Independent Review of Bangladesh's Development

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

National Budget FY2017-18

Post-Approval Observations

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CENTRE FOR POLICY DIALOGUE

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Recalling the Fiscal Framework

- **Revenue** (31.8% against trend growth rate of 15.3%) projected to grow **faster** (to collect additional Tk. 69,494 crore) than **public expenditure** (26.2% against trend growth rate of 14.7%) which will spend additional Tk. 83,092 crore
  - Total budget expenditure is set at 18.0% of GDP (16.2% in RBFY17)
  - Revenue income will be 13.0% of GDP (11.2% in RBFY17)
- **Development expenditure** (37.1%) also programmed to **grow faster** than non-development revenue expenditure (21.3%)
- **ADP**: 38.3% of total public expenditure (34.9% in the RBFY17)
- **Budget deficit** has been projected at **5.0%** of GDP (same in RBFY17, actual may be about 4.0% of GDP)
- High foreign financing target (80.5% growth over RBFY17) has been set with anticipated gross foreign aid flow of USD 7.6 billion (the highest in history – USD 3.5 billion in FY16)
  - CPD maintains that the budget framework is not robust enough

Major Highlights of the Proposed Fiscal Measures

- No notable change proposed for direct tax measures: Income Tax, Corporate Tax and Wealth Surcharge
- Existing provisions for legalising undisclosed income continued: real estate, Bangladesh Infrastructure Finance Fund and voluntary disclosure
- Higher excise duty on bank accounts and international airline tickets, which was later revised for bank accounts
- Implementation of the VAT and SD Act 2012 which was later postponed
- Finance Bill also focused on administrative improvements in the area of income tax collection

Implications of Fiscal Measures for Fiscal Framework

- Inability to implement the new VAT and SD Act will have serious consequences for fiscal framework, particularly for revenue mobilisation
- Three possible scenario –
    - *i. No significant impact on revenue mobilisation and public expenditure – the proposed fiscal framework will hold*
    - *ii. Revenue mobilisation will be significantly lower, but at the same time, public expenditure will also be lower enough to offset any possible impact on budget deficit– similar to the recent trend*
    - *iii. Revenue mobilisation will be significantly lower, but public expenditure will be close to the target – budget deficit will rise significantly and its financing mix has to be reworked*
- Realised scenario may be between (ii) and (iii), but close to (ii)

Three Objectives to be Considered

- Work Plan for implementing the budget for FY18 which needs to consider three objectives –
  - Maintain macroeconomic stability
  - Support private investment
  - Enhance employment impact of growth

Point of Departure

- Estimate possible shortfall from non-implementation of VAT and SD Act
- According to CPD estimates –
  - VAT and SD collection at the import stage should not be affected by any significant margin (around 1% less)
  - SD collection at the domestic stage would be enhanced with new measures
  - VAT collection at the domestic stage will be the most affected as truncated rates are continued (mostly services)
    - at the same time the exemption list was not expanded
- Besides VAT and SD, revenue generation from direct tax along with non-NBR sources, will be critical

