Independent Review of

iRBD

Bangladesh's Development

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

State of the Bangladesh Economy in FY2015-16

Second Reading

CPD's Budget Recommendations

Released to the Media on
17 April 2016, Dhaka

CENTRE FOR POLICY DIALOGUE (CPD)
B A N G L A D E S H
a civil society think tank

www.cpd.org.bd

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Acknowledgement

The CPD IRBD 2016 Team would like to register its sincere gratitude to *Professor Rehman Sobhan*, Chairman, CPD for his advice and guidance in preparing this report.

The Team gratefully acknowledges the valuable support provided by *Ms Anisatul Fatema Yousuf*, Director, Dialogue and Communication Division, CPD and her colleagues at the Division in preparing this report. Support of *Ms Nazmatun Noor*, Deputy Director, Dialogue and Outreach is particularly acknowledged in this connection. Contribution of the CPD Administration and Finance Division is also highly appreciated. Assistance of *Mr Hamidul Hoque Mondal*, Senior Administrative Associate is particularly appreciated.

Concerned officials belonging to a number of institutions have extended valuable support to the CPD IRBD Team members. In this connection, the Team would like to register its sincere thanks to *Bangladesh Bank, Bangladesh Bureau of Statistics (BBS), Bangladesh Energy Regulatory Commission (BERC), Bangladesh Export Processing Zones Authority (BEPZA), Bangladesh Garment Manufactures & Exporters Association (BGMEA), Bangladesh Power Development Board (BPDB), Board of Investment (BoI), Bureau of Manpower, Employment and Training (BMET), Chittagong Stock Exchange (CSE), Department of Agricultural Extension (DAE), Dhaka Stock Exchange (DSE), Diamond Money Exchange Service Ltd., Export Promotion Bureau (EPB), Ministry of Finance (MoF), National Board of Revenue (NBR), and Planning Commission.*

The CPD IRBD 2016 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

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SECTION I. INTRODUCTION

The national budget for FY2017 in Bangladesh will be prepared in the context of a set of traditional, as well as emerging tensions in the national economy. The upcoming budget will be launched also in the backdrop of an inhospitable global economic environment.

Admittedly, Bangladesh economy is currently enjoying a number of advantages. The provisional gross domestic product (GDP) growth figure has been estimated to be 7.05 per cent for the current fiscal year. Macroeconomic situation in FY2016 has largely been rather stable. Low levels of global commodity prices ensured that the inflation rate continued to fall throughout the fiscal year, exchange rate of Bangladeshi Taka (BDT) remained stable, while the overall balance of payments improved significantly. Export performance was resilient and public expenditure experienced expansion.

However, from the perspective of quality of macroeconomic management some conventional issues continued to remain enduring key concerns. Programmed fiscal framework for FY2016 evinced serious weaknesses as targets for both revenue mobilisation and public expenditure fell significantly short of their respective targets. Leakages in public expenditure emanating from lack of good governance, delayed implementation and cost escalation seriously undermined budgetary discipline. Actual revenue growth repeatedly missed the target due to lax implementation of rules, lack of tax compliance and weak governance. Many planned reforms have fallen behind the schedule due to negligence, inertia and failure to recognise the urgency of reforms. Rejuvenation of private investment has again remained elusive while public investment performance was the weakest in recent years.

Weak discipline in the financial market, lack of capital market support and weak supervision of the central bank are undermining the cause of investment, and are not helping to restore investor confidence. Continuing global economic slowdown will likely make continuation of current good performance in exports more challenging in the near-term future. Financial security has emerged as a new concern in the backdrop of various scams in the commercial banks and heist from central bank reserves. The recent Panama Papers episode and rise in Swiss Bank deposits are also reasons for disquiet. All these once again reinforce the cause of taking initiatives towards good governance in the financial sector.

In view of the discussion above, the upcoming budget will need to raise the quality of budgetary and fiscal planning and put emphasis on the needed reforms. Current economic growth projections should be reviewed in view of composition of incremental GDP, which is unlikely to lead to high job creation. This is particular important in view of subsequent developments in the economy from the perspective of implementing the ongoing Seventh Five Year Plan (7FYP). The upcoming national budget provides an opportunity for Bangladesh to reflect on the Sustainable Development Goals (SDGs) and their implementation at the national level. Fiscal policies could be an important tool for the government to make a strong start towards attainment of the global development agenda.

The present report is the second instalment of the state of the Bangladesh economy in FY2016 prepared under CPD's flagship programme titled *Independent Review of Bangladesh Development (IBRD)*. The primary objective of this report is to put forward a set of recommendations in the context of the national budget for FY2017. This report will be followed by a comprehensive analysis of the Bangladesh economy covering FY2016, to be released prior to the presentation of FY2017 budget. The final instalment of this year's IRBD will come up with CPD's reactions to the FY2017 budget once it is presented on June 2016.

The present report has been prepared on the basis of analysis of most recent data relating to key macroeconomic, fiscal and monetary variables. The report has also drawn from the recommendations voiced at the pre-budget dialogue organised by the CPD in Bogra that focused on development of small and medium enterprises (SMEs). Yet another consultation was organised by the CPD with young entrepreneurs and professionals, and their views have also been reflected in this report. CPD had conducted an online opinion survey through Facebook and email platforms to get feedbacks from citizens on expectations from FY2017 budget. This was the first time for the CPD, and views of the participants of this survey have been incorporated in this report. The report has two parts. Section 2 of this report presents a brief overview of the macroeconomic developments in FY2016 which will inform the upcoming budget. In Section 3, recommendations in the context of the upcoming national budget will be presented under six broad categories – fiscal framework, revenue mobilisation, public expenditure, financing of budget deficit, fiscal measures, and economic reforms and transparency in budgetary system. Section 4 closes the report with some concluding remarks.

SECTION II. MACROECONOMIC BACKDROP IN THE RUN-UP TO THE NATIONAL BUDGET FOR FY2017

2.1 Setting the macroeconomic benchmark for FY2016

In preparing the national budget of Bangladesh for FY2017, policymakers will need to calibrate and design the fiscal-budgetary measures and incentives by taking cognisance of the current trends concerning the key of macroeconomic correlates. CPD (2016) in its first interim review of Bangladesh's macroeconomic performance analysis in FY2016, released in January 2016, had pointed out that despite relative macroeconomic stability, the economy was unlikely to achieve the envisaged private investment, revenue mobilisation and public expenditure targets. This cautionary note has now been further strengthened by subsequent developments in the economy that were unforeseen at the time.

The government expects economic growth to cross past the 7 per cent threshold but level of private investment may continue to remain a concern

According to the provisional estimates by the Bangladesh Bureau of Statistics (BBS), GDP growth in FY2016 is expected to be 7.05 per cent. It is only for the second time that in the course of the last two decades (since FY2007) the GDP growth would exceed 7 per cent. Of the 7.05 per cent overall growth in FY2016, agriculture sector is to contribute 0.4 per cent (0.53 per cent in FY2015), industries sector's contribution would be 2.95 per cent (2.74 per cent in FY2015), and that of the services sector to be 3.44 per cent (3.00 per cent in FY2015) (Table 1). As is found, service sector's growth contribution is expected to be boosted by the growth in public administration and defense, education, and, health and social works – as a consequence of significant revision of government pay scale. Indeed, if the growth rates of FY2015 (6.55 per cent) and FY2016 (7.05 per cent) are compared, of the extra growth of 0.5 percentage points, 0.4 percentage points is expected to be contributed by the national pay scale revision. This then draws attention to issues of both quality and sustainability of the GDP growth.

Table 1: Contribution to GDP growth in last eight years *(in Per cent)*

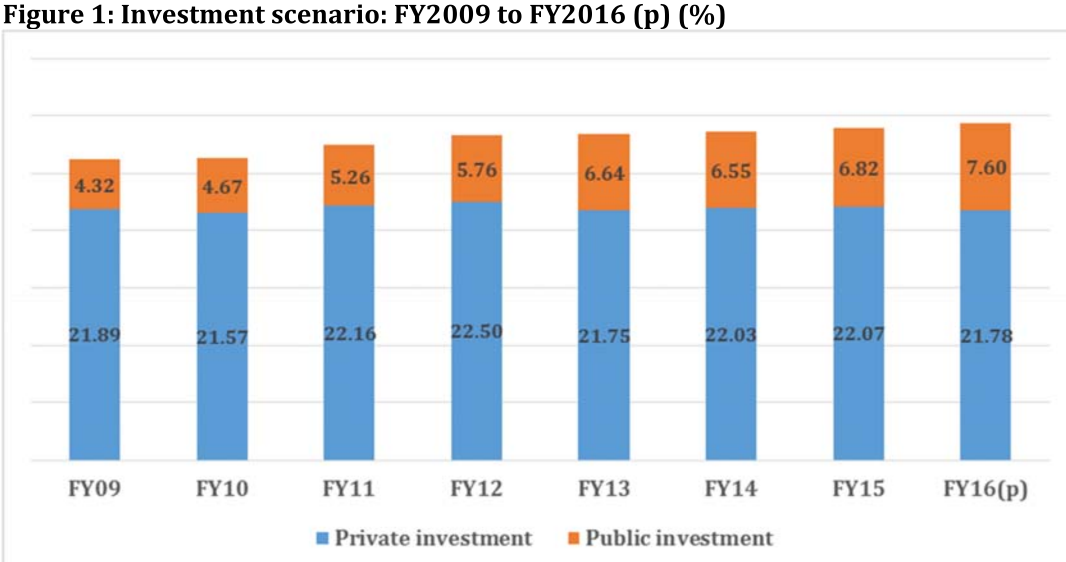
Sectors	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16 (p)
Agriculture	1.21	0.81	0.61	1.07	0.78	0.52	0.41	0.70	0.53	0.40
Industries	2.18	1.73	1.71	1.77	2.31	2.47	2.59	2.27	2.74	2.95
Manufacturing	*1.61*	*1.16*	*1.07*	*1.08*	*1.64*	*1.69*	*1.80*	*1.60*	*1.93*	*1.99*
Services	3.42	3.02	2.66	2.89	3.25	3.43	2.88	2.92	3.00	3.44
Public administration and defense	*0.25*	*0.19*	*0.21*	*0.25*	*0.27*	*0.24*	*0.21*	*0.22*	*0.32*	*0.53*
Education	*0.18*	*0.15*	*0.13*	*0.11*	*0.12*	*0.16*	*0.13*	*0.16*	*0.17*	*0.30*
Health and social works	*0.10*	*0.11*	*0.06*	*0.13*	*0.12*	*0.07*	*0.09*	*0.09*	*0.09*	*0.15*
Tax less subsidy	0.26	0.46	0.06	-0.17	0.12	0.10	0.13	0.16	0.28	0.26
GDP	**7.06**	**6.01**	**5.05**	**5.57**	**6.46**	**6.52**	**6.01**	**6.06**	**6.55**	**7.05**

Source: Calculated from Bangladesh Bureau of Statistics (BBS) data.
Note: p denotes provisional estimates.

For FY2016, per capita gross national income (GNI) of Bangladesh has been estimated to be about USD 1,466, which is USD 149 more than that of the preceding year (11.4 per cent growth). On the other hand, per capita GDP is also expected to increase to USD 1,384 in FY2016 from USD 1,236 in FY2015, i.e. an increase of USD 148 (12 per cent growth).

Investment as per cent of GDP is expected to increase by 0.5 percentage point to 29.38 per cent in FY2016, thanks to the spurt in public investment, as reported by the BBS. Regrettably, private investment as a share of GDP is estimated to come down by about 0.3 percentage point to 21.78 per cent in FY2016 (Figure 1). This has come as a little surprise as reported growth rates of both term loan disbursement and import of capital machineries remained in the negative terrain.[1] Additionally, the rise in the public investment estimate has indeed considered the original allocations of budget for FY2016. As will be discussed later, the year-end public expenditure is expected to be much lower than the planned figures, hence, the public investment and GDP figures will need to be revised accordingly when the GDP growth estimates will be finalised and the actual expenditure figures will be available.

Figure 1: Investment scenario: FY2009 to FY2016 (p) (%)



Source: Bangladesh Bureau of Statistics (BBS)
Note: p denotes provisional estimates.

Logically speaking, the rise expected in the growth in FY2016 should be transmitted to, and reflected in, other macroeconomic correlates. For example, one would have expected that an enhanced GDP growth would result in higher growth in tax collection. However, income tax collection remained much lower than the estimated growth rate of nominal GDP of 14.1 per cent. Pace of new employment generation also was unlikely to gain momentum in the backdrop of slowdown in private investment. It is indicated in a recent media report that during last two years, between 2013 and 2015 (July-September), only 6 lakh jobs were added to the Bangladesh economy (annual average being only 3 lakh). This is a drastic drop from the 13.8 lakh jobs that were created annually (on average) between 2003 and 2013.

For Bangladesh, acceleration in the GDP growth rate is a significant macroeconomic attainment. The nature of recent acceleration of GDP growth suggests that it is largely driven by rise in public

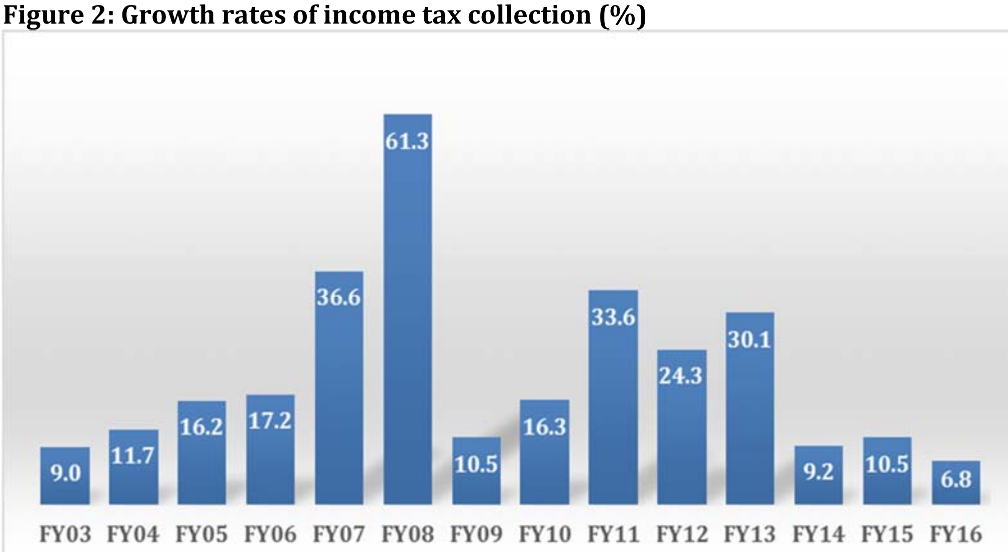
[1] During the first half of FY2016, term loan disbursement declined by (-) 3.0 per cent. Import payments of capital machineries also declined during July-February period of FY2016, (details later in this section).

salaries. It is highly likely that such boost will last for one more year when the second adjustment is made in view of the newly approved government pay scale (allowances). It is crucial that such an acceleration in economic growth is accompanied by enhanced private investment and more quality jobs for the large young labour force of the country. Along with this, it is also equally important to take into cognizance that economic growth can only serve development when it is distributed in a just way. Appropriate fiscal measures, redistributive policies and enhanced delivery of quality public service to the marginalised are the best way to serve this core objectives of the budget in countries such as Bangladesh.

Revenue mobilisation in FY2016 is likely to miss the annual target by a large margin

The resource mobilisation target is in course to be missed once again in FY2016. Collection of both tax revenue and non-tax revenue continued to underperform as the ambitious targets are being chased. Data for the first six months (July-December) of FY2016 indicates that the National Board of Revenue (NBR) will miss its target for the fourth consecutive fiscal year.[2] Tax revenue collection by NBR registered a growth rate of 16.3 per cent during July-December of FY2016 as against the target of 42.3 per cent growth over the actual earnings in FY2015. Furthermore, as shown in Figure 2, income tax collection growth (6.8 per cent) during the first half of this fiscal year was the lowest during the last 14 years (for which data was available with CPD).

