

Dialogue Report on
State of the
Bangladesh Economy and
Budget Responses
FY2008

Annexes

The Dialogue

The dialogue on *State of the Bangladesh Economy and Budget Responses FY2008*, organised by the Centre for Policy Dialogue (CPD), was held on June 14, 2007 at the ballroom of Pan Pacific Sonargaon Hotel, Dhaka. The main objective of this dialogue was to share with the broad public CPD's observations and analysis as regards budget FY2008 presented on June 7, 2007.

Mr M Syedurzaman, Member of CPD Board of Trustees and Chairman of Bank Asia, presided over the dialogue. The Honorable Finance Adviser *Dr A B Mirza Azizul Islam* was present at the dialogue as the Chief Guest. *Dr Salehuddin Ahmed*, Governor of Bangladesh Bank was present as the Special Guest and *Dr Debapriya Bhattacharya*, Executive Director, CPD, presented the keynote paper.

The dialogue saw a broad representation of the civil society with participation of senior government officials and policymakers, economists, academicians, representatives of development agencies, and political leaders. The list of participants is attached in Annex 1.

Introductory Remarks by the Chair

Mr M Syedurzaman welcomed the guests and made the remark that it has been CPD's tradition to prepare the budget analysis with a high degree of professionalism and that this year it has been no exception. He noted that in the recent past several comments by distinguished experts, economists, professionals and also political personalities have been reported in the media where they have given their reactions as regards the budget proposals for 2007-2008. Some have praised the budget proposals unequivocally while others have termed it as traditional or stated that it is not based on sound legal footing. In any case, the circumstances under which the budget proposals for 2007-2008 have been placed by the Finance Adviser were indeed extraordinary. He observed that the manner of presentation of the budget proposals to the nation was truly unique. This was a budget which was not presented by a Parliament or by a chief martial law administrator, and this was also not a budget that was prepared by a finance adviser for a caretaker government of ninety days. For reasons known to everybody, the present government did

not have any concrete philosophy about macroeconomic management. As a consequence, the Finance Adviser and the government had to base the budget proposals on the existing framework, more particularly the Poverty Reduction Strategy Paper (PRSP), the medium term macroeconomic framework (MTMF) and the three-year rolling investment programme.

Mr Syedurzaman thought the budget proposals appear to be pragmatic and in some cases bold and transparent. He noted that the main objective of the budget was attaining 7.0 per cent growth rate. He remarked that those who were looking for a path-breaking budget that would usher in a new era need not be altogether disappointed. Emphasis on infrastructure development, particularly in the power sector, and high allocation for the social sector were entirely unavoidable. The bold initiative that has been taken for closing the so-called "black hole of deficit" by the state-owned enterprises, particularly the BPC, has not been proposed in any of the earlier budgets. However, it was clear that the Finance Adviser had to face many challenging problems while preparing this budget.

Mr Syedurzaman hoped that the audience would discuss some concrete measures that the government should take such as the exact mechanism of financing the BPC's deficit through issuance of bonds (for example, what will be the maturity framework of the bonds). He felt that there should also be discussions as to whether the budget will be contractionary or expansionary; how will the government address and accommodate the growing demand for higher wages and how the issue of rise in price shall be addressed. Finally, the audience would like to know how the budget proposals and the investment proposals could be related to growth of employment.

Following the abovementioned remarks, *Mr Syedurzaman* invited *Dr Debapriya Bhattacharya*, Executive Director, CPD, to make his presentation.

Keynote Presentation by Dr Debapriya Bhattacharya, Executive Director, CPD

At the beginning of his presentation *Dr Bhattacharya* expressed his sincere thanks to the Finance Adviser, leaders of the business community, development practitioners, political leaders, former law-makers and others in the

audience for their presence at the dialogue and mentioned that it was a privilege for him to present the budget analysis, on behalf of the CPD, before such an august gathering. He recalled that the CPD had been producing various policy inputs for the government over the preceding months. He recalled in this connection that on 27th September CPD prepared an Immediate Action Plan and a Hundred Days' Programme for the then newly elected government. CPD also handed over a set of recommendations for the Caretaker Government to the President. When the current caretaker government assumed power on 25th January 2007, CPD prepared a paper titled *State of the Bangladesh Economy in FY07: An "Election Plus" Agenda for the Second Caretaker Government*. In the recent past, CPD has done a Price Study at the request of the government. CPD had submitted a report of this study to the Chief Adviser and the Finance Adviser. He also mentioned that CPD had prepared a set of proposals for 2007-2008 budget which had been submitted to the Finance Adviser. *Dr Debapriya* expressed his satisfaction that many of the CPD proposals have been absorbed in the 2007-2008 budget. CPD had also prepared a "State of the Economy" report just before the budget. Finally, CPD has prepared the present budget analysis.

Benchmarks

Dr Bhattacharya initiated his substantive discussion with the benchmarks against which the 2007-2008 budget was prepared. He highlighted 10 positive features of the preceding FY2006-07:

- A modest growth rate of 6.5 per cent has been achieved although *Dr Bhattacharya* cautioned that according to CPD estimates, the growth rate would perhaps be downsized to around 6 per cent with subsequent revision by the Bangladesh Bureau of Statistics (BBS).
 - Income tax collection was good.
 - The country has experienced a sustained manufacturing growth.
 - There has been a good disbursement of term loan.
 - Export growth has been robust.
 - Capital market has become stronger.
 - There has been a buoyant flow of remittance.
 - Port situation has been improving.
 - There has been increased competition in the telecommunication sector.
 - Most importantly, structural reforms have gained momentum in the fiscal year 2006-2007.
- Dr Bhattacharya* also mentioned some negative features of FY2006-2007:
- Prices of essential commodities, especially food, have gone up.
 - Although the income tax collection was good, government's aggregate revenue collection was weak.
 - Government's revenue expenditure was on the high side.
 - Due to poor inflow of foreign aid, government borrowing was high.
 - ADP implementation rate has been historically the lowest.
 - Crisis of fertiliser, electricity and diesel, particularly for irrigation, has been detrimental to the agriculture sector performance.
 - There has been a fall in the gross disbursement of agriculture credit for the first time. This was presumably the reason behind stagnant foodgrain production.
 - Shortage of electricity has become more acute.
 - The new pay scale in the RMG sector has not been implemented dutifully by all the entrepreneurs.
- With his comments on the benchmarks, *Dr Bhattacharya* recalled the main challenges that the government had to consider while preparing the budget for the FY2008. These were:
- Stabilisation of the prices of essential commodities, particularly the food price.
 - Attainment of the objective of a pro-poor growth.
 - Reduction of inequality.
 - Enhancement of investment.
 - Enhancement of domestic savings.
 - Expansion of the tax revenue base.
 - Increase in the flow of foreign aid.

- Improvement in the quality of ADP and its implementation.
- Increase in investment in agriculture.
- Proper utilisation of funds allocated for power, education and health sectors.
- Sustainability of the export growth.
- Improvement of FDI flow.
- Availability of resources in the capital market.
- Sustainability of remittance flow.
- Implementation of the proposed structural reform projects.

While highlighting some major features of the budget for 2007-2008, *Dr Bhattacharya* noted that it was the first time that a caretaker government has prepared a full year budget. In this connection, he maintained that it is better to prepare the budget from a medium term perspective than to prepare a part-time budget. Otherwise, it is difficult to ensure proper utilisation of resources. Regarding the question on the legality of such a budget, *Dr Bhattacharya* recommended a reading of the Article 83, along with the Article 93 of the Constitution, which he felt provides an unequivocal answer to such doubts.

Dr Bhattacharya said that the budget reflects the transition that is taking place within the country. For the first time in a budget a direct acknowledgment is made of the various types of inequalities that exist in the society including income inequality, gender inequality and regional inequality. An attempt has been made in the budget to bring greater transparency. In view of doubts as regards the PRSP, *Dr Bhattacharya* thought that the Finance Adviser has clarified this and has explained in his speech that the government remains committed to the main principles of the poverty reduction strategy. He felt that the development partners will be reassured by the budget speech of the Finance Adviser where Finance Adviser has reaffirmed his commitment to the PRSP principles by referring to the new three-year long medium-term macroeconomic framework (MTMF) for FY2008-2010.

