Chapter II

Analysis of the National Budget for 2005-06

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1. INTRODUCTION

The Bangladesh economy experienced a respectable growth rate of about 5.5 per cent during the FY2005 in spite of having struggle with two exogenous shocks, viz. floods of July-August 2004 and phasing-out of apparel quota from 1 January 2005. The economy posted a double digit export growth notwithstanding the challenges emanating from a quota-free global trading regime in apparel. A bumper Boro crop, estimated at 13.75 million MT, helped recover from the crop losses due to the flood. A US$2.5 billion worth of foreign direct investment (FDI) proposal from the Tata Group of India transmitted an optimistic signal to the potential investor community. The Privatisation Commission was reactivated with new off-loading mandate. The capital market received a new lease of life, thanks to increased liquidity flow. High import of capital machineries in the wake of robust credit expansion in the private sector and also strong growth of agricultural credit energised the economy in FY2005. Off-take of foreign aid improved marginally, and remittance flow continued to be buoyant and is expected to reach about US$ 3.8 billion by the end of the current fiscal.

However, the macroeconomic achievements could not be translated into overall robust economic development due to a number of weaknesses in the economy. These include failure to implement public investment programmes, coupled with poor revenue collection effort, particularly in non-NBR and non-tax components. The macroeconomic correlates are particularly under pressure from the third quarter of FY2005 due to stressed balance of payment as import greatly outpaced export growth and stretched fiscal balance in the face of runaway growth of revenue expenditure. A rising trend in consumer price index created new tensions in the macroeconomic stability; a deepening state of weak governance with a stillborn Anti Corruption Commission and stagnation in the public administration reform and local government undermined the overall economic management.

In this context, the major challenge before the national budget for FY2006 was to sustain the private investment growth without weakening the macroeconomic stability. In order to sustain the macro-stability in the current context manifested through sober consumer's price index, stable exchange rate and sound interest rate, the budget needed to address the following six major sources of fragility. These are:

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

The budget of FY2006 was placed in the backdrop of the above described macroeconomic scenario. The efficacy of the budgetary measures ought to be looked at from the vantage point of whether it is able to address these concerns or not. On the other hand, the Government of Bangladesh (GOB), for the first time, has prepared a budget ostensibly under the three year framework of the Poverty Reduction Strategy Paper (PRSP). Thus, an additional point of query is whether and to what extent the new budget is in consonance with the Medium Term Macroeconomic Framework

(MTMF) of the PRSP and its allocative guidelines.

It is to be acknowledged that the budget speech of the Finance Minister was more precise in nature; both the text and the issues were restructured is a manner that gave the budget more concreteness and also the presentation was more lucid the current state of the affairs. However, in some brevity led to lack of transparency, for example, the budget speech did not provide information on net outcome of fiscal measures by source.

It may be mentioned here that four (4) of CPD's pre-budget fiscal suggestions were reflected in the new fiscal proposals.

In the present review, the analysis of the budget for FY2006 has been organised under two major blocks of measures: Fiscal Measures (Section 2) and Social Sector and Safety Net Programmes (Section 3). The present analysis of the budget ends with a set of concluding observations.

2. FISCAL MEASURES

2.1 Personal Income Tax

- Budget FY2006 has proposed to increase the limit of tax-free income from Tk 1 lakh to Tk 1.20 lakh, while restructuring the upper limits of taxable income for each of the four slabs. It can be mentioned that in India, the income tax exemption threshold is Tk 1.45 lakh (i.e. Rs 1 lakh).
- Comparing the proposed income tax structure and that of FY2005, it is found that salaried income tax payers will pay relatively less in income year FY2006 than they did in FY2005. However, people in the high income brackets will pay relatively less than the people in the relatively low income brackets. For example, a person with Tk 10,001 monthly salary will pay 10 per cent less than what s/he paid in FY2005, whereas a person with Tk 30,833 or Tk 55,833 monthly salary will pay 18 per cent and 14 per cent less tax respectively.
- It is however unfortunate that people having income of an amount of Tk120,001 will pay an income tax at a rate of 10 per cent, while people having black money will pay at a rate of 7.5 per cent, much lower than the poor tax payers (See Table 9).

