Independent Review of Bangladesh's Development

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

CPD's Recommendations for the National Budget FY2023-24

Weathering the Storm, Containing the Risks

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Contents

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The CPD IRBD 2023 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

CPD's Recommendations for the National Budget FY2023-24

Weathering the Storm, Containing the Risks

SECTION 1. INTRODUCTION

The national budget for FY2023-24 (FY2024) will be the last budget prepared by the incumbent government prior to the upcoming national elections. It is being prepared amidst a number of disquieting developments – both at the global and domestic fronts. The Bangladesh development narrative, with its impressive success in terms of economic performance and commendable progress in terms of key socio-economic indicators, have come under scrutiny in view of the developments of recent times. The challenge facing the economy is to restore macroeconomic stability, consolidate the gains of the past, and adjust to new realities keeping the growth and stability trade-off in the perspective. The upcoming FY2024 budget will need to address these attendant concerns amid election-related uncertainties. This will require renewed efforts towards raising the quality of macro-fiscal planning and management which, in turn, will require some hard choices on the part of the policymakers.

In this backdrop, the present report focuses on six areas: a) macroeconomic management; b) fiscal framework; c) prices of commodities; d) subsidies; e) health and education; and f) environmental concerns. This report highlights some of the key challenges in these areas which require immediate and heightened policy attention, particularly from the macro-fiscal management viewpoint, using the latest available data from official and credible international sources. Finally, this report puts forward a set of recommendations which might be considered by the policymakers while formulating the national budget for FY2024. The analyses and recommendations presented by this report may also inform the electoral debates subsequent to the national budget.

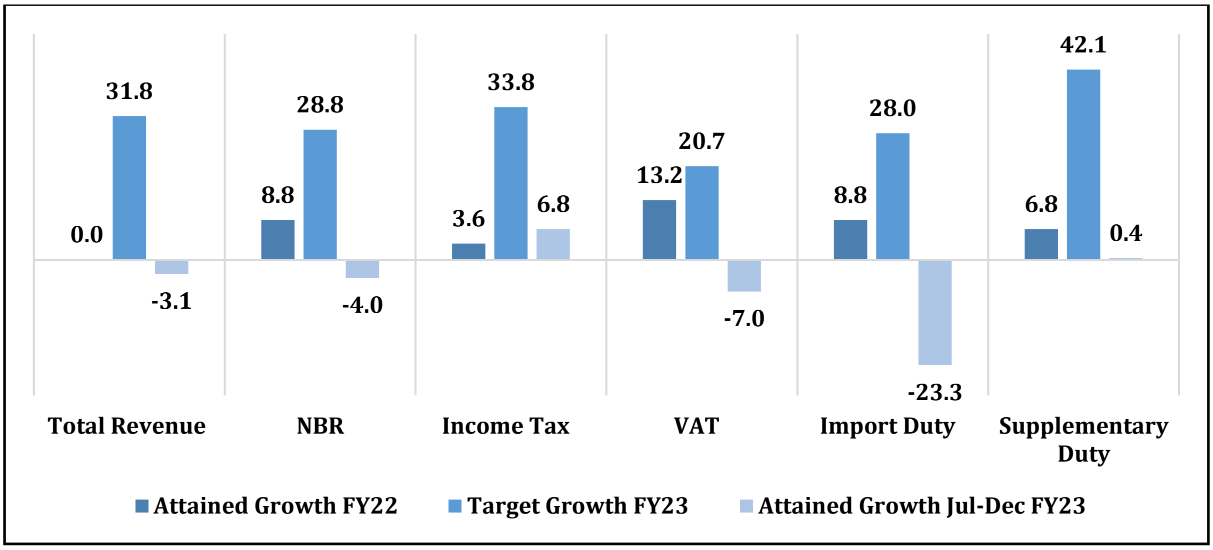
SECTION 2. KEY TRENDS IN MACROECONOMIC CORRELATES

As FY2023 commenced its journey in July 2022, it became evident that the Bangladesh economy would be under severe stress. At a time when the economy was coming out of the worst impacts of COVID-19, the adverse consequences of global price hikes following the war in Ukraine began to be felt on various correlates of the Bangladesh economy. CPD, in July 2022, had cautioned that the emergent macroeconomic pressure would not be short-term in nature and would be exacerbated by embedded structural weaknesses. Macroeconomic instability has remained endemic and a matter of great concern throughout the ongoing fiscal year of FY2023. While adverse impacts of economic headwinds, currency pressure and soaring commodity prices have started to recede in most Asian economies, as the economies took measures to adjust to the new normal, the Bangladesh scenario remained distanced. Indeed, the headline macroeconomic trends in the country evince cautionary signals. As the government prepares to present the national budget for the upcoming FY2024, it is important to acknowledge the changing trends of macroeconomic correlates and identify the elements of the emerging tensions and pursue a coordinated policy package. It needs also be recognised that Bangladesh is currently under an IMF programme, which would call for undertaking adjustments in the macroeconomic targets and defining some of the critical policy choices.

Shrinking fiscal space in the backdrop of a lack of momentum in revenue mobilisation

Total revenue collection declined by (-) 3.1 per cent during the first half of FY2023, driven primarily by the reduced tax collection by the NBR (Figure 2.1). It is rather surprising that despite the rising commodity prices and substantial depreciation of the Bangladeshi Taka (BDT), the collection of value added tax (VAT) was substantially lower in the stated period compared to the previous year. While NBR has kept trying to boost revenue collection, a number of factors have militated against its declared objectives. From the very outset, the government took a cautionary approach towards spending budgetary allocations for ADP projects. This was perhaps one of the reasons for the reduced revenue collection. However, the key reason is more likely to be the slowing economic activities resulting in limited revenue collection since no significant proactive administrative and institutional measures were undertaken. The tightening of imports not only reduced the scope for indirect tax collection at the external stage but also hampered production for the domestic market and consequently led to lowered tax collection at the local level. It is more likely that the IMF's condition (as part of the quantitative performance criteria and indicative targets for the first two reviews) to generate Tk. 3,456.5 billion in FY2023 as tax revenue would remain unmet.

Figure 2.1: Revenue mobilisation growth by sources (in per cent)



Source: Estimated from Monthly Report on Fiscal Position: December 2022 (Fiscal Year 2022-23), MoF.

Budget deficit financing relied highly on borrowings from the central bank

Shrinking fiscal space arising from lower revenue mobilisation has forced the government to go for restraining public expenditure. In spite of this, the budget deficit remained higher in the first half of FY2023 compared to FY2022. More importantly, the government's options for financing of budget deficit were limited to borrowing from the central bank. Foreign financing (both loan and grants components) did not make any significant improvement, while net sales of NSD certificates was negative as encashment exceeded new sales (to the tune of (-) Tk. 3,065 crore), implying that the government borrowed less than what it repaid. Gross sales of NSD certificates declined (by Tk. 12,836 crore during the first seven months of FY2023), while repayments increased (by Tk. 2,395 crore). More stringent administrative measures (such as the requirement to present income tax return certificates for purchasing NSD certificates), lowered interest rates, dissaving, and the reduced ability of middle-income investors to save in the backdrop of declining purchasing power have contributed to this scenario in all likelihood.

Since cash-strapped scheduled banks were unable to provide loans, the government was compelled to resort to the central bank to finance the budget deficit. According to the Bangladesh Bank data, the government borrowed about Tk. 51,266 crore from the central bank during the first half of FY2023 and repaid about Tk. 20,735 crore in net terms to the scheduled banks. On the other hand, it is also to be noted that the central bank also retracted a substantial amount of BDT from the market as it sold a substantial amount of foreign exchange during this fiscal year (USD 10.5 billion as of 15 March 2023). As a result, both broad money supply and reserve money growth rates are within the programmed limits. However, continued borrowing from the central bank will not be advisable as it may lead to added inflationary pressure. Regrettably, in view of the current trends, the government may not have many options as the budget deficit and its financing demand is set to rise during the latter months of the fiscal year.

The liquidity position of scheduled banks tightened amid deteriorating financial sector governance

According to the Bangladesh Bank data, during the first seven months, overall liquidity in the banking system had declined sharply (by Tk. 66,581 crore). Indeed, the Islami banks as a group could not meet the total minimum liquidity requirement by the end of January 2023 (Table 2.1). Significant malgovernance and lack of prudential management were the reasons. Bangladesh Bank introduced a new tool to extend liquidity support to cash-strapped Islami banks, namely Mudarabah Liquidity Support (MLS), with a view to cushioning the banks' ailing financial health. The space also declined sharply for state-owned commercial banks and private commercial banks (as groups) as well. At the same time, with declining purchasing power and lowered propensity to save, currency in circulation outside banks increased by 24.1 per cent by the end of January 2023 (to the tune of Tk. 51,216 crore).

Table 2.1: Excess liquidity by bank types (crore Tk.)

End of Month	SCB	PCB	IB	FCB	SB	All Banks
June 2022	79,430	76,376	21,792	25,743	82	203,424
October 2022	61,970	64,657	10,420	32,394	115	169,556
January 2023	51,387	55,554	(2,218)	32,051	69	136,842

Source: Bangladesh Bank.
Note: 1/ SCB – State-owned commercial banks, PCB – Private commercial banks, IB – Islami banks, FCB – Foreign commercial banks, SB – Specialised banks.
2/ Figure in the parenthesis implies a negative number.

