Independent Review of
IRBD
Bangladesh's Development

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

An Analysis of the National Budget for FY2020-21

Dhaka: 20 June 2020

CENTRE FOR POLICY DIALOGUE

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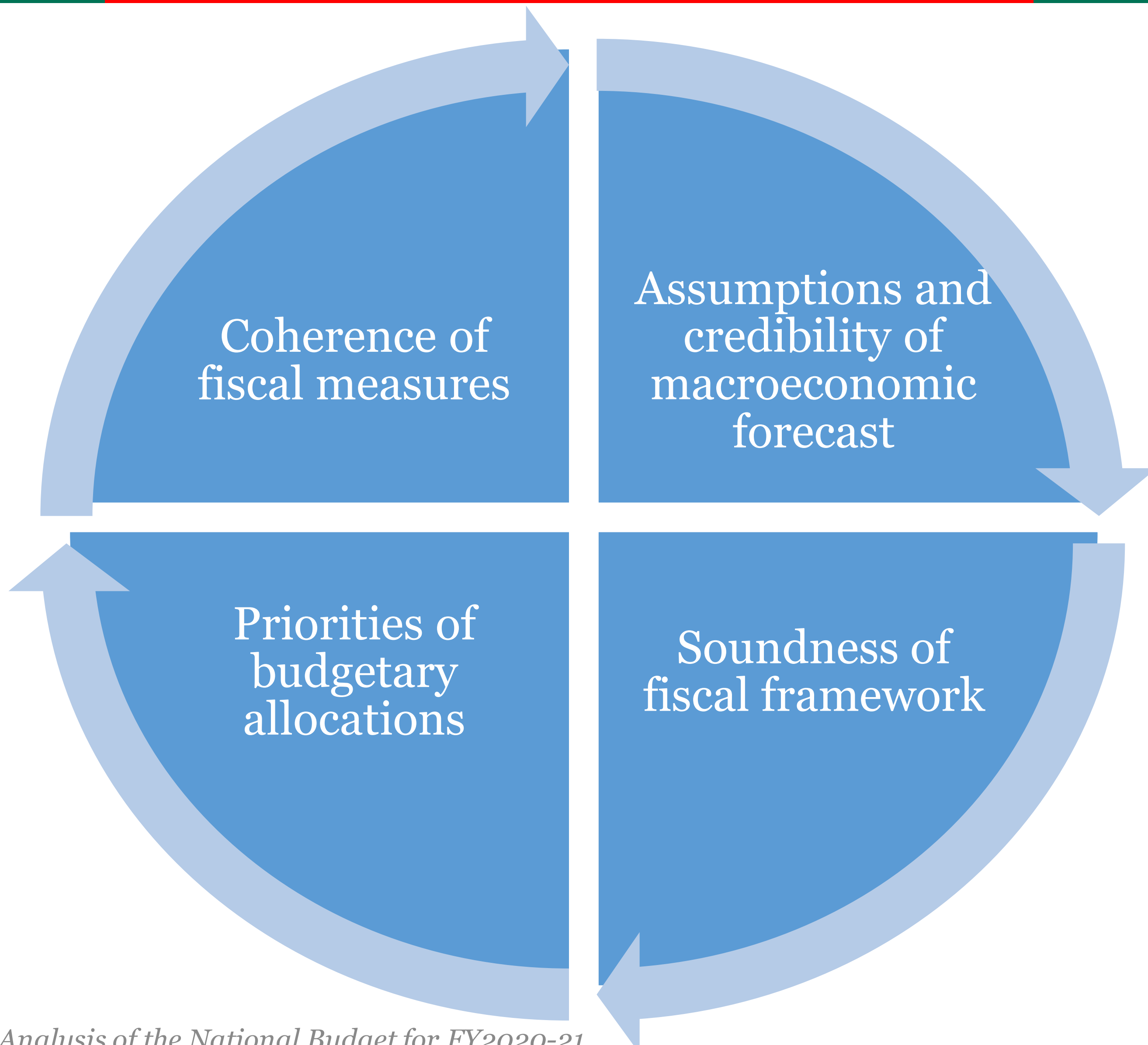
The CPD IRBD 2020 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

