A Set of Proposals for the National Budget FY2015

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Section 1: Introduction

As is known, the Bangladesh economy experienced a high degree of volatility during the first six months of FY2014 in the backdrop of the political movement prior to the January 2014 elections. In view of the emergent uncertainties, many of the important macroeconomic correlates evinced disquieting trends in the first half of FY2014. The possible slowdown in economic growth, for the third consecutive fiscal year, which was likely to drag the GDP growth rate below the threshold of 6 per cent, has been anticipated by analysts in general including the CPD. CPD in its report on the state of the Bangladesh economy presented in January 2014 observed that, from the macroeconomic management perspective, the major challenge for the government will be to put the economy on the aspirational growth trajectory of 7 per cent. It was hoped that the 'ceasefire' on the political front will lead to some acceleration in economic growth in the second half of FY2014. However, whilst economic activities have resumed in view of cessation of disruptive politics, the economy is still to regain its lost momentum as it gets on with the fourth and final quarter of the current fiscal year. Although the macroeconomy is showing some degree of stability, in terms of steady exchange rate, growing foreign exchange reserves and the budget deficit remaining within limits, the underlying factors and weaknesses evince disquieting trends as the economy moves towards the end of FY2014. In this backdrop, the expectation from the national budget for FY2015 will be to help rejuvenate of the performance of major macroeconomic correlates and support growth dynamism through appropriate fiscal-budgetary measures and initiatives.

In the backdrop of the aforesaid assessment, the CPD budget proposals for FY2015 focus on a number of key areas:

i. an assessment of macroeconomic developments in FY2014 and recommendations for the needed macroeconomic policy stance and formulation of an appropriate fiscal framework for FY2015
ii. a review of the state of manufacturing production and investment situation and proposals with regard to manufacturing sector
iii. fiscal-budgetary recommendations on issues related to the rural economy
iv. proposals for strengthening social protection in Bangladesh
v. a number of non-economic issues that need to be taken cognisance of to realise FY2015 budget proposals

Section 2: Macroeconomic Backdrop in the Run-up to the National Budget for FY2015

Macroeconomic Trends in FY2014

The national budget for FY2015 will need to be framed by taking cognisance of the specific features of the developments and performance indicators in FY2014. And on both counts the signs are disquieting. The looming uncertainties afflicting business and investment outlook has continued to persist with adverse implications for major performance indicators. Growth of export earnings is declining for four consecutive months now. Export growth was 3.9 per cent during January-March of FY2014 which was 16.6 per cent during first half of FY2014. Overall, the export growth of 12.0 per cent during the first three quarters has somewhat slipped below the annual target of 12.9 per cent. During the third quarter of FY2014, growth of export earnings from RMG products experienced a sharp decline to reach 6.8 per cent, whilst export earnings from non-RMG products declined by (-) 8.3 per cent compared to the corresponding period of FY2013. The recent trends of export earnings from both RMG and non-RMG products call for careful scrutiny while preparing the forthcoming budget proposals. Growth of overall import payments during the January-February of FY2014 increased to 8.3 per cent which was only 5.5 per cent during July-December period; import of consumer goods (other than foodgrains) experienced a sharp decline ((-) 22.3 per cent). Collection of tax revenue by the National Board of Revenue (NBR) also indicates disquieting trends. Indeed, during January-February of FY2014 tax revenue collected by NBR declined by (-) 0.1 per cent. Growth of total value added tax (VAT) collection (from both local and external sources) increased by only 2.1 per cent during the aforementioned period, whereas during the July-December period of FY2014 the growth was 10.6 per cent. On a welcome note, growth of remittances inflow returned to the positive terrain after six months in February FY2014. Indeed, the inflow of remittances during the third quarter of FY2014 managed to match the inflow during the corresponding period of previous fiscal year. It is to be noted that inflow of remittances during the first half of FY2014 experienced a sharp decline ((-) 8.5 per cent).

Possibility of economic turnaround in the near future also looked somewhat uncertain as the indicators related to investment failed to show signs of improvement. The growth of private sector credit was at 10.7 per cent at the end of February FY2014 which was 10.6 per cent at the end of December FY2013. Import of capital machineries declined by (-) 1.4 per cent during the January-February of FY2014. Public investment in the form of implementation of annual development programme (ADP) also experienced same setback. The gap as regards implementation rate between performance in FY2014 and that of the previous fiscal year widened during the third quarter. During January-March of FY2014 only 16 per cent of the ADP allocation was spent; the corresponding figure for previous fiscal year was 19 per cent.

On the other hand, overall trends in macroeconomic correlates indicate that the economy is, as of now, at somewhat of a stabilised state. Inflation rate remained closer to the target (7.0 per cent) at around 7.5 per cent (7.6 per cent in March 2014). The emerging concern relates to the rising trend of food inflation. Food inflation continued to soar throughout the fiscal year to reach 8.5 per cent in March FY2014 which was 7.9 per cent in December FY2014. On the flipside, non-food inflation declined to 6.2 per cent in March FY2014 (6.9 per cent in December FY2014). This is perhaps a reflection of slowdown of domestic demand originating from stable exchange rate and global commodity and fuel prices. Balance of payment situation remained within the comfort zone during July-February FY2014 period with a hefty surplus of USD 3.3 billion thanks to the resilient growth of export earnings and the lower growth of import payments (6.2 per cent during July-February FY2014) along with a somewhat improved performance in remittance flows. Exchange rate remained stable with an insignificant appreciation of Taka against USD. As a result, foreign exchange reserves increased by about USD 4.8 billion in the first ten months of the current fiscal year. In terms of fiscal deficit, the economy remained within the programmed level. Financing mix of the budget deficit continued to rely mainly on domestic sources. During the first eight months of FY2014, 94.7 per cent of the budget deficit was financed from domestic borrowing (including both bank and non-bank sources) which was 57.1 per cent during the corresponding period of previous fiscal year. It is highly likely that budget deficit financing will continue to remain strongly biased towards domestic financing as the fiscal year closes. Thankfully, the government managed to accumulate more than the annual target of borrowing from net sales of national savings directorate (NSD) certificates (Tk. 4,971.0 crore) in the first eight months (about Tk. 6,245.6 crore) while the banking system remained flushed with excess liquidity (Tk. 94,855 crore as of end January, 2014).

