8.6 per cent respectively, up from 10.5 per cent and 8.4 per cent in FY2007. The PRSP target for FY2008, however, sets higher revenue-GDP ratio at 11.6 per cent and tax-GDP ratio at 9.6 per cent. These targets remain modest compared to neighbouring economies, owing to the successive failure in scaling up revenue mobilisation over last couple of years.

FIGURE 5. TAX-GDP RATIO OF SOUTH ASIAN COUNTRIES



Source: CPD-IRBD Database.

NBR Tax Component

According to the targets set for FY2008, NBR tax earnings will have to achieve a 17.0 per cent growth, compared to 15.5 per cent growth in FY2007. This target leaves NBR to contribute 76.5 per cent of the total revenue earnings for the next fiscal year. In view of the previous trends of achievement, this will be a challenging task and may not be eventually met.

Out of the required additional amount of Tk 7,829 crore as total revenue in FY2008, VAT will have to contribute 28.2 per cent, followed by income tax (24.4 per cent). Import duty will contribute 13.7 per cent of the total additional revenue. In total, the NBR component is expected to contribute 81.4 per cent of the total revenue.

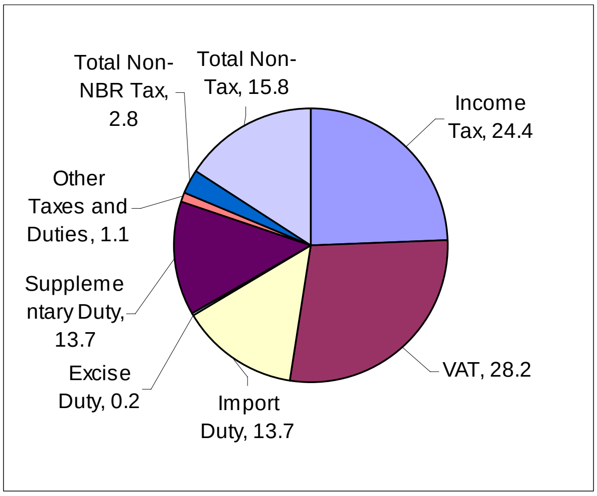
Non-NBR Tax Component

Non-NBR tax component (NL, Vehicles, Land and Stamps) faces a growth target of 12.4 per cent in FY2008. With the benchmark growth of 15.9 per cent in FY2007, the growth target of earnings from the non-NBR tax components looks rather conservative. Contribution of non-NBR tax component in the total revenue earnings of FY2008 will be 3.5 per cent, which was 3.6 per cent in FY2007 (revised). As per the total revenue target for FY2008, non-NBR tax component is programmed to contribute 2.8 per cent of the total increment.

Non-Tax Component

Non-tax revenue component (DP, PO&R, T&T and IFT) is targeted to grow at 12.1 per cent in FY2008 and contribute about 20.0 per cent of the total revenue. The targeted growth of collection in this component is found to be on the low side compared to the achieved 19.5 per cent growth in FY2007 over the actual figures of FY2006. Incremental contribution of non-tax revenue to the total revenue growth will be 15.8 per cent.

FIGURE 6. INCREMENTAL CONTRIBUTION IN REVENUE GROWTH OF FY2008



Source: CPD-IRBD Database.

The composition of revenue growth targets set for FY2008 under different heads indicates that the economy has finally shifted its dependence on international trade taxes to domestic taxes. Concurrently, in FY2008, indirect taxes are going to provide a greater share of the enhanced collection in comparison to direct taxes.

3.2 Public Expenditure

Fragility in the fiscal structure of FY2008 stems from the high expenditure target that has been set by the budget. Total public expenditure budget of FY2008 amounts to Tk 87,137 crore which is Tk 20,301 crore or 30.4 per cent higher than the revised budget of FY2007, whereas revenue earning is set to grow by 15.8 per cent. Public expenditure as a percentage of GDP, against the PRSP target of 15.3 per cent, will amount to 16.4 per cent in FY2008, which is substantially higher than that of FY2007 (14.3 per cent). As mentioned earlier, share of ADP in the total expenditure is getting marginalised. Within the total expenditure, share of ADP and non-development revenue expenditure accounts for 30.4 per cent and 55.5 per cent respectively, while their respective shares in FY2007 were 32.2 per cent and 63.1 per cent.

A sector-wise distribution analysis of total expenditure reveals that public service is set to receive Tk 3,581 crore more in FY2008 than FY2007, registering a growth of 57.7 per cent. Fuel and energy follow closely with an additional allocation of Tk 1,552 crore (51.2 per cent growth) and industrial and economic services will receive an additional Tk 191 crore (38 per cent growth). Excluding ADP, total expenditure of FY2008 will increase by Tk 15,401 crore. Liabilities of BPC and additional allocation in public service together will contribute Tk 11,104 crore or 72.1 per cent of this extra expenditure.

TABLE 5. SECTOR-WISE DISTRIBUTION OF TOTAL EXPENDITURE (NON-DEVELOPMENT AND DEVELOPMENT)

Sector	FY2007 (Revised)	FY2008 (Budget)	Change in Budget FY2008 over Revised Budget FY2007	
			Crore Tk	%
Public Service	6201	9782	3581	57.7
Fuel and Energy	3034	4586	1552	51.2
Industrial and Economic Services	503	694	191	38.0
Social Security and Welfare	2918	3893	975	33.4
Agriculture	5316	6891	1575	29.6
Housing	581	731	150	25.8
Recreation, Culture and Religious Affairs	757	938	181	23.9
Interest	9154	10785	1631	17.8
Transport and Communication	5953	7000	1047	17.6
Education and Technology	10899	12369	1470	13.5
Health	4957	5470	513	10.3
Public Order and Safety	4373	4754	381	8.7
LGRD	7342	7472	130	1.8
Defense Services	5397	5469	72	1.3
Total Expenditure	67385	80834	13449	20.0

Source: CPD-IRBD Database.

Revenue Expenditure

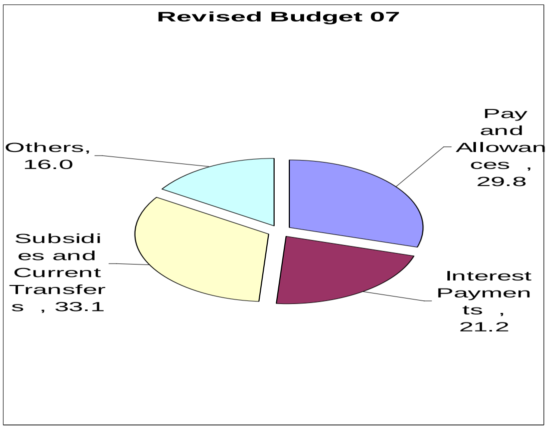
Revenue expenditure target for FY2008 is Tk 49,838 crore[5], which is Tk 6,622 crore or 15.3 per cent higher than the revised figures for FY2007. As percentage of GDP, revenue expenditure stands at 9.4 per cent in FY2008, which was higher than the PRSP target of 8.6 per cent.

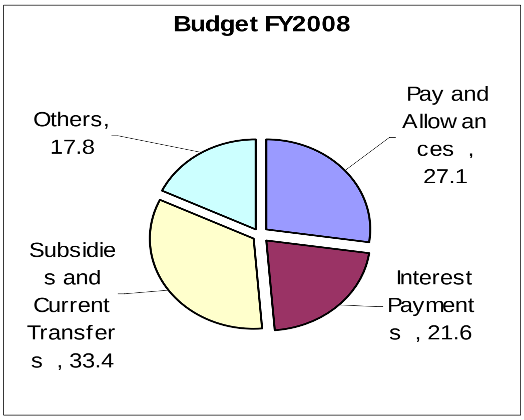
Economic analysis of revenue expenditure reveals that expenditure on account of major three heads, “salary and allowances”, “subsidies and transfers” and “interest payments”, which is set to account for 82.2 per cent in the total actual revenue expenditure, will grow by 4.9 per cent, 16.7 per cent and 17.8 per cent respectively in FY2008. Block allocation will increase significantly, i.e. by 132.5 per cent. It may be noted that the domestic debt

[5] Acquisition of assets and works is not included and recoveries are not deducted here. Total augmented non-development revenue expenditure (after adjustment) becomes Tk 50,259 crore in FY2008 which was Tk 43,832 crore in FY2007 (revised).

servicing liabilities are on the rise. Share of DSL (domestic) in revenue expenditure was 18.2 per cent in FY2007 (revised), which is projected to be 19.0 per cent in FY2008.