Contents

I. Lens taken to examine FY2020-21 Budget Proposals



II. Macroeconomic framework of the budget does not reflect the realities on the ground

The Bangladesh economy, from the very beginning of the ongoing fiscal year, has been grappling with formidable challenges which have been exacerbated by the outbreak of COVID-19. The budget had to be designed and delivered on a relatively weak foundation

↓	↑
Large shortfall in revenue mobilisation	***Stable inflationary trend***
Disrupted implementation of public investment projects	***Steady remittance inflow***
Escalated budget deficit and bank borrowing	***Comfortable balance of payments***
Decelerated export growth	***Steady exchange rate***
Negative import growth	***Increased foreign exchange reserve***

II. Macroeconomic framework of the budget does not reflect the realities on the ground

GDP and investment

Indicator	Actual	Budget	Revised budget	Projection		
	FY19	FY20	FY20	FY21	FY22	FY23
GDP growth (%)	8.15	8.2	5.2	8.2	8.3	8.4
Gross investment (as % of GDP)	31.6	32.8	20.8	33.5	34.5	35.6
Private investment (as % of GDP)	23.5	24.2	12.7	25.3	26.6	27.7
Public investment (as % of GDP)	8.0	8.6	8.1	8.1	7.9	7.9
ICOR	3.9	4.0	4.0	4.1	4.2	4.2

Source: MTMPS

- For FY21, **GDP growth** target has been set at 8.2%
- The budgetary framework of MoF considered a 5.2% GDP growth in FY20
  - Provisional estimates from BBS for FY20 are not yet available
- CPD estimated that the GDP growth rate will not be more than 2.5% in FY20. About 15% of population have joined as new poors; income and consumption inequalities have risen; new groups of people in the labour force are at risk of losing jobs

II. Macroeconomic framework of the budget does not reflect the realities on the ground

- **Apparently, the impacts of the COVID-19 pandemic with lockdowns and largescale supply-side disruptions have not been adequately factored-in into FY21 Budget design**
- Low levels of domestic resource mobilisation (Revenue-GDP ratio) and low share of public expenditure (as % of GDP) had an adverse impact on resource availability and resource allocations in the budget
- Public investment-GDP ratio in FY21 is set to be same as FY20 (8.1%)
- **Private investment** is estimated to be 25.3% of GDP in FY21: a whopping 12.6 percentage point increase from the MoF estimate for FY20
  - In FY21, a staggering **Tk. 446,000 crore** (approx.) will be additionally required for private investment (125.2% increase in nominal terms!) based on the MoF estimate for FY20 (Tk. 356,330 crore)
- **It is envisaged that a 125.2% increase in private investment will be attained in FY21 via a private sector credit growth of 16.7% for FY21 (8.8% as of April 2020)!!**

II. Macroeconomic framework of the budget does not reflect the realities on the ground

- Export growth target is set at 15.0% in FY21 ((-)18.0% in Jul-May FY20)
- Growth target for import is set at 10.0% in FY21 ((-)8.8% in Jul-Apr FY20)
- Remittance growth target for FY21 is set at 15.0%
- Exchange rate is expected to be stable: Tk. 84.0/USD (Currently Tk. 84.95/USD)

Overall observations

- The reliability of the macroeconomic framework for FY21 and its relevance in the present context should come under rigorous scrutiny
- One notes that a "V-shaped" recovery path has been envisaged as regards GDP growth and that the economy will bounce back to pre COVID-19 level within a year of the pandemic and the associated disruptions
  - However, the underlying trends of private investment, productivity, private sector credit, export, import and remittances pose serious questions as regards the predicted recovery path
- **GDP growth rate should not be the anchor outcome variable for economic policies**, including the national budget, in the current context.
- Instead, **focus should be on saving lives of people of the country and reduce the vulnerabilities of the marginalised groups,**