It has now emerged as an urgency that the central bank intervenes to change the current system of administered interest rates and embraces a market-based interest rate regime. The central bank has committed to IMF to adopt an interest rate corridor system with a view to enhancing monetary operations by the end of July 2023. Indeed, CPD has been arguing for some time that the central bank should opt for a market-determined interest rate regime in view of rising inflation and the tight liquidity situation. Recently, Moody's, one of the most reputed global rating agencies, downgraded its outlook for the sector in Bangladesh from "stable" to "negative". The issue of establishing good governance in the banking sector of Bangladesh and pursuing the needed reforms to this end is long overdue. Indeed, the central bank and MoF are committed to the IMF to implement three major reform activities in this regard. These are: (i) Bangladesh Bank completes the pilot risk-based supervision action plan to establish risk-based banking supervision by the end of June 2023; (ii) MoF submits to the Parliament the Bank Companies (Amendment) Act 2020 and the Finance Companies Act 2020, drafted in line with the best practices, to upgrade legal and regulatory framework by the end of September 2023; and (iii) Bangladesh Bank publishes banks' distressed assets in the annual financial stability report to support resolution of non-performing loans (NPL) and take measures to enhance transparency by the end of June 2023.[1] These reforms should be carried out in an unbiased professional manner ignoring the pressure from vested groups and keeping the best interest of the banking sector in mind. Besides, urgent steps must be taken to expedite legal steps against financial misappropriations in the banking sector and the wilful defaulters. One recalls here that CPD has

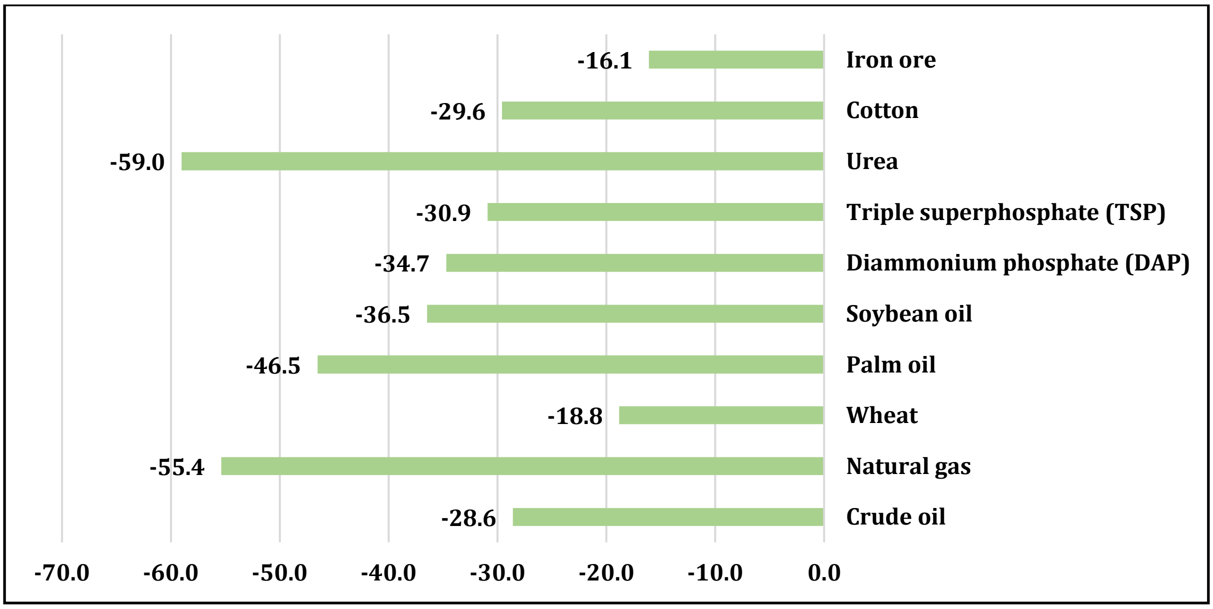
[1] The NPL in Bangladesh continued to be high. Indeed, if the Basel III requirements are applied, the NPL will be significantly higher.

been urging for setting up an independent Banking Commission, which would be mandated to propose a set of actions that would then be implemented in a time-bound manner.

Despite some relief at the global level, there is no respite from rising commodity prices

Headline inflation at the global level has begun to ease. According to OECD data, headline inflation in G-20 countries is expected to decline from 8.1 per cent in 2022 to 5.9 per cent in 2023, while in G-7 countries, it is predicted to decline from 6.4 per cent in 2022 to 4.4 per cent in 2023. Indeed, as is presented in Figure 2.2, according to World Bank Commodity Price data, international prices of 10 major selected imported commodities for Bangladesh recorded significant declines. Regrettably, the falling global commodity prices were not reflected in commodity prices in Bangladesh domestic market. It is true that during this period, BDT also experienced a record depreciation (about 17.3 per cent, according to the Bangladesh Bank data). Also, the government made significant upward adjustments to the prices of petroleum products and electricity, which may have contributed to the upward pressure of commodity prices in Bangladesh. However, considering all relevant factors, it is hard to justify the high level of prices in the country. Weak market and supply chain management, manipulation in the market, syndication, lax enforcement of laws and regulations and weak institutional capacities have combined to lead to this situation.

Figure 2.2: Growth rates in selected global commodity prices between February 2023 and March 2022 (the beginning of war in Ukraine) (in per cent)



Source: World Bank Commodity Price Data.
Note: 1/ Crude oil, average spot price of Brent, Dubai and West Texas Intermediate, equally weighed; 2/ Natural gas index (Laspeyres), average of Europe, US and Japan (LNG), weights based on 5-year average consumption volumes; 3/ Wheat (U.S.), no. 2 hard red winter Gulf export price; 4/ Palm oil (Malaysia), RBD, FOB Malaysia Ports; 5/ Soybean oil, Dutch Soyoil Crude Degummed, EXW Dutch Mills; 6/ DAP, spot, f.o.b. US Gulf; 7/ TSP, spot, import US Gulf; 8/ Urea, (Ukraine), prill spot f.o.b.; 9/ Cotton (Cotton Outlook "CotlookA index"), middling 1-3/32 inch, traded in Far East; and, 10/ Iron ore (any origin) fines, spot price, c.f.r. China.

The government is committed to IMF to adopt a periodic formula-based price adjustment mechanism for petroleum products by the end of December 2023. As the government prepares for this major policy reform, it is critically important that this exercise is carried out in an inclusive and transparent manner. The policy agenda must include an institutional efficiency audit of the monopoly operations of the Bangladesh Petroleum Corporation (BPC) and other state-owned entities associated with contracts, import and distribution. The prevailing tax structure applied at the import stage for these critical intermediate, and final products will need to adjusted in line with the government's overall tariff policy and cross-country practices.

Despite tightening imports, balance of payments remains at risk

The sharp deterioration in the balance of payments resulting in a drastic decline in foreign exchange reserves and significant depreciation of the BDT is one of the most distressing signals witnessed by the Bangladesh economy in recent past years. During the first seven months of FY2023, the deficit in overall balance reached USD 7.4 billion. Over the last months, there has been a conscious effort to curb imports along with the significant depreciation of BDT. Payments for merchandise import shipment declined by (-) 5.7 per cent during the July-January period of FY2023. Opening of letter of credit (L/C) also declined by (-) 22.5 per cent during the first half of FY2023. On the other hand, after recording an impressive growth of 34.4 per cent in FY2022, the export earnings continued to grow in FY2023 amid the fragile global environment. During the July-February period of FY2023, the growth of export earnings was 9.6 per cent (Table 2.2). However, this is solely driven by the growth attained by the RMG products (14.1 per cent). It is a worrying sign to find that combined export earnings from non-RMG products have come down by (-) 9.9 per cent. It is surprising to find that the sharp depreciation of BDT, which should have enhanced their competitive strength significantly, had failed to be realised in export terms. This is even more surprising in view of the fact that unlike the RMG, where the local value addition is relatively low, in the case of these products, domestic value addition is notably higher.

Table 2.2: Growth rates of export earnings (in per cent)

Product	Growth Target FY23	Achieved Growth Jul-Feb FY23	Required Growth Mar-Jun FY23
RMG	**9.8**	**14.1**	**2.1**
Knit	10.3	13.2	4.9
Woven	9.3	15.1	-1.0
Non RMG	**18.3**	**-9.9**	**75.6**
Raw Jute	11.0	-10.6	55.7
Leather	18.9	-14.6	84.6
Home Textiles	22.1	-22.5	92.6
Frozen & Live Fish	19.0	-21.7	150.4
Pharmaceuticals	21.8	-8.8	90.6
Other non-RMG	17.4	-6.1	66.4
Total Export	**11.4**	**9.6**	**14.7**

Source: Estimated from Export Promotion Bureau (EPB) data.

Remittance inflow continued to remain in positive terrain, albeit demonstrating a lower growth, recording a 4.3 per cent growth during the July-February period of FY2023. At the same time, the growth of overseas migration was far more impressive – about 27.5 per cent. Indeed, the average number of Bangladeshi workers going abroad per month was 91,741 during the first eight months of FY2023, an unprecedented number, which was 71,957 during the corresponding period of FY2022. In this backdrop, apprehensions about an increasing inflow of remittance through informal channels have been gaining traction in recent times. Curiously, despite having a large surge in overseas employment of Bangladeshi workers going to middle eastern countries, remittance inflow from this region has failed to correspond to the rising number of migrant workers. Other possible sources of foreign exchange inflow also do not evince any significant positive picture. Despite improvement in the implementation of the project aid component of ADP in BDT terms, foreign aid inflow was lower in FY2023. Indeed, in USD terms, net foreign aid declined by (-) 12.2 per cent during the first seven months of FY2023. Apparently, the required emphasis was not given as regards higher utilisation of the committed foreign aid. While net foreign direct investment (FDI) posted a small positive growth (4.1 per cent), concerns remain in the area of (net) trade credit as this component of the balance of payments was found to be significantly negative ((-) 2.8 billion). In the context of the balance of payments scenario, the financial account has emerged as a key concern, and all the elements here will need to be kept under constant scrutiny and monitoring.

