AIMS of BANGLADESH

B A N G L A D E S H

National Budget 2000-2001

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Provisioned borrowing from the banking system, for the first time since independence, preferred to taxes for plugging an election year deficit-budget : Crunch time ahead?

5.9% deficit with record borrowing from banking system

- **Budget size** **Tk 428.59 billion ↑13%**
- **Revenue collection target** **241.98 billion ↑13.4%**
- **Current Expenditure** **196.33 billion ↑6.44%**
- **ADP** **175 billion ↑6%**
- **Contribution of local resources to ADP** **50.2%**
- **Budget deficit** **186.61 billion ↑12.36%**

The budget has proposed a record borrowing from internal sources to the tune of total Tk 92.40 billion with a provisioned borrowing from the banking system, for the first time in Bangladesh, of Tk 35.14 billion. In the outgoing fiscal year, total borrowing was Tk 77.76 billion with Tk 39.34 billion extra-budget financing from the banking system. Annual Development (ADP) budget has been proposed to increase by Tk 10 billion to Tk 175 billion. Last year the budgeted ADP was Tk 155 billion and later has been revised to 165 billion.

Education continues to receive the highest allocation of 13% of the total budget. It is followed by civil administration 8.54%, defense 7.68%, local government 6.98%, health 6.27%, road transport 6.26%, power 5.13% and water resources 2.84%.

5.5% GDP growth attributed to good paddy harvest

A GDP growth of 5.5% in the outgoing fiscal year (1999-2000) has been estimated by Bangladesh Bureau of Statistics in the new national accounting system. It was 4.88% in 1998-99. The growth in the outgoing fiscal is attributed to a rich paddy harvest with an estimated 24.3 million tons of food grain production against 21.89 million tons in 1998-9, an 11% growth. Rice contributed more than 50% to agriculture and agriculture contributes around 30% to GDP. Therefore, as per AIMS estimate, 11% growth in rice production is to bring about a growth of 1.73% in GDP.

Industrial growth is estimated at 5.5% in the first 7 months of the outgoing fiscal against 2.3% in the corresponding period of the previous. As industrial production constitutes around 11% in the GDP, we at AIMS expect the 5.5% growth in industrial production to contribute 0.60% growth in GDP.

	Contribution to GDP	Contribution to GDP growth
Agriculture -		
Food-grain	15.75%	1.73%
Industry	11.24%	0.60%
Service	50%	
and other sectors	23%	3.17%

AIMS in-house estimate

The figures show that the service sector has contributed the highest to the GDP growth. The budget, however, has remained silent on this aspect. We are skeptical about such a high growth of the service sector.

As per provisional estimates, domestic and national savings in the out-going fiscal year was 17.78% and 22.60% respectively of GDP.

Budget at-a-glance

Tk billion

	Budget 2000-1	Budget 1999-2000 Revised	Budget 1999-2000 Original
Revenue			
Tax	192.77	170.96	186.35
Non-Tax	49.21	42.49	55.16
	241.98	213.45	241.51
Expenditure			
Current Expenditure	196.33	184.44	178
ADP	175	165	155
Internal Loan & Advance	13.11	-2.47	-4.57
Repayment of Foreign Loan	24.8	20.75	18.5
Other Capital Expenditure	19.35	11.81	14.85
	428.59	379.53	361.78
Budget Deficit	186.61	166.08	120.27
Budget Deficit Financed by:			
External Sources			
Foreign Grants	31.83	36.09	32.69
Foreign Loans	62.38	52.23	50.91
	94.21	88.32	83.6
Domestic Sources			
Term Debt (Net)	21.29	2.97	1.79
Budgetary Surplus	2.5	2.5	2.5
T&T Bond	2	1.71	1.71
Savings Certificates	31.47	31.24	30.67
	57.26	38.42	36.67
Extra Financing from the Banking System	35.14	39.34	0
Total Financing	186.61	166.08	120.27

Lowest inflation since 1996-7

Government has highlighted low inflation, which was 3.8% during last April on point-to-point basis and 4.5% on 12 months' average, as a success of macroeconomic management. The Finance Minister observed that heavy borrowing from the banking system and continued expansionary monetary policy had no direct impact on inflation.