Figure 2: Growth rates of income tax collection (%)



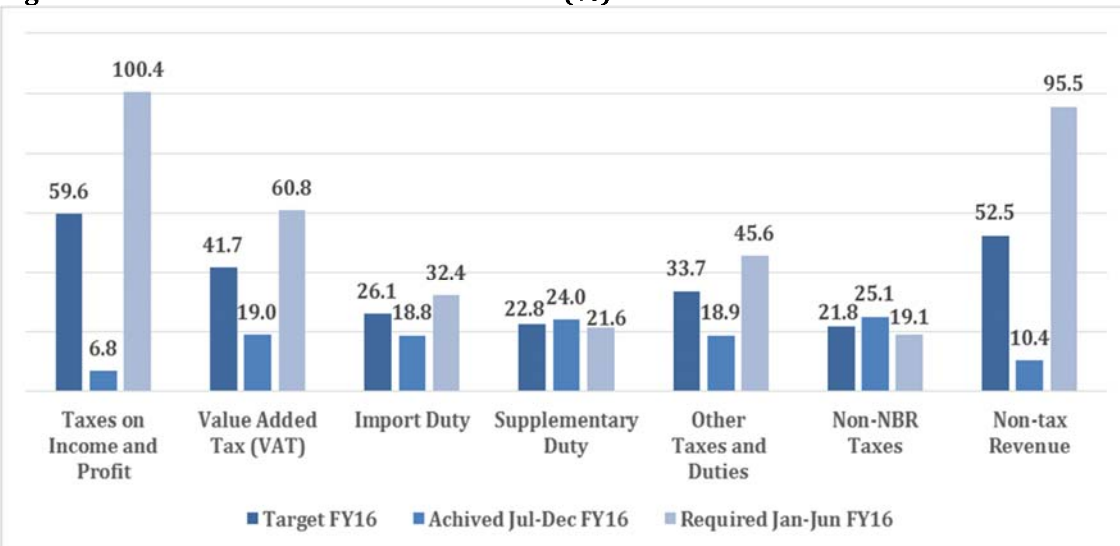
Source: Calculated from the Ministry of Finance (MoF) data.

Growth in the collection of supplementary duties turned out to be the only revenue earning source that exceeded the respective annual target over the period of the first seven months (Figure 3). Collection of import duties was also close to the annual growth target. Indeed, target for these two heads were more realistic, when compared to those that were set in the first place for income tax and value added tax (VAT). Non-NBR tax also registered a strong growth (25.1 per cent). However, non-tax revenue collection increased by only 10.4 per cent during July-December of FY2016, which is far below the annual growth target (52.5 per cent). It may be recalled here that the CPD, in its earlier IRBD report released in January 2016, had apprehended that, overall

[2] Although NBR data shows that the revised target of revenue was achieved in FY2015, Ministry of Finance (MoF) data shows that there is a gap between target and actual collection.

revenue collection in FY2016 may fall short by Tk. 40,000 crore against the ambitious targets of Tk. 2,08,444 crore, if appropriate measures were not put in place to resolve the emergent constraints (CPD, 2016). Regrettably, as it appears from the more recent data, improvement in revenue generation has been rather limited. Despite a hefty profit earned by the Bangladesh Petroleum Corporation (BPC), revenue collection may fall short by about Tk. 38,000 crore in FY2016.

Figure 3: Growth rates of revenue collection (%)



Source: Estimated from the Ministry of Finance (MOF) data.

Public expenditure will be lower than planned in FY2016

On the expenditure side, government's non-development expenditure remained well below the targeted limit during the first half of FY2016. During July-December FY2016, 30.7 per cent of non-development budget[3] for FY2016 was spent, posting only a 4.7 per cent growth.[4] This figure is expected to rise in view of additional payments as per the new pay scale being released from January 2016. Expenditure for major two sources of non-development spending, i.e. 'Subsidies and Current Transfers' and 'Interest Payments' were well within the limit, with respectively 4.8 per cent and 9.6 per cent growth during July-December of FY2016. Expenditure for Annual Development Programme (ADP) was also lower than the past trends of low rate of implementation in the early months. In addition the government disbursed Tk. 1,200 crore for recapitalisation of the state-owned commercial banks (SCBs) till December 2015, for which a budgetary provision of Tk. 5,000 crore was set aside in the budget for FY2016.[5] Thanks to drastic fall in international fuel prices, BPC moved to the profit terrain in FY2015 and continued earning profit in FY2016. Hence, BPC will not be in need of further subsidy, releasing pressure in the upcoming FY2017 budget. The final public expenditure outcome will indeed largely depend on

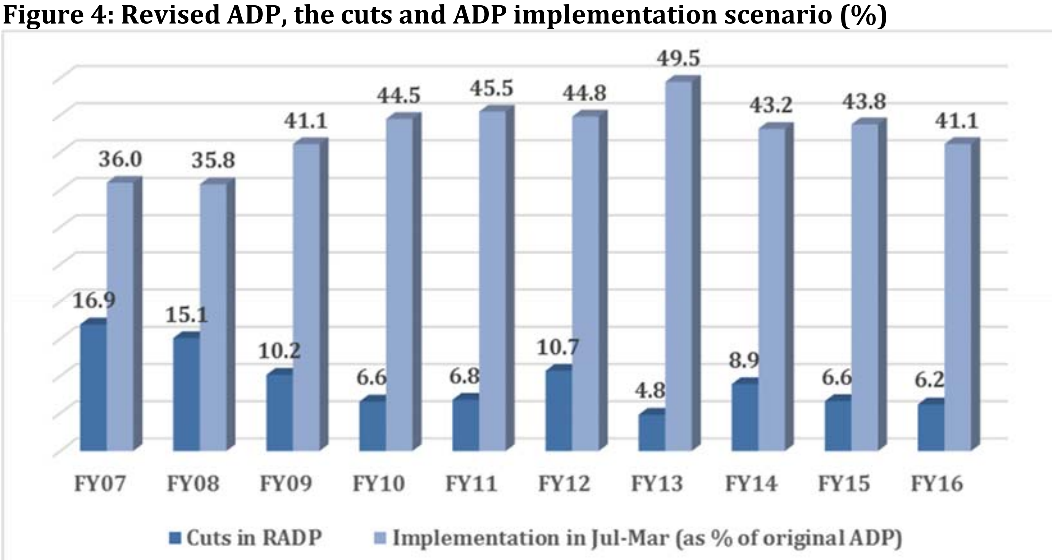
[3] The head includes non-development revenue expenditure, capital expenditure and other programmes financed from non-development budget.
[4] In corresponding periods of FY2015, 41.7 per cent of the similar budget was spent and the growth target for FY2016 was planned at 42.3 per cent over the actual spending in FY2015.
[5] In FY2015, government spent Tk. 1,716 crore for this account.

the government's decision as regards the subsidy package (i.e. decisions on adjustments of administered prices), expenditure for social safety net programmes and recapitalisation of SCBs.

ADP expenditure against allocation is the lowest in recent years

Expenditure on account of the ADP is yet to mark any significant breakthrough in FY2016. Indeed, the performance has indeed deteriorated and registered its lowest growth in FY2016 when compared to recent fiscal years. According to the first eight month's data, actual spending under ADP was 34.2 per cent of the originally planned allocation of Tk. 97,000 crore. This is the lowest level of expenditure in the last seven years (since FY2009). Both taka (36.6 per cent) and project aid components (30 per cent) of the expenditure were the lowest in the recent past (since FY2009 and FY2012 respectively). When ADP was subsequently revised in April, 2016, a number of sectors (e.g. Oil, Gas and Natural Resources, Communication, Physical Planning, Water Supply & Housing, and Public Administration) was subjected to substantial cuts. ADP for FY2016 was slashed by Tk. 6,000 crore (or 6.6 per cent) to bring the size down to Tk. 91,000 crore as shown in Figure 4. Project aid component was reduced by Tk. 5,340 crore (or 18.3 per cent) while GoB (Government of Bangladesh) allocation was reduced by only Tk. 660 crore (or 1.1 per cent). Given the implementation status of the ADP, one would have expected a higher reduction in the ADP allocation. Indeed, in FY2007, when a similar implementation level was experienced during the first nine months, ADP was revised downward by 10.2 per cent.[6]

Figure 4: Revised ADP, the cuts and ADP implementation scenario (%)



Source: Estimated from the Implementation Monitoring and Evaluation Division (IMED) data.

Budget deficit remained within limit

Budget deficit was not a matter of concern in the early months of FY2016 and has remained within the comfort zone. The budget surplus was to the tune of Tk. 609 crore, particularly owing to sluggish public expenditure; to recall, for FY2016 deficit target was set at 5.0 per cent of GDP (excluding grants). The budget deficit was likely to rise in the second half of FY2016. However, it is expected to remain close to the budgetary target in the backdrop of lower levels of revenue

[6] However, only 82.9 per cent of the Revised ADP was actually spent in FY2007.

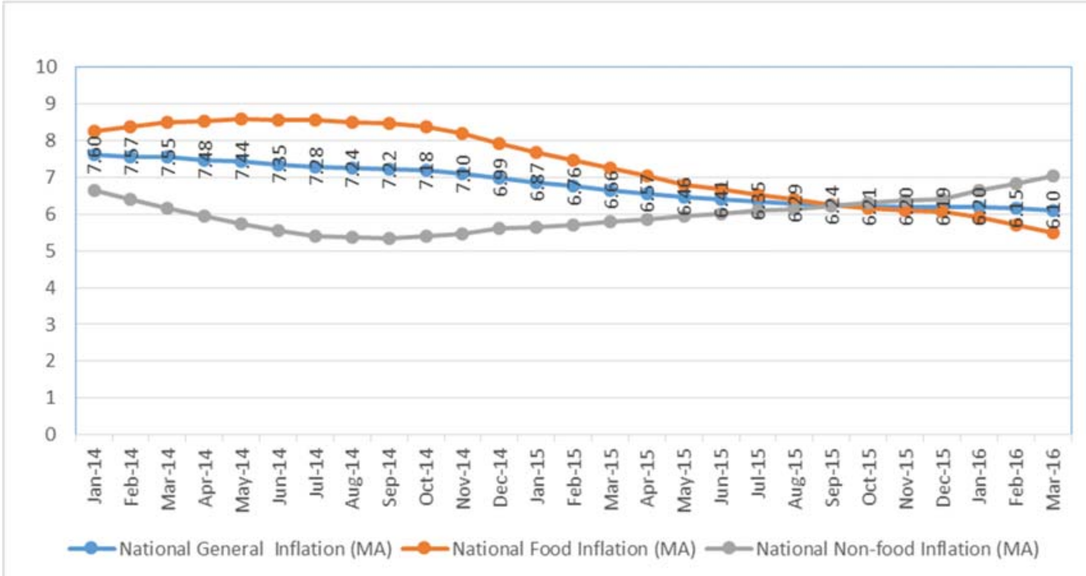
earnings and that of public expenditure. As has been mentioned above, it is apprehended that there will be large revenue shortfall and the adverse impact on deficits was likely to be offset by unutilised budgetary allocations. Data for six months (July-December) of FY2016 indicated that, foreign borrowing was on the lower side while domestic borrowing was negative. Sale of National Savings Bond (NSD) certificates during July-December period of FY2016 (Tk. 13,366 crore) reached close to the annual budgetary target of Tk. 15,000 crore. However, financing from foreign sources will face formidable challenge in the second half of FY2016 once the development expenditure start to post rise. The government received only Tk. 224 crore (3.9 per cent) as foreign grant and Tk. 776 crore (3.2 per cent) from net foreign borrowing during July-December of FY2016 while the respective annual targets were Tk. 5,800 crore and Tk. 24,335 crore.

Inflation came down to reach the target level

One of the welcome trends was that, the growth in annual average inflation reached 6.10 per cent in March 2016 (Figure 5) against the annual target of 6.07 per cent set in the Monetary Policy Statement (MPS) of the Bangladesh Bank for January-June 2016. It is also lower than the 7FYP target of 6.2 per cent. The fall in inflation was driven by declining food inflation which was 5.5 per cent in March 2016. In contrast, non-food inflation has seen a secular rise in the fiscal year and reached 7 per cent.[7] The difference in inflation between rural and urban areas has been widening on a continuing basis since April 2015 with lower inflation in rural area. Lower global commodity prices, nearly stable exchange rate of the BDT with only marginal recent depreciation and restrained growth of broad money supply have been contributing to the falling inflation. Sustained negative growth of global commodity price index since July 2014 contributed to the falling inflation rate in Bangladesh through both direct and lagged pass-on impact. Lower broad money growth, originating from negative growth of credit to the public sector, also contributed. Negative remittance growth also played a role in restraining the inflation rate. Inflation is expected to decline further in the face of sustained lower global commodity prices and the envisaged downward adjustment of administered prices of petroleum products in the domestic market.

[7] The recent pick up of non-food inflation was mainly driven by rent, fuel and lighting, and clothing and footwear.

Figure 5: Annual average inflation rate (%)



Source: Estimated from Bangladesh Bureau of Statistics (BBS) data.

Growth of monetary aggregates remained close to the targets

Credit to the private sector growth was 15.11 per cent as of February 2016 which marginally exceeded the monetary policy target of 14.8 per cent for end June 2016 (Table 2). This is the highest growth since December 2012 (16.6 per cent). The current rising trend of private sector credit growth has been underway since September 2015. Thankfully, Bangladesh Bank had revised the policy rates (repo and reverse repo) downward; this was indeed also recommended by the CPD in its previous review of the economy in January 2016. Sliding real lending rate was perhaps another contributing factor.[8] However, it is difficult to explain the composition of the incremental private sector credit. It is observed that trade activities have gained momentum in recent months which was likely to generate demand for additional credit. However, as has been mentioned previously, industrial term loan disbursement has not registered any momentum. Bangladesh Bank may examine the composition to see how much of the private sector credit growth is attributed to consumer loans, and how much was actually disbursed to productive sectors.

Credit to the public sector declined by (-) 1.9 per cent as of February 2016 due to limited bank borrowing requirements by the government to underwrite the fiscal deficit incurred till now. The trend in the growth of monetary aggregates, however, was accompanied by a strong flow of net foreign assets which posted a growth rate of 25.6 per cent as of January 2016 against the target of 11.1 per cent for the end June 2016. Indeed, robust accumulation of foreign exchange reserves, to keep the exchange rate of BDT stable against United States Dollar (USD), contributed towards this strengthening. Growth rate of broad money, by the end of February, 2016, fell short by 1.9 percentage points against the target of 15 per cent in June 2016.

[8] Average lending rate was 10.91 per cent in January 2016 which was 4.8 per cent in real terms after adjusting for the inflation rate.

Table 2: Growth of monetary indicators (%)

Monetary indicators	FY14	FY15 target	FY15 actual	BB target for Jun 16	Latest 2016 actual (Feb)
Reserve money growth	15.5	15.9	14.3	14.3	15.5
Broad money growth	16.1	16.5	12.4	15.0	13.1
Net foreign asset	41.2	3.6	18.2	11.1	25.6 (Jan)
Net domestic assets	10.3	20.2	10.7	16.2	9.3 (Jan)
Domestic credit	11.6	17.4	10.0	15.5	11.0
Credit to the public sector	34.7	25.3	30.9	18.7	(-) 1.9
Credit to the private sector	12.3	15.5	13.2	14.8	15.1

Source: Bangladesh Bank.

Real interest rates declined, but limited progress made in terms of reducing spread

Real interest rates, on both lending and deposits, continued to decline in FY2016. In February 2016, the real average interest rate on deposits ended up in the negative terrain ((-) 0.1 per cent), a first time in past several years. This implies that the depositors will not make real gains by making deposits in commercial banks. Indeed, falling inflation is not being able to guarantee positive return on bank deposits. Lack of demand for credit has resulted in commercial banks being flushed with liquid assets and banks are discouraged to keep deposits. The fall in yields from bank deposits has pushed depositors to opt for NSD certificates. A negative real interest may discourage people from savings in the medium term, but is likely to boost consumption. Generally speaking, it will be the small savers who will be most hurt in view of this development. Indeed, this is a new challenge for the monetary policy making in Bangladesh.

For a long time, Bangladeshi entrepreneurs have been asking for lowering of the lending rates. The falling trend will be welcome by them. There was a need to reduce the interest rate spread as well but regrettably this did not happen. Indeed, after recording some fall in FY2015, during the first eight months of FY2016, spread did not register any change and remained at 4.8 percentage points. Indeed, in November 2015, Bangladesh Bank issued a circular advising the commercial banks to keep the intermediation spread to a 'lower single digit' i.e. less than 5 percentage points.[9] However, in February 2016, of the 39 private commercial banks (PCBs) 20 and six out of nine foreign banks (FBs) had interest rate spreads of over 5 percentage points.[10] Indeed, the miniscule decline (0.03) between December 2015 and February 2015 was entirely accounted for by the SCBs. It is important for the central bank to examine opportunities to reduce the spread.