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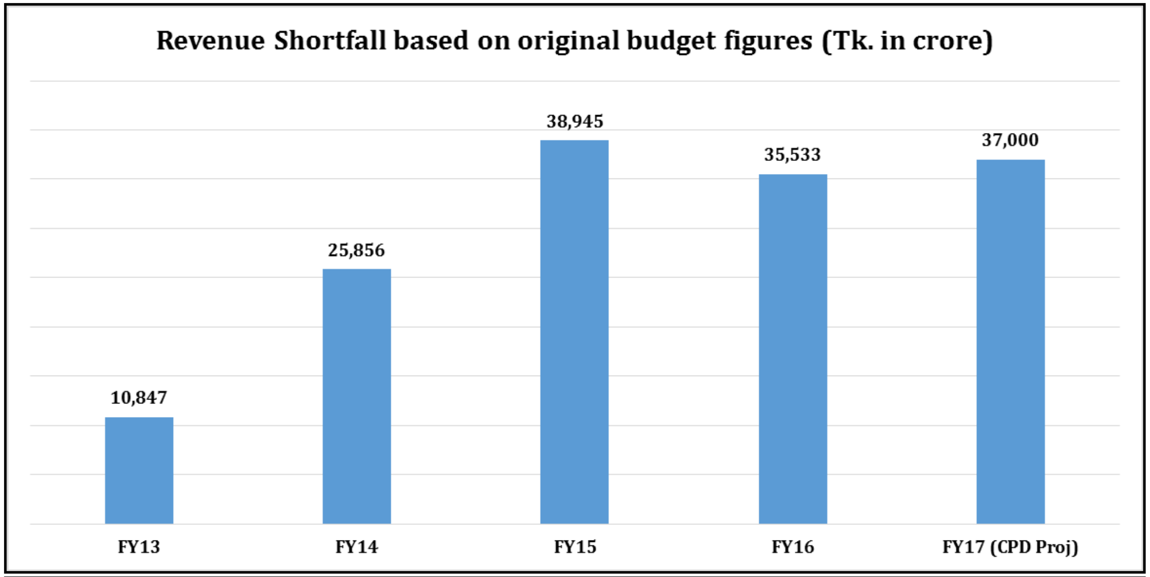
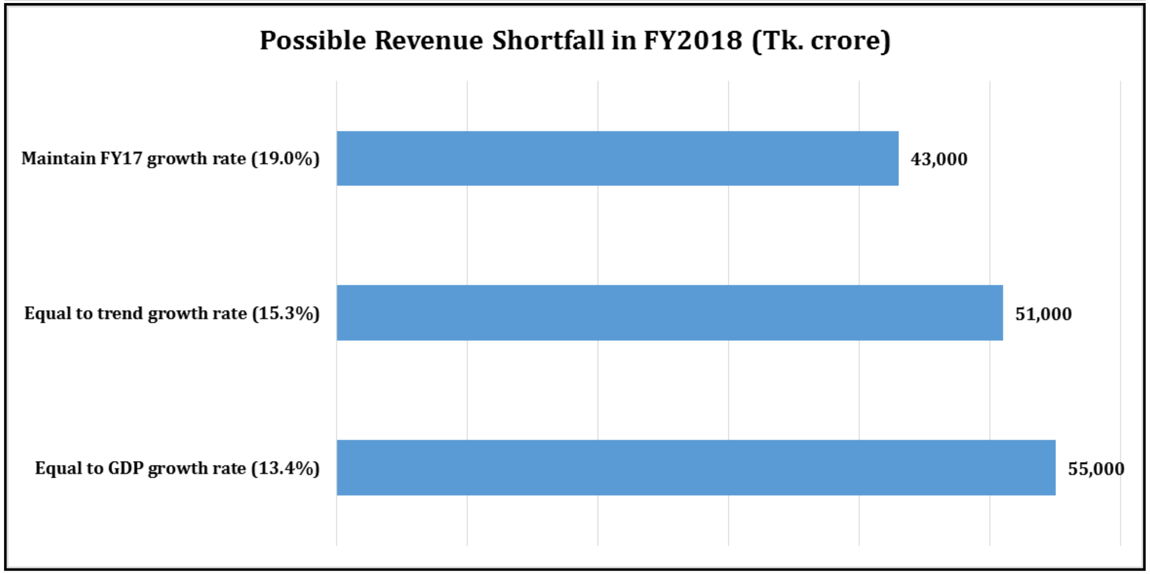
Overall Revenue Shortfall Estimates





- Possible revenue shortfall could be significant, but its extent will depend on ability to deliver public expenditure plan
- Nevertheless, the government will need to put utmost emphasis on mobilising resources from both NBR and non-NBR sources

Overall Fiscal Framework Estimates

Expenditure (Budget, Tk. in crore)	Expenditure (Better Scenario: Tk. 40,000 crore less with 90% of budget implementation)	Expenditure (Worse Scenario: Tk. 60,000 crore less with 85% of budget implementation, i.e. recent trend performance)
400,266	360,266	340,266
Revenue (Budget, Tk. in crore)	**Revenue (Worse Scenario: Tk. 55,000 crore less)**	**Revenue (Better Scenario: Tk. 43,000 crore less)**
287,990	232,990	244,990
Deficit (Budget, Tk. in crore)	**Changes in Deficit (Worse Scenario: Tk. in crore)**	**Changes in Deficit (Better Scenario: Tk. in crore)**
112,276	15,000	-17,000