In the backdrop of the foregoing assessment, it is anticipated that the national budget for FY2015 will face a daunting task in instilling momentum in the performance of the Bangladesh economy. The stabilised state of the macroeconomic situation will help the government to undertake the needed countercyclical policies. However, the recent slowdown in revenue collection will make the task challenging. Thus, the fiscal policy package for FY2015 will need to go for consolidation of public expenditure with prudent prioritisation, an intensification of revenue mobilisation drive from the perspective of both structure of fiscal measures and enforcement of related measures, and paying closer attention to financing of fiscal deficit with greater emphasis on foreign financing.

Recommended Macroeconomic Stance for Budget FY2015

In the backdrop of evolving macroeconomic scenario, the likely outcome and in view of the ongoing budgetary discussion, the fiscal-budgetary framework for FY2015 needs to be informed by some of the following considerations.

On the resource supply side, a pragmatic approach should be taken in planning FY2015 revenue targets. In view of possible revenue shortfall, the government has already slashed the target for NBR for FY2014 by Tk. 11,090 crore. Early hints from government sources indicate that the target for NBR revenue mobilisation may be set at Tk. 149,700 crore which will require attainment of a 19.8 per cent growth over the revised budget figure for FY2014. The present revenue collection trend of NBR indicates a possibility of further shortfall from this revised target, which will certainly push the target growth figure upward. Indeed the target set for NBR tax revenue mobilisation for FY2015 may prove to be rather ambitious as was the case for FY2014. Over the past three years, revenue intake from non-tax sources relied significantly on mobile spectrum fees (renewal of 2G and introduction of 3G licenses).

Fiscal measures and revenue mobilisation. In terms of designing fiscal measures and formulating revenue mobilisation plan, the government may consider the following proposals.

First, the government should revisit and rationalise the tax incentive structure. It is also important to account for, analyse and publish the revenue foregone emerging from these tax incentives. It will be prudent to tie the incentives with the intended objectives. For example, the recent cut in the advanced income tax (AIT) at source for readymade garments (RMG) exports (which is also the final settlement) should be tied with implementation of the new minimum wage. Concurrently, the government must have a plan to "phase out" the incentives gradually. The government may consider phasing out the tax holiday while considering renewal of (quick) rental power plants. The government should also stay away from continuation of provision for legalising undisclosed income/wealth in any form.

Second, the NBR needs to be vigilant to curb tax evasion emerging from trade mispricing, re-invoicing and misdeclaration. A strong and well-equipped specialised taskforce should be set up to deal with this issue appropriately; a number of public institutions (e.g. NBR, Bangladesh Bank and others) will need to act in a coordinated manner to make this successful. At the same time the NBR needs to emphasise operationlising the newly introduced transfer pricing cell without any delay.

Third, the government will have to put emphasis on collection of wealth tax surcharge. This is particularly important from the perspective of establishing economic and social justice. To generate adequate amount of revenue from this source, there is a need to review valuation of wealth, particularly those of real estates (both land, house and flats). The NBR has already proposed to consider to bring this issue under the jurisdiction of income tax ordinance. This is a welcome initiative. In connection with this, the NBR has recently conducted a survey and found that about 162,000 homeowners from major metropolitan cities (e.g. Dhaka and Chittagong) did not submit their tax returns. It was also found by the NBR (as reported by the newspaper) that about 90 per cent of the professionals such as doctors, lawyers and engineers do not pay proper amount of tax. The NBR needs to design an action plan for FY2015 to bring tax defaulters and dodgers under tax net and take measures to enforce the plan.

Fourth, in recent times there is a growing allegation that a number of non-Bangladeshi citizens are working in Bangladesh, who are doing so without any proper paperwork and without paying the due income taxes. This issue needs to be investigated and corrective measures ought to be put in place.

Fifth, the government must not be detracted from ongoing implementation strategy of the forthcoming VAT law. To implement this new law, the government will need to introduce an awareness raising plan among the stakeholders. This will help to mobilise more revenues, ensure buy-ins by stakeholders and reduce hassle faced by business people. The NBR will also have to explore the possibility of expanding the VAT net particularly in the services sector. However, the government needs to consider raising the threshold for turnover tax to safeguard the interests of small traders and entrepreneurs, who were most severely affected by the political impasse.

Sixth, the NBR chairman informed (through the media) that, the government plans to reduce the number of items that face supplementary duties from 1,362 to 170 by 2015. While trimming this list, the NBR should consider both economic benefits and possible revenue loss. (According to the same media report it is anticipated that this will lead to reduction of revenue mobilisation by Tk. 600-700 crore).

Seventh, government will have to explore new ways to tap non-tax revenues. Government should formulate a 'leasing policy of public property' (similar to the recent 'toll policy') on an urgent basis. This policy may consider including a binding constraint in the form of a minimum annual increase of leasing fee taking into cognisance the inflation rate. It is also important to ensure efficiency of public enterprises including financial entities to ensure higher revenue in the form of dividends and profits.

Finally, capacity development and institutional reform as regards revenue mobilisation should be accelerated. It is important to decentralise the revenue collection efforts for widening the outreach and identify new sources.

Public expenditure. The pattern of budgetary expenditure for FY2015 needs to be planned in a prudent way. There is an indication that the size of the budget for the next fiscal year will be to the tune of Tk. 248,000 crore. Indeed, in view of the possible revenue constraint, the government needs to take a conscious policy as regards non-development allocations and subsidy requirements. The demand for subsidy is likely to be within the limit in the backdrop of stable international prices of petroleum products and lower international prices for fertilisers. Nevertheless, keeping subsidy requirements within 2 per cent of GDP will be an achievement. The government needs to carefully plan the price adjustments of fuel and electricity during FY2015 particularly in view of cost of production. Allocation demand for non-development expenditure may see some rise in view of a number of special circumstances in FY2015. An additional Tk. 6,000 crore has been sought for further recapitalisation of the SCBs. (About Tk. 4,100 crore was disbursed in FY2014 for this purpose). The pay scale for public servants is also expected to be revised upward in FY2015. The rising demand from domestic debt servicing liability is likely to continue and the government will have to accommodate it. Indeed, issues as regards non-development expenditure need to be prioritised and rationalised with caution.