In view of the deficit in the overall balance of payments, the foreign exchange reserves declined by USD 10.5 billion (as of 22 March 2023) during this fiscal year. According to the IMF conditionalities, the Bangladesh Bank will need to compile and report official reserve assets as per the Balance of Payment Manual of the IMF (Sixth Edition) definition to improve transparency and reporting standards. This will have to be done by the end of June 2023, to which the Bangladesh Bank has agreed. It is likely that following this revision, it will be clear that the central bank will not have much room to pump foreign exchange and may have no other option but to allow BDT to depreciate as the ongoing pressure on the balance of payments is likely to continue. Indeed, the risks manifested in external sector correlates are far from over. Since global prices have come down in recent months, it will help the government ease some of the prevailing import restrictions in the coming months. However, since the amount of deferred payments from both the public and private sectors is rather high, the pressure on the balance of payments is set to continue over the foreseeable future. It needs to be noted that the Bangladesh Bank will need to pursue a market-determined exchange rate for official foreign exchange transactions to enhance foreign exchange flexibility as part of IMF conditionalities by the end of June 2023. CPD has been arguing for a gradual move towards a market-determined exchange rate regime for quite some time now. This is already happening, although the way the exchange rate has taken the heat has hardly left anytime or space for the external sector to adjust. Now belatedly, the Bangladesh Bank has reacted to the reality, and it will need to go further. Indeed, the central bank should immediately opt for a market-determined exchange rate without further delay. It should also undertake an in-depth study as regards its ramifications on debt servicing, inflation and the balance of payments and strategise as regards flanking measures that will need to be undertaken.

Take preparation towards macroeconomic management in difficult times

The aforesaid trends in macroeconomic correlates suggest that the pressure points in the economy will continue over the coming months. The government in the past has tried to blame the war in Ukraine and the subsequent volatility in the global economy for the current situation. However, the crises in the Bangladesh economy accumulated over the years and were rooted in weaknesses in domestic policies, lack of good governance and inability to implement the needed reforms. Indeed, as the global economic situation is improving and global commodity prices are now coming down, there is hardly any room to blame the global volatility for the ongoing challenges confronting the Bangladesh economy.

As policymakers focus on the macroeconomic situation and policies, the implications for the general people and enterprises can and should not be ignored. The distress in the macroeconomic situation had a far-reaching negative impact on the development pathway of Bangladesh. In FY2023, the general people, particularly the fixed-income earning and low-income population groups, experienced significant erosion of purchasing power, impacting their well-being. They are compelled to opt for lower levels of consumption, depleting savings and curtailing expenses for education and health. The import restrictions have forced many enterprises to operate at significantly lower levels of capacity. The impact of import restrictions, along with the rising cost of doing business and the lower purchasing power of consumers, will have a long-term detrimental impact on business profitability and consumer welfare. The consequent impact on aggregate demand will have a negative knock-on impact on investment demand. Evidently, such negative consequences are much higher for smaller enterprises, be it in the manufacturing or in services sectors. Indeed, many enterprises may find it difficult to survive, and the economy may suffer from significant disinvestment.

If the macroeconomic instability continues, attracting fresh private investment will be difficult. The lower fiscal space has already forced the government to cut back on subsidies and overall public investment. The government's capacity to raise public expenditure on education, health and social safety net programmes will be limited in view of the shrinking fiscal space. The government will need to reprioritise public expenditure and opt for targeted fiscal measures. The national budget for FY2024 will need to be cognisant of this.

It is hard to predict the extent of the impact on the economy as data for the real economy is either unavailable or unreliable. Bangladesh Bureau of Statistics (BBS) is expected to publish quarterly GDP estimates following the conditionality of the IMF beginning from the end of December 2023. The labour force data should also be made available at the earliest. This will help the policymakers assess the economic situation better and make informed policy decisions. This is particularly needed since the GDP data is often unsatisfactory. BBS has also recently conducted a household income and expenditure survey. However, how far the recent loss of purchasing power of the people arising from drastic price rises is captured in the survey will need to be considered.

Macroeconomic management in the coming months will be challenging. Policymakers will need to make hard choices. The fiscal, monetary and institutional policies will need to be reinforcing in nature. Macroeconomic management should be informed by the following three objectives: stability, discipline and consolidation. First, restoring macroeconomic stability should be the anchor of the macroeconomic policy stance. To this end, the government should immediately pursue market-based interest rates and exchange rates. Stabilising the prices of the essential commodities would require economic (e.g., tax and duty relief) and institutional (e.g., market monitoring and ensuring a competitive environment and enforcement of laws and regulations). Social protection measures for the low-income and fixed-income earning population groups should be given priority to ride over these turbulent times. Second, the government should make its best efforts to establish discipline in public expenditure by prioritising and ensuring good value for money. Also, discipline needs to be ensured in the banking sector by establishing good governance. The government should also closely examine the debt situation, which IMF has also emphasised. Debt management will call for consideration from both fiscal and external sector perspectives. The recent exchange rate fall would require much higher foreign debt servicing payments in BDT terms. Third, the government needs to consolidate domestic resource mobilisation and foreign exchange inflow. To this end, the utmost emphasis would be required to curb tax evasion and illicit financial flows. The foreign exchange inflow in all forms, be it export earnings, remittances through the official channels, foreign aid (commitment and utilisation), foreign grants for NGOs, and FDI, should be encouraged without exception. And lastly, policy formulation and implementation should be free from the capture of vested interest groups. The needs of the disadvantaged population groups will need to be met through adequate support programmes and speedy implementation of such declared initiatives as the 'family card'.

SECTION 3. FISCAL FRAMEWORK

Whether the fiscal framework of FY2023 was designed considering the correct set of assumptions remains a critically important question. While the economy was already reeling under immense pressure due to the ramifications of the COVID-19 pandemic, the situation on the eve of presentation of FY2023 budget was exacerbated by the rising pent up demand and price hike in global commodity market consequent to the advent of Russia-Ukraine war in late February 2022. Regrettably, FY2023 budget failed to take cognisance of the emerging scenario and the new realities that should have informed budget design and fiscal-public expenditure proposals. This resulted in a fiscal framework that was rather formulaic in nature and driven by business-as-usual considerations, i.e., lofty targets were set that had a high probability of missing their marks by a considerable margin at the end of the fiscal year. As the halfway marks become available, it is safe to anticipate that the probable will become the reality as the current fiscal year reaches the finishing line. Drawing lessons from this experience, the design and fiscal targets of the upcoming FY2024 should be set in a realistic manner, taking cognisance of the current macroeconomic trends – both domestic and external.

The issue of realistic target setting could take the case of revenue mobilisation as a key reference point. For instance, while proposing the budget for FY2023, the targeted growth of revenue earnings was set at 11.3 per cent over the revised budgetary target of FY2022. However, if the realised revenue mobilisation of FY2022 is considered, the growth target for FY2023 actually turns out to be almost threefold, at 31.8 per cent. As it so happens, according to the Ministry of Finance (MoF) data, revenue mobilisation decreased by (-) 3.1 per cent during the first six months (July-December) of FY2023. This implies that if the annual growth target of 31.8 per cent is to be achieved, then revenue earnings will need to increase by an unrealistic 67.4 per cent over the remainder (second half) of FY2023. Revenue mobilised by the National Board of Revenue (NBR), which accounts for about 85 per cent of the total targeted resource envelope, decreased by (-) 4.0 per cent during the July-December period of FY2023[2]. The decline in NBR tax collection can be primarily attributed to the fall in VAT and import duty collection. This, perhaps, is a reflection of the various import-related restrictions imposed by the government in view of the ongoing foreign currency crisis. On the other hand, this in all likelihood, is also indicative of a possible slowdown in economic activities. If this indeed be the case, then any significant increase in revenue mobilisation over the short term is highly unlikely.

If the current trend of revenue mobilisation persists, a large shortfall (i.e., the gap between the revenue mobilisation target and actual attainment) at the end of FY2023 will become inevitable. In December 2022, CPD came up with the projection that the total revenue[3] shortfall in FY2023 is likely to be Tk. 64,000 crore (CPD, 2022). Taking advantage of the latest available data from

[2] Curiously, data provided by the NBR itself posts a 11.0 per cent growth during the July-December period of FY2023. It may be noted that the July-December FY2023 tax collection figure reported by the NBR surpasses the MoF figure by about Tk. 4,400 crore. Also, the two agencies reported widely different figures as regards the tax collected by the NBR during July-December FY2022. Indeed, it is this figure of FY2022 which is the primary reason for the divergence. MoF reported that Tk. 146,859 crore was collected by NBR during the July-December FY2022 period whereas the figure reported by NBR for the same period is Tk. 131,035 crore. As a result, the growth figure reported by NBR appears to be much higher than the MoF figure.

[3] Total revenue is composed of both tax and non-tax revenue. Tax revenue, in turn, includes NBR tax revenue and non-NBR tax revenue.

both MoF and NBR, and considering the trends of other macroeconomic correlates, we now project that the revenue shortfall at the end of FY2023 could reach approximately Tk. 75,000 crore, with total revenue collection being about Tk. 358,000 crore. In this connection, it must be noted that the International Monetary Fund (IMF) has projected the total revenue mobilisation of FY2023 and FY2024 to be nearly Tk. 387,600 crore and Tk. 454,900 crore, respectively. If the aforementioned CPD projection holds and the IMF projection for FY2024 is to be achieved, then total revenue mobilisation in FY2024 will need to grow by about 27 per cent – a daunting task indeed. Furthermore, as a quantitative performance criterion to avail of the IMF loan facility, the floor of tax revenue collection at the end of FY2023 has been set at Tk. 345,630 crore. This clearly illustrates that the government has an uphill battle in the area of revenue mobilisation for both current and upcoming fiscal years if it wants to avail of the future instalments of the IMF loan.