Dr Bhattacharya expressed his doubt as to whether the Finance Adviser has been able to stick to the principle of determining government expenditure

by taking cognisance of resource mobilisation. He stated that in the final analysis having determined the size of expenditure, the Finance Adviser had to look for additional revenues. *Dr Bhattacharya* felt that although the various economic proposals which have been put forward are logical as separate proposals, he thought these are all standing on a budget framework that is weak. He remarked that an attempt has been made to build another storey on the roof of a dilapidated building and it is vital to observe how strong is the staircase that leads to upstairs. He termed this staircase as the staircase of financing. For this reason, the summary assessment about this budget could be that it *seeks to make a break from the past, but does not make a breakthrough*. This would imply that there have been attempts to make a break from the past, but a full breakthrough is yet to be seen.

Growth, Savings and Investment

Dr Bhattacharya mentioned that there had been some debate as regards the 7 per cent growth that has been targeted for 2007-2008. He maintained that the 7 per cent growth is a challenging target; however, if the agriculture sector, the industrial sector and the service sector performances are improved (particularly the agriculture sector), then the 7 per cent growth is attainable. But the important thing is how much investment is required to reach this target. According to estimates, in order to achieve the GDP growth target of 7 per cent, an extra investment of 1 per cent of the GDP is required, i.e. almost Tk 21,000 crore extra on the benchmark of 2006-2007. Furthermore, an improvement of the ICOR (Incremental Capital-Output Ratio or what is known as the capital productivity) is also essential to achieve this target. A combination of both will be necessary. *Dr Bhattacharya* in this connection felt that Bangladesh does not suffer from inadequate resources. This is reflected by the fact that national savings rate is increasingly diverging from the gross investment rate, indicating that at least 3 per cent of the GDP remains unutilised. The investment rate in Bangladesh is the lowest in this region. In view of this, the main challenge is not just mobilising resources, but to remove barriers which prevent institutional resources from being translated into investment. MTMF projections indicate that over the next three consecutive years the GDP growth is expected to be around 7 per

cent. Of all the targets, it is the investment target which has been reduced. Investment is thus underperforming and the target that has been set for FY2008 seems unrealistic.

Dr Bhattacharya noted that revenue growth target was not attained in the fiscal year 2006-2007 and it was consequently reduced in the FY2008. As for expenditures, they have never remained within limit in the past two years. As a result, it is suspected that the revenue shortfall will be particularly high in the upcoming year. Even if BPC's liability is not accounted for, the revenue shortfall may increase up to 1.5 per cent. Since the flow of foreign aid is low, there has been a tendency to borrow money from the domestic sources. Bank borrowing is seen as the main source, since the interest rate is lower in this case. The interest rates in the case of other sources are relatively higher and borrowing from such sources does not augur well from the perspective of fiscal discipline.

Dr Bhattacharya made the point that the macroeconomic framework, as it stands, is built on a fragile ground because it presupposes that the inflation rate will be moderated in near future. Expenditure growth will still remain higher than the revenue growth and within that expenditure, it is not the development expenditure, but the revenue expenditure which is showing higher trends. Foreign financing may be reduced and the pressure on domestic borrowing will continue. *Dr Bhattacharya* remarked that the caretaker government has taken a high-growth approach not only for 2008, but also for 2009 and 2010.

Employment

Dr Bhattacharya mentioned that there was an absence of discussion on the employment scenario in the budget presentation. He considered this to be a major omission given its importance. Bringing PRSP into the discussion, *Dr Bhattacharya* maintained that on the basis of PRSP's elasticity accounts for the FY2006-2007, CPD estimates about 30 lakh employment opportunities were supposed to be created in that year. He cited another estimate based on GDP growth which mentioned that possibly only about 10.5 lakh job opportunities could have been created. This left a gap of about 20 lakh jobs. Keeping in mind that 12 to 15 lakh workers enter the labour market every year, and accepting PRSP's target for the fiscal year

2007-2008, 30 lakh employment opportunities will have to be created just to provide jobs for the current wave of entrants into the labour market. This, however, does not include the unemployed or the semi-employed ones who are already in the market. Regrettably, the data on employment opportunities and unemployment in this country is scant, and not reliable. The Labour Force Survey (LFS) of Bangladesh is published with a lag of two-three years; and contains no up-to-date or real-time data. As a result, in order to analyse and make projections policymakers and researchers have to depend on indirect evaluations. *Dr Bhattacharya* emphasised the need to put the issue of employment at the focal point of development discourse in the current context.

Revenue Earnings

Referring to the average growth rate of 12.5 per cent for 2002-2005, actual growth of 15.5 per cent for the year 2006, and the revised growth target of 2007 for the National Board of Revenue (NBR) revenue earnings, *Dr Bhattacharya* noted that NBR growth target was 17 per cent for the upcoming fiscal year. He felt that this was a challenging target, but not unreasonable or unattainable. For the income tax target figure, he noted that the last revised budget's target figure for growth rate is 39.5 per cent, while the budget for 2007-2008 puts a target of 21.4 per cent growth. *Dr Bhattacharya* observed that it is not clear why NBR has become less ambitious with regard to income tax collection. However, comparing with the previous year's figures, he noted that the VAT collection growth target of 16.1 per cent was quite reasonable. Referring to the fluctuating performance of supplementary duty and customs duty, he mentioned that this it is not very clear that import had risen by 18-20 per cent. He disagreed with non-NBR tax and non-tax revenue growth targets of 12.4 per cent and 12.1 per cent for the budget 2007-2008. Referring to the historical data and the revised budget targets of 16 per cent and 19.5 per cent for 2006-2007, he remarked that the targets for 2007-2008 are conservative. But even with these numbers, the total revenue target is 15.8 per cent, which is lower than 16.4 per cent of the revised budget. *Dr Bhattacharya* noted that one cannot really convincingly say that the total revenue target is overambitious. He felt the target is attainable since such growth rates have been

achieved in the earlier years. In so saying, *Dr Bhattacharya* also noted that even after the collection of the targeted revenue, the nation will have a tax-GDP ratio that will be less than 11 per cent, which is less than countries such as India, Pakistan, Sri Lanka and even Nepal. So, even if the targets are overshoot, the relative performance will still be very weak.

The government is going to mobilise Tk 7,829 crore as extra revenue in 2007-2008. *Dr Bhattacharya* referred to the CPD analysis which said that NBR part will add 81.4 per cent of the total addition. But he emphasised on the fact that the non-tax component will add 15.8 per cent. He made two major points based on this figure. First, the revenue structure of Bangladesh is now moving away from trade taxes to domestic taxes. The tax collection situation at present is by no means critically dependent on international trade. It is gradually becoming dependent on domestic sources, mainly on VAT and income tax. Second, though it is dependent on VAT and income tax, internally the pressure lies more on indirect taxes, rather than direct taxes: within the incremental Tk 7,829 crore, VAT will contribute 28.2 per cent, income tax will contribute 24.4 per cent. This means those who do not have high income will pay relatively more VAT, whereas those who have direct income will pay relatively less amount.

Expenditure

Dr Bhattacharya dwelt briefly on the expenditure issue. He noted that the target for revenue expenditure growth has been set at 15.3 per cent for 2007-2008. But as revenue expenditure has been systematically overshooting the target in the previous years, he expressed his doubts as to whether at the end it could be contained within 15.3 per cent. He acknowledged that within the revenue expenditure growth will be more visible with regard to subsidies and current transfers. The growth will be 15.7 per cent according to the budget figures. In this context, *Dr Bhattacharya* pointed out that maximum growth is going to take place in interest payment. Twenty-two per cent of the revenue budget is going for debt-servicing liability, especially to repay loans that have been taken from domestic sources. He also noted that total expenditure will increase by 30 per cent and there is an increase of 434 per cent in other

expenditures. He mentioned BPC's liability as the reason behind this high growth. He expressed his concern that although the targeted ADP is 23 per cent higher than the revised ADP of FY2007, it will be very difficult to achieve such growth rate in actuality.