In case of development expenditure, there should be a priority guideline towards quality implementation of the large projects. Emphasis should be given on utilisation of the foreign aid component of the projects to ensure high rate of implementation of the ADP. In this regard, capacity of the line Ministries should be enhanced to better equip them in terms of appropriate use of aid resources. It is often argued that some of the government agencies do not show the required interest in implementing foreign aided projects due to the stringent transparency mechanisms involved. This issue needs to be investigated and the attitude should be discouraged. With regard to Padma Bridge project, it is important to re-estimate the project cost and the tolls to be fixed. The awarding process of the contract should not compromise on the issue of quality and transparency. Indeed, there is also a need to investigate whether the lack of interest in participating the bidding process related to construction of the main bridge indicates a lack of confidence of international construction firms on the financing mechanism of the project and the associated controversies. Number of ADP projects needs to be rationalised given the capacity of the agencies. Indeed, as has been seen, small projects taken under political consideration only increases the size of the ADP and undermines the quality of development spending.

Financing of budget deficit. Accommodating the envisaged budget deficit (excluding grants) within 5 per cent (of GDP) in FY2015 should not be a major concern; rather it would be a welcome initiative from the perspective of macroeconomic management. In contrast, financing structure of budget deficit will be a challenge for the Government. Without significant improvement in investment climate, the demand for credit is expected to remain low. Hence, commercial banks may continue to offer lower interest rates for deposits. Depositors may help government mobilise a higher amount of money from net sales of NSD certificates.

Concurrently, the existing significant amount of excess liquidity will help the banking system to accommodate the required financing in the form of 'government bank borrowing'. A major challenge will be to cater to the envisaged financing from foreign sources, particularly in the form of foreign borrowing. It is likely that amortisation payment will continue to rise. It is to be noted that the bulk of the foreign borrowing is tied with ADP implementation capacities of the government agencies. In view of lower net foreign aid flow, government has already sought budgetary support from the World Bank for FY2015. This, if realised, may help the government restore budget deficit financing mix which will be a prudent strategy both in terms of budgetary discipline as well as debt-servicing liabilities.

Supportive macroeconomic policies. Finally, successful implementation of the budget for FY2015 will require a set of complementary macroeconomic policies. The central bank should maintain stability of the value of BDT and avoid its appreciation. The present money supply situation can comfortably accommodate further accumulation of foreign exchange reserve. It is important to realise that, it does not make sound economic sense to fix the macroeconomic targets, including that of economic growth, at an overambitious level. It will be advisable to set the macroeconomic targets for FY2015 in accordance with emerging realities and streamline the targets for the subsequent years while preparing medium term macroeconomic framework.

Section 3: Manufacturing Sector

Current State of Production and Investment in the Manufacturing Sector Production
Production. Manufacturing sector has been experiencing significant volatility over the past year. High growth of production in most of the manufacturing industries observed in FY2010 (16.9 per cent for large and medium scale industries) did not continue over the following years (9.4 per cent in FY2013). Barring a few, most of the 'small scale' and 'medium and large scale' industries have experienced slowdown in growth during the pre-election period (July-December, 2013). Good performance of some of the key sectors including apparels, pharmaceuticals and food processing has contributed to maintaining noteworthy growth (i.e. 9.1 per cent for medium and large scale industries, but only 2.5 per cent for small scale industries during July-December, 2013). The apparels sector appears to have withstood the fallouts of the fatal incidences of Tazreen fire and Rana Plaza tragedy by initiating a host of corrective measures. However, production of a number of industries such as jute, textiles, chemicals and chemical products etc. was affected as a result of a number of internal and external factors. CPD (2014) found that performance of largely 'domestic market-oriented industries' was comparatively 'poor' during the pre-election period.

Investment. Growth of private investment has been sluggish over the last year. Growth of gross private investment was only 7 per cent in FY2013 followed by 18.4 per cent in FY2012 which caused a decline in the private investment-GDP ratio. This trend has continued in FY2014 - disbursement of industrial term loan during the pre-election period (July-December, 2013) was negative (-1.8 per cent). The situation was rather mixed in the post-election period (January-February, 2014) - growth of import of intermediate goods, industrial raw materials and capital machineries (both in terms of opening and settlement of LCs) did not indicate a robust growth in investment. The rise in opening of settlement of L/Cs for import of raw materials and intermediate products during January-February, 2014 appears to have gone for meeting the needs of the existing capacities in industries in the backdrop of some rise in the demand after the election. Overall, investment is yet to gain momentum in the post-election period due to unfavourable business environment as the economy moved from the phase of political unrest to the phase of political uncertainty in the post-election period.

Public investment, on the other hand, has maintained a high rate of growth during the last two years (32.8 per cent in FY2012 and 36.5 per cent in FY2013); however, this trend could not be maintained in FY2014. A significant part of this investment was targeted towards development of infrastructure which could potentially crowd-in private investment particularly in the manufacturing sector. However, the weak state of private investment in the current fiscal year portrays a rather 'limited' positive impact of public investment. In this context, the progress of 'fast-tracked' projects identified by the government immediately after the national elections – the Padma multipurpose bridge, Rampal thermal power plant, Rooppur nuclear power plant, metro rail, deep sea port and LNG terminal – ought to be very closely monitored from the perspective of timeliness as well as quality of implementation. However, the rationale of a number these projects (e.g. Rampal thermal power plant and Rooppur nuclear power plant) is debatable.

In the backdrop of the current state of investment, long term investment targets as envisaged in the SFYP have become rather 'illusionary'. Given the low level of growth of private investment till date, a 'big' jump will be required to attain the targeted level of investment in the remaining period (i.e. 41.1 per cent during FY2014 and 20.1 per cent in FY2015). The positive global economic outlook for the coming years (i.e. growth of world trade is projected to be 4.7 per cent in 2014 followed by 5.3 per cent in 2015) will likely have limited positive implications for Bangladesh in terms of the needed leap in private investment unless the private sector envisages significant improvements in domestic business environment which will induce it to commit to new long term investment.

