

# Promoting informed policy choices

### THE PROGRAMME

The Independent Review of Bangladesh's Development (IRBD), Centre for Policy Dialogue's flagship programme, is a comprehensive assessment of the country's economic development agenda prepared by a group of Bangladeshi experts. Launched in 1995, it is Bangladesh's first civil society initiative to analyse the trends in the economy linking economic policies to development efforts. IRBD attempts to provide voice to marginalised stakeholders.



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### **CPD's Recommendations for the National Budget FY2024-25**

### Second Reading

### **Key findings**

- 1. Weak revenue mobilisation, declining ADP implementation, inflation above 9 per cent, reduced overseas migration, and GDP growth of 1.81 per cent—all fell short of targets.
- 2. Overly optimistic FY2025 macroeconomic targets led to unrealistic budgetary goals disconnected from economic realities.
- 3. NBR formed a five-member Advisory Committee to propose reforms for the taxation system.
- 4. Rural areas experienced higher CPI inflation than urban ones for 18 of 23 months between April 2023 and February 2025.
- 5. The power and energy sector continued facing challenges, including unpaid import bills, loan repayments, supply disruptions, lack of domestic gas exploration, and rising consumer tariffs due to subsidy burdens.
- 6. High financing costs and economic pressures continue forcing SMEs to shut down, leading to job losses and limited loan access.
- 7. Health allocation in FY2025 was 5.20 per cent of the total budget and 0.74 per cent of GDP.
- 8. The FY2025 education budget was BDT 94,711 crore (1.69 per cent of GDP), but actual expenditures are typically lower than allocations.
- 9. Fiscal policies lack sufficient incentives and funding to support a green transition and sustainable production.

### **Key Policy Recommendations**

- 1. Restore macroeconomic stability by curbing high inflation, maintaining stable foreign exchange reserves, and enhancing fiscal space.
- 2. Set realistic fiscal targets for FY2026 by considering domestic and external economic conditions and learning from past experiences.
- 3. Initiate institutional reforms in the NBR by creating separate entities for revenue policy and administration to improve domestic resource mobilisation.
- 4. Expand cold storage facilities for agricultural products to establish a strategic buffer stock for price stabilisation.
- 5. Secure additional loan funding for BPDB and Petrobangla through consultations between MoPEMR and MoF to clear overdue payments to locally funded IPPs.
- 6. Reinstate the original VAT and tax eligibility thresholds by withdrawing the recent reductions to BDT 50 lakh for VAT and BDT 30 lakh for turnover tax.
- 7. Increase the health budget allocation in FY2026 to reduce out-of-pocket health expenditures and prevent poverty.
- 8. Expand the school feeding programme to cover all 9.3 million primary school students nationwide.
- 9. Provide VAT exemptions and incentive tariffs for renewable power plant equipment and impose a 1 per cent surcharge on goods produced through environmentally harmful means.

### INTRODUCTION

The national budget for FY2026 holds significant importance as the interim government is formulating it amid a challenging macroeconomic environment. The interim government inherited an economy characterised by subdued high inflation, revenue collection, sluggish budget implementation, a liquidity crunch in the banking sector, and declining foreign exchange reserves. The lower momentum in export earnings and remittance inflows has further exacerbated economic vulnerabilities.

Therefore, the FY2026 budget needs to address these pressing challenges through focused short-term measures whilst laying the foundation for medium-term reforms aimed at stabilising the economy and enhancing structural resilience.

In this context, the Centre for Policy Dialogue (CPD) has prepared a set of budgetary recommendations and fiscal measures to guide the upcoming budget for FY2026. These proposals focus on reinforcing macroeconomic stability, improving resource mobilisation, strengthening public finance management, improving social sectors such as health and education, addressing the financial situation of

the power and energy sector, overcoming environmental challenges, and supporting small and medium enterprises. The recommendations consider the current economic realities and propose pragmatic strategies to navigate the prevailing uncertainties whilst promoting medium to long-term economic sustainability.