The failure to utilise planned budgetary allocations has been a regular feature in Bangladesh's fiscal framework. Regrettably, this trend has continued in FY2023. According to the MoF data, total public expenditure recorded a paltry growth of 1.3 per cent during the July-December period of FY2023 (Table 3.1). The most alarming fact in this regard is that the annual development programme (ADP) expenditure recorded a negative (-) 4.9 per cent growth during the aforementioned period[4]. Whether it is due to limited resource availability owing to the fall in revenue mobilisation, the inability to implement the large number of projects, or is a result of the austerity measures taken by the government remains a critical question in this backdrop. ADP and non-ADP expenditures will need to increase by 41.5 per cent and 48.0 per cent, respectively, over the remainder of FY2023, to reach the programmatic public expenditure targets.

Table 3.1: Growth of public expenditure components (in per cent)

Component	Target FY22	Actual FY22	Target FY23	Jul-Dec FY22	Jul-Dec FY23	Required Jan-Jun FY23
a. Total expenditure	31.4	12.8	30.9	8.7	1.3	45.2
a.1 ADP expenditure	41.1	16.5	32.2	2.3	-4.9	41.5
a.2 Non-ADP expenditure	26.3	10.8	30.1	10.7	3.0	48.0

Source: Calculated from MoF data.

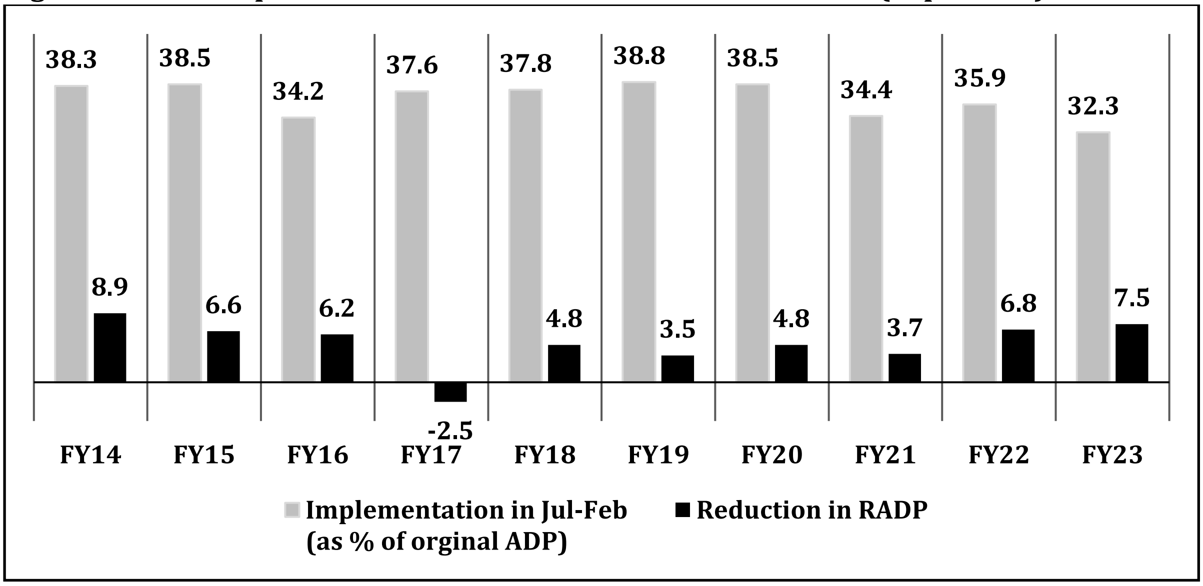
The data available from the IMED gives a more updated picture as regards the ADP implementation scenario. During the first eight months of FY2023 (July-February), actual expenditure on account of ADP implementation was 32.3 per cent of the originally planned allocation of Tk. 246,066 crore which is the lowest in the last decade (Figure 3.1). The utilisation of project aid (35.7 per cent) was marginally higher than the corresponding period of FY2022 and was in line with the trend of last three-four years. It was the Power Division that primarily drove the utilisation of project aid (PA). The utilisation of the local resource (taka) component (30.2 per cent) was the lowest since FY2014. Of the top ten ministries/divisions with a combined share of 72.5 per cent of the total ADP allocation for FY2023, four were not able to utilise their respective allocations at the average level. These are the Ministry of Science and Technology, Ministry of Primary and Mass Education, Health Services Division and Secondary and Higher Education Division. In this connection, it must be mentioned that in the budget speech for FY2023, ensuring

[4] The discrepancy in data reporting is observed once again in this case. According to the data from Implementation Monitoring and Evaluation Division (IMED) of Ministry of Planning, ADP expenditure increased by 7.3 per cent during July-December of FY2023.

timely completion of projects in education and health sectors was identified to be one of the major challenges for FY2023.

In view of the slow pace of implementation, a number of major government sectors (e.g., Education, Transportation and Communication, Health, and Power and Energy) were subjected to significant reduction in the revised ADP (RADP) for FY2023. The ADP for FY2023 was slashed by Tk. 18,500 crore (or 7.5 per cent) (Figure 3.1) which brought the size down to Tk. 227,566 crore. The reduction was fully on account of the PA component with the taka component remaining unchanged. This appears to be rather counterintuitive for two reasons: first, the rate of implementation of the PA component was better than that of the taka component, and second, in view of the ongoing foreign currency crisis, 'utilising funds available through foreign assistance', should have been given highest priority as mentioned in the budget speech.

Figure 3.1: ADP implementation scenario and reduction in RADP (in per cent)



Source: Calculated from IMED data.

Note: In the case of a reduction in ADP, a negative sign implies an increase in allocation.

Given the shortfall in revenue collection, inability to spend budgetary allocations could give policymakers some 'relief'. As a consequence, the level of budget deficit may not become a major concern in FY2023. However, this trade-off, as CPD has repeatedly pointed out, is a false relief brought with significant macroeconomic costs. Along with this, the composition of deficit financing should trigger some reasons for concern. Comparing the July-December period of FY2023 to the corresponding period of FY2022, the government's reliance on borrowing from the banking system has seen some rise. At the same time, due to lower net sales of national savings certificates, net non-bank borrowing has increased rather slowly. Given the persistent inflationary pressure in the economy, the government may need to continue to proactively borrow from non-banking sources in the coming days. However, as mentioned in the previous section, whether it will be possible remains a concern.

In light of the preceding discussion, the following suggestions are placed before the policymakers to take into account while formulating the national budget for FY2024:

- The personal income tax (PIT) structure in the FY2023 budget has remained mostly unchanged from the one introduced in FY2021. CPD has argued that lowering of the highest tax rate (from 30 per cent to 25 per cent) went against the idea of tax equity. In the FY2024 budget, the maximum tax rate should be restored to 30 per cent for highest cohort of earners.
- Given the increased pressure of the commodity price hike, particularly those of food items, the tax-free income threshold for personal income should be increased to Tk. 3.50 lakh. As an alternative, in order to give the low-income earners some respite, the second PIT slab, which is 5 per cent for an additional Tk 1 lakh, should be raised to Tk 3 lakh.
- In the FY2023 budget, the rate of investment tax rebate was fixed at 15 per cent on the eligible amount. This means that higher taxpayers, i.e., top earners receive higher tax rebate benefits, whereas those with annual income below Tk. 15 lakh are not eligible to get any additional tax benefits. The withdrawal of this provision needs to be considered in the FY2024 budget.
- The FY2023 budget also increased the allowable ceiling of perquisite from Tk 5.5 lakh to Tk 10 lakh. Accordingly, individuals with annual income ranging between Tk. 16.5 lakh and Tk. 30 lakh will receive additional tax benefits of up to Tk. 112,500 per year. This is another instance where the tax policies favour high-income groups. The FY2024 budget may consider eliminating this clause.
- All ad-hoc provisions of tax incentives should be stopped from FY2024. NBR needs to be selective and careful in the next fiscal year as more demand for incentives will be lined up in view of current economic situation. Proper cost-benefit analysis must be conducted before coming up with new provisions. 'Sunset clauses' should be introduced in case of existing provisions. There should also be a medium-term plan and timeline as regards phasing out the various tax exemptions. Stakeholder consultations should be an integral part of formulating this plan. An analysis of revenue forgone owing to the various tax exemptions should be provided in the next budget. This will draw much-needed political attention to this burning issue.
- In the FY2023 budget, a new provision (Section 19F: Special Tax Treatment in respect of undisclosed offshore assets) was added to the Income Tax Ordinance 1984 to mainstream money earned and asset acquired abroad into the economy. According to the provision, no authority, including the income tax authority, shall raise any question as to the source of any asset located abroad if a taxpayer pays tax on such asset. This opportunity was to be in force for the full FY2023 period. Such an initiative is ethically unacceptable, will discourage honest taxpayers, and has traditionally did not generate the intended revenue which justified its introduction in the first place. CPD strongly feels that this provision should be discontinued, and no such incentive finds its place in FY2024 budget.
- Provisions such as Section 16H, Section 19BBBBB, and Section 19DD are still in place to legalise undisclosed income and assets under the Income Tax Ordinance, 1984. These should be discontinued from the next fiscal year.
- Since the income tax exemptions for 28 IT-enabled services (ITES) are set to come to an end in FY2024, a thorough examination of the incentives should be undertaken with a view to (a) selection for continuation of incentives, (b) introduction of sunset clause and (c) identify opportunities for imposition of taxes on e-commerce and digital services.