FIGURE 7. CONTRIBUTION OF MAJOR HEADS OF REVENUE EXPENDITURE



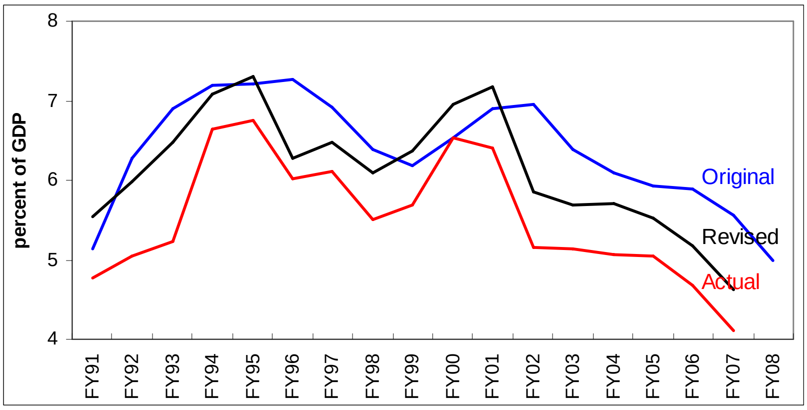


Source: CPD-IRBD Database.

Development Expenditure (ADP)

The new ADP for FY2008 has been set at Tk 26,500 crore, which is 22.7 per cent higher than the revised ADP and 1.9 per cent higher than the original ADP of FY2007. With 38 new projects, ADP of FY2008 includes 927 projects in total. The ratio of domestic-foreign sources of financing is targeted to be the same as revised ADP of FY2007 (63:47). Targeted ADP for FY2008 will stand at 5.0 per cent of GDP — again the lowest since 1991.

FIGURE 8. ADP AS % OF GDP



Source: CPD-IRBD Database.

Free from political pressure, quality of the ADP of FY2008 should be seen as the crucial factor rather than its size. Sectoral allocation pattern of the new ADP reveals that education and religion received highest allocation (16.3 per cent of the total ADP), although the allocation is 2.9 per cent lower than the original ADP of FY2007. Power sector has been prioritised in the ADP of FY2008 and is set to receive 30.7 per cent more allocation than that of in the revised ADP (FY2007), which is also 14.9 per cent higher than the original ADP of FY2007. Agricultural sector got 22.6 per cent more allocation over revised ADP FY2007; however, this is 14.6 per cent lower than the original ADP of FY2007. Social welfare, women and youth development received 7.7 per cent more allocation in FY2008 than the revised ADP of FY2007, which is, however, less than half of the original allocation of FY2007 (55 per cent lower).

An analysis of the pattern of revised ADP FY2007 and ADP FY2008, however, raises the question as to whether there has been an attempt to transfer the fiscal burden from the previous year to the budget for FY2008.

TABLE 6. CHANGES IN ADP IN SELECTED SECTORS

ADP Allocation	**Changes** (in crore Tk.)	
	ADP08 - Revised ADP07	Revised ADP07 - ADP07
Water Resources	269.21	-269.97
Petroleum, Gas and Mineral Resources	585.21	-580.2
Transport	313.59	-318.61
Road Transport	2428.15	-2411.98
Air, Rail and Water Transport	875.59	-896.78
Education and Religion	824.48	-935.18

Source: CPD-IRBD Database.

Sectoral allocation structure, particularly for water resources, petroleum, gas and mineral resources, transport and education and religion, shows that the revised amount between revised ADP and ADP of FY2007 is close to the increased amount allocated in FY2008 over revised ADP FY2007.

Block Allocation

The ADP of FY2008 does not include any sectoral block allocation. Total block allocation decreased by 65.8 per cent over the original ADP of FY2007. However, ADP of FY2008 has kept allocation against unapproved projects. Special block allocation and allocation for unapproved projects have been targeted at Tk 1,413.98 crore and Tk 992.5 crore respectively. The combined allocation comprises 9.1 per cent of the total ADP for FY2008.

Education and Religion

Allocation in education and religion sector was revised downwards by 24.2 per cent in the revised ADP of FY2007 from its original allocation. However, religion related projects received 28.2 per cent more than the original ADP. Similarly, while ADP of FY2008 got 2.9 per cent less allocation in education and religion sector as a whole than the original ADP of FY2007, religion related projects actually received 47.9 per cent more allocation. Keeping in mind that education and religion sectors have an allocation of Tk 187.1 crore against unapproved projects, there is a possibility that allocation for religion related sector may be underestimated here. Why education and religion are reported under the same sector remains a question as this undermines transparency in the allocation structure.

Defence

Following the trend of the last five years, the revised non-development budget for Defence in FY2007 exceeded the original budgeted figure. This difference stood at Tk 536 crore in FY2007—a five year high. In FY2008, total non-development and development expenditure in defence services will stand at Tk 5,397 crore, which amounts to 6.3 per cent of the total budget (compared to 7.0 per cent in FY2007). Defence services received 9.8 per cent of the total non-development budget which is 11.3 per cent more than the revised allocation in FY2007 and 0.02 per cent more than the original budget of FY2007. Alongside, the development budget for defence is set to grow by 61.3 per cent in FY2008.

Defence expenditure for Bangladesh in FY2007 stood at 1.15 per cent of GDP. It will be pertinent to mention here that this which is lower than the comparable spending in Pakistan (2.84 per cent) and India (1.81 per cent) for the corresponding year.

Election Commission

Total development and non-development budget for the Election Commission increased to Tk 536 crore in FY2008 compared to Tk 120 crore allocation in FY2007. This additional allocation will allow the Commission to finance preparatory work for the upcoming elections, including preparation of the voter list.

3.3 Budget Deficit and Financing

A large deficit has been the most prominent feature of the budget for FY2008. The budget deficit (excluding grants) for FY2008 has been estimated at Tk 29,836 crore, which is 5.6 per cent of the GDP. PRSP target of budget deficit for FY2008 has been set much lower at 3.7 per cent of GDP. Given the deficit figure of Tk 17,634 crore in the revised budget of FY2007 (3.7 per cent of GDP), budget deficit in FY2008 increased significantly by 71.8 per cent.

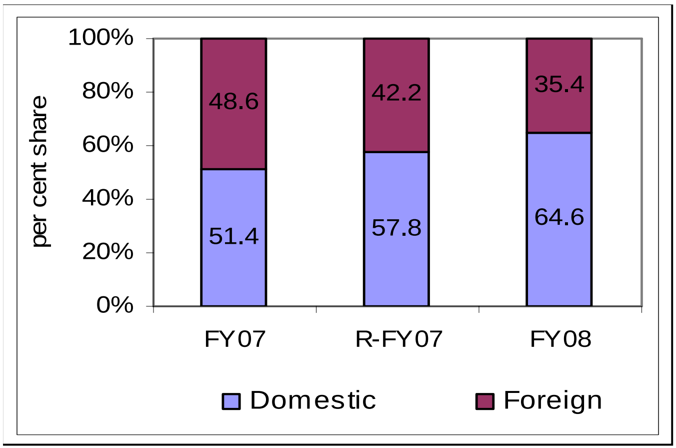
TABLE 7. FISCAL FRAMEWORK IN BUDGET FY2008

	Revised Budget 2007		Budget 2008	
	Crore Tk	% of GDP	Crore Tk	% of GDP
Revenue Earnings	49472	10.6	57301	10.8
Total Expenditure	66836	14.3	87137	16.4
Non-ADP Expenditure	45236	9.7	60637	11.4
Liabilities of Government (from BPC)			7523	1.4
Annual Development Programme	21600	4.6	26500	5.0
Overall Deficit (excluding grants)	17364	3.7	29836	5.6
Financing				
Domestic	10031	2.1	19276	3.6
Bank	6531	1.4	7253	1.4
Non-Bank	3500	0.7	4500	0.8
Non-Cash Bond (Liabilities of BPC)		0.0	7523	1.4
Foreign	7333	1.6	10560	2.0
Foreign Grants	2150	0.5	4255	0.8

Source: CPD-IRBD Database.

However, Liabilities of BPC have added Tk 7,523 crore to the deficit. But even after excluding BPC liabilities, the deficit is set to increase to 4.2 per cent of the GDP.

FIGURE 9. SOURCES OF DEFICIT FINANCING



Source: CPD-IRBD Database.

As regards financing of the deficit, domestic sources will bear 64.6 per cent (Tk 19,276 crore) of the total deficit. Within this, Tk 7,253 crore (37.6 per cent of domestic financing) is expected to come from the banking system, while the non-bank component is estimated to contribute Tk 4,500 crore (23.3 per cent of domestic financing) in financing the deficit. The rest 39.0 per cent (Tk 7,523 crore) of the domestic financing will come from non-cash bond (liabilities of BPC).

The share of foreign financing for this large deficit will stand at 35.4 per cent (Tk 10,560 crore) in FY2008 compared to 42.2 per cent (Tk 7,333 crore) for the revised budget of FY2007. A much higher amount of foreign grants has been projected for FY2008 to the tune of Tk 4,255 crore against Tk 2,150 core in the revised budget of FY2007 (97.9 per cent growth). An estimated US$1,552 million (net) in foreign aid will be needed to finance the deficit.