Factors Responsible for Sluggish Investment

A number of supply-side and demand side factors were responsible for the weak state of production and private investment in the manufacturing sector in FY2014. Besides economic factors, a number of political factors contributed to this situation. Hence finding solutions only in fiscal and budgetary measures will not be adequate to improve investors' confidence.

Supply side factors. Prolonged violence and nation-wide strikes originates from confrontational politics, during the first half of FY2014, led to severe disruption in industrial production. This raised operational cost, particularly related to transport and labour costs, and caused damage to both inventory and transported products. The damage experienced by domestic market-oriented SMEs was rather high compared to the larger ones since the former had only limited flexibilities (CPD, 2014).

Lack of enabling business environment in the pre-election period seriously damaged investors' confidence, discouraging them from undertaking medium to long term investment. The environment did not improve much in the post-election period even though political violence has reduced significantly. The continued political uncertainty in the post-election period appears to be a major cause that informs the continued lack of investors' confidence.

Public investment for development of physical infrastructure is lagging behind the demands of the private sector. Lack of development of energy sector, limited improvement in trade-related and supply-chain related infrastructure (e.g. roads and highways), slow progress in the implementation of industrial cluster development projects (related to garments, leather and ICT) are discouraging private investment.

Existing lending rates underwriting projects financed by the commercial banks are perceived to be 'high' by the investors particularly in the backdrop of lack of enabling environment originating from 'high' risks due to political uncertainties and 'additional' costs arising out of lack of the needed infrastructural facilities.

Demand side factors. Consumers' confidence has been slack in the backdrop of a slowing down of economic growth and weakened purchasing capacity. Domestic demand has slowed down over the years for a number of reasons. *First,* pressure of moderate to high inflation in the previous years (both with respect to food and non-food items) has put downward pressure on consumers' disposable income. The pressure has continued in FY2014 since inflation has been sticky downward (7.48 per cent in March, 2014). *Second,* negative growth in the inward flow of remittances had an adverse impact on disposable income particularly for households which were to a large extent dependent on migrant workers' income. *Third,* temporary/permanent unemployment due to closure of factories during the pre-election period (which has perhaps changed for the better somewhat during the post-election period).

The slowdown in growth in employment in recent period is likely to have adverse impact on household's consumption expenditure. *First,* growth of employment in the domestic market appears to have slowed down due to lower levels of investment in the manufacturing and service sectors. *Secondly*, decline in international migration has reduced employment opportunities in the external job market. Both these have negative implications from the perspective of employment generation and consumers' confidence.

Proposals for Upcoming National Budget FY2015

Fiscal and budgetary measures for reducing supply side constraints. The national budget for FY2015 should go for supportive fiscal measures to create an enabling business environment towards enhanced production and higher investment. The upcoming budget may consider a number of fiscal measures to improve the situation: expansion of subsidized credit facility for domestic market-oriented SMEs in order to help them recover their losses due to political turmoil; special incentives for non-RMG export-oriented industries to improve their competitiveness in export markets; Export Development Fund needs to be increased further from the existing balance of Tk.1.2 billion in order to support export-oriented industries; tax holiday facility provided to selected sectors needs to be assessed with a view to examine whether from efficiency point of view it will be more preferable to go for selected 'strategically' and 'potentially' important sectors which will be given the incentive for a limited period of time.

Government may consider a number of fiscal measures for a set of targeted industries: the exemption limit for VAT for SMEs can be increased from the existing Tk.80 lakh to Tk.1 crore; reduction of import duty on raw materials used in the furniture sector (except those produced locally at significant level) (average import duty at present is more than 50 per cent); similarly, reduction of import duty of raw materials for the pharmaceutical sector; and withdrawal of import duty on networking machinery and data transmission link.

With regard to public investment, government should strengthen its monitoring activities to ensure speedy implementation of the 'fast-tracked' projects which are above controversies. In this context, concerns raised as regards various projects need to be taken into cognisance before going for implementation. A number of other ADP projects also need faster implementation. These include: Dhaka-Chittagong four-lane highway; eleven large scale power plants, expansion of gas connection in the industrial zones, on a priority basis; completion of remaining works for the establishment of Special Economic Zones (SEZs) in selected areas; completion of Kaliakoir High-tech Park, completion of central ETP in the Leather city at Savar and shifting of leather factories from Hazaribagh etc. Government should expedite the tendering process of the remaining off-shore blocks for exploration of gas; needed resources should be allocated to build the infrastructure for the coal-fired electricity projects. As per the recently adopted 'Power System Master Plan 2010' coal will be one of the important sources of the primary energy in the coming years. Government needs to come out with an 'effective' exit plan for the quick rental plants; a total of 16 power plants with a total capacity of more than 1,400 MW were to expire by 2015.

In order to improve connectivity, ADP allocation for the development of the railway sector needs to be increased. According to the World Bank (2014), Bangladesh needs about US$62-82 billion worth of investment between 2011-2020 for the development of different kinds of infrastructure in such diverse areas as transport, electricity, solid waste management and telecom sector.

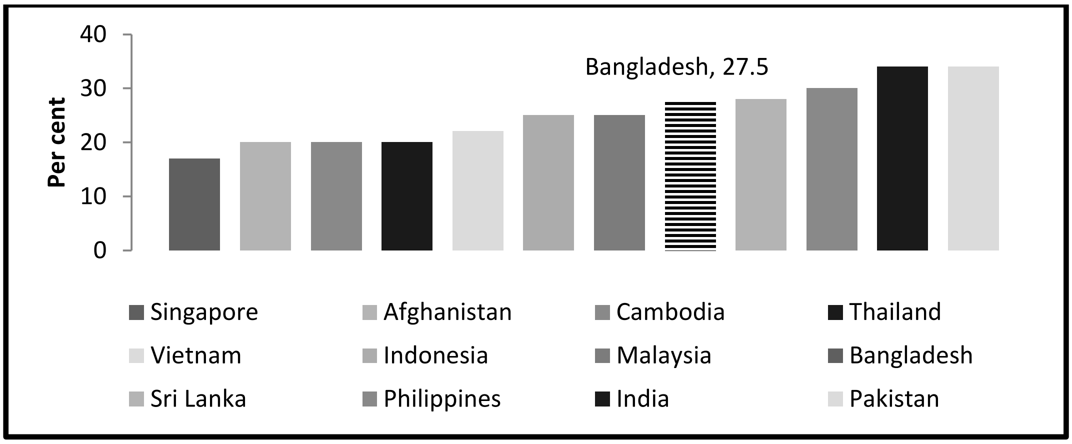
Growth of industrial sector has been increasingly constrained due to lack of adequate supply of skilled workers and professionals. In this context, recently approved project titled 'Skills for Employment Investment Programme (SEIP Phase I)' with an allocation of Tk.1050 crore for a period of 2014-17 for human resource development in six sectors is a welcome initiative. Various components of the projects are geared towards meeting the requirement of special skilled workers and professionals in selected sectors. Budgetary allocation for education sector needs to be increased particularly at high school, college and university levels with a view to developing the needed human resource for the industrial sector.