RMG-led export earnings continued robust growth

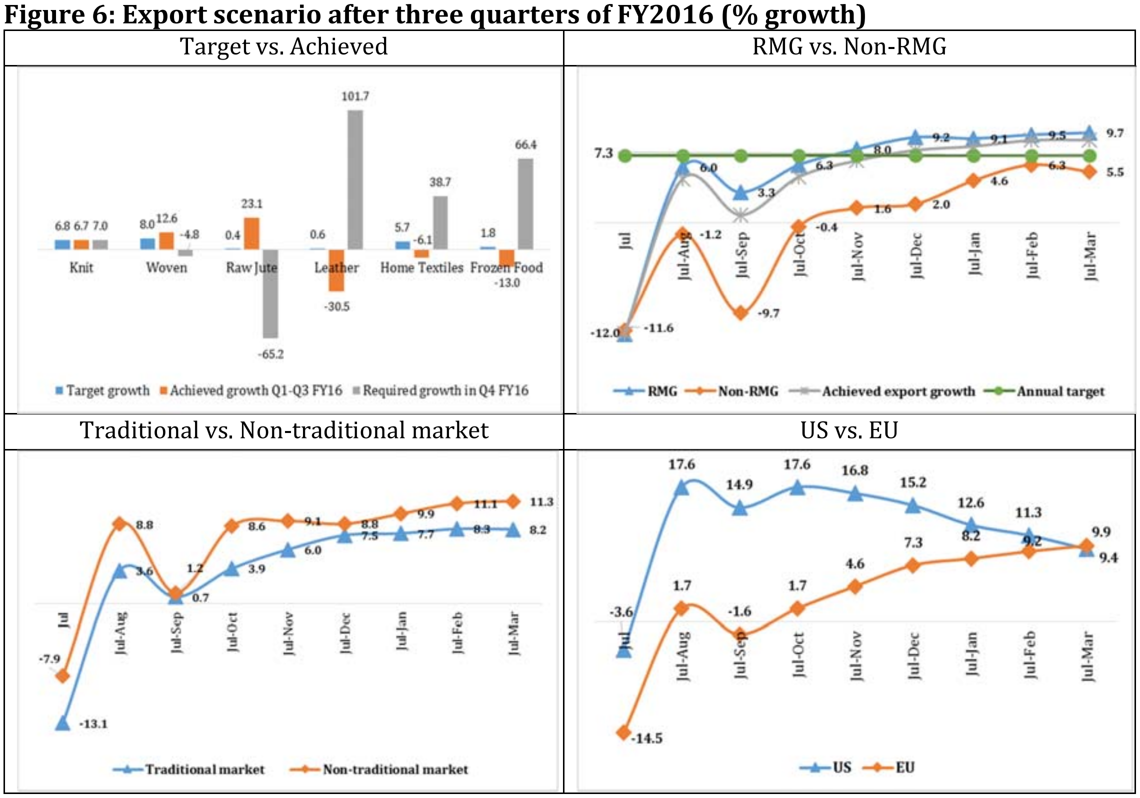
Export earnings during the first nine months of FY2016 have surpassed the envisaged annual target set for FY2016. *First,* according to the Export Promotion Bureau (EPB) data, export receipts registered 9 per cent growth during July-March of FY2016 against the annual growth target of 7.3 per cent, thanks mainly to the robust growth in ready-made garments (RMG) export (9.7 per cent). Woven garments posted the strongest growth (12.6 per cent) (Figure 6). However, non-RMG export growth was volatile and remained subdued at 5.5 per cent over the first nine months

[9] In December 2015, Bangladesh Bank clarified the definition of 'lower single digit' as less than 5 percentage points. The spread here excludes the interest rates for consumer loans and credit to SMEs.
[10] In December 2015, 18 PCBs had interest rate spread higher than this threshold.

of FY2016. In this context, only engineering products, one of the promising sectors in terms of product diversification, have registered high growth (22.6 per cent).

Second, there was some sign of market diversification – export growth for non-traditional markets (11.3 per cent) was higher than that for the traditional markets (8.2 per cent) during the first nine months of FY2016. Of the major non-traditional destinations, export to Japan (16 per cent), Australia (19.2 per cent) and India (22.9 per cent) posted notable performance.[11] On the flipside, export growth to China during the reported period declined by (-) 3.6 per cent mainly due to poor performance of non-RMG exports. In contrast, export to India posted a 22.9 per cent rise.

Figure 6: Export scenario after three quarters of FY2016 (% growth)



Source: Calculated from the Export Promotion Bureau (EPB) data.

Third, among the major traditional markets, export to the US market registered 10.4 per cent growth. Both RMG (11.3 per cent) and non-RMG (22.7 per cent) products fared good growth during July-March of FY2016. However, growth in this market had gradually declined since October 2015 (when the growth was 17.3 per cent).

Fourth, since upturn posted after the first quarter[12], export growth in the EU market was about 7.5 per cent mainly driven by robust growth in woven (16.8 per cent). However, non-RMG products in the same market faced negative growth ((-) 12.8 per cent) during July-March of FY2016 compared to corresponding months of FY2015. Export to Germany and the UK, the two major European Union (EU) economies, showed positive performance (3.4 per cent and 21.4 per cent growth respectively).

[11] Growth in India was an outcome of high growth in non-RMG exports.

[12] During the first quarter of FY2015-16, export growth in the EU market was (-) 4.4 per cent.

Fifth, as was observed, Bangladesh's export performance held fairly well in economies where market was relatively stable and economic growth remained relatively high. Product-level analysis of RMG exports to the US market showed that, Bangladesh's export of a particular RMG product followed the global demand pattern of US for that item. In contrast, Vietnam's export of the top RMG items to the US showed a consistent resilient growth irrespective of the global demand on the part of US consumers.[13] Price analysis of RMG products reveals that, growth of knit and woven items for both Bangladesh and Vietnam in the US market were only partially driven by price (during July 2015-January 2016 period) (Table 3). Conversely, in the EU market, the growth was primarily price driven for both the countries.

Table 3: Price impact of Bangladesh and Vietnam's export growth

Country	Knit (61)			Woven (62)		
	Value	Quantity	Price	Value	Quantity	Price
US market						
Bangladesh	22.33	7.74	13.54	7.93	10.00	-1.88
Vietnam	9.77	8.06	1.57	15.74	9.52	5.68
EU market						
Bangladesh	17.4	4.2	12.6	18.5	0.1	18.4
Vietnam	27.6	0.2	27.4	17.3	-0.6	17.9

Source: Computed from the United States International Trade Commission (USITC) and EuroStat data.

Sixth, Bangladesh's exports may have faced challenges in terms of competitiveness on account of relative exchange rate movements when compared with Vietnam. Over this period, BDT and Vietnamese Dong (VND) against United States Dollar (USD) have depreciated by 0.8 per cent and 5.2 per cent respectively on a point to point basis. On the other hand, against Euro, the two aforesaid currencies appreciated by 13.3 per cent and 9.5 per cent respectively. Vietnam has indeed enjoyed some price advantages in both the US (higher depreciation) and the EU (lower appreciation) vis-à-vis Bangladesh.

There is a need for renewed efforts towards raising competitiveness of Bangladesh's exportables through both product and market diversification. Bangladesh has formulated and announced a new Export Policy Order (EPO) for 2015-18 period to support future development and raise competitiveness of the country's export sector. The policy aspires to project the Bangladesh brand in the global market, diversify the export base, put in place special provisions, and promote incentives for the development of new products and exploration of new markets. It may be noted that the government has recently revised the existing export cash incentive structure to include a number of new exportable products (see Annex Table 1 for details).

Import payments rising despite lower capital machineries import

During the first eight months of FY2016 (July-February), import payments increased by 6.4 per cent over the corresponding months of FY2015; as may be recalled, the overall import growth in FY2015 was 11.3 per cent. After experiencing negative growth in the first quarter of the current fiscal year, imports have gained some momentum over the subsequent five months. Import

[13] It may be noted here that, Vietnam is one of the major competitors of Bangladesh's RMG export to the US market. This is particularly important in view of recently signed Trans-Pacific Partnership (TPP) deal, which may facilitate preferential access of Vietnamese RMG products to the US market which is not being enjoyed by Bangladesh.

growth was driven by imports of consumer goods which recorded a growth rate of 19.2 per cent.[14] Payments for importing intermediate goods increased by 6.4 per cent. In contrast, import payments for capital machinery, a key item having implications for investment, declined by (-) 7.5 per cent. Curiously, during the reported period, import of petroleum products posted a highly robust growth rate of 41.4 per cent at a time when global prices were at very low levels. Despite a positive upturn in recent months, it is likely that growth of overall import payments may remain subdued in upcoming months of FY2016 due to a higher benchmark and stagnant growth of L/C opening.[15]

Migration gained momentum but yet to be reflected in remittances inflow

Over the first nine months of FY2016, the absolute number of migrants (5 lakh) going abroad from Bangladesh had surpassed total annual migration (4.6 lakh) in FY2015 registering a phenomenal growth of 53.9 per cent over the corresponding period. Indeed, a significant boost in migration was observed (monthly average being over 45 thousand) since March 2015 followed by a further momentum gained in November 2015 (monthly average being over 60 thousand). During the reported period, migration growth to Middle East rose by 73.3 per cent. The key destinations for migrants were Oman and Qatar followed by Kingdom of Saudi Arabia (KSA), a destination where in a welcome development after a near-stop migration is picking up.[16] A recent significant boost in female migration has continued in FY2016. About 90 thousand female workers went for overseas employment during this period. Majority of the female migrated to KSA, accounting for 44.7 per cent of total migrants.[17]

The picture as regards remittance flow has been discouraging though. Remittances inflow during July-March of FY2015-16 was USD 11.1 billion which was (-) 1.8 per cent lower than the corresponding period of the previous fiscal year. It is hoped that the rising number of migrant workers in recent times will yield higher remittances in subsequent months and years. Indeed, lower amount of remittance inflow was observed in case of eight out of the 18 major markets for Bangladesh during the period. As can be seen from Table 4, Sri Lanka has also received lower remittances during July-December period of 2015 compared to corresponding period of 2014. On the other hand, Pakistan (6.3 per cent) and Nepal (12.8 per cent) have posted positive growth rates. Indeed, remittance inflow to Bangladesh had continued to fall during the first two months of 2016, while other major countries recorded positive growth. There is a need to examine the underlying reasons in this connection.

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[14] Growth of import payments for edible oil was particularly high – 73.7 per cent despite the global prices being lower.

[15] During the last four months (March-June) of FY2015, import payment growth was about 28.5 per cent – largely driven by high import payments for petroleum products. However, during July-February FY2016, L/C opening growth was (-) 1.7 per cent, and petroleum import L/C opening growth was (-) 40.5 per cent. At the same time, BPC's move to import petroleum products through open bidding may have helped.

[16] Saudi Arabian government has announced plans to cut spending, undertake reforms in energy subsidies and to raise revenues from taxes and privatisation in a bid to reduce its record budget deficit due to the low oil prices (http://www.dailymirror.lk/101647/worker-remittances-inflow-likely-to-slow-down-in-2016)

[17] Indeed, 52.6 per cent of total Bangladeshi migrants travelled to KSA were female.

Table 4: Comparative analysis of remittance growth (%)

Country Name	Growth in FY16		
	Jul-Dec	Jan-Feb	Jul-Feb
Bangladesh	-0.1	-6.0	-1.6
Pakistan	6.3	5.5	6.1
Sri Lanka	-3.0	8.0	-0.6
Nepal	12.8	3.1	10.4
Philippines	0.3	3.2[1]	0.7[1]

Source: Bangladesh Bank (www.bb.org.bd); Nepal Rastra Bank (www.nrb.org.np); State Bank of Pakistan (www.sbp.org.pk); Central Bank of Sri Lanka (www.cbsl.gov.lk); and The Bangko Sentral ng Pilipinas (www.bsp.gov.ph) [Accessed on 7 April 2016].
Note: 1/Up to January 2016.

Balance of payments situation remained favourable

Bangladesh economy experienced favourable balance of payments during July-February period of FY2016 (USD 3.1 billion) over the corresponding months of FY2015 (USD 2.2 billion). Trade balance was USD (-) 4.06 billion and remained almost unchanged compared to corresponding period of FY2015, as a consequence of high export earnings against relatively lower growth of import. Also, current account balance stood at USD 2.7 billion which was USD 511 million higher than July-February of FY2015 – mainly originating from higher services income. Within the financial account, net foreign direct investment (FDI) passed USD 1.4 billion to register a growth rate of 27.2 per cent over July-February of FY2015 whilst net trade credit was negative at USD (-) 1.2 billion.

Foreign exchange reserve continued to rise

In the backdrop of the rising balance of payments surplus, foreign exchange reserve has continued to rise to reach USD 28.7 billion as of 12 April 2016. During the first nine and half months of FY2016 foreign exchange reserve increased by USD 3.6 billion. Major share of the foreign exchange reserves was kept as convertible foreign currencies including securities and also in the form of Special Drawing Rights (SDRs), gold and export development fund, etc. According to World Development Indicator (WDI) data, foreign exchange reserve-to-GDP ratio of Bangladesh was 12.9 per cent in 2014. To compare, the figures for Indonesia (12.6 per cent) and Sri Lanka (10.4 per cent) were lower, whilst those of India (15.9 per cent), Vietnam (18.4 per cent), Philippines (28.0 per cent) and Nepal (31.4 per cent) were higher. Whilst there is no optimal size for forex reserves that a developing country should maintain, the fact remains that the manner in which reserves are accumulated and deployed should be a concern for policymakers. There is a strong case for Bangladesh to revisit and examine the reserve issue, from the perspective of accumulation, deployment, use[18], cost and return, as also safety and security of the foreign exchange reserves.[19]

[18] Use of Foreign exchange reserves to create Sovereign Wealth Fund (SFW) is a case in point. SFW a state-owned investment fund derived from the country's reserve which invests locally or internationally or both.
[19] The issue of security of reserves has become one of heightened concern following the recent heist of about 100 million USD worth of Bangladesh's reserves by hackers.

SECTION III. RECOMMENDATIONS FOR NATIONAL BUDGET FOR FY2017

3.1 Fiscal framework

Plug the widening fiscal projection gap

CPD, in its immediate reaction to the national budget for FY2016, expressed concerns regarding weaknesses in the formulation of fiscal framework in Bangladesh (CPD 2015a). As seen from Table 5, between FY2009 and FY2016, the gaps between planned and actual targets have risen for almost all components of the fiscal framework. Of the key components, net foreign borrowing is the weakest, followed by ADP and revenue mobilisation. In FY2015, 75.6 per cent of the budget target for net foreign borrowing was not realised in the backdrop of lack of ustilisation of project aid. It is also observed that every year the government is earmarking higher allocation for ADP which cannot be spent by relevant government agencies. In last three years (FY2013-FY2015), the gap between target for revenue mobilisation and the actual collection has also increased significantly.

Table 5: Fiscal projection gap (budget target *minus* actual outcome) as % of budget target

Indicators	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Total expenditure	10.6	10.7	3.0	8.3	9.1	14.6	18.7
ADP	24.1	16.2	13.6	22.8	10.8	22.0	25.8
Total revenue	6.9	4.5	(-)0.2	3.9	7.8	15.4	20.2
NBR revenue	7.9	2.6	(-)5.4	0.3	7.9	17.7	17.2
Budget deficit	19.1	25.2	10.3	19.8	12.8	12.1	14.6
Net foreign borrowing	64.0	30.4	75.7	89.8	50.4	77.3	75.6
Net domestic borrowing	(-)17.8	23.0	(-)29.2	(-)13.3	4.4	(-)25.2	(-)18.0

Source: Calculated from the Ministry of Finance (MoF) data.

It is reckoned that, the government is not being able to make the needed allocation to social sectors due to resource scarcity and unattained revenue mobilisation targets. Regrettably, the public expenditure targets, particularly the development head (ADP) allocations were not fully utilised in any of the last seven years. Lower revenue mobilisation accompanied by even lower public expenditure implied failure in utilisiation of the fiscal space offered by the moderate budget deficit. Government borrowing from domestic sources, barring FY2010 and FY2013, overshot targets due to weak budget deficit financing through use of relatively cheaper foreign resources. Overall, the fiscal framework appears to be designed with built-in over-projection.

Design and implementation of national budget for FY2017 needs to reverse this trend. Although the revised budget is placed before the national parliament, actual budget implementation is, regrettably, not discussed adequately. The audit report is also published with a significant time-lag. It is important that the Public Accounts Committee and the national parliament undertake an in depth scrutiny of actual implementation of the national budget vis-à-vis the finalised budget.

Attainment of proposed fiscal framework will once again pose challenge

Analyses of available information as regards the fiscal sector (in Section 2) revealed that the budget for FY2016 is likely to follow the prevailing trends resulting in the end with large gaps vis-à-vis fiscal projections. In this backdrop, it is important for the Ministry of Finance (MoF) to prepare the fiscal framework for FY2017 in a realistic manner. The first step towards this is to revise the fiscal framework for FY2016 in a judicious way. The Budget Monitoring and Resource Committee (BMRC) has recently indicated that both revenue and expenditure targets will be reduced by about Tk. 30-31 thousand crore (Table 6). It is observed that every year a highly ambitious fiscal framework is proposed which is later revised at the time of preparing the budget for the following year; actual realised figures are nowhere near the original targets.