### SNAPSHOT OF MACROECONOMIC CORRELATES

During the July-December period of FY2025, revenue mobilisation growth was subdued (4.4 per cent) (MoF, 2025). If this trend continues, the revenue shortfall could reach BDT 105,000 crore at the end of FY2025. Whilst overall budget utilisation increased during the aforementioned period, annual development programme (ADP) implementation declined. Sharp increases in domestic interest payments and expenditures owing to subsidies and incentives led to higher utilisation of the non-ADP budget. Borrowing from scheduled banks catered for most deficit financing during the first half of FY2025, affecting private sector credit growth and adding to the ballooning interest payment liabilities.



During the July-February period of FY2025, general inflation remained over 9 per cent at national, rural, and urban levels (BBS, 2025a). Food inflation in urban and rural areas was generally higher than non-food inflation. On average, inflation in rural areas was higher than in urban areas. The proposed hike in gas prices might deteriorate the situation.

Regarding export earnings and import payments growth, recovery from the earlier dismal scenario was observed. Remittance inflow exhibited an impressive 22.6 per cent growth during the first eight months of FY2025 (Bangladesh Bank, n.d.). However, overseas migration recorded a considerable decline. Significant improvements were observed in both cases regarding the balance of payments situation. Both foreign exchange reserves and the exchange rate of BDT against USD have stabilised.

During the July-September period of FY2025, estimated GDP growth was 1.81 per cent (BBS, 2025b). It needs to be mentioned that the annual GDP growth target for FY2025 was set at 6.75 per cent in the national budget. As reported in the media, this target will be adjusted downward to 5.25 per cent in the revised budget (Byron and Hasan, 2025). Whether this curtailed target can be achieved remains a question.

Given the current dynamics, the key macroeconomic management stance should be to restore macroeconomic stability by curbing the high inflationary rate, maintaining a stable foreign exchange reserve, and enhancing fiscal space.

### FORMULATING THE FY2026 BUDGET: CONSIDERATIONS AND ALIGNMENT WITH LDC GRADUATION

The upcoming FY2026 budget provides a unique opportunity for the interim government to break free from the formulaic mould, initiate short-term reforms and lay the foundation for medium-term reforms in public finance management. The design and fiscal targets of the FY2026 budget must be set realistically, drawing lessons from the previous years' experiences and considering the emergent macroeconomic scenario.

It must be ensured that the current austerity measures have minimal impact on the social safety net, the health and education sectors, agriculture, and SMEs. The ADP's infrastructure-heavy formulation must be reassessed to give the sectors involved in human capital formation due attention. Given the current foreign exchange reserve scenario, the government should prioritise implementing all foreign-funded ADP projects.

Receiving financing from foreign sources will be a significant challenge in FY2026. The government's fiscal space will be constrained if private sector borrowings are not to be squeezed out, given the commercial banks' liquidity situation and the government's decision not to borrow from the central bank.

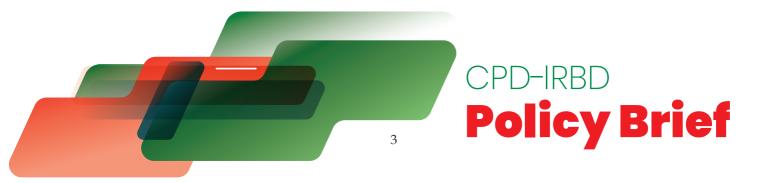
Supporting limited income, disadvantaged and vulnerable groups should be a primary priority of fiscal management in the days ahead. Given the prevailing high inflationary situation, the tax-free income threshold for personal income should be increased to BDT 4 lakh. The public expenditure framework also needs to address the issue of persistently high costs for necessities. Small farmers and households with low or limited incomes should receive special attention.