Table A.1: Implications of Revised Income Tax Rate for Individual Assesses for the Income Year 2005-2006 (Tax Assessment Year 2006-07)

Income	Rate	Per Month Salary (Tk)	Tax (Tk)		Difference	
			2004-05	2005-06	Amount (Tk)	Per cent (%)
Tk 120,001		10,000	2,000	1,800	(2,000)	- 10
Tk 370,000	10%	30,833	30,500	25,000	(5,500)	- 18
Tk 670,000	15%	55,833	81,500	70,000	(11,500)	- 14
Tk 1,020,000	20%	85,000	157,500	140,000	(17,500)	- 11
Above	25%	-				
Minimum taxable income			8,333	10,001	1,668	20
Minimum Tax			1,500	1,800	3,000	20
Exemption			100,000	120,000	20,000	20

Note: Tax rate table for the income year 2005-06, for which the Tax Assessment year is 2006-07.
Source: Estimated from CPD - IRBD Database.

- Budget will allow the banks to make provisions for bad and doubtful debts up to 1 per cent in place of 2 per cent of the total outstanding loans till assessment year 2006-07.
- The budget proposes to withhold advance income tax at 10 per cent on dividends making it taxable for shareholders.
- Rate of advance income tax applicable to profits from approved securities and bonds are proposed to be reduced to 10 per cent from the prevailing 20 per cent.
- Reduced rate of tax at 10 per cent on income from computer software business will be continued up to 30 June 2008.
- To encourage donations to philanthropic and educational institutions by any individual or

industrial enterprise, it is proposed to allow the donors tax-rebate for such donations. However, caution should be exercised against any abuse of such rebate.

- At present, the rates of advance income tax applicable to "Royalty & Technical Know-how fee" and "Professional & Technical service fee" are 10 per cent and 5 per cent respectively, which often causes confusion because the "fees" are of same nature. In order to remove this confusion, the rates of tax for all these fees have been re-fixed in the proposed budget at 10 per cent. The government could think of considering this as final settlement since this may encourage professionally to declare their incomes and hold mobilisation of direct tax from this largely untapped source.

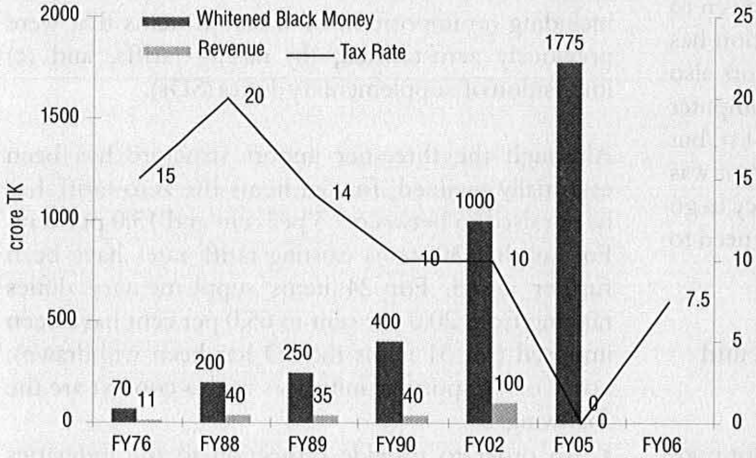
2.2 Investment of Undeclared Money

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

Is it justified when lower middle class people in the lowest income bracket are asked to pay income tax of 10 per cent? We believe it is an unethical and inefficient policy for mainstreaming black money, such a facility should not be perceived as a permanent facility. It may noted that in 1997 India under its Voluntary Disclosure of Income Scheme (VDIS), netted tax collections estimated at Rs 10,050 crore and the opportunity was given only once and only for nine months. This was also a transparent policy as regards the use resources collected.

We think that such backtracking by the Finance Minister will send a wrong signal to the tax payers and undercut credibility of other fiscal measures.

Figure A1: Whitening of Black Money in Bangladesh.



Source: Estimated from CPD - IRBD Database.

2.3 Real Estate

The budget proposes taxing of investment in real estate at a flat rate of 175 Tk/m2 and imposition of 2.5 per cent tax on the price of land to be deducted at source at the time of registration. Such payments are to be recognised as final settlement for the purpose of taxation.