Table 6: Proposed revision of the fiscal framework by BMRC

Particular	Crore Tk.					Growth (%)			
	AFY15	BFY16	RBFY16 (p)	BFY17 (p)	Revision in RBFY16 over BFY16 (p)	BFY16 over RBFY15	BFY16 over AFY15	RBFY16 over AFY15	BFY17 over RBFY16
Total expenditure	204,226	295,093	264,500	340,600	30,593 (10.4%)	23.1	44.5	29.5	28.8
Non-ADP	143,987	198,093	173,500	227600	24,593 (12.4%)	20.3	37.6	20.5	31.2
ADP	60,238	97,000	91,000	113,000	6,000 (6.2%)	29.3	61.0	51.1	24.2
Total revenue	145,950	208,443	177,000	243,000	31,443 (15.1%)	27.6	42.8	21.3	37.3
NBR revenue	123,960	176,370	150,000	200,300	26,370 (15.0%)	30.6	42.3	21.0	33.5
Non-NBR revenue	21,990	32,073	27,000	42,700	5,073 (15.8%)	13.2	45.9	22.8	58.1
Budget deficit	58,275	86,650	87,500	97,600	(-) 850 ((-) 1.0%)	13.6	48.7	50.1	11.5

Source: Calculated from the Ministry of Finance (MoF) data and collated information from several media reports.
Note: 1/A denotes actual, B denotes budget, RB denotes revised budget, p denotes projected.
2/The projected revised budget and budget figures for FY2016 and FY2017 respectively might be different from the final figures to be made public on 2 June 2016 when the Finance Minister will announce the national budget for FY2017 before the parliament.
3/ The figures in parenthesis refer to revision as percentage of original budget target.

As mentioned above, CPD estimates showed that the revenue shortfall could be even larger than expected by the BMRC. At the same time, it is also important to recall that in FY2016, ADP expenditure during the first nine months had been the lowest (as a share of the original allocation) in recent years. Regrettably, this unwelcome reality has not received the needed attention that it deserved during finalisation of Revised ADP (RADP) for FY2016. Non-ADP expenditure may also fall short of the respective revised target. Consequently, the budget deficit was likely to be lower than expected.

To be fair, the envisaged growth targets for FY2017 over the revised budget, e.g. revenue collection (37.3 per cent) [20], public expenditure (28.8 per cent) and budget deficit (11.5 per cent), are moderately ambitious. However, if the revised budget for FY2016 are not realised, which is

[20] Revenue collection is expected to get a boost in FY2017 if the new VAT and SD Act can be successfully implemented.

likely to be the case, the actual growth targets for FY2017 (to be calculated over the lower attainments in FY2016) will be much higher.

In view of the discussion above, the fiscal framework targets for FY2017 including for revenue collection, public expenditure and deficit are expected to be set on the higher side. This is particularly true if the recent trend is considered. The final fiscal framework figures for FY2016 are likely to be lower than the proposed revised targets. Consequently, the required growth for attainment of FY2017 fiscal framework figures will also rise. This was also the case with the FY2016 budget. It is likely that if the fiscal framework targets are set in this manner (as is presented in Table 6), the annual growth targets will once again remain unattainable under a business-as-usual scenario.

It needs to be recognised that both revenue mobilisation (9.6 per cent of GDP in FY2015) and public expenditure (13.5 per cent of GDP in FY2015) in Bangladesh are well below the international standard. Raising the level of both public income and spending is critical for attaining the country's development targets. CPD, in its state of the economy report in January 2016, recommended that a more expansionary fiscal policy be pursued. However, such a policy will also need to be implementable.

In this context, there are two ways to correct this situation. One option for the government is to rein-in the ambition of having a fiscal framework that envisages high revenue collection and high public expenditure. Thus, the budget will need to be prepared by accepting the current reality. Alternatively, the government can set the targets at moderately ambitious level, and give due attention to the task of enhancing administrative capacity and undertake implementation of the reform agendas with due seriousness. At the same time, distribution of allocation may also need to be revisited. The quality of public expenditure should also not be compromised. These issues are discussed in more detail in the following sub-sections of the present report. Some of the proposed measures in this connection are discussed in latter sections. It is reckoned that, in the context of Bangladesh, the second option is more desirable.

SDGs should inform the budget for FY2017

It is to be expected that Bangladesh's commitment towards the SDGs will be mentioned in the budget for FY2017. In this context, it is important that SDGs are taken as an opportunity to bring about the needed changes in the current priorities of Bangladesh. It is hoped that these revised priorities get reflected in the upcoming national budget. As is known, resource requirement for the Millennium Development Goals (MDGs) was not estimated upfront; these were estimated only later on, individually for different goals. This also resulted in double counting. The estimates could not be appropriately used for devising MDGs implementation strategy. This needs to be corrected for implementation of the SDGs. An ongoing CPD study (Bhattacharya *et al.*, 2016) has proposed a framework to this end. Following the finalisation of the SDG indicators, there is a need for estimating resource requirement for implementing the SDGs at the country level for Bangladesh.[21] Consideration of target-based estimates is crucial in this regard. At the same time, synergy and trade-offs among the targets will need to be taken into account in order to avoid double counting. The estimated resource requirement will then need to be matched with existing flow of resources (by sources). This will eventually lead to a more accurate estimates of resource

[21] The Government of Bangladesh (GoB) in collaboration with UNDP has already started this process.

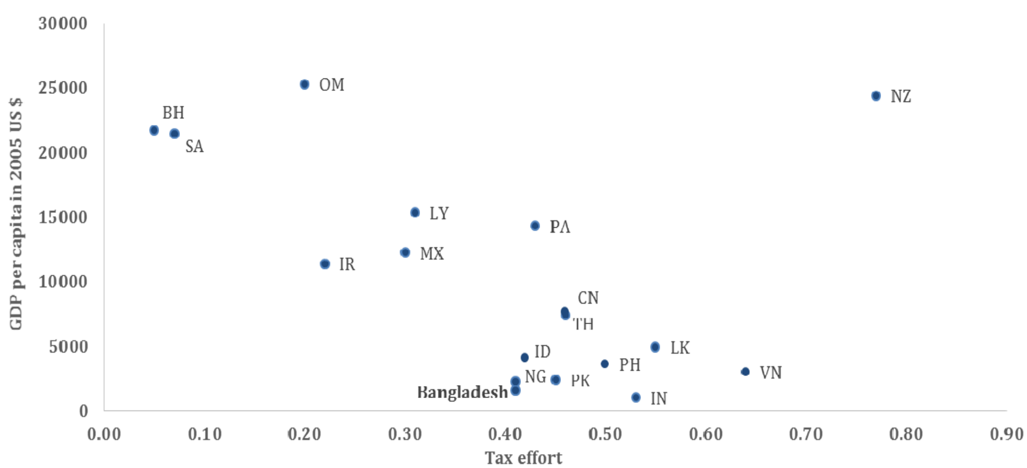
gaps, as also help identify potential sources for financing. The national budget for FY2017 need to take cognisance of this exercise. Priorities and the related resource envelope in view of the SDGs should be discussed in the Bangladesh parliament, and the Parliamentary Standing Committees should remain closely engaged in this process.

3.2 Revenue mobilisation

Concerns as regards greater revenue mobilisation in the backdrop of small tax base, low tax compliance and tax evasion have plagued Bangladesh

The tax-to-GDP ratio in Bangladesh for FY2015 was 8.5 per cent (MoF, 2015), which, compared to the average ratio of 15 per cent for developing countries, was one of the lowest in the world.[22] In recent years less than 1 per cent of the population has paid income tax (NBR, 2011). At 43 per cent, the national tax effort (the ratio between the share of the actual tax collection in GDP and taxable capacity) ranked Bangladesh last amongst its South Asian neighbours who (barring Pakistan) reported tax efforts of 53 to 55 per cent (Figure 7). The 7FYP has proposed increasing the tax-to-GDP ratio to 14.1 per cent by 2020 (GED, 2015a)[23]. There will be a need for concerted efforts in areas of reforms if this ambitious target is to be achieved.

Figure 7: Tax effort and GDP per capita (113 country study): Is Bangladesh lagging behind?



Source: Fenochietto and Pessino (2013).

Widening the income tax base remains a top priority

The 7FYP has argued that an increase in the effective income tax rate[24] to 10 per cent for the top wealth decile[25] would yield a 2.5 percentage point increase in the current tax-to-GDP ratio (Tk. 43,240 crore).

[22] Most countries with a lower tax-to-GDP ratio are rich in natural resources such as oil, and therefore are not reliant on tax as the primary source of revenue.
[23] The Annual Performance Agreement between the NBR and the Cabinet had set a target tax-to-GDP ratio of 10.6 per cent to be achieved by the end of the current fiscal year. However, as has been discussed above, this is unlikely to be achieved.
[24] The effective tax rate is the average rate at which an individual is taxed on earned income, or the average rate at which a corporation is taxed on pre-tax profits.
[25] Decile is a method of splitting up a set of ranked data into 10 equally large subsections.

Geographically equitable access to tax instruments should be extended

A CPD study on estimating potential tax efforts using Household Income and Expenditure Surveys (HIES) showed that the income taxpayer base and tax collections almost doubled and quadrupled respectively from 2005 to 2010. However, a low compliance rates can be observed as only 27.3 per cent of all potential income taxpayers declared income tax in 2010 (Table 7). Hypothetically, doubling the compliance rate would increase the 2010 income tax-to-GDP ratio by an additional 1.5 percentage points (Tk. 13,700 crore). Regional variation in tax efforts was evident as, from 2005 to 2010, the share of households paying income tax rose quite dramatically in Dhaka and Chittagong urban areas and small metropolitan areas (SMAs) (Table 8). Potential taxpayer growth in SMAs suggests that geographically equitable access to tax instruments should be facilitated.[26]

Table 7: Tax effort estimates using 2005 and 2010 HIES data

Year (by availability of HIES data)	Number of potential taxpayers (Lakhs)	Number of actual taxpayers (Lakhs)	Actual-to-potential income taxpayer ratio (%)	Amount of potential income tax (Crore Tk.)	Amount of actual income tax paid (Crore Tk.)	Actual-to-potential income tax ratio (%)	Potential income tax-to-GDP ratio (%)	Actual income tax-to-GDP ratio (%)
2005	89.58	10.00	11.16	17,500.00	2,641.25	15.09	3.63	0.55
2010	70.26	19.19	27.31	19,700.00	9,893.24	50.21	3.05	1.53
Difference (%)	-21.57	91.93	144.72	12.57	274.57	232.74	-15.99	179.52

Source: Author's estimation.

Table 8: Percentage of households, by year and region that declared income tax

Division	Rural			Urban			Small Metropolitan Areas		
	2005	2010	Differences (per cent)	2005	2010	Differences (per cent)	2005	2010	Differences (per cent)
Barisal	<0.01	0.15	>1000	0.47	0.68	44.75	N/A	N/A	N/A
Chittagong	0.09	0.14	65.12	0.65	1.52	133.59	1.67	3.75	124.96
Dhaka	<0.01	0.14	>1000	0.81	1.89	133.17	1.04	6.29	505.38
Khulna	<0.01	0.09	>1000	0.23	1.49	554.63	0.71	N/A	N/A
Rajshahi	0.52	0.53	0.95	2.08	1.88	-9.66	1	0.58	-42.5
Sylhet	<0.01	<0.01	>1000	<0.01	1	>1000	N/A	N/A	N/A

Source: Author's estimation.

Note: Rural tax compliance were very low (below 0.01 per cent) in some surveyed regions. No households in Khulna SMA were recorded as having paid tax in the 2010 HIES, so cannot be used for comparison.

Changes to current advance income tax (AIT) collection system through progressive withholdings-at-source tax rates would reduce scope for tax evasion by high income earners at the stage of final settlement

The Income Tax Ordinance (1984) stipulates service-specific withholding concession. There is an opportunity to introduce progressivity to the current system by setting withholdings rates as a

[26] There is some evidence of under-reporting of income in the HIES datasets which might affect estimates.

function of income.[27] As of now, no formal registration system exists for AIT withholding entities with the NBR. Greater transparency and higher tax mobilisation at source could be achieved through an integrated identification mechanism that links all aspects of the taxpayer's finances, to be achieved through linking e-TIN with the involved party's national ID and/or business identification number. NBR would thus have information on salaries, financial transactions and taxes for employees and business entities. NBR would also provide tax certificates to taxpayers directly through an electronic platform. Provisions for e-TIN should also be made for foreign nationals working in Bangladesh to ensure higher tax compliance from this particular group.

A major source of income tax is forgone because of largely informal arrangements in the labour market

The 2013 Bangladesh Labour Force Survey showed that roughly 50.5 million (87 per cent) of the 58.1 million employed persons aged 15 and above were informal workers.[28] To compare, while only about 10 per cent of the economy in OECD countries was informal, in developing countries the average was around 50 per cent. A three-fold increase in the share of formal employment to 40 per cent could lead to a near parity with the developing countries' average. This could potentially triple the income taxpayer base.[29] There is a need for a plan to raise this share. The government should therefore push for increased provision of formalisation of employment through labour law revisions where possible. In doing so the government must recognise that employment should provide gender parity and transparency of work conditions, and protect worker rights.

Greater formalisation of SMEs is necessary to improve revenue generation

A recent CPD study on SMEs showed that about 20 per cent of average firm expenditures has to be allocated towards formal registration costs, which was supposed to be provided free of charge (Rahman *et al.,* 2013).[30] These higher expenses are reported as the most common bottleneck to tax registration – about 36 per cent of the surveyed firms remain unregistered due to the associated cost of compliance. Since nearly 16 per cent of all Bangladesh-based SMEs are currently not registered with the NBR, reducing compliance cost, incentivising registration and enforcing compliance will help mobilisation of SMEs' tax revenue.

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[27] Some industries, such as construction, display large variance in firm sizes, so a special single withholding rate for the entire industry would place differential tax burdens across firms in that sector.
[28] Over 80 per cent of all non-agricultural workers were employed informally, with the distribution somewhat skewed towards female employees.
[29] However, concerns remain that this process will only bring in marginal taxpayers, where the low increase in tax revenue might not justify the cost of formalisation.
[30] Seventy per cent of all surveyed firms were not interested in obtaining tax benefits through proper tax registration, highlighting the general aversion towards tax declaration due to stringent compliance costs.

Given the current corporate tax collection situation, coupled with recent rate reductions, it is advisable to keep corporate tax rates unchanged for the upcoming budget[31]

The government should address the need for transparency in the declaration of corporate taxes. Proper implementation of the recently enacted Financial Reporting Act should help in this regard. Publicly listed corporations are granted lower tax rates, and they get access to equity in the market through public trading. This provides strong incentives for companies to get publicly listed, which should be heavily encouraged by the government.

Poor land and property taxation policies can lead to under declaration of asset property taxes

Provisions allowing for investment of undisclosed income should be removed. Sections 19BBBBB and 19C of the Income Tax Ordinance (1984) stipulated special tax treatment provisions for investments in real estate and government Treasury bonds that persons with unexplained income sources can avail. India, in order to deal with the problem of black money, introduced a Bill (Benami Property Bill) in 1988 to target transactions carried out in other people's names. The Bangladesh government should consider similar law reforms regarding undisclosed wealth.

Accounting for more than roughly 80 per cent of all exports, the RMG sector is a major source of tax revenue, but suffers from low tax compliance

According to NBR data, only one half of the registered garment companies submitted their income tax returns in FY2015.[32] Significant gains could be made from higher tax compliance of the RMG sector. Compliance had likely lowered due to the discontinuation of preferential corporate tax treatment for garments companies from 10 per cent to 35 per cent, as well as an increase in the tax-at-source rate from 0.3 per cent to 0.6 per cent. Assuming that RMG vendors operate at a 5 per cent profit margin, changing the effective tax rate has the potential to substantially raise revenue generation for the government.

Low VAT compliance performance stem from both governmental and business side bottlenecks

Briefs from the NBR showed that while VAT provides 35 per cent of total government revenue (4 per cent of current GDP), only a small share of all registered businesses pay the mandated VAT. False book-keeping and underreporting of inventory turnover are also widespread. The 2013 Bangladesh Enterprise Survey showed that 41 per cent of all firms (highest in South Asia) were expected to give 'gifts' in meetings with tax officials. Corrective actions are needed to discourage such corrupt practices. The government should reduce incentives for corruption by enforcing a strong reward and punishment system. Non-compliance amongst small businesses was primarily due to lack of access to VAT information and difficulty in filing tax returns. Measures in the form of online filing and payment of VAT, improving e-literacy amongst business owners and switching to electronic cash registers (ECRs) could potentially facilitate increased VAT declaration and collection. Box 1 provides a list of VAT restructuring proposals made jointly by the NBR and the

[31] The current corporate tax rate is 40 per cent, and the Tax Foundation estimated that the weighted worldwide average corporate tax rate and weighted Asian average corporate tax rate were 29.8 per cent and 26.67 per cent respectively in 2015.
[32] http://newagebd.net/197372/half-of-rmg-units-dont-pay-income-tax/

Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), which proposes some revisions to truncated tax and package VAT policies in the view of new VAT law.

Box 1: An update on the new VAT and SD Act 2012

The new VAT and SD Act 2012 is to come into force from 1 July 2016. The Act envisages a number of important changes: universal rate of VAT for all economic activities replacing the truncated rates; discontinuation of package VAT for small traders; no declaration as regards tariff value; significant expansion of business documentation and accounting for all registered businesses; provision of input credit only from registered enterprises. The new law will introduce an integrated online mechanism for VAT registration, return submission, refund and payment.