Given the upcoming graduation from the LDC group in November 2026, Bangladesh's tax policies must ensure compliance with the World Trade Organization (WTO) rules and obligations as applicable for (non-LDC) developing country members. The country's tariffs, customs duties and other charges must be reviewed, rationalised and aligned with the WTO obligations under various agreements.

### REFORMS OF THE NBR AND THE TAXATION SYSTEM

The Interim Government of Bangladesh has identified reform of the National Board of Revenue (NBR) and the taxation system as key priorities. This urgency is underpinned by Bangladesh's weak performance in domestic resource mobilisation (DRM), manifested in the lowest tax-GDP ratios in the world. Against this backdrop, an Advisory Committee was set up at the initiative of the NBR chairman, which was tasked to come up with proposals to restructure the tax system to make it more efficient given emergent policy needs, requirements of higher revenue mobilisation, and making the system fit for the purpose to deliver services effectively to the taxpayers (`Advisory panel formed to reform NBR', 2024). The Advisory Committee has submitted an interim report and is in the process of finalising it.

The proposal being considered is to separate the policymaking function and revenue collection function of the taxation system into two distinct entities. Two bodies are being proposed against this backdrop: the Revenue Policy and Administration Department. The idea is that taxation policy needs to be formulated by taking cognisance of not only what is the best from the vantage point of revenue mobilisation but also by ensuring that the system is aligned with tariff rationalisation and tax expenditure plans, trade and industrial policies, and macroeconomic development strategy of the country. The work of the Policy Department is to be carried out in such a manner that it is not hostage to the imperatives and priorities of revenue collection only. On the other hand, revenue administration should be geared towards mobilising domestic resources through effective measures and strategies aligned with the broad guidance provided by taxation policies.



However, it is argued in the section that whilst reforms are necessary, sufficient factors relate to operational measures deployed on the ground. In connection with this, digitalisation and modernisation of the country's taxation system are crucial. Actions and initiatives on both fronts will be necessary to significantly expand the DRM capacity and align the taxation system with the needs of the 21st century. Given this, a separate Digitalisation Wing has been proposed to be mandated to raise the efficacy of revenue mobilisation and facilitate tax payment through automation, digitalisation, and modernisation of the taxation system.

It has been suggested that changes need to be undertaken concerning some of the new Income Tax Act 2023 provisions to make the Act more taxpayer-friendly and actionable. In this context, changes in requirements associated with random auditing, frequency of submission of TDS (tax deducted at source) reports, and definition of 'Company' in the Act have been proposed. CPD is in favour of reviewing tax expenditure and understanding the rationalisation of tax in anticipation of Bangladesh's LDC graduation. Also, new avenues of taxation, particularly the importance of taxing the digital economy and the introduction of wealth tax and inheritance tax, are measures that the newly proposed revenue administration may like to consider.

### FISCAL POLICY FOR CONTROLLING INFLATION

Inflation has been a persistent challenge for Bangladesh, driven by demand-pull and cost-push factors. The interim government prioritised controlling inflation. By February 2025, it managed to reduce the point-to-point general Consumer Price Index (CPI) inflation to 9.32 per cent, with food and non-food inflation at 9.24 per cent and 9.38 per cent, respectively. However, rural areas experienced higher inflation than urban areas for 18 out of 23 months, exacerbating the vulnerability of low-income households. Social safety nets remain underfunded, with many programmes providing less than BDT 500 per beneficiary per month, highlighting the need for reform.

To address inflation, the government implemented measures such as distributing smart family cards for subsidised essential goods and reducing VAT on supermarket purchases. However, these efforts were only partially successful due to structural issues like reliance on indirect taxes, supply chain irregularities, and inadequate market monitoring. Fiscal policy recommendations include prioritising spending on critical sectors like healthcare, education, and agriculture whilst cutting non-essential expenditures to reduce aggregate demand. Strengthening the Competition Commission to monitor markets and enforce anti-trust laws is also crucial.