One could argue that this was another way of allowing whitening of the black money and the government should reconsider this proposal.

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

2.4 Tariff Structure

The three-tire tariff structure has been retained with marginal rate of 25 per cent and the five supplementary duty structures have been revised and brought down to three, the infrastructure development surcharge continuing. These measures will bring clarity to the structure of indirect tax and will promote transparency in mobilisation of indirect taxes. The new indirect tax measures indicate a conscious policy to support import-substituting domestic industries (particularly through SDs). However, extension/expansion of VAT, SDs and indirect taxes is also likely to put pressure on purchasing power of consumers.

Reduction of import tariffs for some intermediate inputs would help to combat price hike in both domestic and international markets. For example, the proposal to raise import duty on newsprints by 25 per cent in FY2005 deserves to be reconsidered and reduced.

2.5 Incentives for Investment

To encourage investment, the budget has proposed a number of steps: (a) recasted tax holiday facility for selected industries, (b) continuation of cash compensation scheme, (c) provision for investing for undeclared income, (d) widening the gap between listed and unlisted companies, (e) preferential treatment for import of raw materials, and (f) consideration of tax deduction at source as final settlement of tax.

Tax holiday

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

However, the proposal for tax holiday for the RMG sector is somewhat ambiguous as it was only given to the "High Value" RMG sector and no definition has been provided in this respect. Knit-RMG sectors also appear to have been left out. Also, only computer hardware has been included in the tax holiday list, but not the computer software. Besides, energy sector was also not in the tax holiday list. Given the urgency to go for more investment in these sectors, there is a need to review this list.

Enhancing the Dispersion between Listed and Non-listed Company

The budget has proposed to increase tax rate for non-listed companies from 37.5 per cent to 40 per cent. This will further increase the difference between tax rates for listed and non-listed companies. Although the intention to encourage companies to go public and be listed in the stock exchange is understood, such high level of taxation for non-listed companies is likely to harm small and medium enterprises whose scale of operation do not allow them to go public. Government may revise downward the tax rate say from 37.5 per cent to 30 per cent.

2.6 Export Promotion versus Import Substitution

Export Promotion

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

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

Domestic Protection

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

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

- In order to provide protection to the industries engaged in the production of mineral water, the budget has proposed to impose 35 per cent supplementary duty on mineral water at the import stage.

- Imposition of 20 per cent supplementary duty on imported detergents has been proposed in the budget.
- The budget has proposed to impose 20 per cent supplementary duty on all imported lamps and light fittings.
- The budget proposes to enhance supplementary duty from 25 per cent to 35 per cent on some items of processed food and fruit juice.
- Supplementary duty was enhanced from 25 per cent to 35 per cent for all kinds of imported furniture.

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

2.7 Agriculture

Crop Sector

Positive Measures

- Total allocation (revenue and development) for Ministry of Agriculture in FY2006 is Tk 2,213 crore (24.5 per cent more than the original budget of FY2005, but 6.7 per cent less than revised allocation in FY2005).
- It is promised in the budget that in FY2006, agricultural extension, research, field training, production, preservation and distribution of improved seeds, storage and marketing of agriculture produce and irrigation activities will be strengthened. Bangladesh Agricultural Development Corporation (BADC) would be restructured and the Corporation's work involved in seed production, preservation and distribution will be further expanded. This is a pragmatic proposal considering the fact that BADC delivers only about 5 per cent of seed requirement.
- From 1 July 2005 interest on agricultural loan provided for production of pulses, mustard seeds, spices and maize will be reduced to 2 per cent from the existing 8 per cent. This is a welcome measure for promoting agricultural diversification. However, proper utilisation of credit needs to be ensured.
- The budget proposed complete withdrawal of all duties and taxes on some varieties of fertiliser (Magnesium Sulphates, Zinc Sulphates, Disodium Tetraborates). It has also proposed reduction of customs duty from 15 per cent to 7.5 per cent on raw materials needed for the manufacture of parts and accessories of rice and wheat mills. This will be helpful to reduce micro-nutrient deficiency in soil and increase competitiveness of concerned manufacturers.
- The Government has waived interest on classified agricultural loan up to Tk 5,000 as of 31 December 2003. The repayment period of principal amount will be extended from 30 March 2005, as fixed earlier, to 30 March 2006. This will help small loanees.
- The budget has proposed continuation of 20 per cent subsidy on electricity bills of Palli Bidyut Samities (PBSs) for electricity and waiver of minimum charge for all electricity connections throughout the country for irrigation with effect from 1 July 2005. This measure will surely have some positive effect, but this is expected to be limited considering the fact that 83 per cent of the total irrigated area is under diesel operated engines. It is to be noted that in spite of demands from various quarters no support has been given to diesel used for irrigation.
- Cash incentive for export of agricultural products, fruits and vegetables will be continued at 30 per cent. Earlier experience with disbursement of cash incentive indicates that due to absence of clearly spelt out and realistic procedures the allocated amount could not be spent. Hopefully, proper mechanism would be in place and steps for awareness building among potential exporters would be undertaken to promote export of agro-products.