In view of prior consultations with key stakeholders, the government constituted a Joint Committee in October 2014 to deliberate on views and suggestions emerging from these consultations, particularly those voiced by the business community. The Committee included representatives from both the NBR and the FBCCI. The business community raised a number of issues that called for amendments to the Act; the Committee agreed to some of these. The Committee agreed to raise the limit of turnover tax for eligible traders, businesses and manufacturers, provide differential treatment to small traders, businesses and some specific sectors who were to pay VAT at a reduced rate (these will not be eligible to enjoy input VAT credit). However, difference of opinion persisted as regards collection of Advance Trade VAT (ATV) at import stage and provision of differential treatment for bargaining shops, amongst others.

It is to be noted that, introduction of the new VAT Act will call for development of necessary (soft and hard) infrastructure, human resource and skill development, training of VAT officials, and preparation of relevant stakeholders as regards compliance. Automation process for the new VAT regime needs test runs which has not been done as yet. The business community, particularly the SMEs, should undertake necessary preparatory work towards compliance with the new regime. All these preparations need to be done in a coordinated manner through participation of stakeholders and tax officials, at various levels.

The NBR currently lacks adequate administrative resources in terms of human resource power and infrastructure

Dated methods and a largely paper-based work environment have constrained NBR's ability to deliver on its service and compliance improvement goals as envisaged in the NBR Modernization Plan. Greater use of ICT through electronic tax administration and declaration practices, with commensurate skills development will help tax compliance. More frequent tax fairs, raising awareness and establishment of more tax circles in high-density economic activity areas will be needed. In light of provisions being made for centralised processing of both income tax and VAT returns, there is an opportunity to go for digitising tax refunds.[33] Electronic tax compliance could also be incentivised for timely payment. NBR should consider strengthening its auditing capacity to deal with underreporting of income which undermines the cause of tax collection from large taxpayers.

[33] The current tax code does not provide a tractable refund system.

Additional revenue can be generated through expedient resolution of cases by taking recourse to the Alternative Dispute Resolution (ADR) system

NBR Annual Report FY2014 reveals the number of ongoing tax-related cases is significant, of which high income earning groups (above Tk. 10 lakh) constitute a major share (8,562 open cases).[34] Speedy resolution of these cases could be a potential source of revenue earnings. In view of this, energetic efforts should be made to take advantage of the ADR window and bottlenecks should be removed.

More stringent measures be implemented to reduce illicit financial outflows

Kar and Spanjers (2015) showed that around Tk. 44,000 crore (6.2 per cent of current GDP) was annually siphoned out of Bangladesh between 2004 to 2013 – over Tk. 76,000 crore (6.3 per cent of current GDP) was siphoned out of Bangladesh in 2013 alone. Globally, international institutions such as multinational corporations (MNCs) have been found guilty of misreporting transfer prices in order to keep their tax burdens low. The Transfer Pricing Cell should be further strengthened and steps should be taken so that the cell has access to global platforms and databases for tracing and tracking illicit flows, misinvoicing by MNCs and other business enterprises. The recent Panama Papers scandal, coupled with prior information provided by Swiss banks, calls for appropriate investigation by concerned authorities in Bangladesh.

In summation, proposed changes to a progressive AIT system, increased formalisation of labour and enterprise (particularly SMEs), a digitised filing and refund/rebate system, greater transparency in corporate tax declaration, implementation of the new VAT law by taking concerns of the business community in cognisance, improved property and RMG sector tax compliance, an efficient ADR mechanism, reducing illicit financial outflows and overhaul of NBR institutional bottlenecks will significantly improve revenue mobilisation efforts.

3.3 Public expenditure

Allocate resources in a prudent way

During the FY2011-FY2015 period the public expenditure budget could not be fully spent in any year. The government will need to utilise its resources to the fullest to put the economy on a higher growth trajectory. Reorganising and raising expenditure particularly for the social sectors, including social safety net programmes for the marginalised people, will help the government both in short and medium terms. And in this context, the government should not be hostage to the compulsion of keeping the budget deficit within 5 per cent of GDP.

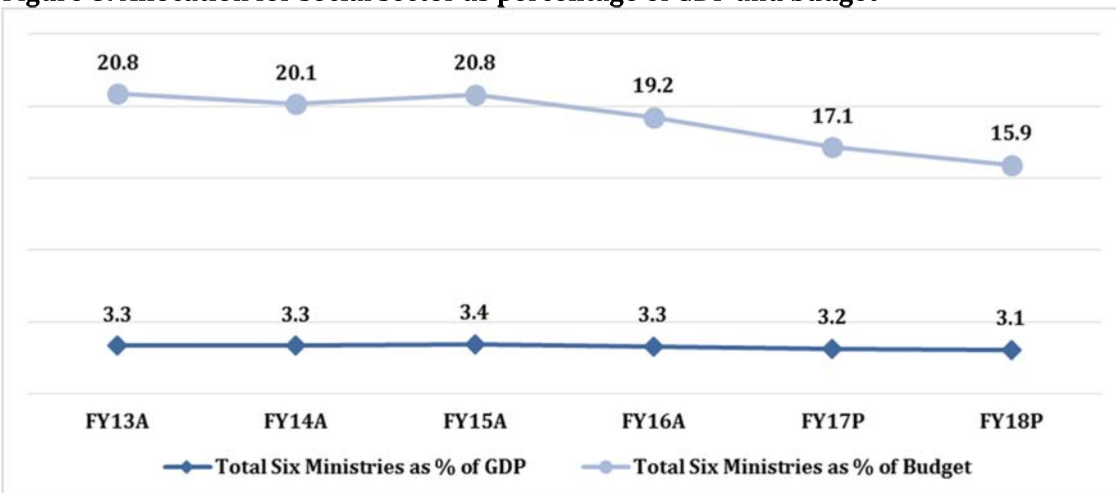
Emphasise allocation for social sector in budget to implement the targets of 7FYP and SDGs

Despite the Government's pledge to give education, health and other social sectors the highest priority, budgetary allocation and future projections regarding social sector spending does not echo this conviction. As stated in CPD (2016), allocations for six ministries concerning social welfare and security, have gone through persistent decline both as percentage of GDP and of total budget. There was a marginal increase in FY2015, but the allocation decreased again in FY2016.

[34] About 10.15 per cent of all unresolved cases stemmed from high-income businesses.

According to the Medium Term Budgetary Framework (MTBF), this declining trend will continue until FY2018 (MoF, 2015b). This trend, as presented in Figure 8, is not in agreement with either the 7FYP or the Sustainable Development Goal (SDG) commitments of the GoB.

Figure 8: Allocation for social sector as percentage of GDP and budget



Source: Calculated from Medium Term Budgetary Framework (MTBF), Ministry of Finance (MoF).
Note: A refers to allocation and P refers to projection.

Reflect National Social Security Strategy (NSSS) targets in the national budget

Proper attention towards adequate allocation favouring social safety net programmes appears to be wanting in the budgetary framework in recent years (CPD, 2015a). Allocation for social safety net programmes (about 27 per cent of which is incurred on account of pension–related expenditure for government employees) hovered around the 2 per cent of the GDP. This allocation was targeted to be raised to 3 per cent of the GDP in the Sixth Five Year Plan. However, this was not to be; also it is observed that the budgetary targets were not aligned with the proposals of the National Social Security Strategy (NSSS). Excluding government pension scheme, the other social safety net programmes' budgetary targets are much lower than envisaged in the NSSS (Table 9). It should also be mentioned that the Government's social safety net programmes are inadequate not only in monetary terms, but also from the coverage point of view.

Table 9: Budgetary allocations and projections vs NSSS targets of major safety net programmes (Taka in crore)

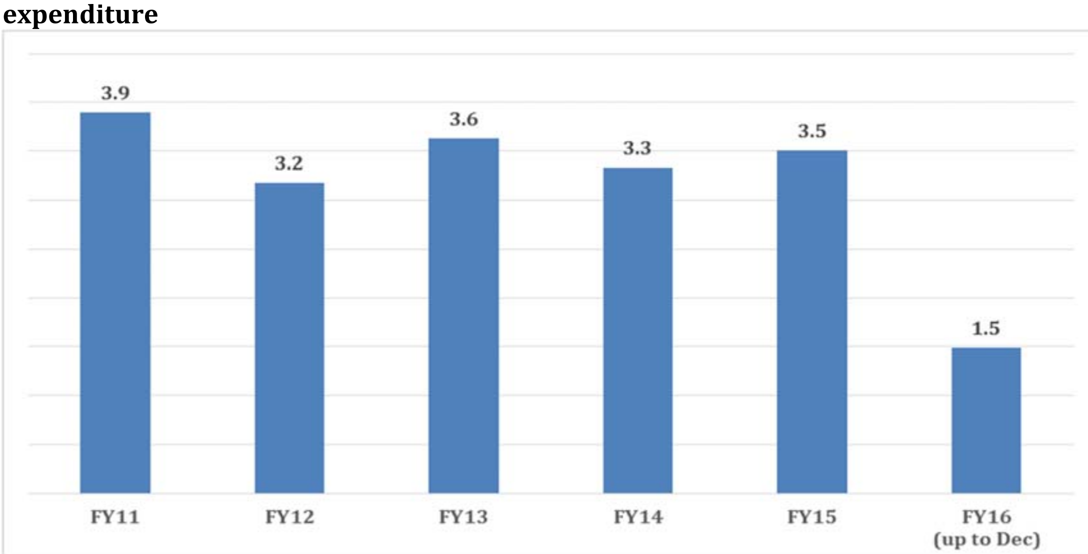
Programmes	Budget			NSSS Target	Projection (MTBF vs. NSSS)			
	FY14	FY15	FY16	FY16	MTBF FY17	NSSS FY17	MTBF FY18	NSSS FY18
Old Age Allowance	980	1,307	1,440	2,010	1,440	3,530	1,440	3,740
Pension for Retired Government Employees and their Families	6,692	8,482	11,584	7,600	N/A	8,000	N/A	8,500
Child School (Primary+Secondary) Stipend	1,000	971	1,159	3,870	0	6,830	0	7,240
Allowances for the Widowed, Deserted and Destitute Women	364	486	534	1,150	534	2,040	534	2,160
Vulnerable Group Feeding (VGF)	1,327	1,419	1,453	N/A	1,575	N/A	1,719	N/A
Employment Generation Programme for Poor	1,400	1,500	1,500	N/A	1,600	N/A	1,700	N/A

Source: Calculated from MTBF, MoF and GED (2015b).

Provide adequate allocation for maintenance of existing infrastructure

Infrastructure maintenance expenditures have remained stagnant in real terms over the past decade (Hussain *et al.,* 2015). Since investment expenditure has been significantly on the rise in recent years, there is a growing concern regarding the ability to ensure proper maintenance of the new capital investments. Expenditure on repair, maintenance and rehabilitation declined from about 3.9 per cent of total non-development expenditure in FY2011 to about 3.5 per cent in FY2015. This share was only 1.5 per cent for the first six months of FY2016. From FY2011 onward this share has been showing a generally declining trend (Figure 9). In view of the increasing expenditure on new physical infrastructure, allocation of funds for maintenance of these infrastructure should be correspondingly increased.

Figure 9: Repair, maintenance and rehabilitation as % of total non-development expenditure



Source: Calculated from Monthly Fiscal Reports, Ministry of Finance (MoF).

It is high time to adopt a 'National Subsidy Policy'

In the backdrop of the low level of international petroleum prices, BPC is unlikely to seek any (subsidy) support during the FY2016 period. Regrettably, as of now, there is no clear reporting on the part of BPC as to the amount of profit being made and the way this profit is being distributed (e.g. repayments of past debt, dividend to government, profit accumulation, etc.). On the other hand, subsidy demand for electricity has remained persistent. The government has stayed away from downward adjustments of administered prices of petroleum products in the domestic market. It may be recalled that, earlier CPD in its state of the economy report released in January 2016 showed that a reduction in prices of petroleum product will be beneficial to the economy in terms of raising GDP, employment and containing inflation. Indeed, CPD estimates showed that a 10 per cent reduction will lead to 0.3 per cent gain in terms of GDP growth. However, apparently revenue concerns held the government back from taking a positive decision in this regard. Recently, the government has announced that it will reduce the fuel prices, but in a phased manner. At the same time, an upward adjustment of electricity and gas prices are also being contemplated. The adjustment of these administered prices should be calibrated by taking into cognisance the revisions of gas and electricity prices, overall impact of the price-change mix on major stakeholder groups and government's subsidy–related expenditure and earnings. Besides, in the context of the required transparency in allocation, efficiency in delivery and accountability in the management of subsidies, there is an urgent need for Bangladesh to have a National Subsidy Policy. This point was forcefully articulated in a recent CPD paper (CPD, 2015b).

A comprehensive strategy for better ADP implementation

Lack of improvement in ADP implementation in FY2016 has once again brought into focus the need for addressing the persistent weaknesses of government's implementing agencies and the challenges faced by them. Some of the major challenges that were identified by the Ministry of Planning in the course of project implementation in FY2015 included land acquisition, preparation of work plan, frequent changes in schedule rates for construction, and recruitment of consultant/firm and manpower including project directors (PDs). Frequent change of PDs has also emerged as a major bottleneck. Procedural lapses which begin with delays in the approval of projects were also identified as a major reason for lax ADP implementation (CPD, 2011, 2015b). Post-approval procedural delays in land acquisition and procurement also hold back timely commencement of project work.

Further, implementation of ADP projects, in a timely manner and within initial cost estimates, continue to be problematic. In FY2014 only 14.2 per cent of the total 'to be completed projects' were actually completed within the stipulated time and planned allocation. About half (48.9 per cent) of the completed projects experienced time overrun (Annex Table 2). Such time overrun led to 51.1 per cent increase in the average cost of all completed projects. However, financial accounting in the form of expenditure does not necessarily mean actual implementation. Release of funds to project account is often taken as a proxy for progress of implementation. While, often financial progress of the completed projects remain high, this is not evidenced by actual progress in physical terms and as per the needed quality of work.[35] Thus, the overall quality of ADP

[35] An ongoing CPD study found that on an average 66.2 per cent of completed projects were declared as completed without 100 per cent physical progress during FY2001-FY2015 period.

implementation is often compromised. In view of above, the following recommendations are put forward to raise the efficacy of ADP implementation in Bangladesh.

Recent government initiatives/plans should be put into effect

Recently the government has taken a number of initiatives to accelerate ADP implementation. A policy on the Project Preparatory Fund (PPF) aiming to facilitate timely and successful implementation of the development projects has been drafted. The main objective of the PPF is to provide funds for completion of preliminary activities before the launch of a development project.[36] This new provision and the attendant costs need to be reflected in the upcoming national budget. The government has also recently informed about its plan to appoint a foreign consultant to fast-track ADP implementation.

One may recall that a number of proposals as regards expediting ADP implementation were announced last year by the Planning Minister. These include: (i) appointing PDs through direct interviews by the line ministries and divisions[37]; (ii) assigning a dedicated official in each government agency for monitoring and evaluating respective projects; and (iii) delisting the longstanding 'non-operational' projects from the ADP[38]. However, these are not being adequately followed up. It is recommended that the upcoming budget will report progress on these issues.

Besides, each year, Implementation Monitoring and Evaluation Division (IMED) provides some recommendations in the annual progress report based on the challenges faced during the project cycle. But, these are often not adequately followed up with concrete measures. These recommendations should be discussed and followed up in the quarterly progress meetings on ADP. The proposals need to be implemented.

Intensive monitoring of priority projects, which are close to being completed, should be a priority

In view of the low level private investment and significant infrastructure deficit, better (in terms of quality) and timely implementation of the ADP, particularly that of growth–enhancing infrastructure projects, should remain a policy priority. Earlier, CPD (2015c) selected a set of 26 projects under the ADP for FY2015; all these projects were supposed to help boost growth and employment. CPD's second interim review of the state of the Bangladesh economy in FY2015 (CPD, 2015d) urged for close scrutiny and tracking of progress of these projects. Fourteen of these 26 projects were supposed to be completed in FY2015 (or even earlier). Cost and completion deadline of number of these projects were revised, for a few more than once. Indeed, barring one project, the other 13 projects were not completed in FY2015 and were carried forward in the ADP for FY2016 (CPD, 2015a). One suspects that the majority of these will not be completed within FY2016. Further cost and time overruns for these priority projects may be a possibility unless special policy and administrative attention is given to speed up their implementation. A special task-force needs to be formed which could closely monitor the implementation of these projects. It is also important that adequate funds are allocated for these projects in the forthcoming ADP.

[36] Preliminary activities include land acquisition, feasibility study and environmental impact assessment (EIA).

[37] Developing guidelines to this end was also planned.

[38] In this connection, it was planned that the concerned ministries and divisions would be served letters on 1 October every year to send the list of non-performing projects to the Planning Commission.