Government may consider allowing nationalised commercial banks to mobilise the required capital from the capital market by off-loading shares. An additional 10 per cent penal tax on tax-free incomes can be imposed in the next budget for companies enjoying tax holiday facilities but not complying with the provision of investing in the capital market. The refinancing scheme introduced to support investors will perhaps not be enough of an incentive since the rate of interest appears to be high (8 per cent).

Fiscal measures for reducing demand side constraints. A major challenge for the government will be to improve consumers' confidence by addressing demand side constraints through appropriate fiscal measures. National budget for FY2015 may consider an upward revision of the exemption limit for personal income tax (from Tk.220,000 to Tk.300,000) with concomitant adjustments as regards other slabs with a view to increase consumers' disposable income; an increase in the tax exemption limit of house rent of individual tax payers (from Tk.20,000 to Tk.30,000) may also be considered.

The demand of the business community for lowering the corporate tax rates calls for close examination and a detailed analysis. *First,* the logic of lowering the corporate tax rate on the ground that it is very 'high' compared to other competing countries of Asia is not 'correct' (Figure 1). The average corporate tax rate of Bangladesh is one of the lowest in South Asia which is close to the average corporate tax rate of South East Asian countries. *Second,* the argument that a lowering of the corporate tax rate will have positive impact on private investment is not 'robust'. In the backdrop of overt dependence on debt-based financing for investment by the corporate sector, a reduction of corporate tax rate may not have adequate positive impact on investment. *Third,* if supportive measures such as a conducive business environment and supportive infrastructure are not put in place, then an increasing investible surplus through lowering of corporate tax rate will likely have only a limited impact on investment.

FIGURE 1: CORPORATE TAX RATES OF SELECTED ASIAN COUNTRIES



Source: KPMG Database

Despite the pressure to go for upward revision of tariffs on gas, CNG and other public utilities with a view to reduce overall subsidy, government may consider the option of not taking such measures as these will have adverse implications for consumers' non-food expenditure. Instead the power sector should target reduction of operational inefficiency in power generation and distribution as well as enhance budgetary allocation for early completion of large scale power generation plants.

Government should take measures to enhance inward flow of remittance by encouraging flow of funds through formal channels and by reducing the cost of transfer of funds. Government should also take proactive measures to increase the flow of migrant workers in key labour markets such as UAE, Saudi Arabia and Malaysia.

Monetary policy stance. Central Bank should examine the process of determination of deposit and lending rates and interest rate spread by the commercial banks by taking into account the nature and extent of 'competitive' practices followed in the banking operation. The so-called 'market-based' approach in determining the interest rate appears to be not 'functional' given the prevalence of widespread market-segmentation and dual-form of governance in banking practices.

Other measures. First, Government should go for a number of reform measures targeting public-sector enterprises and organisations with a view to improve their operational efficiency and competitive practices; this is needed also to create conducive business environment for the private sector. For example, the Board of Investment (BoI) should be reorganised appropriately with a view to transform it into an 'effective' investment promotion agency. The recent decision of the merger of the Privatisation Commission with the BoI, perhaps to accommodate absorption of jobs but without strategic thinking and without taking cognisance of the needs of the private sector, was unlikely to address the real problems.

Second, Ministry of Labour and Employment should be considered as one of the 'core' ministries in the portfolio of the government. The ministry should be vested with the necessary funds for its revenue and development budget particularly with a view to put in place measures set out in the National Action Plan (NAP). Government should encourage the entrepreneurs to deposit part of their profit (0.5 per cent as per the Amended Labour Act 2013 if the profit is more than Tk.1 crore) to the Workers' Welfare Fund.

Third, with a view to improve the governance practices in the capital market and other markets, Ministry of Finance should take up necessary step to finalise the 'Draft Financial Reporting Act'.

Fourth, government should strictly enforce the 'mandatory packaging act' for the selected agricultural products with a view to expand the domestic market for the jute sacks and other jute products against the backdrop of decline in export in key markets.

Section 4: Rural Economy

In FY2014, rural economy (agriculture and allied sector) received Tk. 17,471 crore which is 2.3 per cent of total GDP of FY2014. The allocation was 11.9 per cent lower than FY2013 due mainly to the reduction in allocation for the Ministry of Agriculture. The Ministry of Environment and Forest has also received lower allocation (Tk. 797 crore) in FY2014 than in FY2013 (Tk. 910 crore). However, allocation for the Ministry of Fisheries and Animal Resources (Tk. 1,061 crore), Ministry of Land (Tk. 750 crore), and Ministry of Water Resources (Tk. 2,593 crore) were increased by 18.7, 13.8, and 3.7 per cent respectively in FY2014 compared to FY2013. An amount of Tk. 9,000 crore was allocated as subsidy for fertiliser and other agricultural inputs in FY2014, which was 25 per cent lower than the allocation for FY2013 (12,000 crore).

Lower fertiliser price in international market is expected to reduce expenditure for fertiliser subsidy in the current year. As Bangladesh meets most of her fertiliser demand by importing from the international market, lower global price will have significant implications for her.