Grey Measures

- The budget proposed increase of agricultural subsidy from Tk 600 crore in the original budget of FY2005 to Tk 1200 crore in FY2006. Subsidy for agriculture will be spent on different types of fertilisers (Urea, DAP, MoP and TSP). It may be noted that total allocation for agricultural subsidy and other assistance in the revised budget of FY2005 was Tk 1315 crore. Thus, it is not clear whether total assistance for agriculture has been increased or reduced.
- Bangladesh Bank will provide refinancing at 5 per cent rate of interest to relevant banks to enhance the agricultural credit flow. It is not clear from the budget speech whether Bangladesh Bank will also ensure that the banks provide loans to farmers at 8 per cent as was stipulated in FY2005.

- It may be noted that total allocation (Revenue+Development) for Agriculture Ministry for FY2006 is Tk 2213 crore i.e. 24.5 per cent less than FY2005 (original) and 6.7 per cent less than FY2005 (revised).

Concern(s)

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

Fisheries and Livestock

Positive Measures

- The budget has proposed a total allocation (development and revenue budget) of Tk 549 crore in FY2006 (0.48 per cent more than the original budget of FY2005).
- The budget proposed withdrawal of all duties and taxes on the raw materials of dairy and poultry feed, medicine, other medical inputs and capital machinery required by the livestock sector. These are expected to reduce the cost of importing such items and would be beneficial to the poultry industry by reducing cost of production and enhancing competitiveness.
- The budget has proposed extension of tax exemption period on income from fish farming, poultry and dairy farms, poultry feed production, etc. from the prevailing 30 June 2006 to 30 June 2008. This is a welcome measure to encourage investment, employment and growth in livestock and fisheries sector.

Rural Development

Positive Measures

- Allocation to the tune of Tk 100 crore in the revised budget of FY2005 and Tk 120 crore in FY2006 budget was made to the Union Parishads. Though the amount of allocated money is highly limited compared to the need of resources by the Union Parishads, allocation of resources undoubtedly gives a positive impression about government's willingness to support rural development.
- The budget has proposed a total allocation of Tk 2,214 crore, from revenue and development budget, to the Ministry of Fisheries and Livestock, Ministry of Social Welfare, Ministry of Women and Children Affairs, Ministry of Labour and Manpower and Ministry of Youth and Sports in order to implement 113 projects to accelerate development of the rural non-farm sector and to create additional employment opportunities in the rural areas.
- A "Char Livelihood Project" in 5 districts with an outlay of Tk 475 crore is being implemented to raise the living standards of extreme poor people living in disaster prone districts.
- The "Abashan Project" (with an outlay of Tk 447 crore) is being implemented by the Office of the Prime Minister to provide land, houses, credit facility, education, health, family planning services and employment opportunities to 65 thousand landless and extreme poor people.