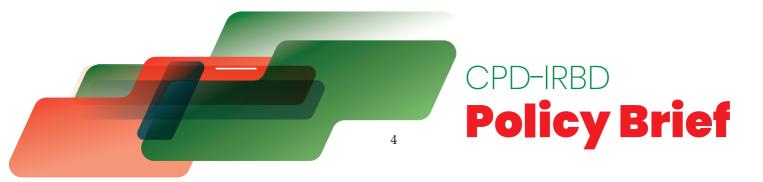
On the supply side, targeted subsidies, investment in agricultural infrastructure, and cold storage facilities can help stabilise prices. Expanding social safety nets, increasing minimum wages, and improving tax collection efficiency are essential to protect low-income households. Additionally, the government should address inefficiencies in social safety net programmes, improve targeting, and establish a unified monitoring framework to ensure effective resource allocation.

In conclusion, a balanced fiscal strategy combining demandside and supply-side measures is necessary to control inflation in Bangladesh. Prioritising critical investments, enhancing market oversight, and strengthening social protection programmes will be key to achieving economic stability and reducing the burden on vulnerable populations.

## BREAKING THE 'VICIOUS CYCLE' OF FINANCIAL CRUNCH OF THE POWER AND ENERGY SECTOR

The power and energy sector of Bangladesh is facing major challenges such as (a) continuous default of import bill payments; (b) repayment of the loans and dues of international companies; (c) disrupted gas and electricity supply; (e) lack of government motivation to explore domestic gas resources; and (f) huge subsidy burden which is passing on to the consumers through increasing power and energy tariff. The national budget for FY2025-26 is expected to propose specific fiscal and budgetary measures to address those challenges and ease the huge fiscal and financial burden passed on to the new regime. The budget should prioritise paying off outstanding dues and loans, taking measures to reduce maintaining subsidies on the power and energy sector, emphasising the exploration of domestic gas rather than importing LNG, reducing tariff barriers for importing renewable energy-related components, and withdrawing all types of discriminatory fiscal incentives/ benefits in favour of fossil-fuel based power generation.

As a short-term solution, the Ministry of Power, Energy and Mineral Resources (MoPEMR) should consult with the Ministry of Finance (MoF) to secure additional loan funding for the Bangladesh Power Development Board (BPDB) and Petrobangla to clear overdue payments to locally funded Independent Power Producers (IPPs). The MoPEMR and MoF should also discuss allocating necessary foreign exchange to clear overdue loans, bills, and charges to foreign-owned companies/foreign-funded projects. In this case, the MoF, especially the Economic Relations Division (ERD), could negotiate with the Multilateral Development Banks, including the IMF, World Bank and ADB, for necessary budget support. Equipment and components related to renewable energy supply chains, including generation, transmission and



distribution, where the Customs Duty (CD) should be reduced to 5 per cent, and taxes should be eliminated on all renewable energy goods. The NBR should impose a minimum of 5 per cent customs duty and a minimum surcharge on importing all the machinery and steel structures of fossil fuel-based power generation companies.

#### FISCAL MEASURES TARGETING SMEs

The small and medium enterprises (SMEs) in Bangladesh are facing high financing costs, with rising interest rates and economic pressures forcing many to shut down, leading to job losses. Access to specialised loan schemes remains difficult due to collateral issues, bureaucratic delays, and banks' reluctance. The recent lowering of VAT and turnover tax thresholds adds to their financial burden and may worsen their struggles. Structural challenges, including weak market regulation and unreliable electricity, may further hinder SME growth and competitiveness. To address these challenges, CPD proposes several fiscal measures for the upcoming FY2025-26 budget. Key recommendations include reinstating previous VAT and turnover tax thresholds, exempting SMEs from Advance Income Tax (AIT) and Advance VAT, strengthening the Competition Commission, and introducing energy subsidies for SMEs. Additionally, increasing the SME loan disbursement target, establishing guarantee funds for micro and small enterprises, and allocating adequate funds for implementing the SME Policy 2025 should be considered.