- Impact on budget deficit may not be very significant
- Financing structure may be changed as foreign aid utilisation may be lower than target – more reliance on domestic sources, particularly non-bank borrowing (!)
- *Time to be vigilant, not to be complacent!*

Elements of the Work Plan

I. Maintain momentum of revenue mobilisation efforts

II. Reasonably restrain non-development expenditures

III. Prioritise certain development expenditures

IV. Discourage costlier borrowing

V. Be vigilant regarding disquieting macroeconomic developments

VI. Move on with reform agenda

Maintain Momentum of Revenue Mobilisation Efforts

- Emphasise implementation of VAT online projects including digitisation of VAT process and bringing in more businesses under the system
- Widening income tax base should be a top priority
  - Only 27.3% of all potential income taxpayers declared income tax in 2010 (based on HIES 2010 data)
  - Set target for bringing in new taxpayers by region and occupation
- Ensure geographically equitable access to tax instruments (beyond Dhaka and Chittagong)
- Provide adequate administrative resources in terms of human resource and infrastructure support to NBR
- Take more stringent measures to reduce illicit financial outflows and actions on revealed cases
- Expedite resolution of cases by taking recourse to the Alternative Dispute Resolution (ADR) system
- Avoid harassment for taxpayers

Maintain Momentum of Revenue Mobilisation Efforts

Non-NBR tax and non-tax sources will become important at the margin

- Sources of non-NBR tax (contributed about 3.2% of total revenue, last 5 years average): taxes on narcotics and liquor; land tax; vehicle tax; and stamps
- Sources of non-tax revenue (contributed about 14.9% of total revenue, last 5 years average): dividend and profit; post office and railways; and interest, fees and tolls
- Collection from non-tax sources remains volatile and unpredictable
- Emphasis on early and successful completion of 4G auction – any related dispute should be resolved at the earliest (Tk. 7.7 thousand crore has been envisaged)

Revenue shares (%)

Sources	FY12	FY13	FY14	FY15	FY16
NBR	80.5	80.2	79.1	84.9	84.6
Non-NBR	3.2	3.2	3.3	3.3	3.3
Non-tax	16.3	16.6	17.7	11.8	12.2
Total Revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Collection rate of various sources of revenue (as % of budget)

Sources	FY12	FY13	FY14	FY15	FY16
NBR	99.7	92.1	82.3	82.8	82.9
Non-NBR	92.8	90.3	89.9	86.5	96.1
Non-tax	82.1	93.5	95.4	62.1	80.4
Total Revenue	**96.1**	**92.2**	**84.6**	**79.8**	**83.0**

Reasonably Restrain Non-development Expenditures

- Non-development expenditure needs to be streamlined subject to availability of domestic resources
  - In FY18, total block allocation for repairs: Tk. 4,798 crore (Tk. 2,499 crore in BFY17)
    - Tk. 3,327 crore has been kept as block allocations (non-development budget)
    - Planning Division received allocation to the tune of Tk.1,066 crore as development assistance to different ministries on special ground
  - Tk. 10,145 crore allocation for Investments in Shares
  - Tk. 2,000 crore has been for Investment for Recapitalisation (for state-owned banks!)
- According to CPD estimates, of the total non-development budget, it may be possible to restrain from spending by about Tk. 25,000 crore (against block allocation, investment in shares and recapitalisation, pay of establishment, and subsidy and transfers)

Prioritise Certain Development Expenditures

- Priorities should be given to 689 carryover and concluding projects (467 and 222 respectively)

- A large part of this year's ADP allocation is given to 9 fast track projects
  - Total Allocation: Tk.30,929 crore for FY18
  - 20.2% of total ADP of FY18 (Tk. 18,727 crore and 16.9% in FY17)
- Except for Padma Bridge, the projects have not made considerable progress
  - Also, it would be difficult to complete the remaining works of Padma (main) Bridge including river training by December 2018
- Fast track projects have been unable to utilise allocated budget in the past (unutilised resources in RADP FY17 was Tk. 3,560 crore or 19% of allocation)

- Revise allocation based on reality!