Gross foreign aid requirement (after repayment) for FY2008 will exceed US$2.0 billion, far above the inflow in a single year for the last one and a half decades. Thus, mobilising foreign resources will be one of the major challenges for successful implementation of the new budget.

IV. OVERVIEW OF FISCAL MEASURES

4.1 Tax and Duty Measures

Direct Tax

The budget proposals have addressed the structure of the personal income tax and selective corporate tax rates. An attempt has been made to reduce general aversion of the taxpayers to pay taxes and avoid procedural complexities.

Income Tax: The budget for FY2008 has brought significant changes regarding income tax. The tax-exempted income limit for individual tax payers has been raised from Tk 120,000 to Tk 150,000. *This will increase the minimum monthly taxable income to Tk 12,500.*

- Proposal to introduce legislative provision on universal self-assessment procedures will encourage taxpayers to pay tax voluntarily.
- Abolition of deduction of tax at source on credit card bill is likely to increase consumer spending by enhancing use of credit cards by consumers.
- Mobile phone operator companies' will be charged tax rate of 45 per cent unless these companies converted to publicly traded companies. *This is likely to persuade the firms to enter the stock exchange and have positive impact on the equity market.*
- Imposition of tax deductible at source at 0.25 per cent on all export earnings to be considered as tax finally paid will simplify tax payment for exporters; *however, this may come at the cost of potential revenue loss from the larger exporters.*
- Extension of tax rebate facility to non-resident Bangladeshi investors may help to induce investment from abroad, given the current state of the economy.
- Imposition of tax on private universities and research institutions registered under Trust Law is a measure which aims at taxing knowledge and is most likely to have an adverse impact on the financial viability and overall functioning of the relevant institutions. The government would do best if it reviews this decision.

Special Tax Benefit

- A proposal for voluntary disclosure of untaxed legal income within 60 days upon payment of regulatory tax plus 5 per cent penalty has been placed. With the ongoing anti-corruption drive, this is likely to raise significant revenues through the National Board of Revenue (NBR).

- Discontinuation of special tax treatment specified for land, apartment and motor vehicles purchase with undisclosed and untaxed money has been proposed.

Outstanding Proposals

- A database of taxpayers needs to be established to help the NBR to have first hand knowledge about the state of tax collection from individuals and companies. The ambit of the large taxpayer units (LTU) should be expanded to enhance opportunities for tax mobilisation.

Indirect tax

- Restructuring of duty slabs at 10 per cent instead of 5 per cent, 15 per cent instead of 12 per cent and 25 per cent (unchanged) and an abolition of the 4 per cent Infrastructure Development Surcharge (IDSC) have been proposed. While the cost of import items may increase for the first two slabs, removal of 4 per cent IDSC is expected to outweigh this cost.
- Assimilation of two different slabs of supplementary duty from 15 per cent and 25 per cent to 20 per cent is expected to simplify the duty structure. Additionally, reduction of existing supplementary duty of 25 per cent and 65 per cent to 20 per cent and 60 per cent respectively is expected to reduce cost of import.
- Withdrawal of zero duty on textile machinery, computer and computer accessories will raise the import costs of these items and may not prove to be favourable to the IT industry.
- Removal of customs duty from crude edible oil and lentils and continuation of zero duty import of essential food commodities and fertilisers for the farmers will allow the government to stabilise the existing price situation.
- Proposal to raise the specific duty rate on raw sugar from Tk 2,250 to Tk 4,000 has been placed to protect local sugar cane growers and prevent misdeclaration. However, this may adversely effect the price of sugar in the local markets.
- Trade liberalisation has been addressed by putting in measures such as the withdrawal of 4 per cent IDSC, reduction of existing supplementary duty and removing customs duty on electronic cash registers.

VAT

- Reduction of the minimum and maximum penalty for tax evasion to 25 per cent and 75 per cent respectively is likely to encourage self assessment by taxpayers.
- Withdrawal of annual renewal of VAT registration by commercial importers will simplify the procurement of commodities from abroad.
- Withdrawal of VAT on insulin, first aid box, hearing aid, shadow-less operation lamps at import will help to reduce medical costs, especially for the poor.
- Imposition of VAT at the rate of 4.5 per cent on coaching centers, English medium schools, private medical and engineering colleges and private universities and health clubs is likely to raise substantial revenue.
- Withdrawal of VAT exemption facility to specialised doctors, lawyers and dental clinics will extend the VAT coverage.
- Further extension of the VAT net through withdrawal of the existing turnover facilities to enterprises including building construction companies, SIM card and internet distributors, cinema halls, health and fitness centres and sports organisers is likely to lead to higher VAT income.

Outstanding Proposals

- VAT registration through commercial banks may be explored by the government to ensure greater certainty of incidence.
- A system of VAT inclusive maximum retail price (MRP) for all products needs to be examined by the NBR.

4.2 Restructuring the Tax Administration

The budget has attempted to address the need for reducing dependence on import based revenue collection and augmenting revenues from domestic sources. While some progress has been made in this direction, reforms in the tax administration need to be continued to ensure adequate revenue mobilisation. In this connection, it is to be noted that the budget proposes reduction of discretionary powers of tax officials and elimination of discriminatory tax collection policies has been proposed.

4.3 Changes in Tariff Structure: Implications for Domestic Industry

With a view to simplify the tariff structure and generate more revenue through import duty, the government has restructured the overall import duty structure by replacing the existing three tier slabs of 5 per cent, 12 per cent and 25 per cent by 10 per cent, 15 per cent and 25 per cent respectively, with the total withdrawal of IDSC of 4 per cent from the current tariff structure. The government has also decided to merge the two slabs of the supplementary duty (SD) of 15 per cent and 25 per cent into a single slab of 20 per cent, and reducing the existing SD from 65 per cent to 60 per cent.

TABLE 8. SIMULATION WITH PROPOSED CHANGE IN TARIFF STRUCTURE

	CD	SD	VAT	AIT	IDSC	RD	Tariff Incidence
	CD increased from 5% to 10%						
Old	5	0	15	3	4	0	27.75%
New	10	0	15	3	0	0	29.50%
	CD increased from 12% to 15%						
Old	12	0	15	3	4	0	35.80%
New	15	0	15	3	0	0	35.25%
	CD remains 25%						
Old	25	0	15	3	4	0	50.75%
New	25	0	15	3	0	0	46.75%
	CD remains 25%; SD increases from 15% to 20%						
Old	25	15	15	3	4	0	72.31%
New	25	20	15	3	0	0	75.50%
	CD remains 25%; SD decreases from 25% to 20%						
Old	25	25	15	3	4	0	86.69%
New	25	20	15	3	0	0	75.50%
	CD remains 25%; SD decreases from 65% to 60%						
Old	25	65	15	3	4	0	144.19%
New	25	60	15	3	0	0	133.00%

Source: CPD-IRBD Database.

The CPD estimate draws attention to the fact that the proposed slab of import duty may create an *anti-domestic industry bias*. Table 4 reveals that the tariff incidence will be increased by 1.75 per cent when customs duty changes to 10 per cent from 5 per cent (SD, VAT, AIT and RD remain at 0 per cent, 15 per cent, 3 per cent and 0 per cent respectively in all the cases), i.e. the tariff incidence would be 29.5 per cent for the new tariff structure in lieu of 27.75 per cent for the old structure. It is to be mentioned here that basic raw materials and capital goods items would fall under this group. On the other hand, the change in tariff from 12 per cent to 15 per cent has not seen significant differences in terms of tariff incidence for the importers of intermediate goods, a decrease in tariff incidence of only 0.55 per cent. The new tariff structure would surely be beneficial for the finished goods importers, who will now face lower tariff incidence (due to removal of the 4 per cent IDSC and same 25 per cent CD). *It is worthwhile to note that the difference between tariff incidence for raw materials and finished goods decreased from 23 per cent to 17.25 per cent with the proposed changes in tariff structure (assuming zero per cent SD).*

Another point needs to be made here which is that SD has been imposed on finished products only (in other words, there is no incidence of SD in the case of earlier 5 per cent and 12 per cent CD slab). When SD is fixed at 0 per cent, tariff incidence for finished products comes down by almost 4 per cent which comes down significantly by 11.19 per cent when SD comes down from 25 per cent to 20 per cent (proposed in the budget). Again, when SD decreases from 65 per cent to 60 per cent, tariff incidence for finished products comes down by 11.19 per cent. On the other hand, when SD increases from 15 per cent to 20 per cent (proposed in the budget), tariff incidence of finished products would increase by 3.19 per cent.