During July 2013-March 2014, the average international price of DAP came down by 20 per cent, TSP by 25 per cent, Urea by 17 per cent and MoP by 19 per cent compared to the same period in the previous year. CPD estimates show that given the current administered prices, the government would require about Tk. 3,050 crore as fertiliser subsidy against the allocation of Tk. 9,000 crore as agricultural subsidy to meet its projected fertiliser demand of 43.7 lakh MT in FY2014. If the government decides to import more fertiliser, it will need to go for lower subsidy allocation in the coming budget.

Implementation of the development budget for agriculture and allied sector has remained poor till the last reported month. For example, during the first eight months of the fiscal year, only 36.7 per cent (Tk. 1,548 crore) of total development budget for the sector was spent, of which expenditure for the Ministry of Land was the lowest (14.4 per cent) and expenditure for the Ministry of Fisheries and Animal Resources was the highest (39.2 per cent). If this pace is any cue, timely implementation of the development projects will be a major challenge in the coming budget.

Proposed Budgetary Measures

Agriculture, food security and food safety. Consumer preferences towards food intake are changing in Bangladesh. During FY2005-FY2009, average wheat consumption in Bangladesh was 2.7 MMT which increased to 3.8 MMT during FY2010-FY2014. This increased demand was mainly met by imports from international market. During FY2010 to FY2014, on average 70 per cent of wheat demand was met through import. In order to reduce import dependency, emphasis should be given to domestic production. Hence, more budgetary allocation should be made for the Department of Agricultural Extension (DAE) to extend wheat cultivation in the areas where weather is favorable for wheat growing. Also, budgetary allocation could be made for the Bangladesh Agricultural Research Council (BARC) to innovate high yielding wheat varieties suitable for Bangladesh.

Production and promotion of high-value crops such as oilseeds, pulses, spices and fruits are important from both nutritional and food security perspectives. More allocation for production of these crops are needed.

Bangladesh's vulnerability to climate change is on the rise. In order to adapt to the impact of climate change, special allocation should be made to innovate and promote crop varieties which are salt and submergence-tolerant as well as drought tolerant and water efficient.

CPD (2014) found that there is a significant gap between grower and retail level prices of agricultural produces in Bangladesh. In order to ensure fair price at both grower and consumer levels, an Agricultural Price Commission needs to be set up with adequate resource allocation. The Sixth Five Year Plan also mentions about this.

Funds should be allocated for establishing a Food Safety Authority which will play a major role in implementing food safety rules and regulations. The authorities could have a food safety inspection and monitoring cell with modern equipment and adequate human resources. The work of this body should support implementation of Consumer Rights Act.

Government should set up agriculture and food safety court in each district which will deal with food safety, agro-market manipulation, and agro-input adultery related litigations.

In order to protect farmers from climatic risks, and rural entrepreneurs from unexpected shocks, government should think about establishing a Rural Insurance Entity.

Agricultural call centers could be initiated in each union under the supervision of DAE and DAM in cooperation with TeleTalk. The centre would provide tele-help to farmers as regards cultivation and marketing related issues.

Bangladesh has considerable potential in food processing e.g., pineapple canning, mushroom growing and dried food production (GED, 2010). However, export of processed food is discouraged by sanitary and phytosanitary issues. To overcome the challenge, adequate funds should be allocated towards strengthening the capacity of Bangladesh Standards and Testing Institution (BSTI).

Price volatility in potato market has been a common feature in Bangladesh in recent years. To reduce this, storage capacity should be increased. In this regard, emphasis should be given to establishment of more cold storage facilities in the bumper producing areas such as Munsigonj, Rangpur, Bogra, and Rajshahi. About 46 per cent of total potato in FY2013 was produced in these four districts.

Livestock, poultry and fisheries. Poultry farmers are currently exempted from income tax; this should be continued in view of the difficulties faced by the sector. Moreover, duty free import facilities for poultry feed may be continued.

Existing 25 per cent custom duty on import of chicks and eggs should be continued in order to encourage local poultry farmers.

Due to alarming levels of pollution in open water bodies, the fishery sector is under risk. Implementation of environmental laws and introduction of water pollution tax are therefore needed to protect fisheries.

Land and water resources. Digitalisation (on-line delivery and management) of existing land recording system will reduce hassles experienced with land registration and will hastens its pace. Evidence from Karnataka Bhoomi project suggests that digitalization significantly reduces bribery and harassment and expedites the registration process. Ministry of Land has taken a pilot project to digitalize land recording system in Bangladesh. The initiative needs to be expanded all over the country.

Soil fertility in Bangladesh has been on the decline due to excessive use of chemical fertiliser, saline water intrusion, and inundation of land by industrial waste. In order to replenish the diminishing soil quality, the government could think of putting in place soil pollution tax on polluters. An incentive mechanism may be developed to encourage adoption of organic and well-balanced fertiliser use.

Overexploitation of ground water has led to overshooting of the capacity of annual recharge of aquifers. This is causing rapid depletion in the ground water level. Therefore, funds should be allocated for re-excavation of canals to increase the navigability. Also, funds should be allocated for renovation of dams, particularly in the northern districts, to conserve the surface water for irrigation purposes.

Rural infrastructure. Government should establish Information Technology Centers with funds from development partners across rural areas in Bangladesh. These centers should have computers with high speed internet connection and be openly accessible to the rural population.

A climate change adaptation institute (a possible name: Bangladesh Climate Change Adaptation Institute) needs to be established which will coordinate adaptation activities and conduct necessary research to find out appropriate adaptation strategies. Currently Ministry of Environment and Forest is performing the task of coordinating various activities in this regard.

Section 5: Social Protection

Social Protection Policy (SPP) is a broad based and multi-dimensional concept which is designed to reduce vulnerabilities of the weaker section of the society who are not able to take advantage of the opportunities in the factor market in the economy. This is done through interventions in the labor market, through provisions of various kinds of cash and non-cash and by help of various measures to reduce economic and social risks faced by the poor including unemployment, disability and vulnerability at old age and adverse impact of climate change. However, the current Social Safety Net Programmes (SSNP) in Bangladesh has been delimited to a few categories of support such as Open Market Sales (OMS), Vulnerable Group Development (VGD), Vulnerable Group Feeding (VGF), Test Relief (TR) food, Gratuitous Relief (GR) good, food assistance in CTG-Hill Tracks area and Food for Work (FFW). The task confronting Bangladesh is to move from the narrowly defined SSNP to a comprehensive Social Protection Policy backed by well-thought design and cost estimates.