- The moratorium on e-commerce taxation, introduced in WTO in 1998, is set to come to an end (by 2024 or 13th WTO Ministerial Conference – MC13, whichever is earlier if no agreement is reached in the WTO in this regard). The government should take adequate preparation to (a) proactively participate in the WTO discussions and (b) identify tax measures if and when the moratorium comes to an end.

- Ambiguities in current tax laws (service code 99.60) in defining e-commerce activities should be removed to enhance the scope and opportunities of revenue mobilisation.

- To collect VAT at the local stage, NBR could install only 4,595 electronic fiscal devices (EFD) / sales data counter (SDC) machines at existing businesses against the target to reach the 10,000 mark by June 2022. Presenting the national budget for FY2023, the Finance Minister stated the plan to reach the target of installing 10,000 EFDs by June 2023. The government plans to install another 300,000 EFDs over the next five years, which is expected to yield an additional revenue of Tk. 10,500 crore, with an initial 60,000 planned for FY2024. NBR needs to aggressively pursue this target.

- NBR should launch at the earliest, a comprehensive online payment system for VAT, income tax and customs together with an interface with iBAS++ and ensure harmonisation and taxpayer data sharing across various wings of the NBR as has been envisaged in the PFM Action Plan 2018-23. The data-sharing issue has also been raised by the IMF.

- As per data from international sources, the larger part of Bangladesh's illicit financial outflows are on account of trade mispricing. The Transfer Pricing Cell (TPC) of NBR, Bangladesh Financial Intelligence Unit (BFIU) and Customs Intelligence and Investigation Directorate (CIID) should work closely to deal with trade-based money laundering. For effective implementation of the responsibility of the TPC, the national budget for FY2024 should ensure adequate allocation for technical and human resources and forensic investigation capacities of the aforesaid entities.

- The upcoming national budget must focus on generating revenue from specialised sources, particularly expediting the realisation of contested revenue claims[5] through the Alternative Dispute Resolution (ADR) mechanism. Steps should be taken to expedite the resolution of pending tax-related cases in tax tribunals and courts.

- Priorities for public spending ought to be set out clearly in the FY2024 budget. The design of the budgetary framework should take cognisance of the rising cost of essentials. In order to do this, appropriate attention should be paid to food production, social safety net programmes (including public works programmes), subsidies for agriculture, energy and power sectors, as well as the health and education sectors. Supporting the marginalised groups should be the central focus of subsidy management.

- Prior government directives to reduce "unnecessary and luxury" public spending (such as the purchase of government vehicles and international travel) should be reintroduced.

- The ADP for FY2024 should be carefully designed with a view to containing the budget deficit. A political government may find it tempting to take on new development initiatives in the run-up to the upcoming election by adopting a populist stance. The budget for FY2024 should,

[5] Regrettably, up to date data as regards this is not available on public domain. However, according to the NBR Annual Report 2019-2020, contested revenue claims in FY2020 amounted to more than Tk. 126,600 crore.

however, refrain from any ostentatious public spending in the backdrop of the macroeconomic challenges facing the economy.

- The government should give priority to implementing all foreign-funded ADP projects in light of the current foreign exchange situation. The government should give higher priority to implementing projects that are nearly finished (about 90-95 per cent completion rate in June 2023).
- Projects that had a 10 per cent or lower implementation rate up till end-FY2023 should be deprioritised. "Carryover projects" that have a maximum implementation rate of less than 30 per cent up till end-FY2023 should be re-examined to justify continuation.
- The government should form an independent commission to assess the rising costs of public infrastructure projects. Concrete steps should be taken to ensure good governance in implementation of public infrastructure projects in particular. As a first step, the government must make all development project proformas (DPPs) available to the public for review and comments. To do this, the government should also think about undertaking a comprehensive assessment of public expenditures as early as possible.

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SECTION 4. PRICE OF ESSENTIALS BEYOND PEOPLE'S REACH

Inflationary pressures have been building in Bangladesh even before the situation in Ukraine began. Recent sharp swings in energy costs have made matters worse in Bangladesh. The continued price growth is due in part to domestic reasons including market distortion by a small number of dominant firms and lax regulation. There are a number of essentials that are more expensive in Bangladesh than in other developing or industrialised countries. Low-income families are fighting to make ends meet as the cost of living continues to rise. Many families, including minimum wage earners across all sectors, are struggling to make ends meet.

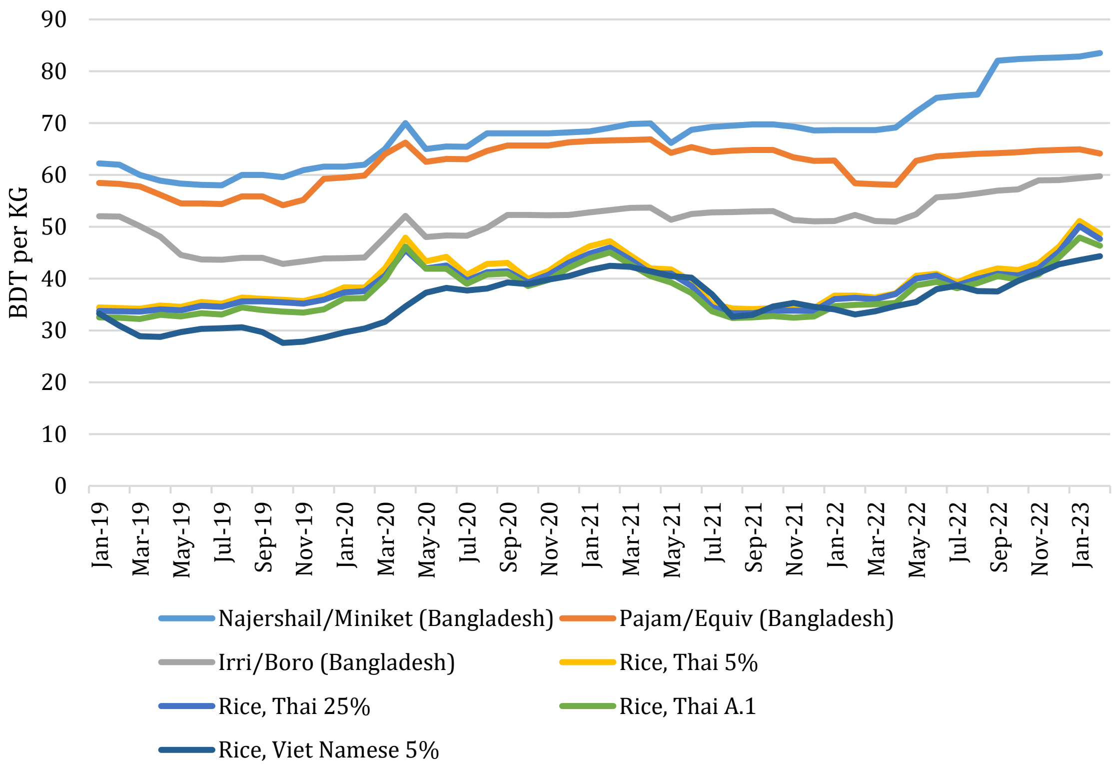
Analysis reveals that at least 28 imported essential food items, currently face a high incidence of tax. These include: fresh or chilled, other cuts of bovine meat with bone; fresh or chilled boneless bovine meat, wrapped/canned up to 2.5 kg; fresh or chilled other cuts of meat of sheep, with bone; frozen cuts and offal of chicken, wrapped/canned up to 2.5 kg; fish (Ruhi, Katla, Pangash, Karp & alike), excluding wrapped/canned up to 2.5kg; Hilsha fish (excluding wrapped/canned up to 2.5 kg); milk & cream of greater than 1% but less than or equal to 6% fat, not concentrated or sweetened, wrapped/canned up to 2.5 kg; milk & cream in powder forms less than or equal to 1.5% fat, concentrated or sweetened, in retail packing up to 2.5kg; milk and cream in solid forms of less than or equal to 1.5% fat imported by vat registration milk and milk product; milk and cream in powder excluding powder, granules or other solid from and imported vat registered companies; milk and cream in powder excluding powder, granules or other solid from and imported vat registered companies; tomatoes, fresh; onions, fresh or chilled; garlic, fresh or chilled; dates, fresh; pepper, neither crushed nor ground; cardamoms: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; seeds of cumin: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; ginger: neither crushed or ground, excluding wrapped/canned up to 2.5 kg; turmeric (curcuma); other maize, excluding wrapped/canned up to 2.5 kg; husked (brown) rice; semi-milled or wholly milled rice; maize (corn) starch; crude palm oil imported by vat registered edible oil refinery industries; palm oil (excluding crude) & its fractions, not else specified, including refined palm oil; refined palm kernel/babassu oil & fractions, not chemically modified; salt (other than pure sodium chloride) solution, salt boulder for crushing & salt in bulk; sugars, pure (excluding glucose, etc.); sugar ethers and salts, etc (National Board of Revenue 2022). In the backdrop of the soaring inflation, the National Board of Revenue (NBR) should reduce the duties and taxes, both at import and domestic levels, for essential commodities to provide some respite to consumers with low and limited income.

High inflation has revealed the inherent weakness in the government's domestic resource mobilisation approach which is largely dependent on revenue collection from indirect taxes. It is likely that if inflation continues at the present rate, the government may be compelled to withdraw indirect taxes on essential items. Thus, fiscal policy which is highly dependent on indirect taxes propagates economic inequality in society and forces the government to trade-off revenue generation in the face of high inflation. It is urgently required to increase revenue collection from direct taxation and reduce dependence on indirect taxes, especially since Bangladesh is now poised to graduate from the Least Developed Countries (LDC) group.