Deficit

Dr Bhattacharya noted that for the 2007-2008 fiscal year deficit has been targeted at 5.6 per cent of the GDP. A major part of it is due to BPC's debt liabilities. Even when this is excluded, the deficit stands to be 4.2 per cent of the GDP. This means that this year the financial deficit will increase. However, *Dr Bhattacharya* noted that this extra deficit is not originating so much in development financing, as in revenue expenditure and other expenditures, even after making the adjustment for BPC, which, to him, is the number one concern about the deficit. To him, the number two concern is that, increasingly, it is the domestic financing which is putting up the bill for the deficit financing. In the 1990's, foreign financing had been underwriting the deficit in a big way, whereas currently it is the domestic financing. He also added that bank borrowing is accounting for 24 per cent, a quarter of the deficit financing. Obviously, it has implications for financing the private sector in many ways. On foreign financing, he said that not only the grants, the component of loan is also substantial. *Dr Bhattacharya* felt that around \$1.5 billion foreign resources would be required to service the expenditure projections. He expressed his concern over the gross \$2 billion foreign resource requirement in order to have a net of \$1.5 billion. He said the country never had \$2 billion foreign resource flow in the last 25 years. Therefore, to him, the target for foreign financing was rather ambitious. The main challenge, therefore, will be not only generating the required revenue surplus, but also accessing the foreign aid.

Some Selected Issues on Public Expenditure

Dr Bhattacharya briefly commented on some selected public expenditure issues. He mentioned that the ADP was getting marginalised. ADP in the budget for 2007-2008 is 30 per cent of the total expenditure, while last year it was 32.3 per cent. He noted that the new ADP will be 5 per cent of the

GDP. But for India and Pakistan, development expenditure of the government stands at 8-9 per cent of the GDP. *Dr Bhattacharya* stated that a targeted ADP of 5 per cent of the GDP will be one of the lowest since 1991. Consequently, lack of capital formation within the public sector is going to constrain not only the private sector's growth because of electricity, communication and others, but it is also going to adversely affect the lives of the poor people because of low utilisation in health, education and other sectors.

Dr Bhattacharya pointed out some aspects of the budget that demand clarity. With regard to the issue of the budget being pro-poor, he stated that the budget has given a figure of 57 per cent of the total expenditure or 73 per cent of the ADP expenditure as pro-poor. Terming such figures as signs of good progress, he emphasised on the clarification of such figures as it is important to know what exactly has gone into it. He also commented on the lack of clarity in the figures of the education and religion sectors. He said it was never understandable why the government has put religion and education together and what is the relationship between these two. Demanding more transparency on the issue, he noted that in the case of direct education the allocation is almost 3 per cent less, whereas religion based projects got almost 48 per cent more.

Dr Bhattacharya mentioned about the defence budget. He said the total development and non-development expenditure for the defence services accounts for 6.3 per cent of the total budget while last year it was 7 per cent. As a percentage of the GDP it will be about 1.15 per cent. Referring to India and Pakistan, he said their expenditures are much higher, around 1.85 and over 2 per cent respectively.

Dr Bhattacharya highlighted the issue of resource allocation for the election commission. The election commission has received Tk 536 crore in 2007-2008 while last year it was Tk 120 crore. *Dr Bhattacharya* argued that the commission should get as much money as was needed. He was of the opinion that election is a matter of national interest and its entire financing should come from the domestic resources so that foreign influence cannot affect the national election process. This is even more so because the people should be ensured as much as possible that the caretaker

government is holding the elections independent of any pressure from donors.

General Fiscal Measures

Regarding fiscal measures *Dr Bhattacharya* mentioned about tariff and quasi-tariff measures, the infrastructure development surcharge, re-fixation of the tariff slabs, harmonisation of the supplementary duty, re-orientation of the taxable income, higher tax rate of the non-listed mobile companies, significant reduction of zero tariffs (except for essential food items), increased amount of VAT and some institutional simplifications and correctional measures that have been proposed in the budget.

Dr Bhattacharya emphasised on issues relating to the restructuring of the tariff rates. He mentioned that the earlier rates of 12, 15 and 25 per cent have been reorganised as 10, 15 and 25 per cent and withdrawal of the infrastructure development surcharge of 4 per cent has now been integrated into the budget. He referred to a CPD estimation based on NBR data. As is known, previously the raw materials were in the 5 to 10 per cent category. The effective tariff rate of these raw materials has increased from 27.7 per cent to 29.5 per cent. This means there has been an increase of 1.75 per cent in the tariff rate on the raw materials. On the intermediate products, which have become 15 per cent from 12 per cent, the tariff rate has marginally decreased from 35.8 per cent to 35.2 per cent. While this is not much of a concern, the problem is with the tariff on the finished product that has decreased from 50.7 per cent to 26.7 per cent. *Dr Bhattacharya* implied that because of the change in the tariff incidence, the relative tariff or the difference between the raw material and finished goods, which was 23 per cent (without the supplementary duties), has now decreased to 17.2 per cent. This means that the protection which was enjoyed by the domestic producers has been reduced by a margin of about 5 or 6 per cent. *Dr Bhattacharya* said he was not sure whether this was intended or not, but he remarked that a large part of it can also be covered by applying supplementary duty. Regarding supplementary duty, he noted that those who were within the 25 per cent slab are facing an increased tariff incidence.

Dr Bhattacharya said the government is suggesting safeguard taxes. He expressed his concerns about

the necessity of such taxes when there are anti-dumping duties and countervailing duties. He pointed out that introduction of a safeguard tax, which is a quasi-tariff, will again take away the effort to bring transparency in the tariff structure. He said, though he supports the process of integration of the tariff, there is a need for more transparency in the tariff structure. He called for a look into the structure of tariff, item-by-item, at the six-digit level and stressed the need for identification and review of the categories on which supplementary duties have been imposed. He also suggested that in some cases there may be a need for reverting back to zero duties.

Dr Bhattacharya expressed his discomfort on the provision of 0.25 per cent tax deductible at source on all export earnings, as this may come at the cost of potential loss for large exporters.

Dr Bhattacharya mentioned about tax imposed on universities and research institutions. He said bringing universities and research institutions under the trust law will result in 10 per cent effective tax (taking account of the 15 per cent rebate). By opposing the move, he maintained that these institutions are non-profit and they are reinvesting resources into their own activities. While the government is not being able to finance all the higher education and knowledge practices, if there is no private profit-making, such institutions should not be taxed and their incomes should be allowed to be reinvested. Otherwise, this could be termed as taxing of the knowledge.

Price Stabilising Measures

Dr Bhattacharya pointed out that the budget has put in three categories of price measures: market measures, non-market measures and institutional measures. These can also be categorised under short term, short to medium term and medium to long term. *Dr Bhattacharya* noted that many of these recommendations were present in the CPD study and acknowledged that most of these have been integrated in the budget. These measures have three strong approaches that relate to improving supply, increasing efficiency of the market and enhancing production. He added that there should also be short-term measures such as strengthening of market intelligence, which, to him, is very weak at present. He demanded mandatory display of market retail prices (VAT inclusive) and emphasised on the

need for close monitoring of the supply situation during the upcoming Ramadan by making necessary preparations in view of any possible exigencies, including a possible flood in the coming months.

Dr Bhattacharya noted two schools of thoughts regarding the solution to the price situation. One considers the current problem of increase in food prices from the perspective of supply dislocation and supply problems including the rise in the global prices and focuses on the supply-side issues. But there is a second perspective, focusing on monetary solutions. He noted that monetary growth has been high and discussed the extent of monetary growth during the last quarters. Growth recorded during July-December of 2006-2007 was almost 21 per cent, while it has sobered down to the level of 18 per cent by the end of March 2007. But even then the monetary growth is higher than the programmed growth which was given in the medium term framework projections at 14.5 per cent and 15 per cent. *Dr Bhattacharya* felt that there is a need for caution and an effective solution to the price hike can be obtained by close monitoring of the credit growth in the coming months and taking supply-side measures.

Reforms in Tax Administration

Dr Bhattacharya felt that the VAT initiatives should include VAT inclusive MRP (maximum retail price). He also suggested that extension of the large taxpayers' unit (LTU) should be there including creation of a data-base at the NBR.