Grey Measures

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

Concern(s)

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

Agro-Processing and Agro-based Industry

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

2.8 Power and Energy

- In FY2006, an allocation of Tk 4,293 crore was made in the power and energy sector under the revenue and development budget. This was only 0.47 per cent higher than the revised allocation of FY2005 (Tk 4,273 crore). This appears to be on the low side considering the demand. To compare, India has increased the allocation for energy and power by 33.4 per cent in FY2006.
- In power sector, a total of 51 projects are on stream under seven agencies. Of these, only 22 per cent fund was allocated for generation, 17 per cent for transmission and the rest 56 per cent for distribution. This lower share of generation-related projects indicates that hardly any substantial improvement in the power situation could be expected in the near future.
- Although power generating companies enjoy tax exemption on income for 15 years, it is to be noted that the sector has not been in the tax holiday list as proposed in the budget FY2006.
- Proposed reduction of customs duty on crude petroleum (from 25 per cent to 7.5 per cent) and customs duty on refined POL products (from 25 per cent to 15 per cent) and withdrawal of supplementary duty of 15 per cent on refined petroleum product will help to reduce the burden of loss that Bangladesh Petroleum Corporation (BPC) incurs to some extent. It has no implication for consumers as the price is regulated by the government. However, without rationalising the tariff on POL products as mentioned in PRSP, recent changes will hardly have any positive impact for the rural poor.

2.9 SMEs

- Under the proposed tax holiday facility, major SME oriented industries such as plastic, melamine, ceramic and sanitary ware, insecticide & pesticides, computer hardware, agricultural machineries, boilers & compressors, textile machinery, etc. have been included. This will have positive impact on investment in these sectors.
- There is no new budgetary allocation to finance small and medium enterprises as government did in the last fiscal year (FY2005). Under "Refining Financial Institutions by Bangladesh Bank for Priority SMEs" the government had earlier allocated an amount of Tk 250 crore at 5 per cent interest, which was fully utilised. In view of the huge demand for this type of credit, the lack of support in the present budget is worth mentioning.
- Proposed tax rate for non-listed companies at 40 per cent instead of 37.5 per cent is likely to negatively impact on the growth of small and medium enterprises. If it is an attempt to push non-listed companies to be listed, this could not be achieved easily since most of the non-listed companies do not comply with the required terms

and conditions necessary for enlisting. A large difference of 10 per cent in corporate tax between large and small enterprises is against the spirit of the PRSP.

2.10 Sectoral Issues

Readymade Garments

- In view of the challenges faced by the RMG in the context of the quota-phase out, the support for RMG sector was rather weak. One positive move is that imports of spare parts, dyes and chemicals for RMG have been zero-tariffed. An initiative has been taken to formulate a programme titled "Post-MFA Action Programme" at a cost of US$ 40 million with the assistance from development partners. In FY2005, the government allocated Tk 30 crore for the purposes of retraining of retrenched garment workers. Only high value RMG has been awarded tax holiday facility, but there is no particular criteria proposed to identify such industries.
- The budget has proposed setting up of a special fund of Tk 20 crore for retraining and creating employment opportunities for employees/ labourers of garment industries.
- In Sri Lanka, government has proposed establishment of a SME bank by this year to enable banking and financial institutions to provide for required working capital and investment needs of the apparel industry, and to modernise the factories. A total sum earmarked for the issuance of this guarantee will be Rs 60 crore (Tk 34.8 crore) so that the industry will be able to raise Rs 200 crore (Tk 116 crore) from the banking system and other financial institutions. It has also allocated support for productivity improvement measures and promotion of markets for apparel exports.

Textile

- In view of the MFA phase out and the need for strengthening local backward linkage industry, the decision to continue with the current provision of 5 per cent cash subsidy in the next fiscal year for textile sector is a positive step. However, support to the textile sector needs to be further strengthened in view of the MFA phase-out.
- Withdrawal of duties from machines, spare parts, some dyes and chemicals essential for textile, terry towel, hosiery and label is expected to reduce cost of production in this sector.
- Consideration of tax deduction at source (at 0.25 per cent of export income) as final settlement for the purpose of tax is expected to have positive impact.
- Although high value RMG have been provided with tax holiday facility, there was a need for further tax-breaks to stimulate backward linkage activities in the textile, particularly in view of the challenges of a quota-free regime.
- A textile technology upgradation fund would have encouraged the sector to undertake the necessary restructuring and upgradation. The Indian Budget FY2006 had not only proposed a budgetary allocation of Tk 43500 crore (Rs 30,000 crore) (5.83 per cent of total revenue expenditure) but also granted Tk 631 crore (Rs 435 crore) for the purpose of setting up a Technology Upgradation Fund (TUF). Though India already has a strong textile infrastructure, it has introduced a 10 per cent capital subsidy scheme for the textile industry.
- There is no special allocation for handloom industry which is a large rural employer. Bangladesh could have taken the initiative to adopt and promote cluster development approach for production and marketing of handloom products, as was advised in the Indian budget FY2006. India has allocated Tk 58 crore (Rs 40 crore) towards this. Besides, a life insurance scheme for handloom weavers has been taken by the Indian government, which will provide insurance coverage of up to Tk 72,500 (Rs. 50,000).