International comparison of prices shows that the price of essential food items do not fall in Bangladesh, even when the international prices fall. Additionally, the data also shows that the price of some essential food items remain consistently over the international prices.

For brevity of exposition, we highlight the difference in domestic and international prices of four food items: rice, soyabean oil, sugar, and beef. Out of these four, rice and beef are mainly produced domestically, whereas soyabean oil and sugar are mainly imported. Nevertheless, we find that the price of all four items in Bangladesh is consistently higher than the international prices. Figure 4.1 shows that the price of three common types of rice have been consistently higher than price of both Thai and Vietnamese rice.

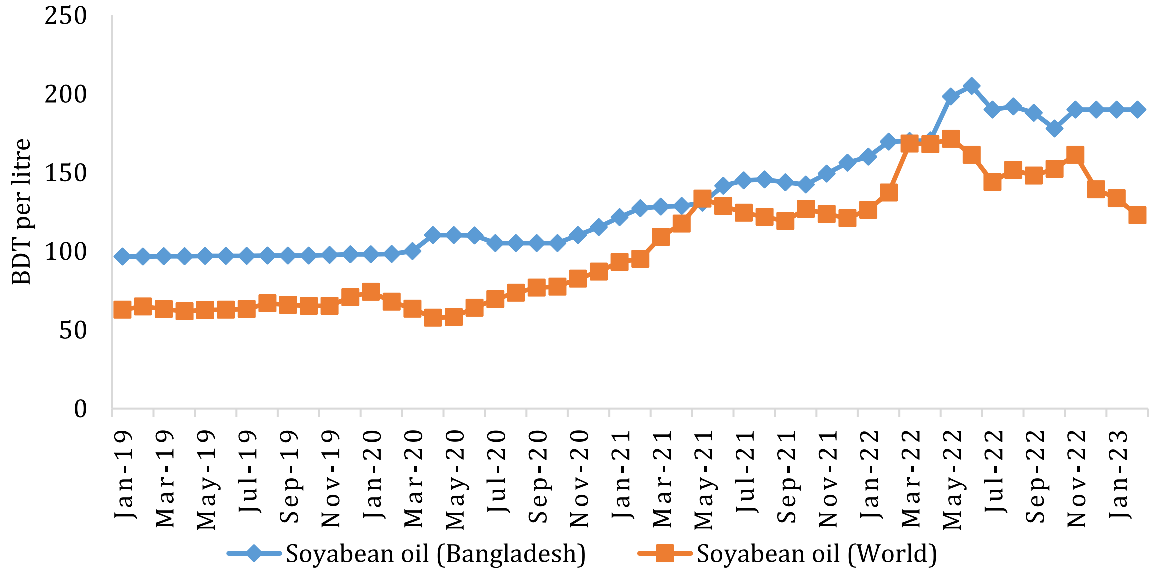
Figure 4.1: Price of rice in Bangladesh and international markets (in BDT per kg)



Source: Author's illustration based on data from Bangladesh Bureau of Statistics (BBS 2022) and World Bank (World Bank 2022)

Figure 4.2 shows that the price of soyabean oil has been falling the international market from November 2022 to February 2023, whereas there has been no decrease in the price of soyabean oil in the local market during the same period.

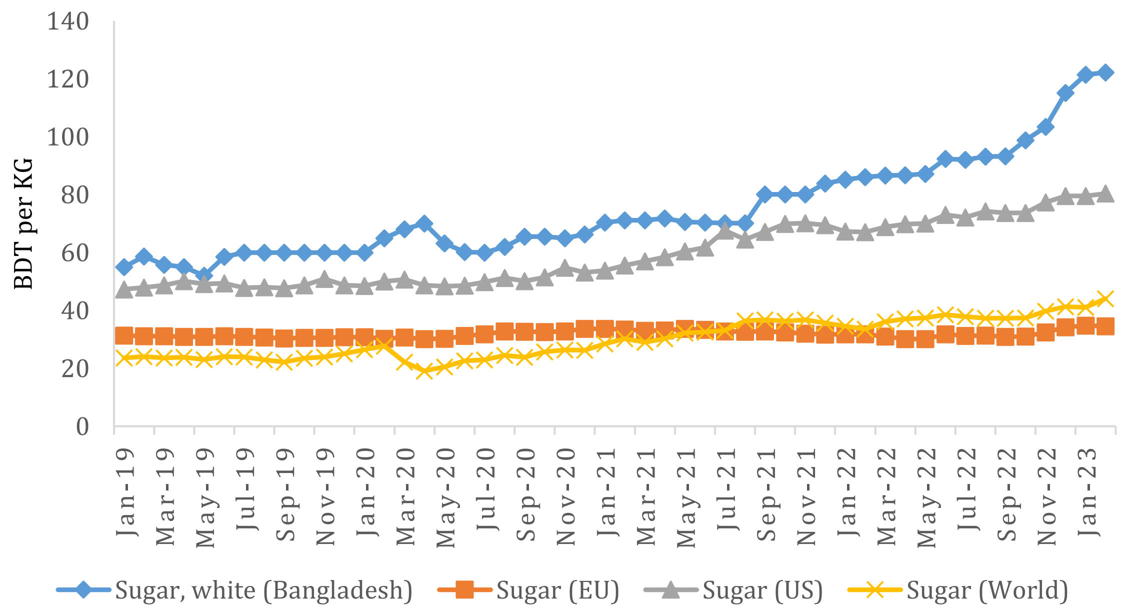
Figure 4.2: Price of soyabean oil in Bangladesh and international markets (in BDT per litre)



Source: Author's illustration based on data from Bangladesh Bureau of Statistics (BBS 2022) and World Bank (World Bank 2022)

Figure 4.3 shows that the price of sugar in February 2023 was BDT 122 per kg in Bangladesh, but only BDT 80 per kg in the US market, BDT 44 per kg in the world market, and BDT 35 per kg in EU market. Even if we consider transport costs, import tariffs, and other trade-related expenses, such high differences in prices appear to be odd.

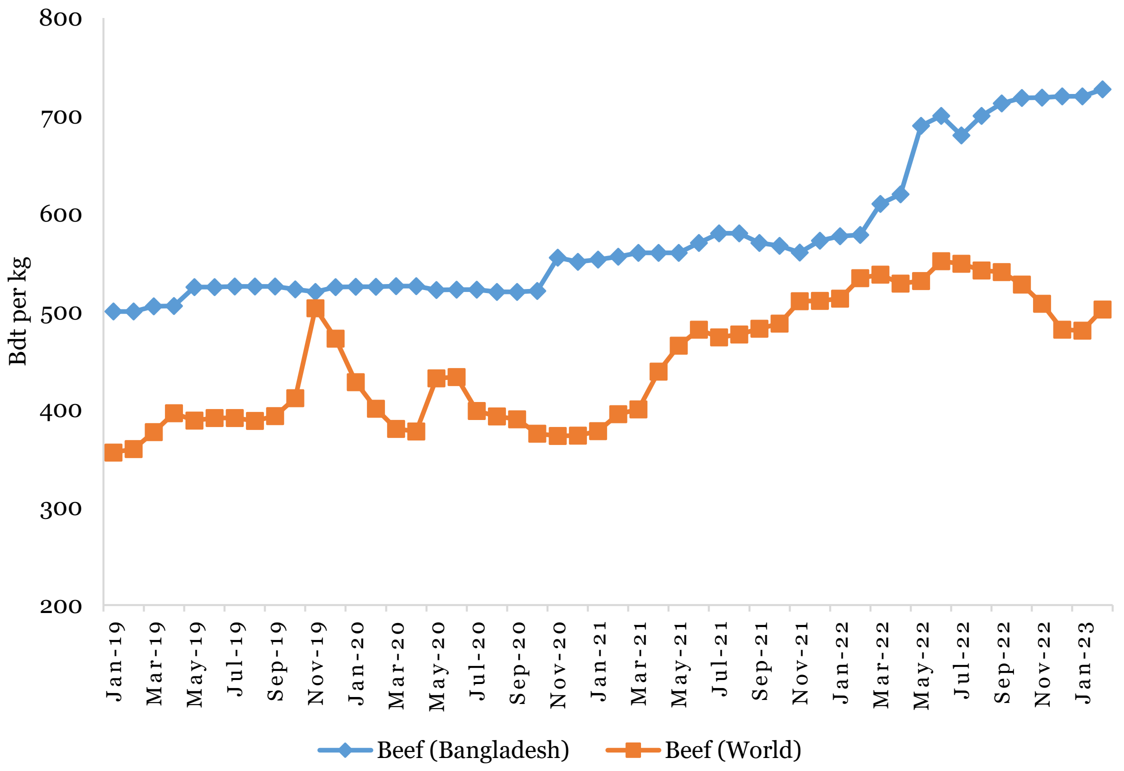
Figure 4.3: Price of sugar in Bangladesh and international markets (in BDT per kg)



Source: Author's illustration based on data from Bangladesh Bureau of Statistics (BBS 2022) and World Bank (World Bank 2022)

Finally, Figure 4.4 shows that the international price of beef decreased from July 2022 to December 2022, whereas the price of beef in Bangladesh increased during the same time. As of February 2023, the price of beef per kg in Bangladesh was BDT 225 higher than the price of beef per kg in the world market.