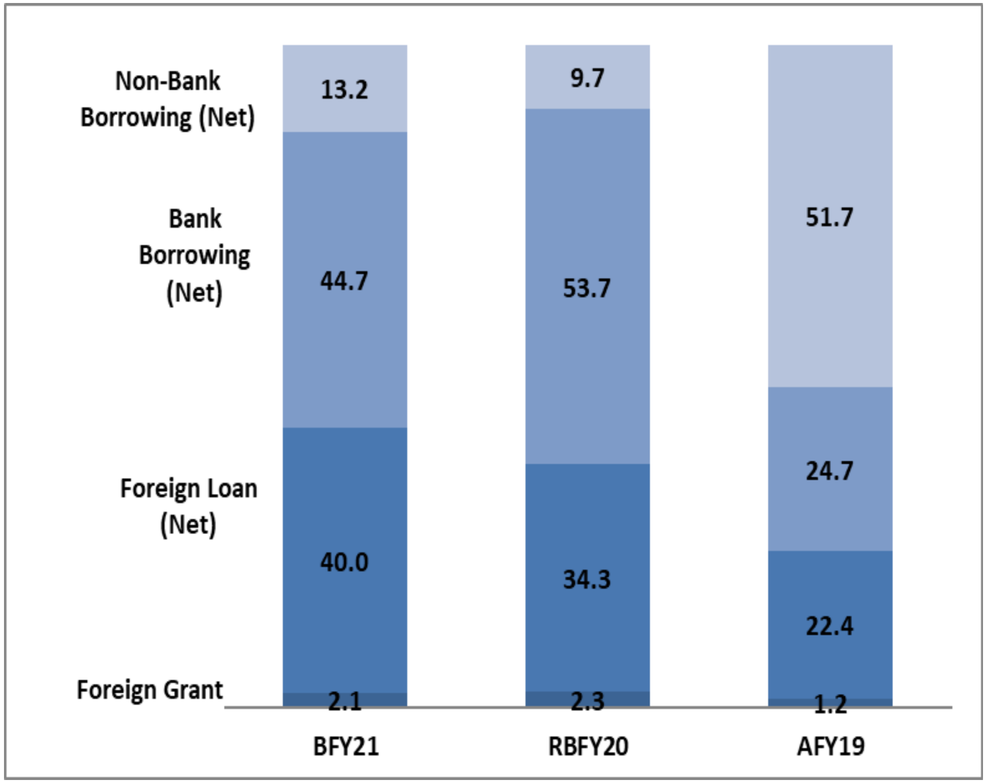
III. Weakness in fiscal framework will undermine Budget implementation

- **The targets set in the proposed fiscal framework do not reflect the realities on the ground**
  - Revised budget targets for FY20 are not estimated in a prudent manner
- Revenue mobilisation: Budget FY21 targets a 8.6% growth over RBFY20
- CPD projected revenue shortfall to be Tk. 125,000 crore in FY20
- Government revised the target by approx. Tk. 30,000 crore
- **Actual revenue growth target may reach 49.5% - approx. an additional about Tk. 125,000 crore may need to mobilised!**
- NBR to deliver almost entire amount of incremental revenue (98.6%)
  - **To be primarily delivered by VAT (51.2% of total incremental revenue) followed by supplementary duty 35.7%**
- Taxes on Income, Profits and Capital Gains is expected to provide only 3.5% of incremental revenue (about Tk. 1,051 crore)

III. Weakness in fiscal framework will undermine Budget implementation

- Public expenditure has been set at 17.9% of GDP (same as RBFY20)
- Share of **domestic financing 57.6**% in FY21 (63.4% in RBFY20)
- Tk 86,980 crore (44.7% of total) will come from the bank borrowing
- Gross foreign aid requirement will be around **USD 11.1 bln** (USD 8 bln in RBFY20) – current commitments in view of COVID-19 **may not be enough**
- **Critical element will be utilisation of foreign aid through faster-paced ADP project implementation with good governance**

Budget Deficit and Financing



IV. Fiscal measures: Some welcome, some questionable

Major revisions made in the personal income tax (PIT) structure

- Annual tax-free income threshold has been raised to Tk. 3.0 lakh from Tk. 2.5 lakh;
  - For female and elderly taxpayers, the threshold has been raised to Tk. 3.5 lakh from Tk. 3 lakh
  - No change for specially-abled and freedom fighters: Tk. 4 lakh and Tk. 4.5 lakh respectively
- Earlier CPD had proposed to raise the threshold to Tk. 3.5 lakh and reduce the first three slabs of tax rates by 5 per centage points
- Tax rates have been lowered to 5%-25% from existing 10%-30% rates for different income levels

IV. Fiscal measures: Some welcome, some questionable

- Following the change, the lowest segment will gain the most (about 28-67%) with monthly income between Tk.30,000 and Tk. 60,000. However, benefit will start to increase again for monthly income earners of 5 lakh and above *– not promoting tax justice*