He urged for speedy implementation of the "Universal self-assessment." He felt that a conducive environment in favour of tax-paying citizens needs to be created. In the same way VAT registration should be simplified.

Sectoral Measures

Agriculture

Dr Bhattacharya disagreed with the decision of withdrawing duty-free import of all kinds of power-pumps and imposing 10 per cent duty on them. He, however, suggested zero duty import of power-pumps to be allowed for irrigation.

Industry

RMG : For the garment workers, a welfare fund of

Tk 25 crore had been created and Tk 20 crore had been allocated for training. However, this fund has never been spent previously. *Dr Bhattacharya* suggested a contributory provident fund instead of traditional fund allocations for training. Such fund for workers has to be created so that when they leave their jobs, they are able to receive some cash. To create this provident fund, *Dr Bhattacharya* proposed that if the owner group contributes one taka per worker, then the government will make a matching contribution of one taka. This will create a safety net for the workers.

Dr Bhattacharya also emphasised on the realisation of the minimum wage structure for the RMG workers. He suggested that fines should be imposed by the government on RMG units that do not implement the minimum wage for workers within the stipulated time. Otherwise, government's sincerity to implement the decision will be questioned. He expressed satisfaction at the stand of the BGMEA in this regard.

Textiles: *Dr Bhattacharya* demanded restoration of the zero duty which was removed from the textile industries in the current budget. At this moment, textile industry is going through a process of restructuring, he noted. New value-added products are being produced in Bangladesh. He remarked that when modern machineries are needed to be procured by the textile industries, the withdrawal of zero duties will be a highly inconsiderate act.

Other Issues: *Dr Bhattacharya* noted that no fund was allotted for handloom sector. He also mentioned about no project being put in place or no funds being created for the jute sector in the budget for 2007-2008. He noted that the expenditure for providing fertiliser to the tea gardens has increased. He proposed that the zero duty for computers should be kept unchanged, while duty can be imposed on the accessories. He also recommended allocation of Tk 10 lakh for small industries and reducing the double-taxation burden from which they are suffering. Acknowledging the reduced duties on newsprint, he differed on the withdrawal of zero tariffs on pulp and suggested that the zero tariff be continued. *Dr Bhattacharya* noted that as a result of harmonisation of the tariff on milk and milk products, final duties have increased from 72.5 per cent to 75.5 per cent. He suggested a reduction of

these duties. For the glucose industry, a supplementary duty of 20 per cent was not imposed, which, he thought, could create problems for the domestic industry. He called upon the government to focus on pharmaceuticals, home textiles, light engineering and leather goods, which have been identified as thrust sectors in the export-policy 2007-09.

Infrastructure and Foreign Investment

Dr Bhattacharya expressed his disappointment at the fact that no allocation has been made in the budget for the mega national projects such as the Padma Bridge, modernisation of Mongla port, modernisation of Chittagong port, a new deep-sea port, another bridge on the Jamuna river, elevated highway in Dhaka, the planned Dhaka-Chittagong express highway. He also regretted the absence of any special proposals for foreign investment, apart from the non-resident Bangladeshi (NRB) investors.

Capital Market

Regarding measures to develop the capital market, *Dr Bhattacharya* noted that apart from the government's decision to upload shares of a number of state-owned enterprises (SoEs) in the capital market and forcing the mobile companies to list themselves (through imposition of higher tax rate if they did not), there was not much of an effort in the budget in this regard.

Safety Net

The government has increased the monthly allowance for the retarded from Tk 200 to Tk 220. Acknowledging the measure, *Dr Bhattacharya* added that it would have made more sense, according to the current market prices, if it was raised to Tk 300. If it could not be done, it should be addressed via under the vulnerable group development (VGD)/vulnerable group feeding (VGF) programmes.

Environment

Regarding environment, *Dr Bhattacharya* said the organisations that do not establish effluent treatment plant should be charged a fine. Otherwise, environment-friendly industries will not develop in the country.

Foreign Aid

Dr Bhattacharya proposed formation of a task force on foreign aid, which will be empowered to negotiate, on behalf of the government, with the development partners to ensure an accelerated release of the \$6-7 billion worth of aid in the pipeline. He disagreed with regard to new loan agreement with the IMF on the ground that IMF provides balance of payment support and did not provide the development support per se. Given the comfortable balance of payment (BoP) situation, he remarked that there is no need for such agreement at the moment.

Concluding Observations

Dr Bhattacharya highlighted the urgent need to have a public-private partnership, without which the government will find it difficult to spend the formidable expenditure budget of the current fiscal year, particularly in the area of developing the physical infrastructure. For social infrastructure, he suggested strengthening of the government and NGO partnership. He also suggested focusing on power sector and giving priority to foreign aided projects.

Dr Bhattacharya concluded his speech by emphasising on two issues. First, strengthening of the monitoring and implementation from the very first quarter. Without this the current ambitious budget cannot be implemented with the required standard. He strongly suggested having a high-powered monitoring committee to oversee the entire process from the very first day of July. Second, he raised the issue of information availability. For a long time, the economic information situation in Bangladesh has been very weak. He observed that currently estimates and projections are being made on the basis of assumptions, and so-called expert opinions. He observed that at present no one was able to tell what the up-to-date, real-time investment is, at private sector level or at the level of industries. There is no reliable figure on private sector investment in the manufacturing sector. Nobody knows what the employment situation is, what is the consumer spending rate, etc. Without enforcing improvement in the information situation, transparency and accountability in the implementation process cannot be ensured. *Dr Bhattacharya* strongly urged the Finance Adviser to restructure the BBS, to endow it with sufficient

funds and human resources and also to make it independent. Without good quality data and reliable information, no one will be able to know how much money is really reaching the poor, he concluded.

Floor Discussion

Public Expenditure

Dr Syed Mainul Absan said revenue expenditure tends to be inflationary and expressed words of caution regarding the large increase in the revenue budget.

Dr Mohammad Abdur Razzaque said it is unfortunate that most of the revenue earned by the government are spent on revenue expenditures, not for development. He suggested looking into the reasons why the revenue expenditure in Bangladesh is so high. He also urged for appropriate institutional reforms in this regard, which, he thought, the current government could possibly undertake and implement – a task which democratic governments will find it difficult to accomplish. He added that there are institutions of the government, involving large number of employees that were actually not needed. He mentioned Bangladesh Rural Development Board (BRDB) as an example. He said while there is agriculture ministry, health ministry and other line ministries in place, it is confusing what the BRDB was doing. By identifying this type of unnecessary institutions, it is possible to lower the revenue expenditure.

Dr Syed Mainul Absan viewed the ADP increase of about 23 per cent in the 2007-08 as not being too high; he thought this had been the usual trend in ADP growth.

Deficit and Financing

Dr Osman Farruk observed that there were attempts during the past years to keep the budget deficit within 4 per cent. In this context, he viewed the 5.6 per cent of GDP deficit in the proposed budget as a matter of concern. He expressed his worries that financing this large deficit would ultimately lead to increased domestic borrowing, which was likely to end up with higher rates of bank borrowing.

Terming the financing issues very critical, *Dr Syed Mainul Absan* observed that the net foreign component is about \$900 million for 2007-2008, which, to him, is not exceptional given the past

pattern. He thought that the gross foreign financing requirement was equivalent to about \$1.5 billion. He felt that the net amount is not outlandish and roughly in line with the normal progression that one would expect based on the experience of last few years.

Dr Masibur Rahman noted that the budget for 2007-2008 aims at high spending. But if the overspending is financed by borrowing, there will be pressure on interest rate. This could crowd out the private sector, which is supposed to be the main engine of growth.

BPC

Regarding BPC bonds, *Dr Masibur Rahman* said that the important issue was how the bond would be managed. He said the government issued bonds in the past but there were no immediate cash transaction. But over a period, the government paid an interest to the organisation which held the bond. Also, if it were given to the banks, it could qualify for SLR (Statutory Liquidity Ratio), although the SLR would have a slightly expansionary impact provided all the other related proposals in the budget remained in place.