Landmark social sector projects should be prioritised in line with the SDGs

There are three major development programmes/projects in the social sector in the ADP— two in the education sector and one in the health sector.[39] Two out of these three projects were supposed to be completed by FY2016 as per respective timelines. But, CPD analysis suggests that these projects will not be completed in time; indeed, one of these two has already experienced time extension.[40] Consequently, special attention will need to be given to these important large social sector projects through adequate fund allocation in the upcoming budget for FY2017. Furthermore, in the next phase, project objectives will have to be redesigned and aligned with the Sustainable Development Goal (SDG) targets.

Separate strategy for foreign-aided projects needed

Foreign-aided projects are often required to follow additional procedural steps in the overall project cycle. Last year, the Planning Minister noted in a meeting that "the project directors often feel discomfort in utilising foreign aid part of the development projects although they feel much comfort in utilising local funds"[41]. This, according to him, was not acceptable. He talked of undertaking an effective strategy through consultation with the Economic Relations Division (ERD) of the MoF. A dedicated strategy is thus needed, with a more proactive role of the aid effectiveness unit of ERD, to simplify the overall process for fund disbursement and procedural delays concerning foreign-aided projects. Hopefully, the next budget will spell out this strategy.

Monitoring and evaluation mechanism needs to be strengthened

Project Completion Reports (PCRs) are important to assess the implementation of a particular project. As per IMED guidelines, preparation and submission of PCR to IMED should be done within three months of completion (IMED, 2012).[42] PCRs should also be made public to ensure transparency. Low quality of the submitted PCRs and also the lack of needed human resources at its disposal (as per IMED organisational structure) often do not allow proper evaluation of completed projects (See Annex Table 3 for recent status). An inter-ministerial committee could be constituted to maintain consistency in the quality of PCRs submitted by different ministries. The number of impact analysis of projects also needs to be increased. More independent experts should be involved in this work. Proper impact analyses could be a great help in designing future projects which will improve the overall quality of implementation and outcome.

Establish an independent Public Expenditure Review Commission

A number of countries have undertaken public expenditure reviews (at both central and state levels) with a view to achieving efficiency and ensuring accountability. These reviews are

[39] These are Primary Education Development Program-III (PEDP-III), Secondary Education Quality and Access Enhancement Project (SEQAEP), and Health Population and Nutrition Sector Development Program (HPNSDP).

[40] Maximum possible completion of these projects will be in the range of 59 to 76 per cent if they spend all their allocation for FY2016.

[41] See http://www.dhakatribune.com/business/2015/feb/16/kamal-asks-project-directors-utilise-foreign-assistance.

[42] As a matter of fact, about 35 per cent PCR of total completed projects were not submitted to IMED on time in FY2012 which rose to 41 per cent in FY2015.

prepared taking into cognisance macroeconomic context as well as fiscal policy, public sector performance and sustainability concerns. At present, there is a need to significantly raise efficacy of public expenditure in Bangladesh, particularly in view of the increased volume and change in the composition. In this context, CPD has earlier urged for setting up an independent Public Expenditure Review Commission (PERC) which would be mandated to provide medium term policy guidelines to the government and formulate a concrete set of strategies in order to improve the current level of efficiency. The proposed Commission may be vested with broad set of responsibilities under its Terms of Reference (TOR). Some of these could be as follows:

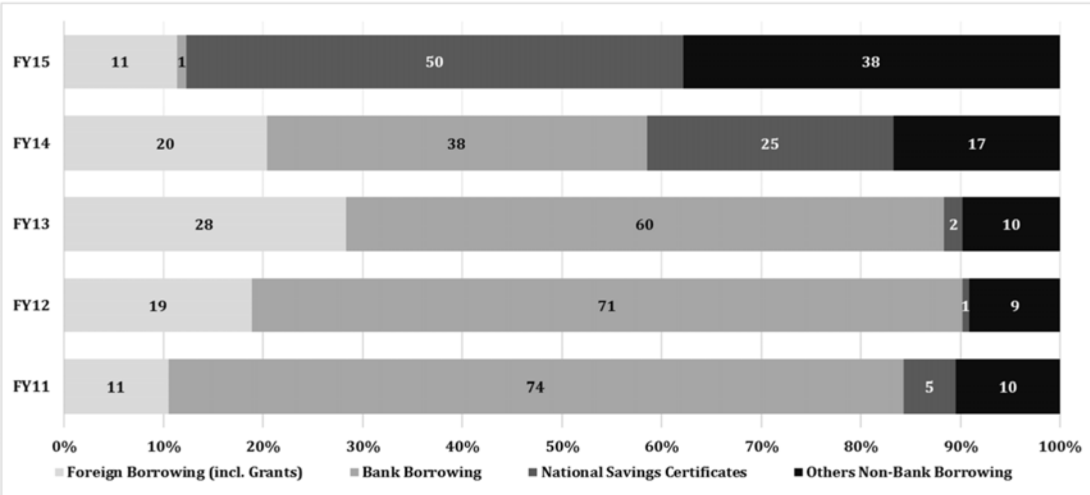
a. Review efficacy of programmes/schemes of major departments with appropriate recommendations to be proposed for their restructuring and convergence to facilitate improvement of their development effectiveness;
b. Develop a framework for performance and outcome monitoring of the development schemes/programmes with a view to raising the efficiency of public spending;
c. Review the scope for consolidation of smaller schemes and expenditure items with common/complementary objectives into a fewer number of viable programmes;
d. Examine classification of expenditure according to the Public Moneys and Budget Management Act, 2009;
e. Suggest appropriate measures in order to address inconsistencies and inefficiency with a view to ensuring rational and effective use of public expenditure;
f. Review issues on data accountability;
g. Review processes and institutional mechanisms of programme implementation and service delivery to improve efficiency and cost effectiveness;
h. Review the framework of all subsidies, both explicit and implicit and examine the economic rationale for their continuance; put forward recommendations for making subsidies transparent and suggest measures for maximising their impact on the target population at minimum cost;
i. Design an effective strategy so that a reasonable proportion of expenditure on services through user charges could be ensured;
j. Suggest areas for adoption of new technologies for effective implementation of programmes and delivery of services;
k. Recommend a set of measures for optimising the staff strength of government departments, attached offices and institutions, for skill enhancement of existing staff, and for redeployment of programmes and delivery of services;
l. Put forward suitable recommendations as regards any other relevant issues with a view to ensuring good governance and improved management of government expenditures.

3.4 Budget deficit financing

Budget deficit financing needs an optimum mix

Over the past few years, a significant change in the sources of budget deficit financing has been observed (Figure 10). As was noted, net financing from foreign sources (including grants) remained low (only 0.4 per cent of GDP) in FY2015 due to low level of project aid utilisation in the ADP. Additionally, amongst the domestic sources, sale of NSD certificates has emerged as the single largest contributor.[43] Indeed, as of January 2016, NSD certificate sale accounted for about half of the total outstanding domestic debt liability of the government (Tk. 1,21,733 crore). A year ago, the corresponding figure was about 43 per cent (Tk. 92,136 crore).

Figure 10: Deficit financing mix in recent years



Source: Estimated from the Ministry of Finance (MoF) data.

As has been mentioned above, NSD net sale remained strong in FY2016 as rate of return from the NSD was significantly higher compared to banking sources (i.e. interest income). People are now more interested to go for savings through preferred NSD instruments. Top four NSD bonds, i.e. – Family Savings Certificate (34.3 per cent), 3-month profit bearing Sanchayapatra (26.3 per cent), 5 years Bangladesh Sanchayapatra (17.0 per cent) and Post Office (12.8 per cent) comprised 90.3 per cent of total sale of NSD certificates in FY2015. Indeed, a rise in the popularity of 3-month profit bearing Sanchayapatra may be observed, as it has a relatively short maturity period (3 years compared to 5 years for other instruments), and thus gain-wise more lucrative for small savers.

In view of the current scenario, it would be advisable that the government balances the borrowings from bank and non-banking sources. In a recent government meeting on resources for budget FY2017, the central bank governor proposed to cut interest rate of NSD certificates. However, it may lead to further reduction of the real interest rate on commercial bank deposits which has recently moved to negative terrain. Rather than bringing down the savings certificate rates significantly, since many small savers do take advantage of the schemes, lowering of the maximum purchase amount could be the preferred policy option. This will also reduce fiscal liability of the government. However, stringent maintenance of eligibility criteria, digitisation of the purchase process and adoption of penalty measures for violation of rules will have to be put in place to deter financially better-off investors from purchasing the relatively high–yielding NSD facilities beyond the reduced limit.

[43] For example, in FY2015, half of the total financing originated from sale of NSD certificates. Indeed, government borrowed only Tk. 514 crore from banking sources against a hefty annual target of Tk. 31,200 crore in FY2015.

3.5 Fiscal measures

Proper assessment of effective fiscal measures needed

Fiscal measures are important instruments deployed by the government in the national budget with a view to achieve specific objectives. Bangladesh's national budgets offer various fiscal measures targeting different groups – consumers, micro, small and medium entrepreneurs, corporate bodies, owners of export-oriented industries, importers and retailers, limited income earners, asset holders, etc. While such measures attempt to target the demands of various groups, in absence of proper pre- and post-impact assessment it is difficult to appreciate whether such measures are adequate or not, how long those measures are needed to be in place, what direct and indirect benefits are enjoyed by the target groups, and what is the overall economic impact of these measures. One general observation in view of the above is that, there should be comprehensive ex-ante and ex-post analyses of the various measures (See Box 2). This exercise will help identify fiscal measures that are most appropriate to address the developmental challenges facing the country.

Box 2: Stakeholders' Perception on Selected Fiscal Measures for FY2016

CPD conducted a number of telephone interviews to get the perception of relevant stakeholders whose interests were impacted by various fiscal measures in the budget for current fiscal year (FY2016). A number of observations came up on some selected fiscal measures following the interviews.

a) Personal income tax: Some low-income earners felt that, raising the threshold limit of the personal income tax from Tk. 2,20,000 to Tk. 2,50,000 and subsequent changes in the other income slabs were good moves, but it did not go far enough.

b) Corporate income tax: The initiative to reduce corporate income tax for public listed companies from 27.5 per cent to 25 per cent and for public listed bank, insurance and financial institutions from 42.5 per cent to 40 per cent, was in general welcomed by budgetary business entities. However, they felt that transition of such moves into investment was contingent upon many other factors.

c) Changes in duty structure at import stage: A total of 1,675 products have seen changes in customs duties (CDs)/supplementary duties (SDs)/regulatory duties (RDs) at the import stage in the FY2016 budget which was a major move towards reducing the effective rate of protection enjoyed by these products. Considering that the levels of development of local industries was quite diverse, competition faced by domestic industries was uneven owing to tax avoidance in case of imported products and incidences of dumping through import, a proper assessment is needed to analytically determine the levels of effective protection that is needed for the development of local industries, and then calibrate fiscal policies accordingly.

The general perception is that there should be more consultations with key consumer-producer groups, these should be appropriately documented and then get reflected in the budget.

During FY2016, government has further extended tax holiday facility for the Information Technology Enabled Services (ITES) and Nationwide Telecommunication Transmission Network (NTTN) sector till 30 June 2024 from the earlier 30 June 2019. Tax holiday has been given for automobile manufacturing and tyre manufacturing industries as well. Besides, existing area-based tax holiday facility has been continued. However, stakeholders gave mixed reaction as regards such measures as they felt that without having necessary infrastructural facilities in place it would be difficult to attract entrepreneurs to invest in those supported sectors; tax holiday facility alone was not enough.

In this backdrop, it is felt that there should be a proper institutional set-up to assess the impact and implications of various fiscal measures announced in the national budgets. As in many other countries, the Finance Ministry should publish a list of all fiscal incentives offered in the budgets and their implications in terms of effective rate of protection (ERP), foregone tax revenues, benefits expected and justification for the duration for which such incentives were to be offered. This type of analytical work and assessments could be carried out by the NBR in association with the Bangladesh Tariff Commission (BTC), and for this necessary human resources and technical support will have to be made available. Impact assessment of various fiscal measures should be made public at the end of the fiscal year when the new budget is presented.

Support needed to make small businesses tax compliant

A large number of SMEs of the country are not tax compliant – many SMEs are not registered with appropriate authorities; many do not have tax identification number (TIN) or have VAT registration (see Box 3 below). NBR should take energetic measures to encourage these informal business entities to get registered through awareness-raising programmes, dissemination of information about advantages of formalisation and enforcement of relevant laws. The majority of small entrepreneurs do not maintain proper accounting system which is an essential pre-condition to be compliant under the new VAT law. Small entrepreneurs often do not have the needed accounting knowledge and also are not in a position to hire accountants. NBR should develop a proper work plan to encourage SMEs to get registered, organise training sessions, prepare manuals, and in general to do all the needful in preparation of introduction of the new VAT law as well as to provide necessary training to make them able to undertake the required tasks to be compliant as per requirement.

Box 3: Pre-budget Dialogue 2016

Development of the SMEs of the Bogra Region:

Challenges and Initiatives

CPD organised a pre-budget dialogue on 24 March 2016 in Bogra city with the objective of getting local level stakeholders' perspectives on various fiscal and budgetary measures favouring the development of SMEs.[44] Based on the presentation and views expressed by the stakeholder on the dialogue, following suggestions emerged in the context of the upcoming national budget for FY2017.

a) Special efforts needed to formalise SMEs: A large part of SME units in the Bogra region are not tax compliant – these enterprises operate without necessary documents such as business registration, VAT identification number, TIN and other documents. Lack of formalisation often does not allow these SMEs to enjoy fiscal incentives; on the other hand under the proposed new VAT Act these entities were likely to face legal difficulties as well. In view of this, there was a felt need for concerted efforts towards formalisation of SMEs.

b) 'Customisation' of financial products for better access to finance: Access to finance is yet to reach the doorsteps of small entrepreneurs due to various reasons. Lack of proper documents is a major reason why they are not being able to access credit from commercial banks which have dedicated low interest windows for SMEs. Given the nature of market demand and the marketing patterns, entrepreneurs would like to have more flexibility in the repayment schedule of loans from banks (e.g. seasonal nature of demand for credit, business cycle, etc.). In this backdrop, commercial banks should identify innovative and 'customised' financial products to reach potential SME clients. A district monitoring committee should be constituted to monitor whether SME loan is being disbursed properly to the target groups.

c) Support to organise the unorganised entrepreneurs: Challenges faced by regional SMEs will be difficult to address in the absence of cluster-based association/groups, as was observed by participants of the Bogra dialogue. Such clusters would be helpful not only for lobbying with appropriate authorities in articulating budget-related demands, but also from the perspective of implementing supportive measures and deploying the fiscal-monetary incentives for SMEs. It was also felt that strong and effective

[44] A paper titled "National Budget and Decentralised Development of SMEs: A Case Study of SME Clusters in Bogra" co-authored by Khondaker Golam Moazzem, Kishore Kumer Basak and Mahtab Uddin Ahmed which was presented in the dialogue.

LGIs were needed for the above to happen. Participants at the dialogue also felt that good infrastructure was needed to facilitate both production and marketing, and in this context, they urged for construction of four-lane Bogra-Tangail highway.

d) Support for development of 'customised' infrastructure: Lack of proper transport facility leads to high production/business costs for SME clusters located in rural areas in the Bogra region. Bogra BSCIC industrial estates lack necessary land and other facilities to accommodate the needs of old and new SMEs. In this context, these regional SMEs need more 'customised' infrastructure for more economically viable operation of their supply chains. In this connection participants urged that a special economic zone for SMEs be set up in the Bogra region.

e) Overcoming challenges to raise competitiveness: Different clusters face different types of challenges in maintaining their competitiveness. These relate to differences in market segments they cater to, domestic or export orientation, product quality and standards, competition with substitute products (both local and imported), lack of infrastructure and linkages with retail markets. Support measures for SMEs should be calibrated according to the particular types of felt-needs that they would like to be addressed. Many SMEs would like to target regional and global markets; they need marketing support to be able to do this. In this backdrop, they are in need for supportive measures and incentives to raise productivity, improve quality and standards, and deal with market access, marketing knowledge and risk management. Regional technical institutes such as (Bangladesh Institute for Technical Assistance Center (BITAC) at Bogra) should be adequately endowed to provide such services.

f) Developing women entrepreneurship: Despite various efforts at the national level, women entrepreneurs at regional level face formidable difficulties in setting up enterprises and in getting access to special credit facilities targeted to cater to their particular needs. Participants complained about lack of gender sensitivity among concerned officials, be it banks or government offices. On their part, banks also complained about difficulty they face in categorising women SMEs and lack of formalisation concerning women-led enterprises which make it difficult to provide credit from special and dedicated window set up to develop women entrepreneurship and women-led enterprises. It was felt that targeted programmes were needed to address the challenges and problems voiced by both sides.