Taxable annual income (Tk.)	Current rate	Proposed rate	Max. monthly taxable income (Tk.)	Tax relief (Tk.)	Tax relief as (%) of tax amount (old rate)
0 to 2.5 lakh	0%	0%	20,833	Tax-free	Tax-free
<2.5 lakh to 3.0 lakh	10%		25,000	5,000	-100
<3.0 lakh to 4.0 lakh		5%	33,333	10,000	-67
<4.0 lakh to 6.5 lakh		10%	54,167	10,000	-25
<6.5 lakh to 7.0 lakh	15%		58,333	12,500	-26
<7.0 lakh to 11.0 lakh		15%	91,667	12,500	-12
<11.0 lakh to 11.5 lakh		20%	95,833	10,000	-9
<11.5 lakh to 16.0 lakh	20%		About 1.33 lakh	10,000	-5
<16.0 lakh to 17.5 lakh		25%	About 1.45 lakh	2,500	-1
<17.5 lakh to 47.5 lakh	25%		About 4 lakh	2,500	0
<47.5 lakh to 60 lakh	30%		**5 lakh**	**62,500**	-5
<60 lakh to 1 cr 20 lakh			**10 lakh**	**3 lakh 62.5 thousand**	-11
<1 cr 20 lakh to 48 cr			**4 cr**	**2 cr 37 lakh 62.5 thousand**	-17

IV. Fiscal measures: Some welcome, some questionable

- Rebate of Tk. 2,000 for first online return submission–*will promote digital transformation of tax department*
- Simplified One page Tax Return form –*may incentivise small taxpayers to submit returns*
- Mandatory return submission for all e-TIN holders – *will enhance the coverage of tax net*
- E-TIN has been made compulsory for Zilla Parishad Chairman and Vice Chairman – *will improve transparency as regards income of these elected people*

Corporate tax for non-publicly traded companies reduced to 32.5% from 35% - other rates remained unchanged *– the tax differential between listed and non-listed companies to reduce; listing of companies to be discouraged*

- For **RMGs**, the provision of 12% (10% for green industry certificate) has been extended for another two years – *will help reduce environmental degradation by limiting negative externality*

- **Withholding tax** has been reduced at 0.5% from 1% on **all types of export proceeds including that of RMG**
  - However RMG has been currently enjoying the further reduced rates through an SRO, which will continue to be in force till 30th June 2020. *The current rate may be continued for one more year in view of the pandemic*

IV. Fiscal measures: Some welcome, some questionable

Untaxed/undisclosed money investment provisions expanded

- These facilities will be available only for FY21
  - Any type of undisclosed house property including land, building, flat and apartment can be disclosed
  - Money can be invested in the capital market on paying <u>10% tax on the value of the investment</u> including a lock-in period of three years
  - Cash, bank deposits, savings certificates (Sanchayapatra), shares, bonds or any other securities can be disclosed on paying <u>10% on the value of the said declaration</u>
- CPD has along argued against this move on grounds of moral hazard, disincentive for honest taxpayers and not having been effective in the past. Such moves undermine the cause of **transparency and good governance**. If this type of provisions are to be at all allowed, the rate <u>should be applicable tax rate plus penalty</u>

IV. Fiscal measures: Some welcome, some questionable

- **Money-laundering prevention:** 50% tax will be levied on the proven amount of over- or under-invoicing, or on the proven amount of false declaration of investment
  - *Good initiative to discourage illicit financial outflows. However, this is a step backward from the earlier provisions (fines; jail terms).*
  - CPD calls for heightened forensic capacity of the Transfer Pricing Cell. At the same time, they should be able to access to international trade database.
  - **Coordination among the concerned agencies** (NBR, dealing banks) is required. NBR's Transfer Pricing cell should take the lead

IV. Fiscal measures: Some welcome, some questionable

No changes on tax-free VAT thresholds and turnover tax rate

- VAT-free annual turnover threshold stands at Tk. 50 lakh; turnover tax ceiling has not changed either (upto Tk. 3 crore); 4% turnover tax also remained unchanged
  - *CPD proposed an upward revision for VAT-free annual turnover threshold to Tk. 1 crore*
- Online-based new VAT law requires mandatory record keeping through **Electronic Fiscal Device (EFD)** and **Sales Data Controller (SDC)**
  - *Government is yet to distribute EFD among the businesses*
- Time limit for input tax credit has been extended up to 4 tax periods from existing 2 tax periods; partial input tax credit mechanism has been made effective and easier; multiple withholding of VAT has been avoided by simplification of rules - *will provide flexibility for businesses*