Recently, Government has prepared a draft on National Social Protection Strategy (NSPS) for Bangladesh. The NSPS proposes a consolidating lifecycle system of social protection which envisages social protection for socially excluded people, strengthening of social protection system for the urban poor and consolidation of special programmes and small schemes. If Bangladesh is to gradually move towards implementation of the National Social Protection Strategy, restructuring of the current schemes, steps to raise allocative efficiency and higher allocations will be required. The allocation for the SSNPs has been falling over the years. Total allocation to the SSNP was 2.51 per cent of GDP in FY2012 which came down to 2.13 per cent in FY2014. Overall allocation to the social protection programmes will need to be increased in Bangladesh in view of the rising demand. A number of studies indicate that less than half of the eligible poor are receiving social benefit in Bangladesh. In view of this, the number of beneficiaries will need to be increased.

The large number of SSNPs call for addressing several issues including governance, institutional capacities, co-ordination, systematic monitoring and evaluation and other administrative issues. Currently there are 95 SSNPs in Bangladesh which are administered by nearly 30 ministries/agencies. However, there is no formal mechanism for sharing information among the implementing ministries/agencies. This will call for rationalisation and strategic consolidation of the large number of SSNPs. Commensurate with this, there will be a need to address issues of scaling up of programmes and creating the needed fiscal space to underwrite the enhanced commitments. Introduction of Management Information System (MIS) can be an important tool towards better management and effective delivery of the social protection programmes. Introduction of MIS was found to be useful in implementing Mexican "Oportunidades" programme and other social protection policies. MIS facilitates collection the necessary data, better targeting of beneficiaries, monitoring and evaluation of the various social protection policies and coordination among involved agencies. Since poverty in Bangladesh in increasingly been concentrated in peri-urban areas, special SSNPs need to be developed for the poor in this areas.

Employment Generation Programme for the Poorest

Among the existing SSNPs, to target the hard core poor, Employment Generation Programme for the Poorest (EGPP) project is being implemented in phases; the cumulative disbursement has been to the tune of USD 150 million up to 2014. About 485 upazilas have been brought under the coverage with 7 lakh beneficiaries having been registered in each of the phases. Considering the number of poor people in Bangladesh (31.5 per cent of total population in 2010), both allocation and coverage of safety net programmes ought to be increased in a significant manner. A mapping exercise as regards spatial distribution of various types of vulnerabilities should be carried over and allocation needs to be made accordingly. Selection criteria for identifying the target groups of the poor should be transparent and monitored as a continuing basis. Local government institutions will need to be involved in this process. Allocation for the operative support component (OSC) under this programme is somewhat inadequate at only 3.8 crore taka and hence should be increased. This has adverse implications for effectiveness and implementation of the programme. Funds should be allocated to introduce an electronic data base of the beneficiaries which will help track allocations, monitor progress and assess outcomes. Recently Bangladesh Bureau of Statistics (BBS) has taken a programme to create a data base for the poor. Electronic data base for the beneficiaries is needed to coordinate the various programmes and undertake the task of ongoing monitoring.

Social Assistance

Social Assistance including Assistance for the Elderly (e.g., noncontributory basic allowances for the elderly, old-age allowances), Family allowances (e.g., in–kind or cash transfer to assist poor families) and disability benefits are important elements of social protection programmes. Old Age Allowance, allowances for widow, deserted and destitute and allowances for financially insolvent physically challenged are rather highly inadequate. Hence, allocation in the social assistance programmes should be increased significantly. The current amount of old age allowance and for the widow, deserted and destitute is only Tk. 300 per month (fixed in 2009). Considering the impact of inflation and rising living expenses, this amount should be increased to at least Tk. 500. In Brazil, the average benefit per family under the *Bolsa Familia*, a well-recognised and successful social protection programme, was bound to be significantly higher in a relative sense.

The allowance for persons with disability is also very low. The allowance should be increased from the current rate of Tk. 350 to Tk. 500. The differential rates of SSN support, according to geographical location, should also be reviewed to reduce the large discrepancies.
Allocation for the welfare of acid burnt and disable should be increased. Current allocation for this fund is only Tk. 1 crore. Considering the high cost of treatment and vulnerability of those people, allocation here should be increased significantly.

Block Allocation

One of the important features of the current SSNPs is that the Block Allocation for various programmes has increased notably over the years. Block allocation rose from only Tk. 6 crore in FY2009 (0.4 per cent of total SSNP allocation) to Tk. 1,009 crore in FY2010; the amount decreased to Tk. 801 in FY2013, only to significantly increase to Tk. 1,933 crore in FY2014 (7.6 per cent of total SSNP allocation).

Whilst higher block allocation could give flexibility in disbursement of resources to address emergency situations, the significantly rising block allocation should be a cause of concern from the perspective of good governance since this type of allocation lacks specification and transparency and undermines effectiveness and accountability. Funds should be earmarked for specific projects to the extent possible.

National Pension Scheme

Pension schemes are one of the important indicators of social protection policy. Currently, Government is planning to introduce National Pension Scheme which will cover private sector employees by 2018 and ensure social security by 2021. It is expected that about 3.0 million officials and employees in the private sector will be covered under the national pension scheme. Putting in place a universal pension scheme will call for adequate planning and appropriate design. India introduced a National Pension Scheme in 2009. In India, central government's contribution to the scheme is 1.16 percent of the basic salary. A certain amount from Employees Provident Fund is also diverted to the Employees Pension scheme in India. Assessing the benefit package and identifying the mechanism of funding will be critical to implementing the proposed National Pension Scheme.

Insurance for the Workers

If Bangladesh is to move towards a comprehensive social protection, Government will need to consider putting in place an adequate insurance policy for workers as well. Group insurance for workers became compulsory for the owners under the Labour Act, 2013. However, the respective part of the labour law is quite inadequate both in terms of related provision and the amount of money to be received by the workers.