3.6 Fiscal, budgetary and other economic reforms

A. Fiscal and budgetary reforms

CPD (2016) strongly suggests in favour of undertaking the needed reform measures with a view to improve macroeconomic and sectoral efficiency. In this connection, more focus is needed on implementing 'second generation' reforms by ensuring higher levels of transparency and independence of regulatory bodies to generate efficiency, competitiveness and distributive justice. Higher transparency in fiscal and budgetary processes should be one of the key areas of these reforms. As some of the other developing countries, Bangladesh practices a budgetary process which is both complex and complicated, and sometimes hidden and inconsistent. Fiscal and budgetary transparency calls for "openness towards the public at large about government structure and functions, fiscal policy intentions, public sector accounts and projections." Transparency could be achieved through five key aspects: a) clarity and openness about the budget decision-making process and the underlying constitutional or statutory authority; b) public disclosure and distribution of budget information; c) detailed reporting of budget expenditure/revenue; d) a comprehensive scope, accounting for assets and liabilities, targets, projections, performance measures and structural balance; and e) budget integrity, control and accountability and budget forecasting and projections. Bangladesh lags far behind in terms of international standards for compliance as regards transparency in the budgetary processes. It may be noted here that, Bangladesh meets only 12 out of 76 standards in the process of implementing national budget. Discussion in the Parliament and Parliamentary Standing Committees and more active engagement of key stakeholders such as civil society actor, workers and business representatives will be needed to ensure transparency in this regard. Indeed, during a consultation meeting with CPD, the young professionals of Bangladesh also called for greater voice in the budgetary process (Box 4).

Box 4: Opinion of Young Professionals in view of the Upcoming FY2017 Budget

CPD organised a discussion session with young professionals titled "Conversation with Future Leaders" on 25 February 2016 as part of a series of consultations which were organised to discuss relevant issues concerning the upcoming national budget for FY2017. Eleven young entrepreneurs and leaders participated in the discussion session. A number of concerns, as also recommendations in view of the upcoming budget emerged from this discussion. The participants felt the need for a more proactive involvement of youth in national policy making. The discussants urged for a platform where the views of the future generation of the country on issues of national importance could be voiced and heard. They felt that policy debates in Bangladesh are often over-politicised and because of this even constructive and meaningful inputs on key developmental issues are often not acted upon. They thought that there is an uncertainty as regards implementation of the needed reform initiatives. Participants put emphasis on the need to ensure that development was sustainable and that policies should be designed in such a manner that the cause of sustainability got advanced. Participants were of the opinion that the FY2017 budget should be formulated by taking cognisance of economic priorities and allocative efficiency. They suggested that fiscal structure, proposals and incentives should be designed in a manner that balances the interests of domestic and export-oriented industries. They urged for higher allocation for education, particularly putting emphasis on tertiary education. They recommended that more resources should be allocated for skills development, highlighting the cause of employability; they also asked for setting up a Green Fund to promote environment-friendly investments and production processes. Participants felt that sectors such as ICT, fashion and design segments in production processes and e-commerce based activities where young people have an interest and advantage should receive incentives and budgetary support.

Present study highlights lack of transparency in a number of areas where reform measures are called for. These include: a) disclosure of financial accounts of state-owned enterprises; b) transparency in government's asset acquisition; c) transparency in defence budget; d) transparency in local government financing; e) transparency of NGO financing; and f) transparency in South-South financial transactions, a case being the Indian Line of Credit (LoC).

a) Disclosure of financial accounts of state-owned enterprises

Financial accounts of the 29 state-owned enterprises (SoEs) need to be made public in a transparent manner in order to better understand financial health of these enterprises. There is a lack of clarity as regards major heads of their financial accounts such as income, expenditure, income, profit/loss, debt, liability and assets, etc. For example, BPC, a state-owned commercial agency, experienced a major change in its financial account and health between FY2014 and FY2016 because of the windfall gain enjoyed on account of the differences in the petroleum prices between the international (low prices) market and the domestic regulated (high administered prices) market. According to Bangladesh Economic Review 2014, BPC incurred a net loss of Tk. 2,489.86 crore till FY2014, it has unpaid debt service liability of Tk. 19,71,617.6 crore (as of June 2013) and total due of Tk. 14,183.64 crore (till December 2013). However, the financial position of BPC has significantly improved over the following period, thanks to the low price of petroleum in the international market. According to Bangladesh Economic Review 2015, BPC made a net profit of Tk. 3,454.7 crore till 22 April 2014; its unpaid debt-service liability has reduced to Tk.

22,28,423.9 crore (as of June 2014) and total due fell to Tk. 11,152.78 crore (till 31 December 2014). Financial position of BPC has definitely improved further in FY2016 due to the falling fuel price in the global market, with domestic prices remaining the same. Higher transparency of the financial account of BPC would help understand how the windfall gain has changed BPC's bottom line, how this has been utilised by BPC till date (a part of this profit was perhaps used to adjust accumulated losses and repay earlier debts). Transparency in this regard will help better and more appropriate policy making in the areas of price adjustments and allocating relative benefits to be enjoyed by key stakeholders and sectors (e.g. farmers, transport users, producers, exporters and consumers).

Bangladesh Jute Mills Corporation (BJMC), another SoE, has been operating with a huge loss for last several years (net loss at the end of FY2015 was Tk. 640 crore) and its unpaid debt service liability was to the tune of Tk. 412,260.6 crore and the outstanding amount was Tk. 1,219.08 (by FY2014). Recently, the GoB has decided to disburse a total of Tk. 1,000 crore to meet BJMC's dues with its workers which include Tk. 275 crore for gratuity, Tk. 300 crore for provident fund and workers' salaries for eight months' worth Tk. 48 crore and the rest towards other activities. In business as usual case, expenses related to gratuity and provident fund are supposed to be adjusted in a 'built-in' manner which either was not the case here or the accumulated reserves were used for other purposes which should not have been the case. It is not clear whether dues with jute growers and jute traders will be adjusted from this additional budget. There is no denying that workers should not be penalised for bad policies and their dues have to be given. However, there is a need for transparency in the manner BJMC works and about its accounting and management practices. BJMC should present a detailed financial account including the assets and liabilities it has, its debts and dues and its accounting practices. This is needed for a better understanding about its work and financial position. Likewise, other SoEs should also disclose their financial accounts and management practices in a transparent manner. Taxpayers' money help run the SoEs and they have a right to know how their money is spent and whether it is well spent.

b) Transparency in government's asset acquisition

Each year the government allocates a significant amount of resources for non-development, capital expenditure which includes acquisition of assets and works and investments in shares and equities. According to the budget statement of FY2016, this expenditure has almost doubled over the most recent two years – from Tk. 10,441 crore in FY2014 (actual) to Tk. 19,988 crore in FY2016 (budget) (Table 10). While the rise in such expenses is well understood in a growing economy like Bangladesh, the quality of the capital expenditure remains questionable. For example, government has spent about Tk. 14,477 crore for investment for recapitalisation of nationalised commercial banks over a period of three years with a view to help the NCBs meet respective capital shortfalls. Given the persistent weakness in the governance of the NCBs along with operational weaknesses, this type of periodic rescue will hardly address the root causes. Rather, it helps sustain the anomalies and inefficiencies. There is an urgent need to examine the underlying causes in an in-depth manner. It may be recalled in this connection that CPD has been persistently arguing for setting up a Financial Sector Commission with a view to addressing the emergent challanges.

Table 10: Non-development capital expenditure (Crore Tk.)

Sources of expenditure	Actual FY14	Budget FY15	Revised FY15	Budget FY16
Acquisition of Assets and works	***5,607***	***7,025***	***8,231.00***	***8,038***
Acquisition of Assets	3,857	5,763	6,456	6,683
Acquisition of Lands	487	144	193	158
Construction and works	1,263	1,118	1,582	1,197
Investments in Shares and Equities	***4,834***	***18,985***	***13,797***	***11,950***
Share Capital	57	11,160	7,472	5,025
Equity Investment	300	2,800	1,300	1,900
Investment for Recapitalisation	4,477	5,000	5,000	5,000
Others	-	25.00	25	25
Total -Non-Development Capital Expenditure	10,441	26,010	22,028	19,988

Source: Ministry of Finance (MoF), GoB

c) Transparency in defence budget

The reporting mechanism concerning the defence spending in Bangladesh is highly non-transparent – it does not even provide aggregated budgetary figures as regards the allocations for defence spending (e.g. spending on arms and ammunition, soldiers' pay, etc). Analysis of defence budget during FY2009-FY2015 reveals that revised budget has always been higher than the budgetary allocations for the respective year (Table 11). Except for two fiscal years, the actual spending is also higher than the revised budget. Thus, for the last six fiscal years (FY2009-FY2015) actual spending on defence is found to be significantly larger than the budgetary allocation of the respective year. In FY2014, there has been a significant increase in the actual spending as compared to the budgetary allocation, by about Tk. 4,000 crore. In the same fiscal year, the share of defence spending in total government expenditure increased from 7.1 per cent of budgetary allocation to 10.3 per cent in real terms. Rise in expenditure is mainly attributed to significant jump in non-development expenditure which outweighed the reduced development expenditure in each successive years. This pattern of defence spending indicates better capacity in utilising the budget by concerned bodies. However, questions about allocative efficiency remain a concern at a time social sectors are failing to meet the targets for lack of resources. Indeed, a number of sectors experienced same or almost similar trend in case of budget spending including public order and safety (same), recreation, culture and religious affairs (partly same) and agriculture, fisheries and livestock (partly same). In this backdrop, more transparency in the defence budget will be helpful in bringing more transparency in overall budgetary transparency and predictability. Apart from this, a number corporate activities are in operation mainly through the Army Welfare Trust and the Sena Kalyan Sangstha with a view to support the families of the armed forces. The legal entity of these corporations and other related activities need to be better clarified, and in case these entities are legally linked with the Armed forces, their financial accounts should be presented transparently in the national budgetary process. All these will help bring transparency and accountability in overall budgetary process in Bangladesh and will hopefully lead to better allocation and allocative efficiency of resources.

Table 11: Trend in defence spending in Bangladesh (Crore Tk.)

FY	Allocation/Disbursement			Difference		
	Budget	Revised Budget	Actual	Revised - Original	Actual - Revised	Actual - Original
2009	6644.9	6885.5	6251.5	+240.6	-634.0	-393.4
2010	7051.4	7875.1	8471.6	+823.7	+596.5	+1420.2
2011	9175.6	9319.5	10222.4	+143.9	+902.9	+1046.8
2012	11246.8	12212.7	12218.4	+965.9	+5.7	+971.6
2013	12886.1	13502.6	12988.4	+616.5	-514.2	+102.3
2014	14457.1	15180	18330.8	+722.9	+3150.8	+3873.7
2015	16462.1	17770.1	17484.6	+1308.0	-285.5	+1022.5

Source: Author's calculation based on Ministry of Finance (MoF) data.

d) Transparency in local government financing

Absence of detailed information as regards financing of the local government institutions (LGIs), lack of consistent pattern in central government transfers to the local government (LG), and the non-transparent way as to how resources should be allocated among the different LG departments are some of the key challenges that were identified in research works related to LG finance. In addition to poor financial management and the fiscal stress, LGs have also been criticised for weak accountability mechanism and lack of transparency (Bhattacharya *et al*., 2013). To deal with the above mentioned challenges, three recommendations have been proposed: a) a *separate budget for Local Government* to reflect the local needs and demands. For instance, India prepares separate budget for the railway; b) proper clarification as regards the much hyped fate of d*istrict budgets* is needed as it appears to have been dropped. Introduction of the district budget was a good move and is important to address regional disparity in resource allocation and strengthen empowerment of district administration; and c) establishment of a *permanent 'Local Government Finance Commission (LGFC)'* to ensure proper devolution of power, appropriate financing for LG and to make these self-sufficient.[45] Such a commission may be constituted as an autonomous body. The commission may be mandated to advise the government as regards budgetary allocation of LGs, central government transfer/special grants to the LGIs, potential sources of revenue, appropriate tax levels to be levied by LG, resolution of disputes between LGs over financial matters and tenders, overseeing of auditing, financial management and accountability and monitoring of overall performance, citizens' participation, implementation of the Local Economic Development (LED)[46] and financing aspects for SDG implementation at the local level.

e) Transparency of NGO financing

The NGO sector in Bangladesh deals with significant resources. These resources are deployed in a host of activities which have developmental consequences for the country. However, these activities and the involved resources are not properly reflected in the national budget. A major

[45]This type of LGFC is found in Uganda (operational since February 1995), and recently an independent Commission on Local Government Finance has also been established in England in 2014 to examine the system of funding of the local government in England.

[46]Bangladesh is a signatory of the document promoted by the Commonwealth Local Government Forum (CLGF)

share of the finances to the NGO sector is allocated from foreign aid. Since FY2009, proportion of aid disbursed through the non-government sector has increased significantly. The latest figures show a fall in allocation in absolute figure but a rise in share. For instance, the proportion of total official assistance going to non-government sector rose from 20 per cent in FY2015 to 26 per cent in FY2016. On the other hand, project-level finance released through the NGOs as a proportion of GDP as well as the fiscal budget has been declining since FY2013 (see Annex Table 4). The contribution of NGOs activities in some sectors (in terms of non-government aid allocation vis-à-vis total public expenditure) is quite significant – these include labour and employment, health and nutrition and agriculture (Table 12). Previous budget analyses carried out by the CPD have pointed out lower budgetary allocation for women and child affairs, primary and mass education and health and family welfare, from FY2012 to FY2016. Despite this, significant achievement in a number of social sectors such as reducing under-five mortality and infant mortality, improving enrollment in primary education and reducing the proportion of population living below the national upper poverty line, etc. have indeed been possible, thanks to significant contribution made by the NGOs in respective areas (GED, 2015c). It is reckoned that, reflecting NGO allocation and activities in the budget will provide a more comprehensive picture as to the overall development plan of the country. MoF, with the support of NGO Affairs Bureau, could develop a suitable format for reporting NGOs' activities in the national budget.

Table 12: Contribution of NGOs in different sector (non-government. aid allocation as % of total allocation)

Sector	FY11	FY12	FY13	FY14	FY15	FY16
Agriculture	0.66	1.59	1.10	4.81	8.36	1.39
Health, Nutrition, Population and Family Welfare	0.31	1.33	2.81	8.64	4.56	3.62
Industries	0.00	0.00	7.63	5.21	3.17	-
Labour and Employment	1.75	3.05	26.64	27.38	12.71	-
Power, oil gas	0.00	0.00	0.00	0.02	0.05	0.07
Public Administration	0.11	0.12	0.12	2.56	0.33	0.22
Rural Development and Rural Institutions	0.05	0.72	0.92	5.70	2.02	0.96
Transport	0.00	0.00	0.00	0.00	0.03	0.00

Source: Based on ERD data.

f) Transparency in South-South transactions: Case of Indian LOC

The importance of South-South Cooperation as a complementary source of finance is getting increasing recognition, and also gaining growing importance in many developing countries. This is more so in the backdrop of declining net official development assistance (ODA) from the 'traditional' providers of the North (Development Initiatives, 2016). In recent times, Bangladesh has signed two Memorandums of Understanding (MoUs), for two bilateral dollar credit lines with India, one in 2010 and the other in 2015.

As is known, South–South development finance often face the challenge of lack of a guiding framework within which these transfers take place. Development organisations from the North such as Japan International Cooperation Agency (JICA), Korean International Cooperation Agency (KOICA), World Bank and Asian Development Bank (ADB) generally operate within their clearly defined institutional and operational rules. In case of Southern financing projects such guiding principles and rules are often absent. Bilateral finance, like the one from India, is at first negotiated by the ERD under the MoF; however, implementation and project-wise allocation is made directly with the concerned ministries under which the selected projects are to be implemented. The finance, in this case, is transferred from one ministry to another without any central authority supervising it. Consequently no clearly defined central reporting takes place and the transactions are made on an ad hoc basis. For example, JICA and KOICA directly deal with Economic Relations Division ERD to provide funds centrally. On the other hand, Indian Export-Import (EXIM) Bank will provide funds from the USD 1 billion LoC directly to the project ministries or the contractors according to the allocation decided from the development project proposal (DPP) and technical project proposal (TPP). In this context, there is a concern as regards consistency and quality assurance of the projects undertaken with the funds as there is no binding rules and regulations guiding the financial flows. Also, it is very difficult to carry out economic analysis because feasibility studies, which include analysis of the environmental impact of these projects, and also the monitoring reports, are not shared with the concerned policymakers and stakeholders. This also impedes the ability to make suggestions vis-à-vis the economic and social implications of projects under bilateral South-South credit as opposed to those under North-South finance.

In this backdrop it is suggested that the DPP and TPP of the projects financed by the LoC be made available to the policymakers and other stakeholders to enable adequate analysis of the economic impact of the LoC deals. Also the quarterly monitoring and evaluation reports should be prepared. These will help monitor implementation status of the projects, calculate the rate of return on investment and assess the socio-economic impacts of the project. In order to maintain such reporting and information, there is a need to set up a central reporting system. Clearly defined operational rules and regulations should be formulated. These will also help address the issues of 'tied aid' and 'untying of aid' which have been a concern in the context of Indian LoC, particularly as regards local procurement to be made from the credit. These steps will enhance transparency and accountability in projects under South-South cooperation.