### FISCAL POLICY FOR PROTECTING PUBLIC HEALTH

The health sector in Bangladesh is severely underfunded, with only 5.20 per cent of the FY2025 budget allocated to health, representing 0.74 per cent of GDP (MoF, 2024a)—the lowest among 45 least developed countries (LDCs) in 2021 (The World Bank, 2025). Out-of-pocket health expenditures remain high at 73 per cent of total health spending, pushing many into poverty (The World Bank, 2025). There is a need for increased health funding, better resource utilisation, and reforms to address systemic issues like inadequate infrastructure, insufficient medical personnel, and poor governance.

Key recommendations include raising the health budget for FY2026 to reduce out-of-pocket expenses, implementing specific excise duties on tobacco products to curb consumption, and increasing taxes on sugary beverages to address public health risks like obesity and diabetes. Tax reforms are needed to support the pharmaceutical industry, particularly as Bangladesh transitions from LDC status, which will impact access to affordable medicines. Additionally, tax exemptions on sanitary napkins are necessary to improve menstrual hygiene

and affordability for women and girls. The July 2024 protests resulted in significant casualties and injuries. The government should allocate funds for medical support and rehabilitation for victims. Overall, there is a need for balanced budget allocation, effective monitoring of health initiatives, and fiscal measures to protect public health, reduce poverty, and achieve Sustainable Development Goal 3 (SDG 3) on health and well-being.

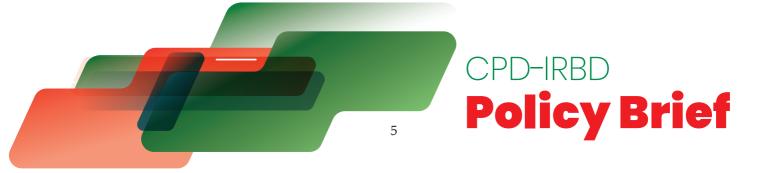
### FISCAL POLICY FOR INCENTIVISING EDUCATION

Bangladesh's education budget for FY2025 is BDT 94,711 crore (1.69 per cent of GDP), but actual expenditures are consistently lower, with FY2023 spending at BDT 62,079 crore (1.40 per cent of GDP) (MoF, 2024b). This places Bangladesh among the lowest spenders on education globally, ranking third lowest among least-developed countries (LDCs) (The World Bank, 2025). The budget primarily covers operational costs, leaving little for development, which hampers quality improvements. There is an urgent need for high-quality education, given Bangladesh's youth bulge and high youth unemployment (8 per cent) (BBS, 2024). Despite a 76 per cent literacy rate (MoF, 2024), the education system fails to equip students with essential skills, as evidenced by low computer literacy scores among graduates. The COVID-19 pandemic exacerbated these challenges, causing learning losses and disrupting school feeding programmes that benefit millions of children.

Key policy recommendations include expanding the school feeding programme to all primary students, introducing scholarships for those injured or disabled during the 2024 July Revolution, and increasing stipends for all education levels. CPD also suggests removing taxes on educationrelated expenses, such as VAT on English medium schools and imported books, to make education more affordable. Additionally, the government should reduce corporate income tax on private universities and invest in top universities to improve research and education quality. It is vital to increase the education budget to meet national targets (3.5 per cent of GDP by 2031) and address systemic issues like high dropout rates, teacher absenteeism, and inadequate resources. By implementing these measures, Bangladesh can harness its demographic dividend and improve educational outcomes, ultimately fostering economic growth and social development.