Figure 4.4: Price of beef in Bangladesh and international markets (in BDT per KG)

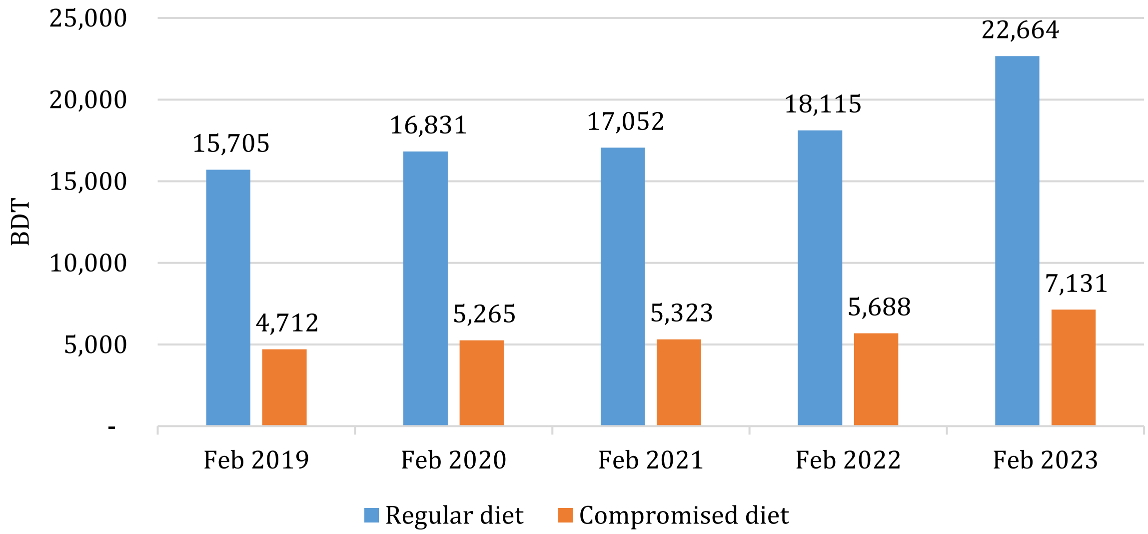


Source: Author's illustration based on data from Bangladesh Bureau of Statistics (BBS 2022) and World Bank (World Bank 2022)

These numbers indicate that the inflation prevailing in Bangladesh at present may not necessarily be imported inflation, as is commonly presumed. On the contrary, the inflation in Bangladesh appears to be a largely domestic phenomenon.

As a result of these price increases, the cost of living has increased rapidly causing immense suffering to low income and fixed income households. Figure 4.5 shows that the average monthly food expenses for a household of 4 individuals in Dhaka city have increased continuously during 2019 to 2023. The average monthly cost of consuming a compromised diet for a household of 4 individuals increased from BDT 4,712 in February 2019 to BDT 7,131 in February 2023, and the average monthly cost of consuming a regular diet for a household of 4 individuals increased from BDT 15,705 in February 2019 to BDT 22,664 in February 2023.

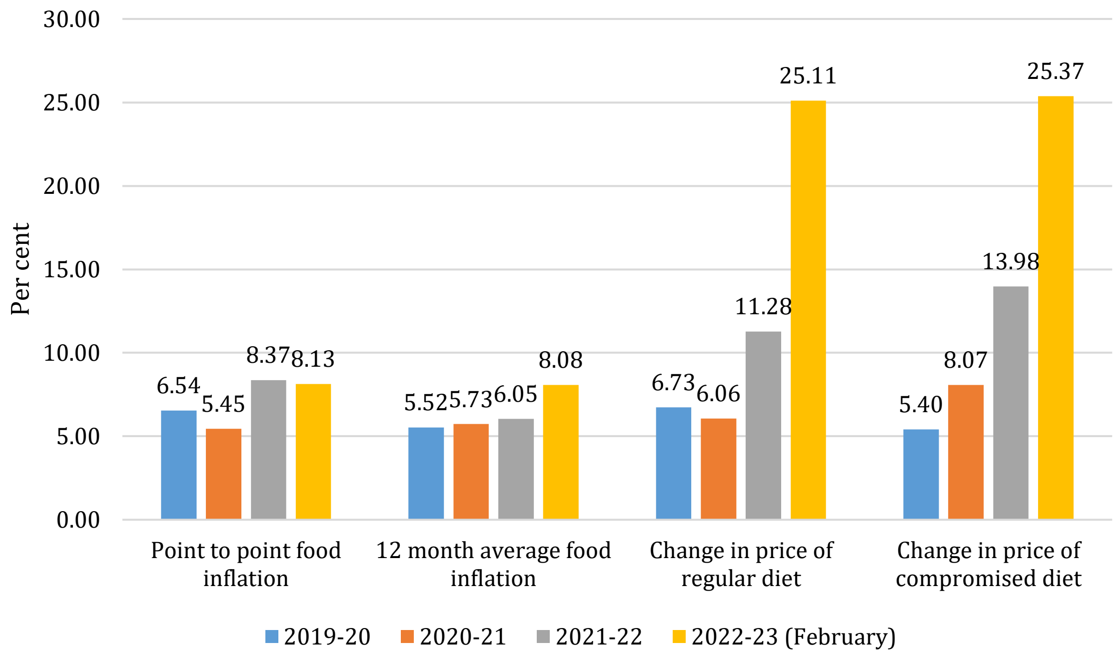
Figure 4.5: Average monthly food expenses for a household of 4 individuals in Dhaka city (in BDT)



Source: i) Authors' calculations based on data from Bangladesh Urban Socioeconomic Assessment Survey 2019 (BBS 2020), Bangladesh Household Income and Expenditure Survey 2016 (BBS 2019), and Trading Corporation of Bangladesh (TCB 2022)

A simple comparison shows that the percentage change in the price of essential food items was significantly higher than the officially reported food inflation. Figure 4.6 shows that the 12 month average food inflation in February 2023 was 8.08 per cent, whereas the percentage change in the price of essential food items in the same period was 25.37 per cent.

Figure 4.6: Food inflation versus change in price of essential food items



Source: CPD illustration based on data from Bangladesh Bank and Trading Corporation of Bangladesh

In view of the above, the following suggestions are put forward for consideration of policymakers for controlling the price of essentials in the upcoming budget of FY2023:

- The Minimum Wage Board should consider increasing the minimum wages in all industries so that workers earning minimum wages may at least afford basic food. Private sector corporations should consider a higher salary increment in 2022, given that a 5 per cent increment of salary in the face of double-digit price hikes is compelling workers to seriously compromise their standard of living.
- Government should carefully examine the duty and tax structures of the essential commodities, both at import and domestic levels, and make downward adjustments with a view to provide some respite to low and limited income-earning consumers. The increased price level of most of the other commodities should be able to compensate for the potential revenue loss to this end.
- Tax-free income threshold for personal income should be raised to Tk. 3.50 lakh in view of the added pressure of the rising food inflation and income erosion induced by the pandemic. The next slab for personal income tax, which is 5 per cent for an additional Tk. 1 lakh, should be increased to Tk. 3 lakh to provide a cushion for the middle-income earners.
- Government should extend the scope of direct cash/kind assistance programmes for low-income population groups.
- Volume of essential commodities sold through the open market system (OMS) should be increased. Government should set higher targets for foodgrains procurement and food distribution programmes. To this end, adequate resources should be allocated in the FY2023 budget. Furthermore, the distribution of these commodities must be managed efficiently and without corruption so that only the eligible can obtain the essential items at lower prices.
- Competition Commission's role should be strengthened. Required skilled professionals should be hired to this end, particularly with a view to monitoring markets for essential commodities on a regular basis. The Commission should create a database, monitor the operations of prominent market players on a regular basis, investigate market control and manipulation (if any), and take appropriate actions. An adequate budget should be earmarked for the Commission to perform these duties. To this end, the Ministry of Commerce should also work in tandem with the Commission. The Bangladesh Competition Commission should adopt a strong stance against cartels and a zero-tolerance policy towards collusive practices. Furthermore, the Competition Act 2012 should be revised to directly address monopolies and include specific anti-trust clauses, along with concrete penalties for violators.
- Government should provide additional support for subsidised credit programmes for the agriculture sector (both crop and non-crop) to incentivise production during the next fiscal year.
- Government should continue providing stimulus to the small and medium enterprises to help them survive the difficult times.

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SECTION 5. SUBSIDY RATIONALISATION AND MANAGEMENT IN MAJOR SECTORS

The subsidy expenditure of the government has skyrocketed within a short period of time and has become a major concern in view of limited fiscal space. In the national budget FY 2022-23, total subsidy expenditure is projected to be Tk 82,745 crore, which is about 1.9 per cent of GDP (Table 5.1). Between FY2015-16 and FY2022-23, the subsidy expenditure increased by about five times (494.3 per cent). The subsidy is distributed in three forms- (a) cash loan, (b) subsidy, and (c) fiscal incentives. Rise of cash loans to Bangladesh Power Development Board (PDB), subsidy to gas and cash incentives to agriculture and remittances are the main areas which caused such a rise in subsidy expenditure in recent years. Hence, the government has made specific commitments with regard to subsidy rationalisation and management as part of meeting the loan conditionality set by the IMF. This section discusses the current state of subsidy in main economic activities/sectors, initiatives undertaken for subsidy rationalisation and management and possible alternative ways to address those issues.

Table 5.1: Total Subsidy (in Billion BDT and as % of government expenditure)

Items	Subsidy (Tk in billion)							
	FY16	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Cash loan	29.07	51.73	35.52	113.41	128.86	110.49	133.73	
Subsidy	10.86	29.43	50.20	91.44	76.86	89.57	208.0	
Fiscal incentives	99.31	80.05	96.81	118.17	213.54	182.56	260.25	
Total subsidy	139.24	161,21	182.53	323.02	419.26	382.62	601.98	**827.45**
% of government expenditure	5.8	6.0	5.67	8.25	10.14	8.22	10.15	**12.20**
% of GDP								**1.9**

Source: Based on Ministry of Finance.