General Fiscal Measures

Mr Mir Nasir, Chairman of FBCCI, emphasised on the need for shifting the dependence from import duty to direct tax and VAT. Regarding the duty structure, he considered two proposals to be important: one was that the lowest slab of 5 per cent was increased to 10 per cent and the other was the withdrawal of IDSC. According to him, it will have impact on the prices of capital machineries because the rate will increase from 5 per cent to 10 per cent for all items for textile and jute industries, this will be raised to 10 per cent from zero per cent. He thought that this will negatively affect the private sector.

About the increased tariff on powder milk, *Ms Taleya Rahman* was of the opinion that this was mainly a baby food and therefore should not be made more expensive.

Inflation

Dr Osman Farruk stressed that food price inflation was the major problem of the day and it had to be contained. While this would require various

measures to address the anomalies in the marketing chain, confidence of the private traders and merchants had to be restored since marketing was essentially a private sector driven activity.

Welcoming the various provisions that have been made in the budget, *Dr Farruk* particularly appreciated the endowment fund for agriculture and hoped that this could be materialised in an appropriate manner. As regards subsidies given on soybean oil, he expressed his apprehension that government may lose Tk 300 crore as revenue due to subsidies on soybean but most of the benefit may not reach the consumers if the price level of soybean and other edibles are at a lower level than what it was across the border in India. *Dr Farruk* called for caution whenever subsidies are provided, whether it is on fertilisers or any other item particularly when there was a possibility of cross-border smuggling because of differential price structure between Bangladesh and India.

Regarding inflation *Mr M K Anwar* noted that despite withdrawal of duties on pulse and edible oil, prices of pulse in the markets have increased by Tk 4-6 and oil by Tk 2. Even in the case of the price of sugar, this was not supposed to increase before July 1, was raised by Tk 4 in advance. He suggested an analysis of the fundamental reasons why prices, of commodities are increasing while duties are being reduced; he also suggested to find out if there is any problem in the supply chain. He noted that for the upcoming year, inflation has been targeted at 6.5 per cent, but unless a strong monitoring system is in place at the earliest, inflation may cross even 7 per cent.

Mr Rashed Khan Menon noted that the process of market correction has been left entirely to the market itself. In this regard, he pointed to the recommendations made by the CPD to put in some legal and institutional measures to control the market. He felt that what have been proposed in the budget are some fiscal measures and attempts to reduce tariffs, but none of these was likely to have a positive impact on the market. He mentioned that the BDR, and not the economists, is investigating some of the developments in the market and making recommendations, as to whether any alternative distribution systems could be setup. He emphasised on bringing this alternative distribution channels within the legal and institutional folds. The issue needed urgent attention because the real

income of consumers has fallen drastically due to the current high inflation. He supported the CPD suggestion to introduce a 15 per cent dearness allowance for low paid government employees.

Dr Razzaque opposed the pressure created by some of the developed countries and development partners to withdraw subsidy on agriculture. He felt that Bangladesh should rather ask them to provide assistance so that Bangladesh could give subsidy to enable low cost import from the developed countries. This was required particularly because Bangladesh has turned into a persistently deficit country. He also thought that providing allocations to projects is not enough. The Agriculture Extension Department and other line ministries should be given strict targets which they must fulfil. He believed that with good governance, price stabilisation is possible even with the technology that this country already has.

Mr Subel Ahmed Chowdhury emphasised on the need to deal with supply side issues concerning Dhaka city. This was important considering the huge size of the population living in the city. He thought that the option of establishing 6-8 more *Arots* in Dhaka city should be considered seriously. He also stressed on looking at this issue as a long term rather than a short-term measure. According to him, this could have positive effect in terms of bringing the price of essentials down by a considerable extent.

Mr Chowdhury also stressed on the issue of planning in advance so that any external shocks such as production shortage in food exporting countries do not adversely affect the price in Bangladesh.

Regarding farmers' cooperatives, *Mr Chowdhury* felt that this could be a good solution to deal with price hike only if large scale contractual farming is practised.

Regarding import through Trading Corporation of Bangladesh (TCB), *Mr Chowdhury* said TCB cannot be as effective as it was in the 1970s due to the open market economy that is prevailing now. Rather than strengthening TCB, a private trading company could do better as the time required to import would be much lower for them.

Given the current inflationary pressure, *Mr Jonathan Donne* from the IMF said there is an urgent need to coordinate monetary and fiscal policies and this certainly required interest rate to increase, although it may increase the borrowing cost for the budget.

Agriculture

Terming the subsidy structure in agricultural erroneous, *Mr M K Anwar* said the cost of operating pumps by diesel is at least 25 per cent more than that of electricity. Therefore, the allocation of Tk 750 crore as diesel subsidy may not be adequate to create a similar price structure for the diesel and electricity in operating pumps. He felt that additional fund was needed in view of this, and the structure also needed to be reviewed.

Regarding the duty imposed on import of irrigation pumps, *Mr M K Anwar* thought that this should be withdrawn. Referring to news reports, he apprehended duty hike on seeds. He felt that if it was true, the move will be suicidal.

Mr M K Anwar considered the creation of the endowment fund of Tk 350 crore for agricultural research as a positive move. However, he was of the opinion that the responsibility of administering this fund should be given to Bangladesh Agricultural Research Council (BARC) and not to the ministry.

Mr Anwar noted that ADP allocation for the agriculture ministry has gone down from Tk 1,221 crore to Tk 838 crore. He felt that it was not clear why this has been done, and asked for an explanation for this.

About the import duty on power pumps in the agriculture sector, *Mr G M Quader* maintained that the 10 per cent duty should be brought down to zero per cent. He recalled that the agriculture sector is making substantial contribution to the GDP, although farmers do not get due recognition.

Mr Quader welcomed the move to give subsidy in diesel directly to the farmers. However, he was not clear as to the mechanism of distribution of this subsidy to the farmers. He cautioned that if there is no strong mechanism for distribution of the subsidy, the allocated funds will be wasted as has happened with many other subsidies.

Ms Laila Rahman Kabir stated that putting emphasis on agriculture in the budget was long overdue. She thanked the government for its budget initiatives in support of agriculture, particularly in view of the fact that a large part of the population in the rural areas was dependent on agro-based employment. She remarked that the effort to increase agricultural productivity makes economic sense.

Ms Kabir also highlighted the issue of fertiliser

distribution in the tea industry. She strongly felt that in order to make agriculture productive fertiliser must be made available to the producers in the right time and in sufficient quantity. She said the current fertilizer requirement for the tea sector was 12,000 metric tonne and this had to be supplied in its entirety during the months of June and July. Till now, supply of only 2,500 metric tonne has been made available. She added that after much persuasion it has been assured that a further 2,500 metric tonne will be made available but the price of fertilizer has risen 6 times, from Tk 4,800 to above Tk 28,000 per ton. Usually, the supply was procured from Fenchuganj but this time it was advised that fertilizer be procured from North Bengal. *Ms Kabir* expressed her concern that in the process of all these, the time for applying fertilizers this year was nearing its end. She argued that increasing agriculture production will require the government to ensure that fertilizer is made available in the right amount and at an appropriate time to the growers.

Mr Subel Ahmed Chowdhury, however, disagreed with the concept of providing subsidy on fertiliser for tea industry. He said the industry is making good profits and should not be provided with new subsidies.

Dr Razzaque stated that there was significant development in the agriculture sector during the late 1990s. At the time Bangladesh agriculture crop sector posted a 4-5 per cent growth on average. He believed that there was a need to build on the past; the nation was observing a fall in growth of agriculture and its gradual decline into a deficit country. *Dr Razzaque* felt that there is every opportunity for Bangladesh to become self-sufficient in agriculture. He appreciated the decision to give subsidy to diesel. He stressed on the need to develop the livestock sector along with the crop sector. In this connection he remarked that the livestock sector was a sector with great potentiality; however, as in the past the budget has neglected this sector.

Domestic Protection

Mr Nasir mentioned that 15 per cent duty has been withdrawn from glucose and this is likely to have impact on domestic industries. He also emphasised on the need to build backward linkages for the textile industry. He mentioned that while there has been some progress in this regard in the case of

knit, achievements in woven sector were not satisfactory.