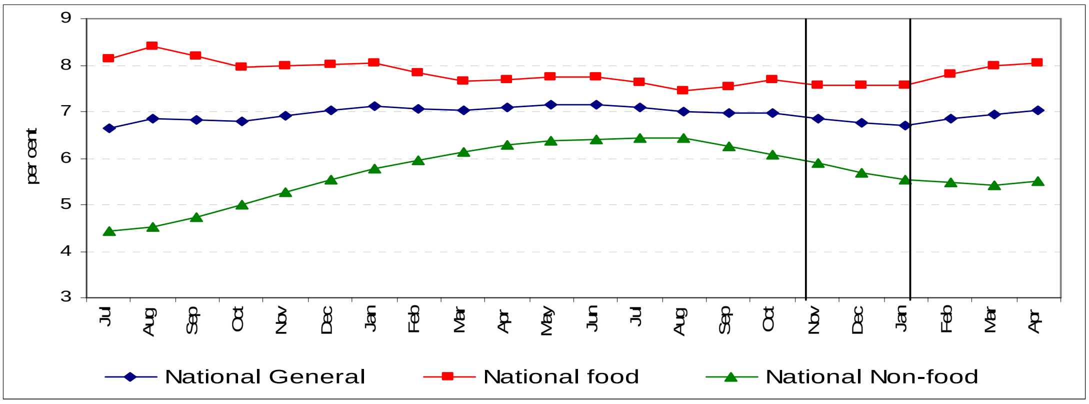
The upshot of this analysis is that there is a high possibility that the proposed restructuring of tariff, notwithstanding being progressive in nature, may create an anti-domestic industry bias!!!

Government has revised the tariff structure to make it simple and more transparent in the proposed budget of FY2007-08. We are confused with the recent initiative taken by NBR to impose safeguard tax on import of products posing threat to export items. Imposition of such a tax apparently contradicts with the objective of a more transparent and simple tariff structure.

V. PRICE STABILISATION MEASURES

Price hike has been one of the major challenges for the CTG. Two distinctive features have been observed of the recent inflationary trend: food inflation is higher than non-food inflation and rural food inflation is higher than urban food inflation. On the basis of moving average, consumer price inflation decreased from 7.09 per cent in April 2006 to 7.02 per cent in April 2007. The inflation rate on a point-to-point basis was 8.28 per cent during the same period. Food inflation had been higher than the non-food inflation during the first three quarters of FY2007 and the trend continued till April.

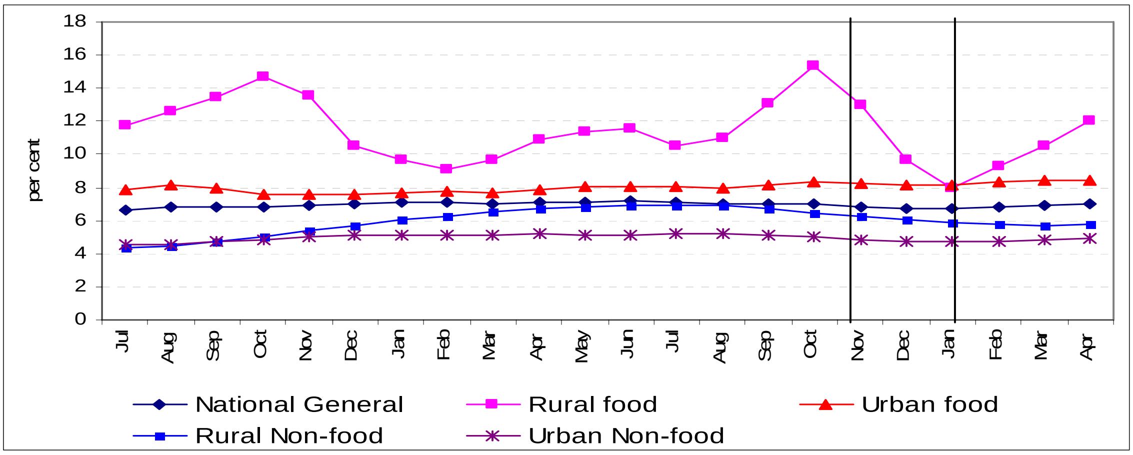
FIGURE 10. TREND IN NATIONAL INFLATION



Source: CPD-IRBD Database.

Rural food inflation is notably higher and volatile than all other classifications of inflation, most of the times, if not always. Similar trends were observed during the first three quarters of FY2007 and in April. Only in January 2007, the urban food inflation (8.1 per cent, moving average) was higher than the rural food inflation (8.0 per cent, moving average). Rural non-food inflation declined at a steady rate throughout the first three quarters of FY2007 and into April whereas both urban food and non-food inflations were stable except for few insignificant deviations.

FIGURE 11. TREND IN FOOD AND NON-FOOD INFLATION



Source: CPD-IRBD Database.

A recent CPD study has made an attempt to diagnose the reasons behind the current creeping inflation, particularly food inflation.[6] The reasons identified are both domestic and international by nature. Domestic reasons include increased production cost of domestic commodities, market concentration/collusion of market agents (both at importers and bepari levels), information gap between different stakeholders, too many market intermediaries, dislocation in market structure due to anti-corruption drive, increased transportation cost, relatively high cost of doing business, high interest rate and bank charges, lack of institutional monitoring mechanism and finally an inflationary expectation originating from the current inflation trend. International reasons include global supply shocks due to adverse climatic conditions in major exporting areas and global price hike of petroleum products.

By investigating the nature and reasons of the recent inflationary trend, the following observations can be made. The inflation has mainly originated from a change in relative prices, indicating a cost-push inflation which is more of a supply-side issue. It is not a macroeconomic problem; rather, it is a product specific issue. Finally, based on current domestic market trends and taking note of the global and regional inflation projection for the next few months, the national inflation is unlikely to come down below 7 per cent in the near future (till Aman), while the food inflation is expected to be hovering around 9 per cent during the first half of FY2007-08.

[6] CPD (2007). Price of Daily Essentials: A Diagnostic Study of Recent Trends. A report prepared for the MoC, GoB.

Considering the reasons and nature of the inflation, persuasion of price stabilisation approach to decrease price volatility in the short term, and increase production and productivity growth in medium term appears to be the best strategy to address the issue of inflation. The Central Bank should also cautiously monitor the growth of monetary sector. Table 5 shows that in the third quarter of FY2007 the growth of total domestic credit is lower than the previous two quarters. Broad money and private sector growth have been projected at 15.0 per cent and 14.5 per cent respectively. Considering the target, the growth of monetary sector should be monitored carefully.

TABLE 9. TRENDS IN GROWTH OF DOMESTIC CREDITS

(Outstanding stock)

(Tk in crore)

	Credit to Government	Growth (point to point)	Other Public	Other Public (point to point)	Private Sector	Private (point to point)	Total Domestic Credit	Total point to point
Jun 06	31260.00	21.95	15074.20	34.72	130971.80	18.27	177306.00	20.16
Sep 06	33698.00	28.36	15296.10	18.86	134811.30	17.70	183805.40	19.62
Dec 06	36777.20	35.89	15675.90	3.61	142393.40	19.44	194846.50	20.72
Mar 07	34839.60	31.94	15589.60	3.02	145405.60	16.59	195834.80	17.79

Source: CPD-IRBD Database.

Both short-term and medium-term policy recommendations have been articulated in the aforesaid CPD report to mitigate the inflationary pressure. These can be divided into three broad groups based on the intervention level: market based intervention, non-market measures and institutional reforms. The expected outcomes from these interventions could be any of the following four:

a. To increase supply of essential commodities with increased import and higher production.
b. To reduce production and import cost.
c. To raise efficacy of marketing system by reducing the number of market intermediaries and to continue temporary measures like OMS by BDR, TCB, Food Directorate and establishment of open market (Unmukta bazaar).

d. To provide price support measures to the poorer segments, dearness allowance for the public servants and widen the social safety net programmes (e.g. FFW, VGD, TR, GR)