Existing six CD slabs and 12 SD slabs will remain unchanged

- There are **two broad reasons** as regards duty changes at import stage:
  - A wide range of tariff reduction at import stage has been proposed – particularly with a view to import raw materials for the development of potential sectors
  - Some duties have been raised to protect local industry and to generate revenue

IV. Fiscal measures: Some welcome, some questionable

CPD welcomes a number of positive changes in tax and duty structure

- ***COVID-19 emergency response:*** All duties exempted at import, manufacturing and trading stage for 17 types of **medical equipment** including soapy alcohol, COVID-19 testing kits, PPE, 3-ply surgical masks, protective spectacles, goggles, and raw materials for hand sanitisers, surgical masks, and disinfectants. **Meditation services** have also received exemption for one more year. CD reduced on essential raw materials for **locally produced Autoclave machines** used for sterilising medical instruments *– welcome decision in view of the adverse affect of pandemic*
- ***Development of agro-based industries:*** CD/VAT reduced/exempted for manufacturing of potato flakes, manufacturing of maize starch, production mustard oil and import of poultry feeds, deep-sea fishing equipment and agricultural machineries *– will help promote agro-related investment*
- 5% CD imposed on **imported onion** *– will protect local onion producers to get fair market price*
- ***Development of export-oriented sectors:*** Duties have been rationalised and import of raw materials are allowed at a concessional rate to facilitate protection, expansion and diversification of a number of export-oriented sectors including footwear, electronics industry, shipbuilding industry etc. *– welcome move*

IV. Fiscal measures: Some welcome, some questionable

- ***Development of domestic industrialisation:*** Various tax and duty changes will encourage local manufacturing industries including local ICT sector development, manufacturing of local cellphones, development local textile, promotion of steel industries, manufacturing of LPG cylinder, growth of detergent industry, sanitary napkin and diaper industry, paper, plastic and packaging industries *– timely initiatives*
- Reduced tax rate on **import of SME product-related raw materials** *– will help SMEs during these trying times*
- VAT exempted on up to 60-amp solar battery production to **promote clean energy** *– will support environment-friendly clean energy growth*
- **Tobacco tax sees new height** (both price and SD raised) *– will discourage consumption of health hazardous products and also generate higher revenue*
- Withdrawal of exemption benefit on **import of furnace oil** *– will discourage installation of furnace oil-based power plants*
- Increased SD on luxury services i.e. chartered aircrafts and helicopters; BRTA services for private car and jeep *– will generate additional revenue*

IV. Fiscal measures: Some welcome, some questionable

Measures that are not well reasoned

- VAT exemption facility in cases of government's priority and fast track projects – *will have adverse impact on revenue mobilisation and induce demonstration effect for future projects*
- SD increased to 10% from 5% on locally manufactured cosmetics - *no mention about imported items*
- SD raised on services provided through mobile phone SIM/RIM – *will increase cost of mobile phone and internet use. Adverse impact in view of mobile and internet use by students, retail business etc.*
- Shrimp production, furniture manufacturers received little attention

Excise duty has been raised by 20-60% on bank deposits amounting Tk. 5 lakh and above savings

- ED on bank deposits is considered to be taxing on savings. *ED should be waived on bank deposits not exceeding Tk. 50 lakh to give respite to low and middle-income group savers*
- Rationalisation of taxes and duties are often administered on an ad-hoc basis driven by political will and business lobby. However, these need to be based on **revenue rationale** and **economic return**

IV. Fiscal measures: Some welcome, some questionable

Reform initiatives: the unsung agenda

- **Modernisation of the Income Tax Ordinance** – No concrete deadline proposed
- Government has taken initiatives to establish the **Bangladesh Single Window Commissionerate** – in this context amendments of Customs Act, 1969 is necessary
  - CPD has been persistently advocating in favour of speedy passing of Customs Act and Direct Tax Act 1969
- **Expansion of the tax net** and implementation of the **BITAX project**
  - Government is going to make income tax returns mandatory for every TIN holder
  - At the same time, online filing of return has been introduced and tax payment process is much easier than before
- CPD urges the need for broader <u>use of technology</u> to boost revenue mobilisation efficiency: <u>Introduction of an e-TDS system</u> will make tax evasion difficult