A comprehensive guideline for compensation should also be developed in line with ILO Convention. Bangladesh should also be a signatory to ILO Convention CO17 (worker's compensation convention).

Insurance for the Flood Victims

A broad based insurance for the flood victims may also reduce the vulnerability of the flood affected people. It may be recalled that Oxfam International has introduced flood insurance for the Char communities in 2012 to protect the low income earners in the flood affected area. This experience may be reviewed for replication and scaling up.

Fund for Climate Change

It is important to note that the fund for climate change has been on the decline over the past years. Allocation from this fund reduced from Tk. 700 crore in FY2012 to Tk. 400 crore in FY2013, coming down further to Tk. 200 crore in FY2014. This should be looked at and reviewed. Allocation for the extreme poor in vulnerable areas, particularly in the Char and the haor areas, should be enhanced.

School Feeding Programme

National Social Protection Strategy focuses on consolidating the lifecycle system of social protection. In view of this, the school feeding programme, introduced on limited scale, should be further scaled up. Since Bangladesh is lagging behind in terms of achieving MDGs in areas of malnutrition intake and stunting of children, this particular programs ought to receive due priority. Implementation of school feeding and stipend programmes should receive similar attention particularly in view of the special needs of the students in the char and *haor* areas.

Section 6: Importance of the Non-Economic Factors in FY2015

Along with economic factors, non-economic factors play an equally critical role in contributing towards socio-economic development of Bangladesh. More specifically, macroeconomic performance and budget implementation are significantly influenced by non-economic dimensions of institutional and policy environment of the country. These underlying factors have assumed greater importance in the second half of FY2012-13 and have continued to matter in terms of their significance for the performance of the economy over the upcoming fiscal year.

Non-economic factors underpin social and political environment, indirectly affecting the macroeconomic performance. Some of these non-economic factors are structural in nature and had informed and influenced developmental outcomes in Bangladesh for some time. "Traditional" non-economic factors may be broadly classified into three categories: (i) weak implementation capacity of the state relating to, inter-alia, human resource management, devolution of power and autonomy and data/information availability and monitoring; (ii) weak oversight capacity relating to, inter-alia, rule of law, democracy and representativeness and control of corruption and leakages; and (iii) weak capacity for reforms relating particularly to regulatory reforms, administrative reforms and legal and institutional reforms.

Along with traditional non-economic factors inhibiting macroeconomic performance and budget implementation, a number of "new issues" have emerged which impinge on delivery capacity of the government. These issues, on the one hand, aggravates some of the traditional factors (e.g. severe deterioration of rule of law). On the other hand, new dimensions have been added by the continuation of the democratic disquiet in the backdrop of the recent non-participatory national elections. This protracted political uncertainty is definitely undercutting investors' confidence in the short if not medium term.

Implementation capacity of the Government of Bangladesh (GoB) has been historically inadequate. Weakness in the human resource management of the public sector is one of the foremost impediments to developmental progression. Excessive rotation of government officials undermines institutional memory and discourages specialisation. Political influence often plays a major role in this process. Moreover, effective autonomy of parastatals is hardly seen in practice. Inadequate processes and practices in the area of monitoring as well as information asymmetry constitute two core shortcomings of the current state of implementation capacity in Bangladesh. As is known, the Implementation Monitoring and Evaluation Department (IMED) of the Ministry of Planning suffers from acute resource shortage. When projects do get monitored this is usually done in terms of funds spent rather than the actually achieved results. Earmarked funds in successive ADPs have systematically remained underutilised. Lack of implementation capacities of the line ministries can be largely held responsible for this. However, corruption and bureaucratic procedures also contribute to the non-utilisation of funds. In cases where signs of progress are visible, e.g. collection of direct tax by the NBR, limits of efficiency induced performance are quite obvious.

Low level of oversight capacity is another non-economic factor which remains a lingering concern in Bangladesh. In a general democratic setting, policies set by the legislature and implemented by the executive organs of the state are often monitored by the judicial and quasi-judicial bodies. The parliamentary standing committees traditionally play an effective role in this regard. However, in Bangladesh institutions belonging to the "national integrity system" including the Anti-Corruption Commission, Human Rights Commission and Information Commission have often remained inefficient (and often partisan). Pervasive corruption and inadequate enforcement of rule of law are significantly undermining the economic growth prospect in general and the government's ability to raise revenue and implement development projects. Such a situation also discounts the value for money invested by the government. Furthermore, the state of malgovernance affects the most disadvantaged sections of the society and by implication frustrates the anti-poverty stance of the development policies.

Regarding reform capacity of the Bangladesh government, it may be recalled that while a number of regulatory, administrative, legal and institutional reform proposals are being discussed for quite some time, implementation of these initiatives had been rather disappointing. At the end of the day, lack of political commitment has held back these proposals from being implemented in reality. As a result, Bangladesh economy has been deprived of the necessary impetus to attain accelerated economic growth.

The "new non-economic factors" are in some sense due to extreme aggravation of the factors underlining the weak implementation, lax oversight and inadequate reform capacities of the state. This situation has been triggered by the recent national elections which have produced a government of truncated legitimacy and circumscribed moral foundation. The emerging nature of the polity has further weakened the transparency and accountability process, widening the scope for arbitrary and discretionary actions by the political power of the day. In the absence of political predictability, lumpy and irreversible investments are shying away from the Bangladesh economy.

In view of the preceding discussion, the following proposals can be considered for the upcoming FY2014-15 budget:

i. The government should consider a Task Force to spearhead adoption of the pending reform measures including adoption of the Civil Service Act. Promotion of a civil service based on merit, informed by professionalism and free from political interference is a singular necessity for the development process to gather new momentum.
ii. Local government bodies are to be endowed with effective devolution of power and fiscal autonomy.
iii. Capacities of agencies implementing major public investment projects of the government should be strengthened. The profile and capacity of the IMED should be enhanced so that it can deploy modern processes and techniques while monitoring the implementation of development projects.
iv. The transaction costs of contract enforcement have to be reduced by improving the judicial processes and creating alternative dispute settlement mechanisms.
v. A participatory and pluralistic democratic polity, driven by an inclusive and credible national election, will be necessary to provide the much needed confidence to the investors.

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