TABLE 10. CPD'S RECOMMENDATIONS AND CTG'S RESPONSE TO MITIGATE INFLATIONARY TREND

Measures	Intervention Type	Expected Outcome
Short Term Measures		
1. Four wholesale markets in Dhaka city	Market based measure	More competition
2. Strengthen BDR's Dal-Bhat programme	Market based measure	Increased supply
3. Eight lakh tons of food grains imports by public sector	Market based measure	Increased supply
4. Intensify internal procurement of foodgrains	Market based measure	Increased supply
5. Six lakh MT tonnes of foodgrains will be distributed through TR, GR, FWP and VGD	Market based measure	Increased supply
6. Special project to control bird flu and encourage hygienic poultry production and marketing	Market based measure	Minimise production risk and facilitate supply
7. Withdrawal of customs duty on crude edible oil and lentils and continuation of duty free treatment of rice, wheat, onion, matar dal and chola dal	Non-market measure	Import cost reduction
8. Existing supplementary duty has been reduced from 25 per cent and 65 per cent to 20 per cent and 60 per cent respectively.	Non-market measure	Import cost reduction
9. Commercial banks to provide credit facilities on softer terms to new importers	Non-market measure	Reduction of import cost reduction
10. Withdrawal of the provision of annual renewal of VAT registration by commercial importers	Non-market measure	Import cost reduction
11. Continuance of duty-free facility to import of fertilisers for farmers	Non-market measure	Increased production
Short and Medium Term Measures		
12. Subsidy for diesel used in irrigation directly to card holding farmers amounting to Tk 750 crore	Non-market measure	Production cost reduction
13. To continue 20 per cent subsidy for electricity used in irrigation	Non-market measure	Production cost reduction
14. Tk 1,500 crore as fertiliser subsidy	Non-market measure	Production cost reduction
15. Distribution of agricultural credit (Target Tk 6,351 crore)	Non-market measure	Increased production
16. Increased coverage and the amount of individual grants under the social safety nets programme	Non-market measure	Increased supply and price support
Medium-Term Measures		
17. Tk 350 crore endowment fund for agricultural	Non-market measure	Increased production

Measures	Intervention Type	Expected Outcome
research		and cost reduction
18. Increased allocations for road maintenance and railway maintenance	Non-market measure	Import cost reduction
19. Allocated Tk 68 crore (19 per cent of total allocation) for repairing of two fertiliser units (Zia and Jamuna Fertiliser Company)	Non-market measure	Production cost reduction
20. Establishment of task force at national and district level to review prices of essential commodities regularly	Institutional measure	Reduction of market volatility
21. Inter-ministerial monitoring committee to analyse price situation of essential commodities and making recommendations	Institutional measure	Reduction of market volatility
22. A legal framework to protect consumers' rights	Institutional measure	Reduction of market volatility

Source: CPD Price Study and Budget Documents.

Among the 22 measures, 6 could be categorised as market based (four for increasing the supply, one for escalating the effectiveness of market and one for minimise production risk and facilitate supply), 13 non-market based (four for reducing the import cost, four for decreasing the production cost, two for increasing the production, one for increasing production with reduced cost and one for escalating both supply and price support) and 3 as institutional measures for reducing market volatility. It was found that majority of CPD's recommendations to mitigate the price hike of essential commodities have been reflected in the budget.

However, before anything else government should come up with a concrete and uniform estimate of national balance-sheet of food availability and demand of essential commodities on a priority basis. Based on this estimate, relevant government agencies should draw an annual plan to maintain food security of the country and take necessary measures to stabilise the price of essential commodities. Other short-term measures include taking necessary measures to reduce the production cost with increased availability of electricity to the agricultural sector through load management, increased agricultural credit facilities to the farmers and availability of subsidised agricultural inputs (such as fertilisers, distributing quality seeds, etc.), enactment of "Supply and Regulation of Essential Commodities Ordinance (2007)" with powerful implementing agency, widening of OMS initiatives by BDR, TCB, Food Directorate and private entrepreneurs, restoration of business confidence in the market, mandatory display of MRP, reduction of financial charges and reduction of the buying-selling difference of the

USD and BDT, and reduction of transportation cost. Careful preparations will need to be made in view of any likely flood in July-August months, and also the upcoming Ramadan. Medium-term recommendations include promoting producers' marketing association, strengthening of the TCB as a modern corporate organisation, establishment of terminal markets with "hub and spoke" format, especially for perishable goods and establishment of an Advanced Agri-Portal.

VI. SECTORAL AND REGIONAL MEASURES

6.1 Agriculture

Crop Sector- Increased investment, Subsidy for fertiliser, Diesel Card for Farmers

- **Subsidy for Diesel and Electricity Used in Irrigation:** Tk 750 crore has been proposed as subsidy on diesel used in irrigation for the Card Holding farmers. The Finance Adviser has also proposed to continue the 20 per cent subsidy for electricity used in irrigation. It is pertinent to mention here that the government has increased price of diesel by 21 per cent (from Tk 33 to Tk 40 per litre) on 2 April 2007. About 11 lakh metric tonnes of diesel are used for irrigation and 83 per cent of the total irrigated area is irrigated through diesel operated engines, and the rest is irrigated through electricity operated engines. Therefore, *this is a good initiative. CPD suggested for such an initiative through its budget recommendations to the Finance Adviser.*

- **Fertiliser Subsidy:** The budget for FY2007 has allocated Tk 1,500 crore as fertiliser subsidy against Tk 1,100 crore in FY2007 budget and Tk 1,541 crore in the revised budget of FY2007. CPD considers this to be a good initiative.

- **Fund for Agricultural Research:** An allocation of Tk 350 crore has been proposed in FY2008 as endowment fund for agricultural research compared to Tk 244 crore allocated for this purpose in FY2007. Agricultural research generates technology and most important determinant of agricultural growth in Bangladesh was technology and better management techniques generated through research. Growth in agricultural production through increased productivity and thereby reduction in per unit cost of production mainly depend on success in technology generation and dissemination. Therefore, *CPD welcomes this proposition, and hopes that it will be effectively and efficiently utilised to achieve desired goals.*

- **Fund for Small Farmers Affected by Natural Disasters:** Compared to Tk 50 crore in FY2007 allocation has been increased to Tk 100 crore in FY2008 on this account. Recent studies have shown that agriculture sector has experienced a significant change and has been shifting toward high value and high risk production system. *So, this is a welcome measure.*

However, implementation would be the major challenge here. It is learnt that only about 52.8 per cent of the allocation made for FY2007 was actually spent until February 2007; 77 per cent of ADP allocation was released and 56 per cent of ADP allocation was spent up to April 2007.

Crop Sector-Tariff Reduction on Import of Agro-commodities Would Not Affect Domestic Production

- **Duty-free Import of Fertilisers:** The budget has proposed continuation of duty-free facility for importation of fertilisers for farmers. Considering high price of fertiliser in the international market and lack of domestic production to meet the demand, this is a realistic measure.
- **Duty-free Import of Agro-commodities:** The Finance Adviser has proposed withdrawal of customs duty on crude edible oil and lentils. He added that the import duty of a number of essential commodities, including rice and wheat, has been already withdrawn. For these commodities, zero duty import will continue. Withdrawal of import duties on agro-commodities is a very crucial issue. Here, balance of interests between farmers and consumers needs to be maintained. In the international market, currently the price of rice and wheat is very high. On the other hand, domestic production is less than the requirement. In the case of lentil, only one-third of total requirement is produced domestically. Most of the edible oil is imported as crude oil which is then refined and marketed in Bangladesh. Therefore, it is unlikely that reduction of import duty will negatively affect farmers.
- **10 Per cent Duty on Irrigation Pumps:** Withdrawal of duty-free import provision and introduction of 10 per cent duty on import of power pumps have been proposed by the Finance Adviser. It is likely to have negative impact on irrigation and agriculture. *We suggest for continuation of duty-free import of irrigation pumps.*
- **Agricultural Credit:** Agricultural credit has been proposed to increase. The target for FY2008 is Tk 6,351 crore compared to Tk 6,316 crore in FY2007 and actual disbursement of Tk 4,294.93 crore (up to April 2007). The budget has proposed to distribute agricultural credit through Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB), four nationalised commercial banks

(NCBs), Bangladesh Rural Development Board (BRDB) and Bangladesh Cooperative Bank (BCB).

Poultry– Special Project to Tackle Bird Flu and Zero Tariff on Import of Inputs and Machineries

- Two projects for poultry sector have been initiated in the ADP. These are: (i) Prevention and Control of Avian Influenza: Tk 19.81 crore for FY2008 (total budget: Tk 154 crore for 4 years), and (ii) Poultry Technology Development and Testing Project: Tk 18.21 crore for FY2008 (total budget: Tk 33.51 crore for 5 years). In his budget speech, the Finance Adviser has stated, "Immediate and emergency measures have been taken to tackle the situation arising from the attack of avian influenza virus. A special project costing Tk 20 crore has been approved in addition to the allocation made from revenue budget to ensure constant monitoring, payment of compensation and hygienic production and marketing of poultry products."
- The Finance Adviser has also mentioned that the Government remains focused on the prevention of *jhatka* fishing and on quality control of fish and fishery products.

These are welcome measures but real challenge will be implementation, particularly in view of the fact that only 34.1 per cent of allocation in FY2007 was spent till February 2007. CPD recommended for duty-free import of equipments for poultry industry and special projects to tackle bird flu (Avian Influenza).