Independent Review of IRBD Bangladesh's Development

V. Allocative priorities are hard to follow

Total Public Expenditure

Sector	Share in BFY21	Share in RBFY20	Change in FY21B over FY20R		Incremental Share
	%		Crore Tk	%	%
Public Service	19.9	16.0	32756.0	40.7	49.3
Education and Technology	15.1	15.4	8724.0	11.3	13.1
Transport and Communication	11.4	11.7	6093.0	10.4	9.2
Interest	11.2	11.5	6137.0	10.6	9.2
LGRD	7.0	8.1	-901.0	-2.2	-1.4
Defence Services	6.1	6.5	1777.0	5.4	2.7
Social Security and Welfare	5.6	6.1	1155.0	3.8	1.7
Agriculture	5.3	5.4	2963.0	11.0	4.5
Health	5.1	4.7	5555.0	23.4	8.4
Public Order and Safety	5.0	5.5	1229.0	4.5	1.9
Energy and Power	4.7	5.2	604.0	2.3	0.9
Housing	1.2	1.5	-509.0	-6.8	-0.8
Recreation, Culture and Religious Affairs	0.8	0.9	52.0	1.1	0.1
Industrial and Economic Services	0.7	0.8	-41.0	-1.0	-0.1
Others (Memorandum Item)	0.8	0.8	829.0	21.0	1.2
Total Expenditure	100.0	100.0	66423.0	13.2	100.0

- **Public services sector alone account for 49.3% of total incremental expenditure; followed by education, and technology (thanks to Rooppur Power Plant)**

V. Allocative priorities are hard to follow

- **Within Public Services Sector,** Finance Division received an incremental amount of Tk. 33,399 crore which is about 50.3% of total additional public expenditure for FY21
- **Tk. 27,961 crore has been kept for Investments in Shares and Equities** in FY21 (Tk. 13,459 crore in RBFY20) in a year when every penny counts
- Tk. 22,771 crore has been allocated for providing loan to autonomous bodies
- **To compare, annual total new allocation in view of COVID-19 for FY21 is equivalent to Tk. 21,022 crore (3.7% of total budget)**
- Total incremental allocation for Interest Payments is Tk. 6,731 crore; of which, domestic - Tk. 5,456 crore (88.9% of total)

New Allocations (annualised) in view of COVID-19 for FY21	Tk in crore
Allocation for COVID-related emergency health response	10,000
Paying the interest on an incentive package for businesses	3,000
Subsidise the bank loan interest whose payment was postponed during the April-May period	2,000
Cash incentives for targeted population (2,500 for 50 lakh families)	500
Compensation for family members of the deceased public servants	322
Incentives for farm mechanisation	200
Refinancing scheme for small income farmers and traders in the agriculture sector	3,000
Credit for self-employment venture (through Palli Sanchay Bank, Probashi Kallyan Bank, Karmasangsthan Bank and PKSF)	2,000
Total	**21,022**