However, record of poor revenue collection, uncomfortable level of forex reserve, increasing burden of debt servicing and poor investment demand indicated by significant idle reserve of Tk 40 billion, 6.3% of deposit, in the banking system, do not suggest a healthy state of the macro-economy. We believe that satisfactory food grain production with poor demand from the private sector due to low growth of private investment, has contributed to the low level of inflation.

Government defends heavy borrowing from banking system as non-inflationary

Government defended heavy borrowing from the banking system to be not harmful as it did not trigger inflation and banks are having excess liquidity. We would like to contradict the claim, especially, on excess liquidity. We view that as the banks have tightened their credit sanctioning and disbursement to curb loan default as directed by Bangladesh Bank and high lending rates (around 15%) due to heavy borrowing by the government at high interest rates, have deterred private investment which resulted in excess reserves with the banks.

Thankfully, government has decided to lower the interest rates on savings schemes in the proposed budget.

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Persistent and rapid growth of money supply can still trigger inflation

Government is continuing with expansionary monetary policy through borrowing from Bangladesh Bank. Cash reserve requirement was lowered from 5% to 4% and Bangladesh Bank's discount rate has been recently reduced from 8% to 7%. All these have caused money supply (M2) to grow by 13.4% in the first 9 months of the outgoing fiscal against 7.5% in the previous fiscal. Domestic credit grew by 13.8%, though growth of credit to private sector, 4.89% YOY in December 1999, and lies far behind 22.30% growth of credit to government. Government borrowed Tk 3.934 billion from the banking system, half of which came from Bangladesh Bank.

If food production cannot be sustained at the current level, which is very natural in Bangladesh, persistent and rapid monetary growth can trigger inflation.

Increasing debt servicing liability with poor revenue collection can lead to a vicious circle of debt

Persistent revenue shortfall of the government is forcing government to borrow which is increasing debt-servicing liability (principal repayment and interest). This is creating further revenue shortfall and therefore pushing the government to borrow. In 1999-2000, debt servicing has taken out Tk 56.29 billion, which is 15% of the total budget.

On the other side, revenue collection has fallen short of target by 28.06 billion or 11.61%. It however, increased by 8.35% over the realized revenue in 1998-9. In the budget for 2000-2001, debt-servicing liability is estimated to increase to Tk 62.28 billion, 11% up from that in 1999-2000

Moderate export growth

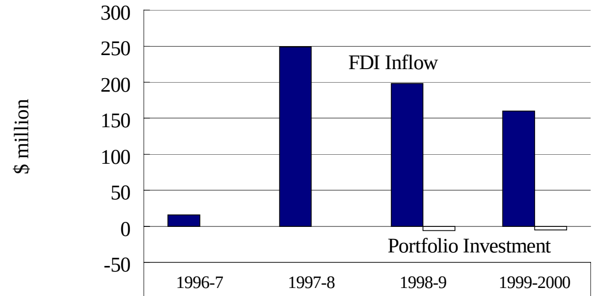
Exports grew by 8.4% during the first 9 months of the outgoing fiscal though it has fallen short of target by 4.15%. We consider it moderate compared to the export growth in 1997-8 and 1996-7 of 16.83% and 14% respectively. In 1998-9, it drastically fell to 2.9% due to colossal damage caused by the last deluge. RMG, the highest exporting sector has registered a 5.9% growth and knitwear 20.15%. Frozen food, leather, and raw jute also achieved higher export that the previous fiscal. Export of jute goods, tea and handicraft has declined. The budget has not offered any new incentive for export diversification. Export oriented industries; however, have received significant duty concessions on import of required raw materials. The statistics is as follows:

Export Statistics

Sector		Up/down from last fiscal, %	Export, $ million		Short/above target, %
RMG	↑	5.91%	2251.29	↓	3.17
Knitwear	↑	20.15%	884.08	↓	1.77
Frozen Food	↑	11.60%	225.52	↑	1.59
Jute goods	↓	1.58%	208.32	↓	10.40
Leather	↑	16.03%	143.91	↑	6.60
Raw Jute	↑	9.23%	52.18	↓	3.37
Tea	↓	58.17%	15.21	↓	49.30
Handicraft	↓	23.41%	3.73	↓	50.27