Leather and Leather Goods Industries

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

Telecommunication

- Investment in the telecommunication sector will be encouraged in the next fiscal year as a result of reduction of import duty on telephonic machinery (from 15 per cent to 7.5 per cent) and reduction of supplementary duty (from 15 per cent to 0 per cent) on telephone answering machines and dictating machines.
- Local mobile phone battery producers will be benefited because of the increase in the import duty from 7.5 per cent to 15 per cent.
- Imposition of a tax of Tk 1200 for connection of each SIM/RIM Card, or for the same purpose CDMA technology at local stage is likely to create distortions in the mobile telephone market.

- Firstly, this would create a disincentive for lower income groups since clients will be required to pay same amount (i.e. Tk 1200 for connection + Tk 300 for the set) irrespective of income levels. Secondly, there is an apprehension that this will create entry barrier for new entrants and may encourage anti-competitive behaviour.
- However, on their part the mobile operators, rather than passing the whole burden on the customers, could take up steps towards burden-sharing, e.g. reduce call rates.
- Surprisingly the National Board of Revenue (NBR) has circulated a notice to implement this tax structure with effect from June 09, 2005. Since this is only a budget proposal and the budget has not been discussed and passed in the parliament, such advance implementation undermines the participation of legislature in the national policymaking.

Manufacturing Items

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

Vehicle

Customs duty of vehicles within the range of 1500cc and 1649cc in CKD has been raised from 15 per cent to 25 per cent; also for vehicles exceeding 1649cc in CKD. Will it stimulate local vehicle body building industry?

Tax Base under VAT

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

2.11 Local Government

Under 11 heads in the ADP, a total of block allocation accounting for Tk 826.5 crore has been allocated for various local government institutions this amount is 5.3 per cent more than that of the comparable figure in FY04 (revised). Interestingly, the largest increase to place under the head of Gram Sarkar (50 per cent more) and allocation for various Chittagong Hill Tract (CHT) related heads did not experience any growth (Tk 115 crore).

However, Tk 244 crores has been earmarked for the CHT as investment project in the proposed development budget of FY2006 which of 31.1 per cent higher than the allocation is the revised budget of FY2005.

Under the revenue budget, CHT Ministry received Tk 126 crore in FY2006 which is 10.5 per cent higher than the revised budget (Tk 114 crore) of FY2005.

3. SOCIAL SECTOR AND SAFETY NET PROGRAMMES

Towards targeted poverty reduction, social safetynet and employment generation programmes, the budget for FY2006 proposed an additional allocation of Tk 4,600 crore from the non-development budget. This allocation is about 12.1 per cent of the total non-development budget. This allocation (besides ADP) for social safety net include the following: (a) continuation of existing programmes, (b) new programmes introduced, (c) special programme for mitigating economic shocks, (d) special credit programmes for employment generation.

3.1 Social Sector

Education

- As in the last budget, education has received the highest allocation of Tk 9487 crore which is 14.94 per cent of the total budget. Out of this, Tk 3227 crore (34 per cent) will be spent from development budget for implementing 61 projects.