6.2 Industry

The government has allocated Tk 341.8 crore for the "industry" sector in the ADP of FY2008, which is 25.3 per cent lower than the original ADP and 18.2 per cent higher than the revised ADP of FY2007. Domestic resources will finance 42.4 per cent of the planned expenditure while project aid will finance 57.6 per cent of the proposed allocation. The number of projects has been decreased to 29 (15 Investment and 14 TA projects) from 39 during the previous fiscal and no new project has been included. Highest allocation has been provided to the project "Refurbishing Assets of Chittagong Still Mills and Adamji Jute Mills for Converting into EPZ." Besides, Tk 68 crore, which is nearly 19 per cent of total allocation, has been allocated for repairing of the two fertiliser companies, namely Zia and Jamuna Fertiliser Company. Surprisingly, no projects of agro-based and agro-processing industry have been included in the ADP despite these being identified as thrust sector in the Industrial Policy 2005.

6.3 Textile and Readymade Garment

The FY2008 budget proposed an allocation of Tk 10.18 crore for 4 projects for the development of textile and readymade garment industries. The majority of this funding has been provided by the GoB (about 51 per cent) and the rest 49 per cent of the allocation has been financed from foreign aid. Highest allocation was made for the development of our textile industries, with a view to proper integration with our RMG sector. Around Tk 8.48 crore has been allocated for three different projects to strengthen the capability and capacity, and enhance the quality of the country's textile industry. An amount of Tk 4.68 crore has been proposed for the development of 10 textile vocational institutes; another Tk 3.5 crore has been allocated for "Strengthening of NITTRAD's & TSMU's Capability for Development of Textile Sector". A grant of Tk 1.7 crore in the form of technical assistance has been made to the Ministry of Commerce (MoC) as a support to the RMG sector in view of post-MFA challenges. Apart from this, the government has also allocated Tk 25 crore for welfare benefits of the RMG workers and Tk 20 crore for training and enhancing efficiency of the garment workers.

The withdrawal of zero duty on textile machineries and imposition of a customs duty of 10 per cent have been made at a time when the garment sector of Bangladesh is addressing the post-MFA challenges. It is to be mentioned that the RMG sector's performance has been stellar. The sector has posted a positive growth rate of over 21 per cent during the first 9 months of FY2007; the knitwear sector is doing particularly well. However, in view of the emerging market scenario, particularly the competitive pressure from China, Bangladesh's export-oriented RMG sector needs to remain alert to the challenges of maintaining the current momentum. Consequently, providing support to the backward linkage textile industry and the zero-duty on capital machineries should be continued.

6.4 Handloom

Interestingly, there has been no mention of the handloom industry in the FY2008 budget. No development initiative has been taken by the current CTG for the development of this sector which is considered to have large potential. It is pertinent here to recall that our neighbouring country, India, has allocated Rs 321 crore for the development and strengthening of this sector in its budget for FY2008.

6.5 Jute

While jute has been identified as the third most import thrust sector in the industrial policy, we see no reflection of it in the budget. Obviously, just acknowledging the sector as a thrust sector is not enough. Concrete initiatives to develop the jute sector should be taken.

6.6 Newsprint

In view of the problems of newspaper industry and at the same time to keep the raw materials for newsprint duty-free to develop the local newsprint industry, the budget has proposed a reduction of customs duty rate from 25 per cent to 15 per cent on the import of newsprint and also withdrew duty-free import facility if 50 per cent newsprints are local. Ten per cent CD has been imposed on basic raw materials of paper industries (pulp i.e. HS47.01-47.03) and on capital machinery (HS 84.39, 8439.91, 8439.99 and 59.11) which was 0 per cent and 5 per cent in FY2007. Considering huge investment and growth of this sector, reintroducing “zero” tariff facility for raw materials (pulp i.e. HS 47.01-47.03) for this industry may be considered.

As a result of this measure, the facility enjoyed by the importers to import 50 per cent of their demand duty free on condition that the rest 50 per cent will be met from local sources is gone. Hence, the government may consider further reduction of the customs duty rate than the proposed rate. The government has to be vigilant as regards misuse of the facility by dishonest importers.

6.7 SME: Loser against Large Scale

While the small and medium enterprise (SME) has been identified as one of the priority sectors and the driving force for industrialization in the Industrial Policy 2005, not much has been done for the development of this sector in the FY2008 budget. Only an amount of Tk 40.06 crore (11.8 per cent of total industrial allocation) has been allocated for the development of this sector. In the proposed ADP, Tk 20.66 crore has been proposed for the Small Enterprises Development Credit Project (SECP) and a further Tk 16 crore has been allocated for the development of tannery industry. A decision has been taken to establish an SME Foundation under the Ministry of Industry as a new initiative. An endowment allocation of Tk 100 crore has been proposed in the budget, while Bangladesh Small and Cottage Industries Corporation (BSCIC) has allocated Tk 23 crore to create a Thrust Fund to provide SME loans. Another initiative of the present government is to re-fix the ceiling of invested capital in plant, machineries and equipment from Tk 5 lakh to Tk 7 lakh for cottage industry, which will hopefully benefit the SME industry.

Taking cue from the earlier paragraph, we see that rather than to help developing our industries to go global, the CTG has imposed a customs duty of 10 per cent (earlier it was zero duty) on textile machineries, computers and computer accessories; whereas India has raised the exemption duty for small scale industries from Rs 1 crore to Rs 1.5 crore in FY2008 to promote the SME. On the other hand, Pakistan has identified CNG dispenser, leather and shoe industry as their thrust sectors and exempted them from customs duty.

CPD has put forward some suggestions for the development of SMEs to cope up with the rising global competition:

- Budgetary declaration of re-fixation of the ceiling of invested capital in plant, machineries and equipment from Tk 5 lakh to 7 lakh for cottage industry could be increased up to Tk 10 lakh.
- SMEs based on imported raw materials suffer from double VAT collection and hence loses competitive edge—this issue needs to be addressed as soon as to enhance the price competitiveness.
- Turnover tax should be collected from larger SMEs.
- For better access to credit facilities by the SMEs, loan procedure should be made easy.

6.8 Agro-based Industry

Agro-based Industry– EEF and Credit Support to Sustain Growth

The budget has allocated Tk 100 crore as agriculture Equity Entrepreneurship Fund (EEF). In FY2007, Tk 100 crore was allocated under EEF for agriculture and ICT sectors. An allocation has been made for Tk 150 crore as credit support for agro-based industries to be channeled through Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank (RAKUB), BASIC Bank and Karma Sangsthan Bank (KSB).

Specific duty on raw sugar from Tk 2,250 per metric tonne has been increased to Tk 4,000 to avoid mis-declaration and to protect the interest of sugarcane growers and local sugar industries.

The withdrawal of SD on glucose and glucose syrup (1702.30.10, 1702.30.20, 1702.30.90 & 1702.40.00) will lock down the local industries, as they will not be able to compete with the imported items. SD of 20 per cent on these items may be retained to protect domestic industries.

6.9 ICT

The budget has proposed withdrawal of zero duty on computer and computer accessories to protect the domestic industries. However, it may have negative impact on education and overall economy. Therefore, we suggest maintaining zero duty on computer while keeping the proposed duty on computer accessories.

6.10 Milk and Milk Powders

Tariff incidence on milk and cream in powder forms has increased from 72.31 per cent to 75.5 per cent whereas, tariff incidence on other milk products has decreased from 50.75 per cent to 46.75 per cent and from 32.0 per cent to 28.0 per cent. In view of rising trend in international price, introduction of specific duty may be considered.

6.11 Export Promotion and Diversification: Less Priority!!

The government has allocated Tk 1,100 crore for subsidising our exports and Tk 800 crore has already been released during FY2007. While the current Export Policy 2006-2009 identifies six thrust sectors, only agro-products and agro-processing products, and software and ICT got Tk 100 crore each through the EEF. The rest was not mentioned at all in the budget. The way the budget has been prepared it looks as if the export sector has been punished for its robust performance!!!

6.12 Environment

Environment – Special Focus to Monitor and Curb Pollution Without Any Measures

No concrete financial measures have been proposed in the budget of FY2008 for environmental protection apart from reiterating the problem of pollution and the proposal of the creation of a website and database on climate change by the Department of Environment (DoE). Mandatory establishment of effluent treatment plant to prevent industrial pollution in highly polluting industrial plants was a provision of the previous year (FY2007) where a proposal was made to withdraw import duty from effluent treatment plants. In order to make the policy more effective, CPD recommended penalty on those who will not install treatment plant within stipulated period.