Prioritise Certain Development Expenditures

- This year's ADP allocation has been biased towards large projects
- Top 25 projects (according to allocation) have received 41.5% of total allocation and 53.4% of total project aid allocation
- Implementation of these projects will determine the ADP financing needs in FY18 and foreign aid utilisation
- Top projects are:

  Rooppur Nuclear Power plant, Padma Rail Project, 4th Health Population and Nutrition Sector Development Programme, Padma Bridge, PEDP III, Dhaka Metro Rail, Dhaka Khulna (N8) highway, Matarbari 600MW Power Plant, Kanchpur, Meghna and Gumti 2nd Bridges Construction and Existing Bridges Rehabilitation Project, Village Electricity: 15 lakh customers, Multi-Lane Tunnel under the river Karnaphuli, Dohazari to Cox's Bazar via Ramu and Ramu to Gundum near Myanmar Dual Gauge, SASEC Road Link Project-11: Elenga-Hatikamrul-Rangpur Highway Four-Lane Upgradation, Important Rural Infrastructure Development Project 2, Information and Technology in Non-government Colleges

Prioritise Certain Development Expenditures

- ❑ Implement a number of reforms with a view to raising the ADP implementation rate
  - ➢ operationalising Project Preparatory Fund (PPF)
  - ➢ appointing project directors through direct interviews
  - ➢ assigning a dedicated official in each government agency for monitoring and evaluating respective projects
  - ➢ delisting the longstanding ‘non-operational’ projects from the ADP
  - ➢ discontinue projects with nominal allocations
- ❑ Prioritise implementation of projects with higher employment and private investment impact

Discourage Costlier Borrowing

- 94.0% of total foreign resources are for ADP projects; hence, utilisation of foreign resources for deficit financing is essentially tied with ADP implementation
- If revenue mobilisation falls short of the target and public spending remains strong, deficit financing needs to be catered by domestic borrowing
- To this end, the government needs to restrain borrowing from sale of NSD certificates
  - It may now be difficult for the government to reduce the interest rates, so purchase limits may be rationalised
  - Digitisation of the NSD sales data needs to be undertaken
  - Individual purchases need to be scrutinised
  - Submission of e-TIN may be made mandatory for higher purchases
  - Institutional purchases should be discouraged

Be Vigilant regarding Disquieting Macroeconomic Developments

- Prepare for possible external sector volatility
  - Import payments may continue to register stronger growth, particularly if the large infrastructure projects are implemented close to the planned manner
  - Outlooks for export and remittances are not promising
  - Much will depend on possible financial account surplus, i.e. utilisation of foreign aid and private inflow of finances
  - Pursue a rather careful and conservative approach towards Bangladeshi investors' plea to invest abroad
  - There may be a need for another round of BDT depreciation
- Maintain commodity price stability and plan for possible flood
  - Exempt import tariff for rice
  - Encourage rice import for another five-six months for enhancing public stock of rice (currently at 150 thousand MT)
  - Intensify PFDS in flood-affected areas
- Support SMEs
  - Encourage credit to SMEs
  - Project aid utilisation with SME linkages

Move on with Reform Agenda

- Reform agenda should not lose its way
- Take lessons from VAT and SD Act experience
  - Make independent assessment of possible economic and social impact of VAT and SD Act
  - Progress with the issues with consensus
  - List the disputed issues – seek for common grounds
  - Keep working on capacity-building and coverage-enhancing initiatives of VAT onlineproject
  - Build consensus among the economic, political and social stakeholders
- Progress in the technical areas of other reforms related to revenue mobilisation
  - Customs Act
  - Direct Tax Act
  - Transfer Pricing

Move on with Reform Agenda

- Initiate complementary institutional and policy reforms
  - Set up an Independent Financial Sector Reform Commission
  - Set up a Public Expenditure Review Commission (PERC) to ensure quality of public investments underwritten by scarce domestic revenue
  - Set up an Agriculture Price Commission to ensure incentivised price for the producers while maintaining market stability and protecting consumer interests
  - Setting up an Independent Statistical Commission to initiate necessary reforms in this area including validation of the macroeconomic correlates

Concluding Remarks

- The situation is manageable subject to certain adjustment measures
- Develop a work plan based on fresh assumptions and new circumstances
- The relevant Parliamentary Standing Committees may provide inputs towards preparation of the work plan
- A Cabinet Sub-Committee may scrutinise and endorse the work plan

Thank You