- This allocation is Tk 2366 crore (33.23 per cent) more than the last year's revised budget and 23.53 per cent more than that of the proposed budget.
- Development budget this year is 57.49 per cent more than the revised budget of the previous year and 5.08 per cent more than the proposed budget. Increase in revenue budget is Tk 296 crore (23.4 pre cent) from revised budget and is 35.82 per cent more than that of the proposed budget.
- Share in total GDP allocation is 2.27 per cent which was 1.93 per cent in FY2005 revised budget and 1.84 per cent in the proposed budget.
- In line with PRSP, budget has put a lot of emphasis on girls' education. The budget will bring 29 lakh more students under the stipend programme. In addition, the budget has increased the number of scholarships at various levels.
- Expenditure upto March 2005 was 44 per cent. Number of projects in ADP is 51, of which 13 were targeted to be completed but none was completed. In FY04 budget 39.1 per cent was spent upto March which went up to 88 per cent in June.
- No new project was included in education sector.
- Ministry of education has been brought under the Medium Term Budgetary Framework (MTBF) which is a new initiative of the Government. Indicators of attainment of targets and output target of those indicators are specified under this new initiative. So hopefully the targets can be better monitored.

Health

- Combined allocation in health is Tk 4240 crore which is 6.6 per cent of the total budget. This allocation is Tk 1065 crore (33.5 per cent) more than the last year's revised budget and 31.6 per cent more than the proposed budget.
- Development budget increased by 58.7 per cent compared to the revised and only by 4.7 per cent compared to the proposed budget. Revenue allocation increased by 14.4 per cent from the revised and by 24.9 per cent from the proposed budget.
- Share in GDP allocation is 1.0 per cent as against 0.9 per cent of the last revised budget. This share is 0.9 per cent of the FY05 proposed budget.
- Expenditure up to March 2005 has been only 33 per cent of the allocated amount. Number of projects in the ADP was 16. One was targeted to be completed but was not completed by March 2005. In FY2004 budget 34.4 per cent was spent upto March 2005 which went upto 71 per cent in June.
- Only one new project has been included but this was under the local government division.
- On the whole, allocation in social sector in FY2006 as percentage of total budget has increased by 1.39 per cent.

3.2 Social Safety Net

Continuation of Existing Programmes

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

- Increased monthly allowance under Old-age Allowance and Allowances for the Widowed, Deserted and Destitute Women, from Tk 165 to Tk 180, and increased number of beneficiary coverage from 19.15 lakh to 21.25 lakh.
- Increased number of beneficiaries under Honorarium for Insolvent Freedom Fighters, from 60 thousand to 70 thousand.
- The budget proposed an additional allocation of Tk 75 crore to the Fund for Mitigating Risks due to Natural Disasters.
- The budget proposed an additional allocation of Tk 20 crore to the Fund for Rehabilitation of the Acid-burnt and the Physically Handicapped and an additional allocation of Tk 75 crore to the Fund for Housing the Homeless.
- The budget proposed an allocation of 10.32 lakh tons of foodgrain for VGD, VGF, Food for Works Programmes, Test Relief and Gratuitous Relief (GR) in FY06 which is 18.6 per cent higher than the revised budget of FY2005 but 22.3 per cent lower than original budget in FY05. In addition, it proposed an allocation of Tk 300 crore in FY2006 as Food for Works Programme (Cash) which is 13.6 per cent more than the revised budget of FY2005.
- The budget made a lumpsum allocation of Tk 100 crore to the Ministry of Flood and Disaster Management to meet the emergencies due to natural disaster.

New Programmes Introduced

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

- *Allowance for the Fully Retarded:* The budget has proposed to provide a monthly subsistence of

Tk 200 to 104000 fully retarded persons; the budget allocated an amount of Tk 25 crore towards this programme.

- *Seasonal Unemployment Reduction Fund:* The budget proposed to create a fund of Tk 50 crore for the marginalised poor of some selected areas in Bangladesh where remain unemployed per force for certain periods in a year owing to natural and geographical constraints. This is expected to mitigate their miseries by creating employment opportunities for them.

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

3.3 Programme for Mitigating Economic Shocks

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

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

3.4 Special Credit Programmes for Employment Generation

The government has taken up a number of special credit programmes (Tk 831 crore) under both revenue and development budgets for creation of employment opportunities for the poor (see table A2).

However, the test of the actual efficacy of these allocations will be in their implementation and capacity to reach the target groups.