6.13 Transport

Transport sector received the second highest allocation (Tk 3303.74 crore, 12.47 per cent of the total ADP) in the ADP of FY2008. Sub-sectoral distribution is: Tk 2,428.15 crore for roads and Tk 875.59 crore for railways, shipping and civil aviation. The allocations for road and railway maintenance have been increased by 76.5 per cent and 40 per cent respectively in the proposed budget of FY2008. At present financial and management restructuring is underway to improve Biman's efficiency, and a decision has been taken to convert Bangladesh Biman into a public limited company. The transition of Biman to public limited company should lead to an increase in its efficiency and profitability. However, no specific deadline has been mentioned for completing the corporatisation. Customs duty on CNG driven trucks has been reduced from 25 per cent to 10 per cent, whereas customs duty on CNG driven bus has been enhanced from 5 per cent to 15 per cent to develop assembling industry for CNG-driven bus. One major negative aspect of the proposed budget is the lack of coherence in the definition of sectors in the ADP and the proposed budget of FY2008. Projects related to road, railways, shipping and civil aviation have been included under the "Transport" sector in the ADP, whereas those were mentioned under the sector "Communication" in the budget of FY2008. This incoherence leaves scope for confusion and misinterpretation. Besides, no allocation has been made for some of the most critical projects in this sector including Padma Bridge, Mongla Port, Chittagong Port, Deep Sea Port, Second Bridge on Jamuna, Dhaka Elevated Highway and Dhaka-Chittagong Express Highway.

6.14 Communication

Communication sector is the only sector that has received lower allocation (3.3 per cent) compared to the revised ADP of FY2007. An amount of Tk 550.69 crore has been allocated in FY2008, whereas Tk 569.71 crore was allocated in revised ADP of FY2007. The notable positive aspects of this sector are:

- Mobile phone operator companies' corporate tax rate would be 35 per cent if these companies are converted into publicly traded companies and are enlisted with the stock exchanges.
- Supplementary duty at the rate of 60 per cent on the SIM card has been imposed. The government should be able to earn more revenue considering the high growth of mobile phone users.
- The policies for bringing VOIP business under legal framework are going to be finalised soon. Though consumers have to pay more money as call charges, this initiative will ensure higher revenue earnings for the government.

However, similar definitional problem exists in the budget for this sector.

6.15 Energy

Power

The government announced a plan to increase power generation over the next three years by 345 MW in the first year, 900MW in the second year and 1050MW in the third year. The proposal is to allocate Tk 1,155.06 crore for electricity generation. Inclusion of 14 new unapproved projects has been proposed, of which 9 will add 2295 MW new electricity in the national grid. However, project-specific allocations and timeframe regarding the completion of these projects have not been clearly mentioned. Initiatives have been taken to add 600 MW electricity to the national grid by completing the maintenance of neglected power generation plants by the end of this year. A loan of Tk 350 crore has been provided to Power Development Board (PDB) to settle the outstanding bills of the independent power producers (IPP). The government has also proposed to offer tax holiday facility to solar energy plants to encourage the use of alternative source of energy to mitigate the power crisis. This is a good initiative considering the acute shortage of power at present.

Oil, Gas and Natural Resources

The government has allocated Tk 729.47 crore for oil, gas and natural resources sector in the ADP of FY2008. Allocation for this sector registered a growth of 406 per cent which is much higher than previous year's allocation. This has been mainly due to the inclusion of the project "Monohordi-Dhonua, Elenga-Jamuna bridge (eastern side) gas pipe line establishment and establishment of compressor in Ashuganj and Elenga." The allocation amounts to Tk 278.34 crore which accounts for 38.2 per cent of the total sectoral allocation. In order to maintain the flow of import of petroleum products, Tk 600 crore has been provided to BPC. Besides, the government has decided to assume the accumulated default loan of BPC (Tk 7,523 crore) as its own liability by issuing treasury bonds of equivalent amount. However, details of the bond issuance process have not been provided.

6.16 Physical Planning, Water Supply & Housing

An amount of Tk 1,596.28 crore has been allocated for the physical planning, water supply and housing sector which is 15.7 per cent higher than the revised budget of FY2007. Government has set a target of raising supply coverage of safe drinking water to 90 per cent and sanitation coverage to 100 per cent in the next three years. Besides, the programme for construction of 15,000 flats on khas land in Dhaka, intended to rehabilitate the uprooted people, slum dwellers and the low-income families, will soon be implemented.

6.17 Foreign Investment

Not much has been said about foreign investment in the proposed budget. However, the government has proposed to offer tax rebate facility to the non-resident Bangladeshi investors. This might have a positive impact on FDI as the tax rebates could attract more investment.

6.18 Capital Market

The proposed budget did not have any fiscal incentive for the development of stock market other than the indirect pressure on the mobile phone companies, though the capital market in Bangladesh is gradually being widened and deepened. The government has decided to off-load the shares of a number of SoEs (under power, telecommunication and energy) in the capital market during FY2008. The listing of SoEs will surely energise the capital market and make it more vibrant. However, the names of the specific SoEs were not mentioned in the budget.

6.19 NCBs and SOEs

Restructuring of NCBs: Restructuring of several NCBs is under progress. The sale process of the Rupali Bank is expected to be completed by mid-June of 2007. Besides, corporatisation of the other three NCBs has also made some progress. Though Janata and Agrani Bank have already received the licenses, no progress has been made with regard to the Sonali Bank.

State-owned Enterprises (SOEs): Several state-owned enterprises (SOE) are going through restructuring with a view to enhancing their efficacy. Efficiency of both Chittagong and Mongla Ports has increased in recent times. Technical and financial feasibility studies in relation to building a deep-sea port have now been completed.[7] The government has already concluded agreements to transfer six land ports to the private sector, two of which have been made fully operational on a Build, Own and Transfer (BOT) basis. Besides, decision has been taken to convert Bangladesh Biman into a public limited company. Legal reforms have been initiated to reduce the complications related to land registration process. Measures taken in the budget for the reform of the SOE sector are appreciable, however, but proper implementation of these initiatives poses formidable challenge for the CTG.

6.20 Local Government, Regional Development & Chittagong Hill Tracts

Concerted Efforts for Balanced Regional Development: The ggovernment has allocated Tk 2,953.47 crore under various ADP projects in the northern region (Rajshahi Division), which is 34 per cent higher than the revised ADP allocation in FY2007. Southern region (Khulna and Barisal) received an allocation of Tk 2,652.56 crore under different ADP projects, which is 42 per cent higher than the revised ADP of FY2007. This is a good initiative for fostering and promoting development in some of the relatively

[7] Pacific Consultants International from Japan has started working on establishing the deep-sea port.

underdeveloped regions of the country. However, the number of new projects or the specific breakdown of these allocations has not been mentioned. A division-wise allocation would have been better than the regional allocation, especially for southern region. In the ADP of FY2008, six projects solely focused on Chittagong Hill Tracts (CHT) have been included with an allocation of Tk 133 crore. Besides, Tk 105 crore has been allocated as special development assistance (previous block allocation) for CHT.

LGRD—Efforts for Strengthening Local Government: Priority has been given for rural road communication to establish connectivity of the growth centres with national highway network. Implementation of the poverty reduction programmes in *char, haor* and in coastal belts is being strengthened. Development assistance for local government institutions including Chittagong Hill Tracts will be increased to Tk 987 crore (increase by Tk 150 crore). Special food and development assistance for Chittagong Hill Tracts districts will continue

These are welcome measures. Real challenge will be timely release and effective implementation of the programme, particularly in view of the past record when only 35.6 per cent of allocation in FY2007 was spent up to February 2007.

VII. SOCIAL SECTORS AND SAFETY NET PROGRAMMES

The budget has given explicit importance to areas related to human development. The Finance Adviser has proposed an allocation of Tk 19,701 crore for human resources development which is 25 per cent of the total budget. Of this 15.2 per cent is allocated for education and 6.9 per cent for health sectors.

7.1 Education

- The budget focuses on capacity building and increase in the quality of education.
- The budget proposed Tk 10 crore as education research grant. This grant is expected to allow the Government to provide financial assistance to the faculties of physical science, life science and mathematical science of any public or private university in the country if they can publish at least three research papers in recognised and well-reputed journals and also can organise an international seminar in a year. It was also mentioned that the proposed assistance will be provided following a purely competitive process based on specific research proposals. This is a very positive and innovative measure which will hopefully encourage research in educational institutes.
- The Finance Adviser has also proposed a monthly stipend of Tk 100 for 55 lakh primary students. It has also targeted 6.5 lakh persons who have attained literacy through mass education programme for income generating training through continuous education within the fiscal year 2008. Recruitment of 15,000 primary teachers has been proposed (60 per cent of whom will be female) and 10,000 teachers will be trained to improve the quality of education. As many as 18,186 classrooms will be built.
- The proposal to establish one computer lab in one school in each district is a right decision but inadequate to cater to the growing needs of the time.

7.2 Health – *No Concrete measures towards a successful HNPSP programme*

- The budget has proposed for continuation of the duty-free import of various lifesaving drugs, including insulin.
- The budget has stated that steps will be taken to increase the number of nurses rapidly by setting up more nursing institutions in public sector, and through

support from private hospitals, universities and other institutions. However, no targets have been fixed.