Declining Foreign Direct Investment (FDI)

The budget remains silent about declining foreign direct investment (FDI). Enthusiasm of the foreign oil and gas explorers has dried out due to the disagreement between the companies and the government over the issue of gas export to India. After a surge in 1997-8 to the tune of $249 million, FDI inflow has dropped to $160 million in the outgoing fiscal according to Bangladesh Bank. We anticipate it to further decline as foreign gas companies are reportedly reconsidering their stake in Bangladesh.



	1996-7	1997-8	1998-9	1999-2000
FDI Inflow	16	249	198	160
Portfolio Investment			-6	-5

Robust agricultural credit disbursement

Tk 20.55 billion was disbursed during the first 9 months of the outgoing fiscal as agricultural credit. In the previous fiscal, a record Tk 30.05 billion was disbursed in the sector for post-flood rehabilitation. Easing conditions for obtaining agricultural credit and enhancing access to credit for marginal and landless farmers, have given desired results.

No significant progress in reforms

The Finance Minister highlighted the following reform measures being taken:

- **Banking reform**
  - Steps taken to intensify surveillance by Bangladesh Bank and enhance its powers
  - Bankruptcy Act in force to address bad debt cases
  - Amendment of Bangladesh Bank Order and Banking Company Act is planned for further reforms
- **Capital Market reform**
  - Amendments of related laws have been tabled before the Parliament for approval
  - Law for Central Depository System (CDS) has been promulgated and setting up of the CDS is underway
- **Judicial and Administrative reforms**
  - A project has been taken for strengthening judicial reforms.
  - Administrative reform commission has been working and expected to submit their report in a short period.
  - Local administration is being restructured as per the recommendations of the commission formed for the purpose.

However, we observe that the steps so far taken are taking time to bear expected results.

Slow pace of privatization and loss of SOEs

Though the government tried to bring few changes in mode of transferring the State Owned Enterprises (SOEs) to the private sector, the progress is painfully slow. The following changes have been adopted:

- Paying dues of the employees before offering for sale of the SOEs earmarked for privatization
- Considering handing over the ownership to labor unions
- Treating the excess land of the enterprises separately for sale

However, during the last 31/2 years, only 5 industrial units have been successfully privatized and the SOEs incurred Tk 31 billion loss in the outgoing fiscal. Slow pace of privatization is generally attributed to the lack of political commitment, bureaucratic tangles and conflicting interests.

Relief to banks with burden of bad loans extended to SOEs

The Budget proposes to infuse fresh liquidity to the Nationalized Commercial Banks (NCBs), burdened with bad loans extended to SOEs, in the form of bonds of Tk 18 billion. Government has planned to reduce interest rate for lending to priority sectors like infrastructure, IT, textiles, oil and gas and agora-based industries and providing interest rebate by 10% to the performing credit recipients from the fund infused.

Changes in tax provisions

- Floor limit for taxable income of individuals has been raised to Tk 100,000 from 75,000. Minimum tax rate remains at 10%.