Mr Nasir recalled the allocation for the sick industries made in previous budgets. He said the budget for 2007-2008 does not have any such allocations, and requested a reconsideration of this.

Mr M K Anwar remarked that an import-friendly tax policy will create renewed pressure on the domestic industries. He thought it would be beneficial for the national economy if this pressure could be averted. Referring to *Dr Bhattacharya's* presentation where he argued that level of protection would be reduced by 5 per cent, he continued that the government must be careful to ensure that there is no reduction in protection. He added that without the protection, industrial production may fall and eventually the GDP may be adversely affected.

Mr Latifur Rahman thought that the budget appears to favour imports of finished goods rather than the import of raw materials and intermediate goods which was required for most industries in Bangladesh. He argued that while the import of finished goods may increase the customs duty for the time being, to sustain continued growth in VAT the country needs to have a thriving local industry. This requires policies that favour imports of raw materials. He said that it is important that the budget favours such imports.

Mr Abdulla Al Mahmud noted that import duty on newsprint has been brought down to 15 per cent from 25 per cent. He noted that this sector has almost Tk 20,000 crore domestic investment and new investments are still coming. The reduced import duty was likely to severely affect domestic investments. In this connection, he argued in favour of restoration of the previous duty structure.

RMG

Ms Parveen Mahmud noted the allocation of Tk 25 crore made in support of the retrenched workers and capacity building in the RMG sector. She supported the CPD recommendation for a Contributory Provident Fund. She supported establishment of mini-garments, especially in the *Monga* areas, which could have a spill over effect on the *Monga* areas to generate employment in the villages.

Regarding the RMG sector, *Mr Anwarul Alam Chowdhury* considered that interest rate was too high

in this country. He said it will be very difficult for this sector to compete unless the interest rate is brought down to a tolerable level. He also mentioned about the shortage or load shedding of electricity hindering production in the RMG sector by adversely affecting both timely delivery and production cost. He added that efforts should be there to have a target to make the country self-sufficient in electricity within 6-7 years; however, the budget does not reflect any such intentions. He stated that there was a 25-30 per cent employee shortage in the sector. He acknowledged the Tk 20 crore allocation that has been made in the budget for skill development in the RMG sector and noted that this would help employment generation and export promotion in this sector. Acknowledging the budgetary effort to simplify customs procedures, *Mr Chowdhury* added that the sector badly needs tax holiday facility as well as soft loan facility at a lower interest rate of 7 per cent. He also stressed on developing the textile sector as this is the backward linkage industry for the RMG sector. He suggested providing subsidy to textile machineries to help textile sector grow.

Ms Tasmima Hossain pointed out that some type of benefit should be given to the sector similar to the cash incentives given earlier. This could also be provided in the form of reduced interest rates or subsidy in energy supply for exporters who are performing well, she opined. She also noted the withdrawal of zero duty in textiles sector.

Mr Subel Ahmed Chowdhury thought that the government could do something about skill development but provident fund for the RMG workers with contribution from the government was not a good option. He said skill development and labour welfare should be kept separate.

Jute

Mr G M Quader observed that traditionally the people of North Bengal have been economically dependent on jute which was still the case. He thought it was difficult to understand why the sector was not getting due importance in the budget at a time when jute industries are coming up strongly in neighbouring countries such as India. He recommended to the Finance Adviser that the jute sector should be given due importance.

Taking cue from *Mr Quader*, *Mr Rashed Khan Menon* regretfully noted that while the jute sector could be

one of the major thrust sectors of the country, there has not been any allocation to the jute sector in the entire budget. He noted that the jute sector was going through an uncertain period at a time when jute production was on the rise and there are renewed opportunities for profit making by the jute processing plants.

Liberalisation

Mr Jonathan Dunn felt that Bangladesh may end up having a more protective trade regime than it had prior to this year's budget because of the 15 per cent supplementary duty has now gone up to 20 per cent, and this covered a very large number of items. He added that if it is aggravated by an aggressive attempt to add a safeguard tax, protection may even turn out to be higher. He observed that Bangladesh needs to remain competitive internationally, and protection will not help achieve that.

Employment

Ms Parveen Mahmud acknowledged that the budget is set to stimulate self-employment and wage employment as can be seen from the allocations for SME foundation, BCIC Trust, expansion of existing micro-credit programmes and Agriculture Equity Entrepreneurship Fund. She also acknowledged that there is focus for reforms in the insurance policies. In this regard, she requested to put emphasis on micro-insurance, SME insurance and insurance for agriculture.

Safety Net

Terming street children rehabilitation as a major problem for Dhaka city, *Mr Shab Hannan* suggested allocating Tk 5 crore for this purpose, and placing the responsibility to the Dhaka Municipal Corporation. He also suggested taking the programme to other major cities.

Mr Hannan also mentioned about the problems of river erosion. He said the government does not have an agency to handle this long term problem. He suggested allocating Tk 5-10 crore for 2007-2008 and continuing the measure for some years until an agency is created to deal with this problem. *Mr Hannan* suggested handing over this responsibility to Bangladesh Red Crescent Society (BRCS).

Gender Discrimination

Ms Mahmuda Islam maintained that Bangladesh has a

clear cut approach about women's development. But the budget for 2007-2008 does not reflect this approach. She said sectoral allocations do not address gender justice or gender inequality and urged for their inclusion.

Education and Religion

Based on her experience in the field, *Dr Shabeda Obaid* shared her thoughts as regards utilisation of funds in the education sector and observed that although allocations are available for education projects, the problem was with appropriate utilisation of the funds. Terming teachers' training as a big problem for the education sector of Bangladesh, she maintained that extensive training programmes are required for teachers, especially for those outside Dhaka at all levels, from the primary to higher education.

Referring to the CPD analysis, *Mr Hannan* noted that it was mentioned that religion and education were lumped together and CPD termed this as not understandable. *Mr Hannan* remarked that these ministries are separate and their accounts are kept separate. For convenience, some of the 60 ministries are lumped together in clusters for estimation purpose. He noted that within the education and religion sectors, education holds 97 per cent share and religion accounts for only 3 per cent. He stressed on the need for highlighting this fact, he was afraid that otherwise there will be propaganda in the international press that Bangladesh was becoming a fundamentalist state.

Power

Mr M K Anwar termed the additional allocation of Tk 244 crore in the power sector as inadequate, and recommended upward revision of the decision.

ICT

Ms Taleya Rahman strongly opposed the withdrawal of zero import duty on computers. She said this may negatively affect the growing ICT sector and training centres which were making important contributions towards human resource development of the country.

Mr GM Quader maintained that keeping in mind the modernisation effort needed for the country and the high potentials for employment opportunities in the sector, ICT sector should be ensured continued

support. He came up strongly in support of continuing with the zero duty on computers.

Dr Shabeda Obaid believed that it would be ideal to have one computer for each student in the country. But since this is not possible, she recommended not to tax computers so that computers were available at relatively lower price.

Debt Sustainability

Dr Syed Mainul Absan remarked that not much has been said in the budget for 2007-2008 as regards the issue of debt sustainability. Overall, Bangladesh's debt was equivalent to over half of GDP about 51 per cent. If the net deficit of 4.5 per cent is added, it rises to about 55 to 56 per cent, which is the lowest in the region. He said all the major countries in South Asia have a higher debt and analysis of Bangladesh Bank shows that debt sustainability over the long run is not an issue for Bangladesh. It is not a big problem as long as the budget could be implemented to the fullest. However, *Dr Absan* noted that financing cost of this small debt is exceptionally high in Bangladesh compared to the other countries of South Asia.

Legitimacy of the Budget

Dr Masibur Rahman disagreed with CPD when it said that there is no constitutional issue regarding the legitimacy of the budget. He said the *budget by ordinance* is given in the powers of the President and this has to comply with Articles 87 and 90. Under these articles the annual estimates have to be submitted to the Parliament. *Dr Rahman* said it does not make sense if the government has spent most of the money and then goes to the Parliament as the Parliament's control over expenditure and taxation is very important. He added that one can argue, in the unusual situation that the country is going through, that this is something the government has to do. However, this should be done by recognising that the government is doing something extra-constitutional (and not something unquestionably consistent with the constitution).