- Increased advance tax deduction from hospitals, diagnostic centres and doctor's fees from existing rate of 5 per cent to 10 per cent. Major concern here is whether NBR will be able to take advantage of this.

During July-Feb 2007, only 39 per cent of allocation in FY2007 was spent; consequently, major challenge will be in the area of implementation. In this regard, one observation of the Independent Review Team (IRT) which has assessed the performance of the HNPSP and released Annual Programme Review (APR) 2007 in April 2007 is of high importance to note. According to the IRT, HNPSP has failed to address three most critical areas: programme management and leadership, financial management, and procurement. IRT opined, "at the moment the HNPSP looks like a very ill patient in need of intensive care without which it is likely to become a terminally ill patient". Therefore, special attention for implementation would be needed.

7.3 Analysis of Gender Sensitivity of the Budget—Demand for More Clarification

The share of direct and indirect gender equality expenditure has been claimed to be 24 per cent in the proposed budget as compared to 22 per cent of the previous budget. An allocation of Tk 309.8 crore to ensure gender equity has been explicitly mentioned in the budget. The highest allocation, amounting to Tk 217.8 crore or 70.3 per cent of the explicitly mentioned allocation, has been provided to for widowed and destitute women. Government has allocated Tk 17 crore for the new programme "Maternity Allowance for the Poor Lactating Mothers" for safe motherhood and safe birth. This is an appreciable measure as the disadvantaged and marginalised women will be directly benefited from this project. Besides, Tk 10 crore has been allocated for acid burn and disabled women respectively. These are positive measures which will help the low income people in the society. It is pertinent to mention here that 50 ministries/ departments have set up Gender Budgeting Cells in India. The outlay for the 100 per cent women specific programmes is Rs 8,795 crore in FY2008. It may be recalled here that Pakistan has allocated Rs 415 million in self-employment programme under its national gender action plan to provide preferential assistance to women. Women are also being given special concessions in terms of income tax.

Given the disadvantageous situation of women in Bangladesh, additional support and enhanced clarity in terms of the details about expenditures related to gender equity are needed. Here also the challenge of proper implementation of these allocations continues to be a defining factor.

7.4 Social Safety Net – *More Per Capita Allocation*

Towards targeted social empowerment, social safety net, poverty reduction, and employment generation (including microcredit support scheme) programmes, the budget for FY2008 proposed an allocation of Tk 3,893 crore which is 33.4 per cent higher than revised budget of FY2007. An amount of Tk 2,273.90 crore will be spent for expansion of existing safety net programmes which is 36.23 per cent higher than the allocation in the revised budget in FY2007. Along with this, the number of beneficiaries of the allowance has increased from 25.14 lakh to 27.5 lakhs (9.3 per cent increase). However, no allocation for housing of the homeless in rural areas has been made in this year's budget.

TABLE 11. ALLOCATION OF FUNDS FOR SOCIAL SAFETY NET PROGRAMMES

(CroreTaka)

Existing Programmes	FY2007 (budget)	FY2007 (Revised budget)	FY2008 (budget)	Growth (per cent) over FY2007Revised budget
Old-age allowance	384.00	384.00	448.80	16.90
Allowances programme to the widowed, deserted and destitute women	156.00	156.00	198.00	26.90
Honorarium programme for insolvent freedom fighters	60.00	78.20	99.50	27.20
Programme for the assistance to the fully retarded	40.00	40.00	52.80	32.00
Fund for mitigating risk due to natural disaster	130.00	130.00	135.00	3.80
Fund for rehabilitation of the acid burnt women and the physically handicapped	10.00	5.00	10.00	100.00
Fund for the housing of the homeless	50.00	0.00	0.00	--
Seasonal unemployment reduction fund	55.00	00.00	50.00	--
Retraining and employment of voluntarily retired/retrenched employees/ labourers	30.00	10.00	0.00	-100.00
Development fund for the readymade garment workers	20.00	0.00	20.00	--
VGD, VGF, Test Relief and Gratuitous Relief (GR)	10.57 lakh Mt	1232.00	1649.00	33. 80
Total		1669.20	2273.90	36.23

Source: Budget Documents.

Fund for Monga: A "Seasonal Unemployment Reduction Fund" of Tk 55 crore was created under the proposed budget for FY2007 to mitigate the seasonal unemployment.

The proposal in FY2008 is to make a further allocation of Tk 50 crore to this Fund. *However, the concern would be utilisation of these fund as those allocated for FY2007 was not spent at all.* In this regard, Bangladesh could take lesson from India's National Rural Employment Guarantee Scheme (NREGS) with an allocation of Rs 14,300 crore (Tk 22,022 crore). NREGS seeks to provide guaranteed employment to one member of every needy rural household for at least 100 days a year, especially in the lean season for a minimum wage of Rs 60 per day (Tk 92). The scheme involves programmes of irrigation, development of rural infrastructure and afforestation, among others. All the projects are clearly defined in the NREG Act. Technical experts draw plans for individual villages in consultation with local leaders and elected representatives, and local people are involved in the implementation of the projects through *Gram Panchayats* and *Gram Sabhas*.

Fund for Welfare of RMG Workers: Government proposed to allocate Tk 25 crore for the welfare of RMG workers and Tk 20 crore for training for enhancement of the efficiency of workers. Regrettably, the allocated money for Skill Development Fund for the RMG workers in the budget 2006-07 remained unutilised. Under the circumstances, it will be better if the government introduces a contributory provident fund for garment workers where the government will make matching contribution equivalent to the company's contribution.

Several New and Desired Schemes: In addition to the existing schemes, the Finance Adviser has proposed for several new and desired schemes. These are:

- Maternity Allowance for the Poor Lactating Mothers: To ensure safe motherhood, and better health and nutrition of hardcore poor mothers as well as safe birth and sound upbringing of infants. An allocation of Taka 17 crore has been proposed for the expecting poor mothers who will get an allowance of Tk 300 per month. About 45, 000 mothers of 3,000 unions will be brought under this programme.
- Rural Employment Opportunities for Protection of Public Property: Proposed targeted employment creation for 24,000 destitute women in 387 unions.
- The budget has proposed construction of flats for freedom fighters and the Freedom Fighter Park. However, no targets are mentioned.
- Rehabilitation of the uprooted people, and slum dwellers, by constructing 15,000 flats on khas land in Dhaka has been proposed.

- Allocate Tk 5 crore for the education of mentally and physically challenged children.

7.5 Special Credit Programmes for Employment Generation

The budget has proposed an allocation of Tk 550 crore for the existing microcredit programmes to help the marginalised poor (monga and river erosion) in FY2008. It has also proposed Tk 20 crore as allocation for microcredit to generate employment opportunities for women.

VIII. CHALLENGES OF IMPLEMENTATION

Our aforesaid analysis of the various aspects of the budget for FY2008 has pointed out to the strengths of the prepared budget for FY2008 and also some of the anomalies and conflicting aspects in the proposed budget. The CTG has proposed a large number of measures in the budget for FY2008 which should have positive impact on the economy. Through resource allocation, income redistribution and overall macroeconomic impact on growth, the proposed measures in the budget could potentially bring about positive results in terms of poverty alleviation, higher GDP growth rate and reduced income disparity. However, much will hinge on the ability of the CTG to implement those measures, both in the area of revenue mobilisation and also expenditures on account of revenue budget and development budget.

Some of the major challenges in various areas and initiatives that need to be taken, in the context of above discussion, are perceived to be the following:

Revenue Generation

- Maintain the current momentum of revenue mobilisation
- Emphasis on assessee-friendly institutional issues
- Introduction of universal self-assessment as early as possible
- Simplification of VAT registration

Foreign Aid Flow

- Form a Task Force for accelerated disbursement of held-up project aid
- Negotiate new budgetary support for development finance
- Given the comfortable BOP situation, a new loan agreement with IMF is not advisable in the current context

Government Bank Borrowing

- Avoid volatility in bank borrowing to avoid pressure on private borrowing

Annual Development Plan

- Energetic kick-off from the very first quarter
- Develop a strategic approach focusing on e.g. power sector
- Quality must be ensured while including new projects

- Strengthen linkage with local government for project implementation
- Enhanced public-private and government-NGO partnership
- Gear up foreign aided projects
- Focus on power sector

Strengthened Monitoring of Implementation and Greater Transparency

- Periodic review of implementation status
- Mid-course speedy correction if and when deviations are detected
- Public-private partnership to monitor progress in key areas

Need for Quality and Real Time Economic Data and Improved Access

- Computerisation of tax mobilisation activities
- Generation of regular and periodic updates on key budget related indicators
- Putting in place a system whereby budget related data and information is easily accessible to stakeholders.