### FISCAL MEASURES FOR THE ENVIRONMENT

Bangladesh urgently needs to adopt green fiscal policies to address environmental challenges, including air and plastic pollution, and to transition towards a sustainable economy. The current fiscal policies are inadequate, with limited tax



incentives and green funds to support sustainable practices. Air pollution in Dhaka has significantly worsened, with 76 per cent of respondents in a CPD survey noting a decline in air quality over the past 2-3 years (Khatun et al., 2023). Plastic pollution remains a critical issue, with mismanaged waste contributing to environmental degradation and urban flooding. Fiscal policies need to be aligned with environmental goals, such as reducing greenhouse gas (GHG) emissions and promoting renewable energy. Bangladesh's Nationally Determined Contribution (NDC) aims to cut GHG emissions by 6.73 per cent by 2030, with a conditional target of 15.12 per cent if international support is provided (MoEFCC, 2021). However, the country lacks sufficient fiscal measures to support a green transition, only partially implementing VAT exemptions and green funds for renewable energy.

Policy recommendations include introducing VAT exemptions for all renewable energy equipment, imposing higher Advance Income Tax (AIT) on fossil fuel vehicles compared to electric and hybrid vehicles, and reinstating a 5 per cent supplementary duty on plastic bags. Additionally, the government should phase out fossil fuel subsidies, implement a formal feed-in tariff for renewable energy, and increase customs duties on plastic waste to encourage domestic recycling. Furthermore, there should be bilateral initiatives with India to reduce plastic waste in shared rivers and recommends imposing excise duties on single-use plastics. These measures aim to reduce air and plastic pollution, promote green energy, and align Bangladesh's fiscal policies with its environmental and climate goals. By adopting these recommendations, Bangladesh can move closer to achieving its sustainability targets and mitigating the adverse effects of climate change.

### **CONCLUSION**

The national budget for FY2026 is being formulated when Bangladesh faces formidable economic challenges, requiring decisive and well-calibrated policy measures. Restoring macroeconomic stability remains the foremost concern for policymakers. This requires targeted interventions to address inflationary pressures, stabilise the exchange rate, and ensure fiscal prudence. Given the current economic landscape, the budget must prioritise the protection of vulnerable and disadvantaged groups and economic recovery.

The FY2026 budget will probably be the only budget formulated by the current interim government under new leadership at the Ministry of Finance. In this context, the upcoming national budget presents a unique opportunity for the interim government to move beyond conventional approaches, implement short-term corrective measures, and establish the groundwork for medium-term reforms

in resource mobilisation, public finance management and expenditure efficiency. A crucial first step in this process would be the development of a credible and well-structured fiscal framework.

By taking a pragmatic and forward-looking approach, the government can not only navigate the current economic turbulence but also set the stage for a stronger and more stable economic future for Bangladesh. It is expected that the elected political government will take these measures forward.

#### POLICY RECOMMENDATIONS

#### Macroeconomic Correlates

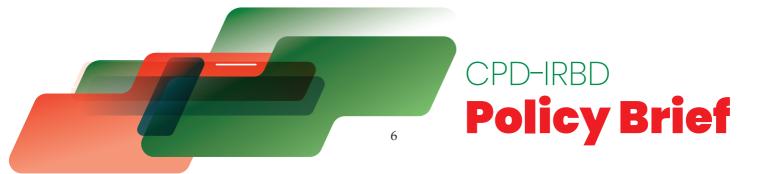
- The key macroeconomic management stance should be to restore macroeconomic stability by curbing high inflation rates, maintaining a stable foreign exchange reserve, and enhancing fiscal space.
- A balanced approach is required when financing the budget deficit, especially considering the impact on the private sector.
- Precautionary measures must be implemented considering the growing uncertainty in the global economy.

### Considerations and alignment with LDC graduation

- Set the design and fiscal targets of the upcoming FY2026 realistically, taking cognisance of both domestic and external economic scenarios and drawing lessons from previous years' experiences.
- In light of the current foreign exchange reserve scenario, prioritise implementing all ADP projects supported by foreign sources.
- To access the special and differential treatment accorded to developing countries after LDC graduation, tariff lines must be identified where customs duties and other charges exceed the respective bound duties which Bangladesh committed.