V. Allocative priorities are hard to follow

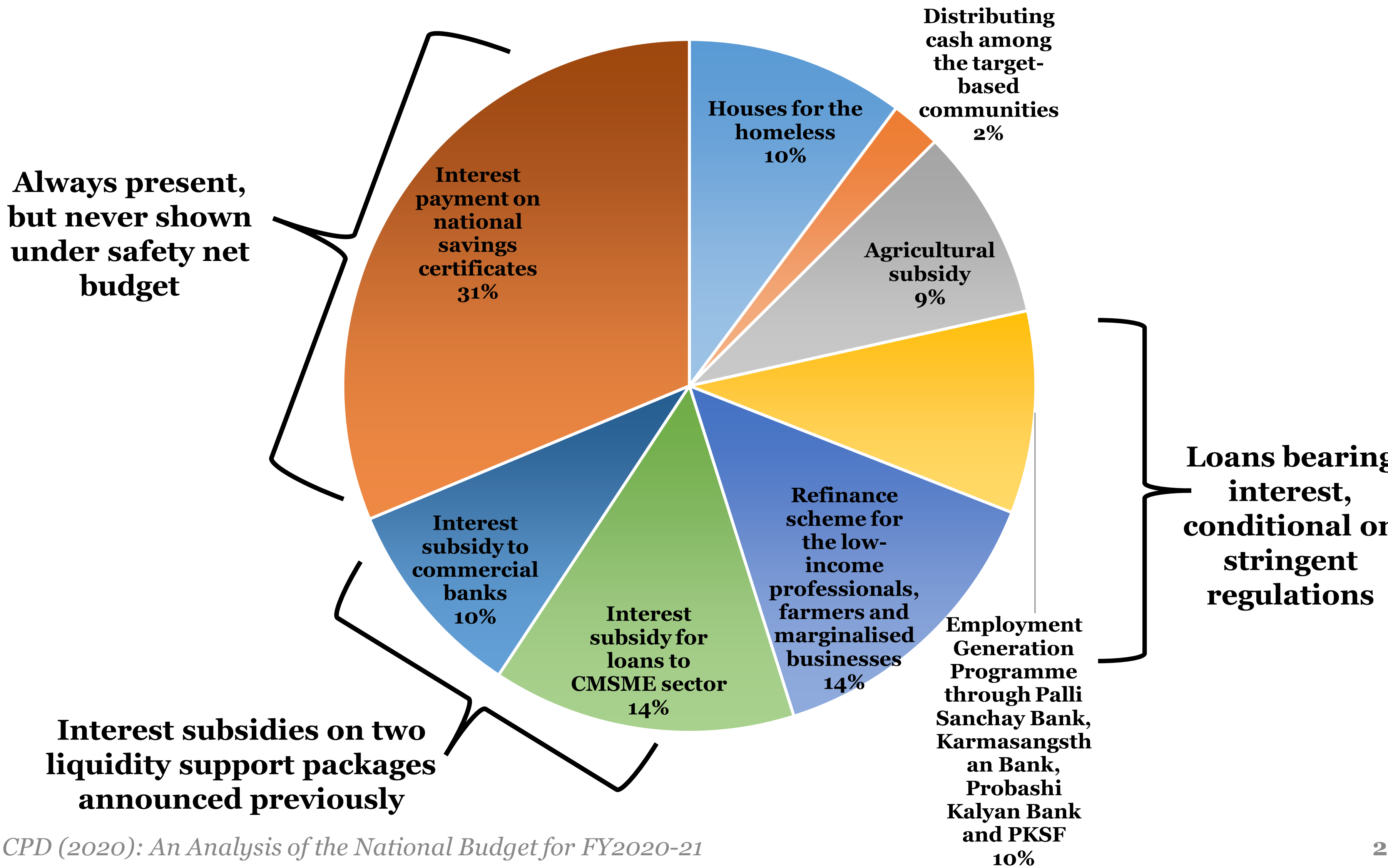
- ADP for FY2021 did not follow required allocative priorities in view of the need to respond to the ongoing COVID-19 pandemic
  - Allocation for **HNPFW** remained unchanged; has risen only marginally for **Agriculture**, **Social Welfare** and **Labour & Employment sectors** compared to FY20
- Limited effort towards exploring new projects to address COVID-19 emergencies
  - **Only one COVID-related project was included in Health sector**
- No high ambition in financing ADP from foreign aid. Indeed, foreign aid expectation in terms both allocation and number of projects decreased drastically in FY21. Financing from revenue surplus is also on a declining trend
- GoB could not restrain itself from including and allocating funds for the **'carryover' and 'ageing' projects** in FY21 – in fact both of these have increased!
- The government should have avoided taking populist projects (e.g. 'symbolic projects' for transport and physical planning sectors)

V. Allocative priorities are hard to follow

- Total budget allocation for health increased only by 14%, from BDT 25,733 crore in FY20 to BDT 29,247 in FY21 – still less than 1% of GDP
- Additional Tk. 10,000 crore has been kept aside as COVID-related emergency health response
- There is a need to detail out the estimates for resource demand for COVID-related emergency health response to understand if the budget is adequate
- Allocation for Agriculture and Allied Sectors (AAS) is to increase by only 5.7% in BFY21 (from Tk. 27,018 crore in FY20 to Tk. 29,981 crore in FY21) compared to that in RBFY20
- Subsidy for agriculture sector is to increase to Tk. 9,500 crore - a large amount of unutilised subsidy (about 10% in RBFY20) over past years calls for clear indication how the additional amount will be utilised
- Timely disbursement of credit under the stimulus packages, particularly among *Amphan* affected agriculture entrepreneurs are urgently needed