- Up to December 2004, within the purview of different development programmes microcredit amounting to Tk 6,000 crore has been disbursed from Government's own resources through different ministries /divisions/ departments. The budget has proposed a further allocation of Tk 200 crore from the revenue budget to the micro-credit fund which has already been created under the Rural Development and Cooperative Division, Ministry of Fisheries and Livestock, Ministry of Youth and Sports, Ministry of Liberation War Affairs and Ministry of Women and Children Affairs.
- The budget has allocated Tk 281 crore to PKSF (Palli Karma Shahayak Foundation) to implement microcredit programmes through NGOs in FY2006.
- Increased allocation of funds for the Bangladesh NGO Foundation from Tk 50 Crore in FY2005 to Tk 100 crore in FY2006.
- Allocated AN additional amount of Tk 100 crore in FY2006 as Special Fund for employment generation of the hard-core poor.
- The budget has increased an allocation of Tk 50 crore for development of micro-enterprises in the rural areas. PKSF is implementing this programme through 70 NGOs.
- The budget is going to provide credit support of Tk 100 crore through Bangladesh Krishi Bank, Rajshahi Krishi Unnayan Bank, BASIC Bank and Karma Sangsthan Bank to promote agro-based industries.

Table A 2: Special Credit Programmes for Employment Generation: FY2005-06

	Existing (FY05)	Additional Allocations proposed (FY06)
Total New Allocations for Microcredit Programmes		1379
Government departments/ agencies	6000	200
PKSF	*	281
NGO Foundation	50	100
Employment generation for the hard-core poor	*	100
Micro enterprises in the rural areas	*	50
Credit support to promote Agro-based industries		100

** Data not available.*

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

Comment

An analysis of actual expenditure of money allocated as special block allocation for poverty reduction in FY2005 (Tk 230 crore) under ADP revealed that not a single Tk was spent until March 2005. On the other hand, data on utilisation level of targeted programmes for poverty eradication and employment creation during the FY2005 is not available. In the absence of utilisation level, it is not known how far they were implemented in FY2005 and what will be the fate of these allocations in FY2006.

Finance Minister in his budget speech mentioned, "Fifty-four per cent of revenue and development budget will be spent to finance direct and indirect poverty reduction programmes in the next fiscal (FY2006)". However, he does not mention how he has derived these figures and which ministries/agencies/programmes/projects are included in this. A separate annex at the end of the speech could have resolved this problem. Currently, the most important public development document of the country lacks transparency regarding resource allocation to its most important objective, i.e. poverty alleviation.

4. CONCLUDING OBSERVATIONS

Three major trends may be observed from the proposed budget for FY2006.

- First, care has been taken to upgrade some sectors in terms of allocative priority from poverty alleviation consideration. These include the initiatives in the area of health and education. Other initiatives belonging to this category are those contributing to agriculture and rural development. There had also been a conscious effort to expand and deepen the social safety net programmes. However, without a proper poverty audit, it will be difficult to say what is the actual pro-poor intensity of the budget FY2006.
- Second, with a view to provide support to investment and employment generation in the backdrop of limitation of available resources, the budget for FY2006 has made a number of compromises. This has been reflected through recasting of tax holiday provisions, continuation of a number of cash incentive schemes for selected export sector, and rationalisation of tariff and para-tariff structure.
- The third trend in the proposed budget for FY2006 suggests that the fiscal measures were in fact generated through collusive behaviour. The extreme manifestation of this was the extension of the time period for tax amnesty for undisclosed income. Some other fiscal measures would also invoke such suspicion (for example, tax on SIM card).

At the end of the day, the "reality check" of the budget for FY2006 will be in its implementation. If the implementation behaviour pursues its earlier track record, then both the fiscal and external balances will be in jeopardy, ultimately undermining the savings-investment prospect. Admittedly, under such a scenario, the poor will be affected more than the rich.

Some of the "not so pro-poor trends" in the public finance basket are the following. First, revenue expenditure increasing at a rate faster than that of revenue earnings and development expenditure. Second, increased contribution of the VAT in incremental contribution to the total revenue intake. Third, extremely poor level of utilisation of resources allocated to some of the social sectors (e.g. primary health care and education sectors) which essentially benefit the rural poor.

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

The concern for such a grim possibility increases as the government's[1] inclination to commit one by one all the "eight sins" identified by the CPD earlier. These were:

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

We regretfully observe that the tally has reached three through the budget for FY2006. Will the rest follow as well?

[1] *See for details IRBD 2005 Second Reading.*