#### Reforms of NBR and the tax system

- Initiate institutional reforms of the NBR by putting in place two distinct entities, the Revenue Policy Department and the Revenue Administration Department, to separate policymaking and policy implementation functions concerning domestic resource mobilisation.
- To promote digitalisation, automation and modernisation of the taxation system, establish a dedicated Digitalisation Wing within the NBR. This wing would be responsible for coordinating the digitalisation of the various NBR wings, ensuring system and software interoperability and



- facilitating greater involvement of local IT companies in implementing digitalisation programmes and projects.
- Align expenditure patterns with income tax statements by introducing a unique identifier (such as the NID), which must be provided when making certain expenditures (as determined by the Tax Administration) and making submitting the number mandatory whilst submitting tax returns.

### Fiscal policy for controlling inflation

- Prioritise spending on critical sectors such as healthcare, education, and agricultural infrastructure whilst cutting non-essential expenditures to reduce aggregate demand and alleviate inflationary pressures.
- Expand cold storage facilities for agricultural products to create a strategic buffer stock for stabilising prices.
- Strengthen the role of the Competition Commission by hiring skilled professionals to monitor markets, investigate market manipulation, and enforce anti-trust laws with a zero-tolerance policy.

### Fiscal and financial measures for clean energy

- The MoPEMR should consult with the Ministry of Finance (MoF) to secure additional loan funding for the Bangladesh Power Development Board (BPDB) and Petrobangla to clear overdue payments to locally funded Independent Power Producers (IPPs).
- The MoPEMR should consult with the MoF and the Ministry of Planning (MoP) regarding channelling additional resources to the MoPEMR by discouraging the allocation of funds for low-priority and less-important projects of other ministries/departments.
- For the equipment and components related to renewable energy-related supply chains, including generation, transmission and distribution, reduce the Customs Duty (CD) to 5 per cent, and all taxes should be eliminated on all renewable energy goods.

#### Fiscal measures targeting SMEs

- Withdraw the recent decision to lower the VAT and tax eligibility thresholds—reduced to BDT 50 lakh for VAT registration and BDT 30 lakh for turnover tax, from the previous BDT 3 crore and BDT 50 lakh, respectively—and reinstate the original thresholds.
- Exempt SMEs from Advance Income Tax (AIT) and Advance VAT; additionally, the non-refundable nature of

- AIT and Tax Deducted at Source (TDS) should be revised to allow for adjustment against final tax liabilities for SMEs.
- To ensure balance in the market, strengthen the capacity
  of the Bangladesh Competition Commission by increasing
  funding for digitalising its market monitoring mechanisms
  to ensure fair market practices. Additionally, offer direct
  legal and financial support to SMEs to help them combat
  the market dominance of large enterprises.

### Fiscal policy for protecting public health

- Increase the allocation for health in FY2026 budget to prevent people from being pushed into poverty due to outof-pocket health expenditures.
- Introduce simple, specific, and universal excise duties to reduce the consumption of cigarettes, other tobacco products, soft drinks, and energy drinks.
- Allocate funds to provide financial assistance and medical support to those who were injured and to the families of individuals who died during the July uprising.

### Fiscal policy for incentivising education

- Expand the school feeding programme to include all primary school students, which is 9.3 million (MoPME, 2024).
- Launch a scholarship programme in FY2026 to fund the education of individuals injured or disabled during the July uprising, ensuring support until they complete their undergraduate degree at any public or private university.
- Introduce finance programmes or schemes in top universities in Bangladesh to improve the quality of education and research outputs.

#### Fiscal measures for the environment

- Introduce VAT exemptions and incentive tariffs on all types of equipment for renewable power plants, and charge a 1 per cent surcharge on goods produced through environmentally harmful means.
- Add 5 per cent to 50 per cent higher Advance Income Tax (AIT) to fossil fuel-driven motor vehicles, depending on the size of the vehicle's engines and electric motor, compared to the AIT on hybrid and fully electric vehicles to encourage the consumption of green technology.
- Reinstate the 5 per cent supplementary duty on plastic bags, initially withdrawn in FY2023, immediately.



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