Transparency

Dr Masibur Rahman said the budget shows allocation for the agencies in the defence establishment, but it does not specifically show how much is allocated for the Navy, Army and for the Air Force. He said there should be more transparency on the issue.

Dr Rahman also added that the economic classification should be shown in each organisation's budget allocation. As an example he said there is a substantial allocation for agricultural subsidy, however, the budget for the Ministry of Agriculture or sector does not mention about the expenditure for the subsidy.

He also noted that the Chief Adviser and the Prime Minister have the same budget head for expenditure. As the constitutional right is completely different for them, these should be separated and should be treated separately in the budget.

Recovered Illegal Money

Dr Syed Mainul Absan suggested that structural revenue be separated from non-structural revenue. All the extra money coming in, either bad taxes or black money being deposited in the bank, which has reached Tk 600 crore already and may reach higher numbers, should not be lumped with the revenue budget because these are not structural. He said it would be improper if it is used up and a low deficit is shown. For the sake of transparency, it should be shown separately; he further requested that this irregular income or external revenue be earmarked for external expense like SOE restructuring, particularly the BPC bond issue. He also mentioned the absence of discussion as regards possible expenses related to the restructuring of other SOEs, such as nationalised commercial banks (NCBs) in the budget.

Dr Masihur Rahman said the recovered illegal money does not become revenue until confiscated through a legal process. He also agreed with *Dr Syed Mainul Absan* that this is a one time receipt and if the government uses it as a normal resource, there will be a corrupt touch to it. He added that this should be kept separate from structural revenue and used for certain sectors where more expenditure is necessary including electricity, expansion of employment, provision of relief to the poor people. He suggested that this fund should not be spent in the year it was collected but over a period of time in order to sustain expenditure level.

Implementation

Terming the budget a very big one, *Dr Osman Farruk* maintained that implementation of such a budget will need a major effort on the part of the

government. He also conveyed his concern with regard to the heavy duty that has to be performed by the ten advisers each of whom was responsible for multiple ministries. This is a major challenge, he felt.

Dr Absan felt that implementation of such a big budget will require a more decentralised framework of governance which the country does not have at the moment.

Mr Niels Veenis from the Royal Netherlands Embassy mentioned about serious shortage of personnel and staff in the partner organisations which made implementation of expenditures commitments on the part of the donors an almost impossible task. He said there are simply not enough people to implement the development projects. He particularly highlighted the situation in the water sector in this regard.

Mr Niels Veenis also mentioned about the structural rigidities in the implementation of the projects. He referred to the *Development Project Proforma (DPP)* which is an instrument that has to be drafted at the beginning of a project. If a project is to run for a seven year period, this DPP can be changed only twice. At the outset of the projects, it takes about two years to approve a project. This leaves only one chance to adjust any financial allocation in the course of a project. This, in a very practical way, hinders the implementation of a project. For instance, if there is an increase in the fuel price or increase in the cost of concrete or metal for any infrastructure work, or wage, the project cannot be started since tenders cannot be floated because the total costs are not in accordance with the DPPs. He sought attention of the Hon'ble Adviser in this regard.

Mr Jonathan Dunn said that the budget is ambitious but not unattainable. However, he added that if the budget does not materialise, it will be important not to substitute that financing with domestic financing, keeping in mind the current inflationary pressures. He said reducing subsidies that are not targeted to the poor would be one way to achieve this.

Dr Shabeda Obaid said transfer of concerned persons hinders project implementation of Bangladesh. In particular, when the people in charge or the consultants get transferred in the middle of a project life cycle, the project tends to falter. She requested to have a look into the matter.

Mr M K Anwar said the budget is somewhat ambitious but perhaps it was a necessity under the circumstances. He noted that the size of the budget is nearly 30 per cent larger than the revised budget of the last year. Even excluding BPC, the budget has increased by 19 per cent. Interest payment related expenses have increased by 43 per cent. He remarked that to achieve these targets, there needs to be strong efforts by the government.

Response from Dr Salehuddin Ahmed, Governor, Bangladesh Bank

Dr Salehuddin Ahmed expressed his views regarding concerns over internal borrowing. He said there are worries that borrowing from the banking sectors may crowd out the private borrowing. He said the central bank is monitoring the issue and mentioned that despite the government borrowing in the last fiscal year, the private sector borrowing has not actually gone down; rather it has grown by more than 16 per cent.

About the growth in broad money, which is thought by many to induce inflationary pressure, *Dr Ahmed* informed the audience that the growth was 20-25 per cent couple of years back. So the current growth was not expected to add much to the inflationary pressure. But gradually the central bank is tightening up and targeting to bring it down to around 15 per cent.

Dr Salehuddin Ahmed remarked that the current inflationary pressure is not due to demand-side constraints, rather it was the supply-side issues which are driving inflation. What is important is to find appropriate response to the supply-side factors. However, *Dr Salehuddin Ahmed* said that the central bank is also trying to address some of the demand management issues such as excess reserve, excess liquidity, etc. This was not an easy task. He said that doing this will require the interest rate on bonds and bills to increase, which will again increase the cost of lending to the private borrower. He mentioned this as a challenge that the central bank has to face.

The Bangladesh Bank Governor noted that the current state of most of the macro variables was alright. National net reserve is good and he thanked exporters and particularly migrant workers for this commendable achievement.

The Governor also dwelt on the current LC situation. He observed that both opening and

settlement of LCs for various essentials have increased. However, at the same time he noted that although LC situation has improved in value terms, the volume or quantity may not have increased because of higher international prices.

Dr Ahmed agreed that the cost of borrowing is very high for the private sector, but at the same time he noted the high rates of profit that the sector is making. He said if the interest rate for the garments is lowered then others will be deprived since supply of loanable fund is limited. He acknowledged the contribution of exporters, but at the same time he noted that the country's export sector has to be more competitive and entrepreneurs will need to look for new and innovative measures to increase efficiency.

Regarding *Dr Debapriya Bhattacharya's* comment that the government is attempting to build another storey on the roof of a fragile building without a strong staircase, *Dr Salehuddin Ahmed* conceded that the building is indeed fragile. However, several reform measures have already been put in place which will act as reinforced concrete pillars for the weak house and that will definitely create some kind of good base for the growth. He said 7 per cent GDP growth target is indeed an achievable target. He added that there was a consensus among independent observers to the effect that Bangladesh's macro economic management is fairly good, perhaps the best in South Asia. There is also a widespread belief that Bangladesh is the next destination for foreign investment.

Response from the Finance Adviser

Honourable Finance Adviser appreciated the richness and the wide variety of comments that were presented at the CPD dialogue. He informed the audience that he would like to extend the time for comments on the budget by three more days. He requested dialogue participants who shared their views on various aspects of the budget to send their comments to the Ministry in written form.

The Finance Adviser said no matter what has been done, the budget will hurt interests of some people and groups and consequently budget proposals will be subject to criticisms. In this sense the budget FY2007 is no exception. The budget has tried to balance various conflicting interests, however, his paramount consideration was the government's honest perception of the larger interest as regards

the country. It is this consideration which dictated him to take certain decisions. But there are judgments that require people's opinion and that is the reason why the government has opened up the option of seeking comments from various stakeholders.

The Finance Adviser said there are two key macroeconomic assumptions underlying the budget: growth rate and the inflation. He said the government is convinced that 7 per cent growth is not something very easy, but it is not something which is unattainable. The same thing applies to inflation. In the case of inflation, he added that inflation is always calculated on the immediate past base. Already the economy had a rather high base and faced considerable pressure on consumer goods that was generated externally. As a result, according to him, 6.5 per cent inflation for a whole year is not a very unrealistic target, or an unrealistic assumption.

Responding to the deficit issue, the Finance Adviser said the total deficit would be about 5.6 per cent of GDP, of which 1.4 per cent is contributed by assumptions about BPC liabilities. As regards the net foreign loan issue, he said it is a fairly realistic estimate considering the huge pipe line. It will depend essentially on the capacity to implement projects and may require introducing certain desired reforms. With regard to current year's disbursements the Finance Adviser observed that in January the disbursement was less than 400 million; by June it has reached about 1.2 billion US Dollar. Therefore, the assumptions that have been made in the budget are by no means unrealistic.