V. Allocative priorities are hard to follow

Distribution of new additions to safety net budget



V. Allocative priorities are hard to follow

- The budget speech has reiterated Stimulus Packages for different sectors/economic activities
  - BDT 5,000 crore for the export industry, BDT 20,000 crore for SMEs, BDT 30,000 crore for large industries and services, and BDT 5,000 crore for agriculture sector
- Given the huge demand from enteprises, such allocations are not likely to be adequate
- CPD (2020) suggested that the government consider **additional allocation of subsidised credit for the SMEs**
  - Introduction of **credit guarantee scheme** for new entrepreneurs and risky borrowers will encourage banks to invest in CMSMEs - budgetary support for such a scheme should be provided
- Creation of BDT 2,000 crore fund for returned expatriate workers, unemployed youths and village farmers: will hopefully encourage self-employment activities
- **Rural employment through public works programme was not emphasised**

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V. Allocative priorities are hard to follow

- **Education budget** as a share of GDP decreased to 2.09% in FY21 from 2.12% in RBFY20
- Addressing the challenges at grass roots level through effective local government institutions has emerged as an urgency in times of pandemic
  - **Allocation for LGRD** will be **decreased by 2.2%** in BFY21 compared to that in RBFY20
- Budget allocation for the **energy and power sector** has increased in BFY2021 (Tk.24853 crore) compared to that in RFY2020 (Tk.26,154 crore): Budget should have examined the structure of expenditure
- **Gender budget** as a percentage of total budget has increased slightly from 30.06% in RBFY20 to 30.98% in BFY21
  - Poor inter-ministry coordination and lack of transparency are the twin concerns in this connection
- Climate relevant allocation declined from 0.81% of GDP in RBFY20 to 0.76% in FY21

VI. CONCLUDING REMARKS

VI. Concluding remarks

- *The government has mostly opted for a business as usual budget*
- COVID-19 induced health, economic, humanitarian and social crises are unprecedented, and the budget for FY21 needed to be more innovative to address this multidimensional crisis
- The government appears to have prepared the budget under the assumption that the fallout from COVID-19 will be managed within a very short period, and the economy will bounce back in FY21
- However, COVID-19 situation is an evolving one; there are significant uncertainties regarding its duration and extent of impact
- CPD, in its budget recommendations, had urged to give priority to four sectors: health, social safety net, agriculture and employment generation
- The government has rightly put emphasis on these sectors. However, its promises and priorities have not been translated into actions (through innovative approaches and allocation of adequate resources)

Independent Review of IRBD Bangladesh's Development

VI. Concluding remarks

- *COVID-19 has exposed the high cost of weak implementation capacity which CPD has drawn attention to over successive budget presentations*
- Low capacity of resource utilisation and recent incidences in connection with procurement and management in the health ministry itself are a stark example of this
- Government's inability to undertake the much needed reforms, which it had announced earlier in FY20 budget (e.g. direct tax, Customs Act, banking commission, Shashya Bima) has constrained its ability to cope with adverse impacts of the pandemics and implementation of budgetary measures
- Rising number of new poors, and increasing income and consumption inequality, require differentiated measures which the budget have not adequately addressed

VI. Concluding remarks

- *Macroeconomic framework of the budget does not reflect the realities on the ground*
- Perhaps the government did not want to depart from the MTBF, which was prepared before COVID-19
- During a crisis such as the COVID-19 pandemic the main objective should be supporting the poor and affected people, instead of being too much concerned with GDP growth. Several countries have been facing negative growth which is natural during a pandemic. The focus should be on coping, adjustment and mitigation with a view to subsequently get on the recovery track
- A realistic estimate about economic performance is also necessary because Bangladesh needs to access COVID-19 related funds from international organisations, particularly when the government is expecting to underwrite a large part of the budget deficit from foreign borrowing
- In view of the evolving COVID-19 scenario the government should be ready, if required, to revisit the budget and undertake necessary corrective measures in view of realities on the ground

Stay Well, Stay Safe