	Tax Rate
First Tk 100,000	0%
Next 50,000	10%
Next 150,000	18%
Balance	25%

- Undisclosed income to be accepted without question subject to payment of 10% tax on the amount.
- Tax-relief investment limit has been raised to Tk 200,000 from Tk 150,000. For investment in IPOs, it has been further raised up to Tk 225,000.
- Tax holiday facilities for industrial undertakings have been extended upto 2002.
- Income earned by extending micro-credit has been made tax-free.
- The rate of income tax imposed in the 2000-2001 budget will remain applicable for 2000-2001 and 2001-2002 to facilitate planning on the part of taxpayers.
- Minimum and maximum import duty of 5% for raw materials and 37.5% on finished goods remain unchanged.
- Conditions to pay taxes through self-assessment system have been eased. Currently, self-assessment system is not applicable for income shown less than that of the last year. It is not also applicable for individuals who are directors of a company owning 10% shares and businesses with initial capital of more than Tk 1,000,000. In the budget, the initial capital limit has been raised to Tk 2,000,000 and the other conditions have been withdrawn.
- Tariff value earlier used as the base to determine import duty has been abolished for 2200 merchandises replacing with transaction value.
- For strengthening tax surveillance, mandatory submission of Tax Identification Number (TIN) certificate has been expanded to the following:
  - providing licenses or enlistment to general insurance surveyors
  - purchase of land and apartment in the areas under City Corporation
  - Registration and fitness renewal of vehicles not used for renting
- Permanent TIN certificate instead of the provision of renewing the TIN certificate every year.
- Pre-Shipment Inspection (PSI) has been made mandatory irrespective of import value.
- VAT on retail (10%) and wholesale (15%) level has been unified at 13.35%
- Definition of trade services related to VAT has been withdrawn
- VAT on services by specialist doctors, lawyers and dental clinics has been exempted.
- Net wealth exceeding Tk 1 million and up to Tk 3 million is subject to a surcharge of 10% of applicable income tax and 15% over Tk 3 million.
- Net of tax-at-source and VAT has been expanded.
- 10% deduction of tax-at-source on interest on savings and term deposits has been proposed to be treated as the final settlement of taxes for the amount for individuals.
- System of 10% deduction of tax-at-source on interest on government savings certificates has been withdrawn.
- Deduction of tax-at-source at the time of getting approval of plan of real estate properties has also been exempted.
- Limit of deduction of tax-at-source has been raised on the following items:
  - payment to contractors and suppliers from Tk 200,000 to Tk 300,000
  - rent on house properties from Tk 10,000 to 15,000 monthly
- Tax deduction on vehicles of less than 10 years' age acquired for rental purposes at the time of registration has been increased.
- Import of three-wheelers with two-stroke engines has been banned.
- VAT has been imposed on four-stroke auto-rickshaw and tempo, on import and production of polythene bags and on cigarettes through introduction of bandroll system, and on chartered plane and helicopter services.
- Import of CNG propelled double-decker buses has been exempted from all taxes including VAT and Advance-Income-Tax (AIT).
- Import duty on talcum powder, copper and aluminum rod/wire has been raised.
- Duties on color television, video recording system, and cassette players have been withdrawn.
- Supplementary duties on locally produced mineral water, tissue paper and floor carpets have also been withdrawn while duties on their import have been raised.

Incentives to Capital Market

Capital market has received a number of incentives in the budget:

- Tax rebate @10% of tax payable will be allowed to the listed company that declares 25% dividend
- Limit for deduction of tax-at-source from dividend income has been raised to Tk 40,000 from 30,000.
- Requirement of deduction of tax-at-source on bonus shares, which was imposed in the last budget, has been withdrawn.
- Investment in secondary market has been made eligible for tax credit
- Investment allowance upto Tk 225,000 in place of Tk 200,000 has been allowed if investment is made in IPOs.

Incentives to the IT sector

IT sector has been given significant incentives in the current budget in continuity with the budget of the previous year. An equity development fund with an allocation of Tk 1 billion has been proposed for encouraging the entrepreneurs to invest in software development and food processing industries. Ventures in these sectors can receive upto 25% equity fund from Bangladesh Bank.

Apart from that, a lump sum Tk 1.5 million has been allocated for grant to the institutions preparing programmers for the IT sector. In the last budget import of computers was made duty-free. In this budget duties of other accessories i.e. toner cartridge, CD ROM drive, CDs, modems, magnetic tapes and disks, ink jets, refill kits used in computer printer and software have also been made nil.

Incentive to domestic Industries

Leather, textile, agro-based and food processing, ceramic and melamine, tea, poultry and fishery, plastic footwear, bicycles and newsprint industries have received significant duty concessions on import of raw materials in the budget as a continuity of the last budget. Import of capital machinery by 100% export-oriented industries will remain duty-free with indemnity bonds.

Duty on waste thread, yarn, and cotton fabrics used in textile industry has been reduced from 15% to 5%. Duties on raw materials of ceramic and melamine industries, zinc oxide, aluminum hydroxide and barium carbonate have also been slashed.