Responding to the issue of whether the domestic financing will create inflationary pressure, the Finance Adviser noted that there are long-term bonds as far as the BPC part is concerned. He said it will obviously impose some burden on the budget in later years due to repayment on the principals and interest payments. But for the interest of transparency and restoring health to the state owned enterprises and also the banks which lend to BPC, it was an absolutely necessary step. He felt that there was no serious problem on the financing side.

Responding to the revenue generation issue, the Adviser mentioned that increasing the revenue-GDP ratio from 10.4 to 10.8 per cent was a moderate attempt. If this modest target is not realised, then the dependence on either domestic

financing or on external financing would increase, but this was not actually desirable.

Regarding ADP implementation, the Finance Adviser said he intends to undertake more systematic reviews of the implementation process and bottlenecks with the concerned ministries as soon as the government is through with the budget. He said he is not willing to wait until the revised ADP is prepared to review the attendant problems.

The Finance Adviser responded to queries regarding distribution of subsidies to targeted groups. He informed the dialogue audience that he has already told the Finance Secretary that as soon as the budget was over he would sit down with concerned ministries that are responsible for administering subsidies. He assured the audience that he would try to address any procedural flaws in this context so as to make certain that subsidies really go to the targeted recipients.

As regards the growth in revenue expenditure, the Finance Adviser reminded the house that to a large extent revenue expenditures were mandated. There is an automatic increase in the salary payments. There is also the interest payment that will be due in the current year largely because of debt that was incurred by previous governments. Also, the government has paid electricity bills for all government departments and for the ministerial bodies. He mentioned that these are some of the reasons why the revenue expenditure has gone up. As far as other avoidable and non-productive revenue expenditures were concerned, the Adviser assured the audience that the government will certainly try to keep it tight.

The Finance Adviser responded to the issue of protection of domestic industry and the revised duty structure. He said that true economic protection, what is popularly known as effective protection, cannot be discerned simply from the nominal rates of duties. The issue is how much value addition one is making in domestic prices, compared to the value addition at the world prices. Keeping this in mind, even where the nominal protection is 50 per cent or 55 per cent, in many instances the effective rate of protection would probably go up to 60 per cent or 70 per cent. He added that although there is an apparent duty rate, in many of these cases a lower operative duty rate was enforced through SROs. Also, the government has removed the infrastructure development

surcharge. In addition to the published customs duty, there is also the supplementary duty which is another source of protection to the domestic industries, the Adviser explained.

Regarding the allocation in the agricultural sector, the Finance Adviser said that as far as the agriculture ministry's allocation was concerned, development and non-development budget taken together has been increased by 38 per cent this year over the revised budget for the preceding year.

Responding to the issue of jute industries, the Adviser stated that the jute industry is supposed to be an export-oriented industry. It gets export incentives including cash incentives. Even then the public sector jute industries are not in a position to survive. He was convinced that as long as it is managed by the public sector, the sector will not be viable. He said he has received a request from the jute ministry only a couple of days ago for Tk300 crore per year. He remarked that there was no free lunch in economics. If one sector was receiving a subsidy, one sector was getting a tax benefit, somebody else have to pay for those. Accordingly, he requested those who were supporting the jute industries, to take a pause and to seriously think as to whether these industries could really be protected if those were in the public sectors. He thought that although this may not be a very popular choice, there was no other option.

The Finance Adviser responded to the issue of lack of employment focus in the budget. He said that although the budget does not talk about the number of new employment opportunities that was added to the labour force, structure of investment expenditure, which is basically the annual development programme and its allocation, reflects that it was mostly the labour intensive sectors such as agriculture, rural development, water resources, etc. which have received the maximum allotment. He stated that the government has deliberately chosen these sectors with two considerations. First, these are more directly connected with poverty alleviation, and being more labour intensive in nature these sectors generate more employment. Second, one sector which has received emphasis is the infrastructure, particularly the power and road communications. Here the employment focus comes partly from the direct employment generating nature of this investment and, more importantly, this sector helps generate employment in the private sector

particularly in view of the fact the private sector is handicapped in a major way by the lack of appropriate infrastructure. Therefore, the Adviser remarked, the criticism that the budget does not have an employment focus is not perhaps entirely an objective observation.

The Finance Adviser briefly discussed the inflation situation prevailing in the country. He stated that the government attached a great deal of importance to the issue, particularly the increase in the prices of foodgrains. It was because of this that an independent study has been commissioned by the government and CPD was entrusted to carry this out. He informed the audience that the government had held very detailed discussions with the CPD researchers where the chief advisor was also present. He said that even the CPD will admit that there is very little that can be done in the short run. And whatever could be done in the short run, the government has already done those. He said that he was unable to explain why, in spite of the 5 per cent reduction, the price of soybean should increase the following day. He thought that there was something wrong with the marketing infrastructure. What was important is that the government has taken a number of short-term measures to address the attendant issues. First, it has taken action on the customs duty front. Second, the government was trying to build an alternative marketing channel through the Bangladesh Rifles (BDR). The Adviser informed the audience that the government was also considering to what extent the TCB could be brought into play in this context. The Adviser remarked that any immediate attempt to break the existing marketing structure was not likely to succeed since such channels have developed over many years. He said that the gap between the farm-gate price and the consumer price has evolved over time because of the presence of a large number of intermediaries. He also advised the audience to bear in mind that these intermediaries are also providing certain employment. He remarked that the medium term and long term solution to the price situation lie in enhancing production capacity and probably in also organising farmers' cooperatives.

The Adviser said that in order to increase production, the government has taken a number of measures that have got reflected in the budget. However, as regards farmers' cooperatives, this was an initiative that should not be taken by the government. Rather, the government may provide

inducements to encourage this. He added that the performance of TCB has not been praiseworthy. The Adviser remarked that market related activities in the public sector historically have turned out to be inefficient and there is no reason to believe that it is possible to make them efficient in the near future. So, basically the government has to encourage, may be the NGOs or the private sectors, to form alternative marketing channels.

Responding to the issue of recovered money as to how they should be treated, the Finance Adviser said for the time being they are going into a consolidated fund. It is a sort of a miscellaneous type of revenue of the government. He assured that the government is conscious that this is not a regular source of revenue. He said that the amount that the government receives on this account will help finance the budget deficit for the current year.

Honourable Finance Adviser thanked CPD for organising the discussion. He also appreciated the contribution of other discussants who voiced their comments. He concluded his speech by requesting all the participants to send their comments in written forms so that the government has an opportunity to analyse them at a greater depth and take appropriate steps.

Closing Remarks by the Chair

Mr Syeduzzaman thanked the honourable Adviser for his careful consideration of all the comments and for responding to all the issues that were raised in the dialogue. He said the additional three days available for giving comments on the budget will be welcomed by many groups and organisations as well as individuals.

Mr Syeduzzaman flagged some concerns which were voiced at the dialogue and in the CPD analysis. He mentioned about the all time low ADP implementation as pointed out by CPD in FY2006-07 and said that it remains to be seen how the ratio is going to improve in FY2007-08. Even then, public investment will be only about 25 per cent of the GDP. He said Bangladesh remains an underinvested country and talked about investment and ICOR that required for attaining 7 per cent growth. He noted that the contribution of foreign aid and foreign direct investment will be extremely important in achieving the largely. Consequently, to him the major concern for the government was how to make best use of the available foreign investments in the pipeline.

Mr Syeduzzaman felt that it is important to remain of the fact conscious that Bangladesh has a private sector-led free-market economy, and the private sector has delivered quite well. Acknowledging the importance of the private sector, he added that to have a strong private sector, the country needs a strong public sector as well, so that thorough regulatory intervention is possible to prevent distortions. He hoped that the Finance Adviser and his government will have the opportunity to strengthen the public sector. *Mr Syeduzzaman* remarked that 18 months is not a short period for strengthening the public sector of an economy.

Mr Syeduzzaman thanked the chief guest, the special guests and all other guests for being present in the dialogue and for sharing their insights. He hoped that CPD will continue giving its budget response in future years.

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