B. Economic reforms

Economic reforms in the present analysis highlights a number of areas. These include: a) enforcement of Public Service Act 2015; b) commission for financial sector reform; c) setting up of other commissions; d) enforcement of 'financial reporting act'; e) Enactment New/Amended Laws, Rules and Acts; f) operational reform; and g) organisational reform.

a) Enforcement of Public Service Act 2015

The Public Service Act has been under consideration for quite some time now. Enforcement of the Public Service Act will hopefully improve management and operation of public offices as it puts talks of undertaking a number of special focus on administrative reforms. The Act recommends separate rules for examination for promotion, performance appraisal, career training and skill development, privileges, incentives and preservation of quota for disabled persons and backward communities. It is felt that, there should be clear guidelines in a number of areas including establishment of proper mechanism for performance appraisal (designing evidence-based rules for performance appraisal) and digitalisation of public service provisions (providing good practice-based rules on digitalisation of public service provisions). There should be proposals for reorganisation and rationalisation of public offices, reorganisation of cadre services and reconstitution of Senior Service Pool (SSP), etc. It is hoped that the national parliament will carry out an in-depth review of the Public Service Act and the Act will be verified soon.

b) Commission for Financial Sector Reform

In the recent past, a number of financial scams, particularly concerning the NCBs, have exposed major weaknesses in the banking sector. These include poor decision-making and supervisory capacity, weak risk management system, and also failure of the central bank to carry out due diligence and undertake its supervisory tasks (CPD, 2012). Rising Non-Performing loan (NPL), quality of outstanding loans and declining profitability are also concerns. Some of the non-NCBs are also not immune to such maladies. They way licenses for new banks are issued have also given rise to questions. The overall health of the financial sector has emerged as an area of increasing disquiet.

The recent heist of USD 101 million from the central bank from its foreign currency reserve account in US Federal Reserve through cyber-hacking, is one of the most crucial events that are of concern to the governance in the banking sector. ATM fraud has added a new dimension to financial sector governance in Bangladesh. Preceding this it was the stealing of money by cloning ATM cards from private local banks. According to a Bangladesh Institute of Bank Management (BIBM) study, average spending by Bangladesh Bank's commercial banks for cyber security is significantly lower when compared to the needed level.

In this backdrop the CPD has proposed setting up an Independent Financial Sector Reform Commission (IFSRC) which will undertake an in-depth review and assessment of the health and performance of the financial sector of Bangladesh. The Commission will assess the needs of customers and the economy, identify the weakness, review governance structure, security system, incentives, and risk management system; it will provide guidelines to deal with NPL and recapitalisation of banks, rescheduling of bad debt. The non-bank financial institutions (NBFIs) could also be included within the remit of Commission's scrutiny, including insurance companies and capital market. The Commission will prepare guidelines and make recommendations as regards reforms needed, automation, risk-management, real-time scrutiny, checks and balances, in-built good governance mechanisms, internal control, role of various players in banks and other financial institutions. In view of the recent heist, the Commission may also be entasked with the responsibility of coming up with recommendations to improve cyber-security, good governance, efficiency and operations of the central bank.

c) Setting up other commissions

A number of independent commissions need to be set up in order ensure better transparency in economic governance. These could include an independent statistical commission to validate the macroeconomic correlates and an independent public expenditure review commission.

d) Enforcement of Financial Reporting Act

Financial Reporting Act could be a major vehicle towards ensuring greater transparency in financial reportings made by commercial/business entities in the country. As it stands, after the Act was passed by the Parliament no visible progress has been made as regards the follow up activities that were needed. Steps should be taken, with proper timelines, for setting up the envisaged Financial Reporting Council. Besides, it is important to fix the financial reporting and auditing standards in order to implement the Act properly.

e) Enactment of new/amended laws, rules and acts

A number of investment, commerce and business-related policies need to be amended and updated in order to make them functional, modern and effective in the current and future contexts. These include Customs Act 1969, Foreign Private Investment (Promotion and Protection) Act 1980, Companies Act 1994, Trade Mark Act 1940, Mine Act, 1923, Port Act, 1908, Export and Import Control Act 1950, Patent and Design Act, 1921, Inland Shipping Act, 1976, Weight and Measurement Act, 1961, and Acquisition and Requisition of Immovable Properties Act, 1982. Besides a number of new laws/acts are required in order to make businesses more functional and efficient; some of these are Business Organization Act, Anti-Dumping and Countervailing Act, etc.

A number of rules and regulations related to various laws and acts need to be upgraded/amended/added. These include rules for Investment Act, Port rules, PSI Order 2000, Import, Export and Indentors' Registration Order 1979, Patent and Design rules, Pre-shipment Inspection Order 2000 and Import, Export and Indentors' Registration Order 1979. A number of new policies need to be adopted in order to facilitate private investment in manufacturing and related service sectors; these include Coal Policy and Shipping Policy.

f) Operational reforms

Entrepreneurs often suffer from lack of clarity concerning the various rules and regulations. New investors, particularly the SME entrepreneurs, are not aware of the different procedural requirements in order to carry on their respective businesses. Given the differences in the business processes, authorised public domains should be put in place where necessary documents and related formalities, procedures and processes would be available on the website. Lack of clarity as regards business processes also discourages foreign investors. Anecdotal information indicates that foreign investors get better guidance from publicly available documents in India regarding investment opportunity, modalities for registration and process of approval from different public entities despite the fact that investment regime in India is more stringent compared to that in Bangladesh. Clearly spelt out public documents as regards business processes should be made easily available (preferably on dedicated website) so that investors have a sound understanding about the entire range of business processes.

There is a large gap between adopted policies/rules/regulations and their implementation at the business level. For example, a number of incentives and support measures have been announced under the Industrial Policy 2012, Export Policy 2015 and SME Policy Framework 2005, for different categories of sectors/industries that include 'booster sectors', 'thrust sectors' and 'high-priority' sector, etc. However, procedures, eligibility and documentation to avail of those incentives have not been spelt out in a clear and transparent manner. Neither are these readily available. Since these incentives are mentioned in the policies but not in acts/laws, there is no binding requirement either to provide these services to the entrepreneurs. Unless these incentives are included in the finance bill, there is no guarantee that investors will actually get those benefits. Also, there should be greater coherence as regards policies and measures put in place by different ministries and departments. Besides, proper implementation of different rules/regulations/policies should receive due priority from the relevant public institutions.[47]

Foreign investors often face problems both at pre- and post-establishment phases of investment. Although, in a formal sense foreign investors are welcome to invest in Bangladesh in any sector without limit (except for the few 'reserved' sectors), functionally they are confronted with a variety of 'hidden' barriers. Cases of non-cooperation from various related agencies and institutions are not unknown. This contradicts with the stated policies pursued by, and Acts enacted in, Bangladesh. Foreign investors often do not have access to industry-related information such as market size, major market players and their market shares, major risks, sources of raw materials, and information on major suppliers in the supply chain, market access conditions, etc. Easier access to and availability of all related information concerning the different sectors are needed to enhance the ease of doing business in Bangladesh.

g) Organisational reforms

Organisational reforms are urgent to raise efficacy of public institutions, particularly in view of the changing nature of demands for public services in a fast-changing world. For example, a number of organizations under various Ministries act as facilitators for private investment; these include Bangladesh Investment Development Authority (BIDA) (previously Board of Investment (BOI)), Bangladesh Export Processing Zone Authority (BEPZA), Bangladesh Small and Cottage Industries Corporation (BSCIC), Bangladesh Economic Zone Authority (BEZA) and different local authorities. Given that the nature of work is similar, there is a need for clear division of focus and labour of these institutions; at the same time there is a need for greater coordination among those.

The Ministry of Industry needs to revisit and then refocus its overall objectives and activities. Despite the fact that the Ministry is supposed to play a key role in the context of Bangladesh's industrialisation, till date its role has only been a limited one. The Ministry should be developed as the focal point for pursuing the cause of industrialisation in Bangladesh and its activities ought to cover all types of industries (both domestic market-oriented and export-oriented). It should act as a repository of industry-related information, providing technical support and ensuring business facilitation. Strengthening of the associate institutes including National Productivity Organization (NPO), Patent, Design and Trade Mark Division, Bangladesh Institute of Management (BIM) and Bangladesh Standard and Testing Institution (BSTI) is also of critical importance if the Ministry is to play its desired role.

Government should conduct a serious rethink about the future of the loss-making SoEs. As is known, these are managed under the Ministry of Industry and Ministry of Jute and Textiles. There is scope for further rationalisation of the operation of some of the SoEs. Independent studies should be carried out to examine the various options in this regard. Government should also design an appropriate policy to lease out land of the SoEs to the private sector for establishment of new enterprises. At present, this is often being done on an ad hoc basis, in a non-transparent manner.

[47]Anecdotal information indicates that individual entrepreneurs tend to encounter difficulties at the micro-level when their business cases are dealt by designated desk officers.

There is a need for more interaction between the public and the private sector; at present this is done only on a limited scale. A 'Private Sector Development Policy Coordination Committee (PSDPCC)' was constituted in 2013 under the office of the Prime Minister; however, scope of work of this Committee appears to be limited. In order to better facilitate the workings of the private sector, it is important to set up a Commission to identify institutional bottlenecks both at macro and micro levels. The Commission will come up with concrete suggestions for respective ministries and departments to undertake necessary measures in a time-bound manner. These recommendations could include both laws and regulations as also operational tools and modalities, documentation and procedures. For a continuing interface and interaction between private sector and policymakers, institutional arrangement such as the Better Business Forum set up by the Caretaker Government (CTG) in 2007 can also be considered.

SECTION IV. CONCLUDING REMARKS

The budget framework for FY2017 has to be more robust in comparison to that of the earlier years, particularly by setting the targets based on more realistic revised budget figures of the elapsing year. Further, for making the budget more realistic, one has to either forgo the ambition of attaining high revenue collection and public expenditure targets or give due attention to the task of enhancing administrative capacity and undertake implementation of the reform agendas for realisiing moderately ambitious targets.

While a country such as Bangladesh needs more public expenditure (as percentage of GDP), it is only to be expected that the country will make stronger efforts not only in financial resource mobilisation, but also in appropriate utilisation of the mobilised resources from both domestic and external sources. Reclaiming the momentum of domestic revenue collection – particularly under the income tax head – will be critical in this respect. Operationalisation of the new VAT Act would need a number of preparatory measures including those in the area of capacity development on the part of concerned institutions as well as the business. As regards external financial, enhanced utilisation of foreign aid in the pipeline would make the critical difference in ADP implementation. It goes without saying that tax evasion and leakages through illicit financial outflow have to also get priority in the ensuing budget. Taking advantage of the expended fiscal space triggered by reduction in subsidy demands, self-financed allocation may be increased in human development sectors as well as towards promoting social protection schemes. Indeed, such an expansionary move is supposed to alleviate domestic demand depression. It is quite disappointing that the government has secularly failed to make good use of the available fiscal space which has by default resulted in a below programme budget deficit.

Efforts to mobilise more financial resources to service the expenditure targets have to be underpinned by measures geared towards institutional reforms. These measures should include, among others, expansion of the tax base, introduction of a Benami Property Bill, changes in tax procedures for exporters, greater use of ICT-based tax compliance, operationalisation of Transfer Pricing Cell and expanded use of ADR.

There should be a proper institutional set-up to assess the impact and implications of the various fiscal measures in terms of ERP, foregone tax revenues, benefits expected and justification for the duration for which such incentives were to be offered in the national budgets.

Possibility of mobilisation of more domestic revenue in FY2017 will be closely related to the possibility of the capacity to improve both the quantity and quality of public expenditure. In this connection, strengthening of the monitoring and evaluation (M&E) system of the IMED will be of defining importance. Indeed, one has to make a decisive move from financial disbursement based project assessment method to results-based assessment. This new approach needs to be introduced in tandem with putting in place a prioritised monitoring mechanism for the foreign aid projects which will also be crucial for improving the performance of the ADP.

A separate but integrated budget for LGIs may also provide a strong impetus towards improving the opportunities for higher domestic resource mobilisation as well as the possibility of improved demand-driven public investments. Evidently, one is still awaiting to know why the district budget initiative was so unceremoniously discontinued in FY2016. It is strongly reckoned that establishment of a permanent Local Government (Finance) Commission may effectively contribute towards devolution of power and introduction of appropriate financing modalities and help to ensure that public expenditure has greater impact at grassroots levels.

It will not be an overstatement to observe that the banking sector and the financial market are currently least prepared to provide the necessary support towards implementation of the contemplated budgetary measures as well as to boost private investment. Indeed, it is high time that we setup a high-powered Financial Reforms Committee (Commission) to provide an objective and in-depth assessment of the current health of the banking sector as well as non-banking financial markets and recommend measures to address the attendant problems and for enhancing performance of financial institutions. It will be also important to fix financial reporting and auditing standards in order to properly implement the Financial Reporting Act.

In the same vein, it has become imperative to finalise and put in action the much overdue Public Service Act. Similarly, in the backdrop of ongoing debate as regards GDP growth figures the rational for setting up an independent National Statistics Review Committee has become all the more stronger.

It should be emphasised that substantive success of the national budget for FY2017 will be defined not so much through its allocative gestures, but through reform measures it will recommend (and implement) in different areas of budgetary process. One such set of reform measures will entail bringing more transparency to this process. Such measures should include the followings:

- Presentation of detailed financial accounts of the SoEs including their assets and liabilities, contingent debts and dues, and accounting practices;
- Full disclosure of the details of projects financed from external sources through foreign LoCs of different non-concessional loans;
- More sunshine on defence economy covering budgetary and off-budget allocations and spending as well utilisation of income from quasi-commercial sources;
- Linkages of NGO finances with government spending in different sectors as per the approvals provided by the NGO Affairs Bureau.

Finally, it may be pointed out that notwithstanding the immediate benefits gained from the fall in fuel price, the evolving global economic environment may not remain supportive for Bangladesh economy which is being increasingly integrated with the international supply chains. Thus, the upcoming budget should have some built-in safeguards in its implementation strategy which may be triggered in case of adverse impact emanating from the global economy.

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ANNEXURE

Annex Table 1: Recent changes in export incentives

Export items	Old rates (%)	New/revised rates (%)[1]	Previous circular dates	New circular dates
Revisions in cash incentives				
Leather Goods	12.50	15.00	13 July 2015	4 April 2016
Jute Goods	10.00	10.00	13 July 2015	7 April 2016
Textile	4.00	6.00	13 July 2015	4 April 2016
Shrimp[2]	3.79	4.98	3 June 2003	4 April 2016
Other fish[2]	1.10	1.97	12 December 2002	4 April 2016
New cash subsidies				
Furniture		15.00		11 April 2016
Plastic Products		10.00		11 April 2016
Potato Starch		20.00		4 April 2016

Source: Compiled from Bangladesh Bank Circulars.
Note: 1/ All new and revised rates are retrospectively effective from 1 July, 2015.
2/ Celling for maximum f.o.b value in USD per lb.

Annex Table 2: Projects that are not 100% physically completed but declared as completed

FY	Total completed projects	No. of projects with 100% physical progress	No. of projects that are not 100% physically completed but declared as completed	% of total completed projects
FY01	162	96	66	40.7
FY02	162	87	75	46.3
FY03	169	73	96	56.8
FY04	232	25	207	89.2
FY05	164	38	126	76.8
FY06	225	93	132	58.7
FY07	181	65	116	64.1
FY08	239	112	127	53.1
FY09	173	50	123	71.1
FY10	195	42	153	78.5
FY11	257	55	202	78.6
FY12	199	44	155	77.9
FY13	206	57	149	72.3
FY14	233	52	181	77.7
FY15	240	119	121	50.4

Source: Author's compilation from the Implementation Monitoring and Evaluation Division (IMED) data.

Annex Table 3: Status of PCR submission and impact evaluation

FY	Number of completed projects	PCR submitted	PCR not submitted	% of total completed projects	Impact evaluation
FY12	Not available	Not available	Not available	Not available	10
FY13	206	134	72	65.0	22
FY14	233	141	92	60.5	14
FY15	240	141	99	58.8	15

Source: Author's compilation from the Implementation Monitoring and Evaluation Division (IMED) data.

Annex Table 4: Share of ODA disbursed through the non-government sector

Year	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Total aid disbursement (USD Million)	38.77	108.05	149.16	238.70	629.38	4270.71	3580.76	1677.50
Total allocation to non-Govt. sector (USD Million)	7.79	34.42	31.26	86.26	262.05	1142.06	719.69	439.65
As a % of total aid disbursement	20.09	31.86	20.96	36.14	41.64	26.74	20.10	26.21

Source: Aid information Management System (AIMS), Economic Relations Division.