5.1 Subsidy in the Power and Energy Sector

The power and energy sector is the government's biggest subsidy expenditure shareholder (40 per cent of the total subsidy allocation in FY2022-23). Within this sector, the power sector gets the lion's share of the distribution (79.3 per cent of total allocation for the sector). During the budget of FY2022- 23, a subsidy of Tk 17,000 crore was proposed for the power sector, which has been revised upward to Tk 23,000 in the revised budget for FY2022-23. In addition to that, imported LNG has been subsidised for several years. In the budget for FY2022-23, Tk 6,000 crore was proposed for importing LNG. An additional subsidy of Tk 5,000 crore was requested but was not approved in the cabinet. There is no subsidy allocated for imported petroleum (Table 5.1.1). It is to be noted that a part of the expenses related to generating electricity or importing petroleum and LNG have been passed on to the consumers as adjustment of tariffs through the administered process.

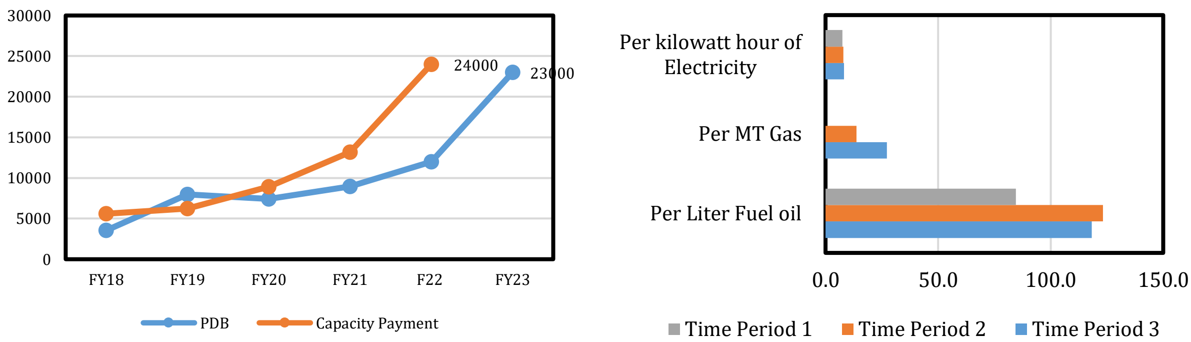
Table 5.1.1. Subsidy in power and LNG in last fiscal years

	Power (Crore Tk)	LNG (Crore Tk)	Petroleum (Crore Tk)	Share of the power sector in total subsidy (Per cent)	Share of LNG sector in total subsidy (Per cent)
RFY22	12,000	6,000	0	35.12	17.56
PFY23	17,000	6,000	0	30.21	10.66
RFY23	23,000	6,000	0	31.47	8.21

Source: MTMPS 2022- 23 to 2024- 25, The Business Standard.

The high amount of subsidy that the BPDB claims for the power sector is based on the argument of rising import price of raw materials such as- HSD, HFO and LNG, and their higher transmission and distribution costs to the power plants. However, a large part of the subsidy burden is caused due to excess power generation capacity and resultant capacity payment to the independent power producers (IPPs). Figure 5.1.1 postulates the trend of subsidy provided in the power sector and capacity payment to the IPPs. The trend of capacity payment and subsidy shows almost a parallel increasing trend indicating how the positive growth in capacity payment induces higher subsidy in the power sector (Figure 5.1.1).

Figure 5.1.1: Trend of subsidy and capacity payment in the power sector and change of tariff (in Tk crore) [6]



Source: MTMPS 2022- 23 to 2024- 25, The Business Standard, BERC, BPC and MPEMR.

The subsidy in the LNG sector is mainly due to the import of expensive LNG from the spot market. Bangladesh's government has resumed LNG import from the international market and intends to import even more LNG in future.[7] Even though the price in the global market shows a downward trend, the LNG import at a higher amount to meet the gas shortages will cause a higher subsidy burden. A part of the high expenses has been met by passing it on to the consumers at a high retail price of LNG/gas. The subsidy burden could be eased significantly if domestic gas exploration onshore and offshore was being prioritised by Petrobangla.

[6] In case of power tariff January, February and March 2023 have been considered as time period 1, 2 and 3 respectively.
In case of gas tariff June 2022 and January 2023 have been considered as time period 1 and 2 respectively.
In case of fuel oil tariff October 2008, 10 September 2022 and 30 September 2022 have been considered as time period 1, 2 and 3 respectively.

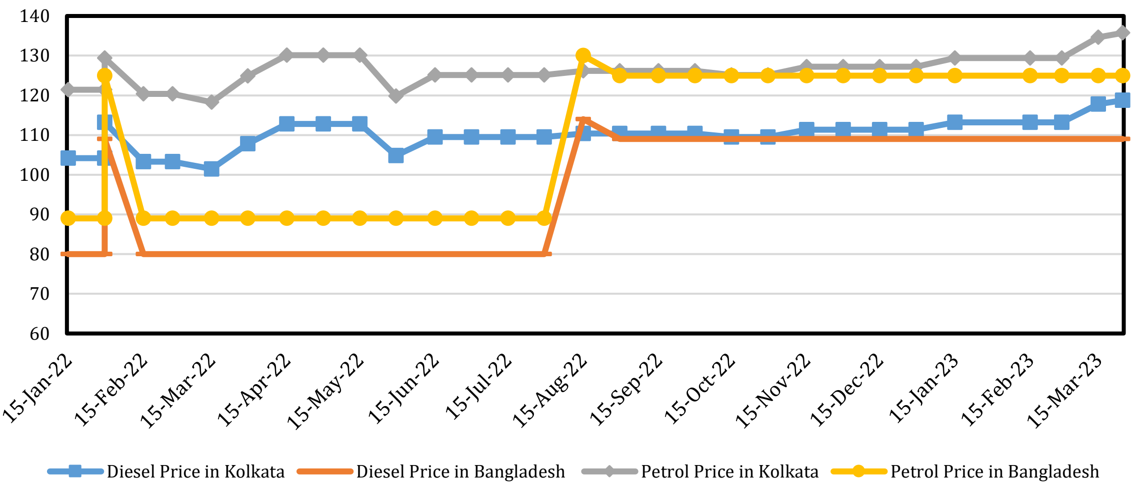
[7] The government has approved the purchase of 12 LNG cargoes from the spot market until June, 2023 and the first shipment will arrive in April, 2023. In upcoming months, Petrobangla eyes up to four cargos to maintain the daily supply of 3,000 million cubic feet.

In the budget for FY2022-23, no subsidy was allocated for petroleum products. However, the Bangladesh Petroleum Corporation (BPC) requested a subsidy of Tk 19,358 crore at a later stage which is not accepted with the argument that it is making a profit on petroleum products (e.g. diesel) after the recent adjustment of tariff at the retail level.

To ease the subsidy pressure in the power and energy sector, the government has gradually increased the retail price of electricity, gas and fuel. This initiative aligns with the government's commitment to comply with the IMF condition of slowly moving towards market-based tariff rates for petroleum products. As part of this initiative, a number of times tariffs have been adjusted during the current fiscal year. The government has hiked fuel oil prices by 42.5 per cent to 51.6 per cent during August 2022. It increased gas prices by 179 per cent for industries effective 1 February 2023. During January-March 2023, the electricity price was hiked three times by 15 per cent (5 per cent each month) by government executive orders. According to an estimate by the finance ministry, subsidy expenditure is reduced by Tk 23,105 crores through those initiatives.[8]

Unlike Bangladesh, India follows a market-based price-setting mechanism in case of energy price. Figure 5.1.2 shows the overall tariff trends in Kolkata (India) and Dhaka (Bangladesh) for diesel and petrol since January 2022. Following the market-based rates, diesel and petrol prices fluctuated in Kolkata. However, after the adjustment of tariffs, a sharp jump in both diesel and petrol prices can be observed in Bangladesh. The petrol price in Dhaka is higher than that of Kolkata while the gap in diesel price has reduced significantly and the prices in both cities are almost similar.

Figure 5.1.2: Difference between the diesel and petrol price in Kolkata and Bangladesh



Source: NDTV and BPC Website

In order to ease the pressure of the subsidy burden, the following initiatives could be undertaken by concerned departments of the Ministry of Power Energy and Mineral Resources (MoPEMR).

1) Subsidy of the power sector should be rationalised by reducing the burden of capacity payment provided to IPPs and QRRs: The government should gradually step out of the vicious cycle of capacity payment to the IPPs and QRRs through signing/renewing agreements under 'no electricity, no pay' clause. Moreover, expensive fuel-based power plants, outdated power plants,

[8] https://www.thedailystar.net/news/bangladesh/news/govt-aims-save-tk-20000-crore-3196371

low-efficiency power plants, and QRRs should be gradually phased out to ease the pressure of the subsidy burden.

2) A market-based price-setting mechanism should be introduced in the power and energy sector: According to the IMF, introducing a periodic formula-based fuel price adjustment mechanism will help ensure no structural subsidies for petroleum products. India long ago had transited from Administered Pricing Mechanism (APM) to Market Determined Pricing Mechanism (MDPM) through the phase-in period approach. As the energy prices at global market is gradually declining, and domestic petroleum companies are now in surplus, it is the right time to introduce a periodic formula-based fuel price adjustment mechanism. BPC should start market-determined price-setting mechanism for petroleum prices from July 2023. The price can be monitored and adjusted on a monthly basis in accordance to the global energy market.

3) Budget allocation should be provided on a priority basis for domestic gas exploration: The national budget of the ongoing fiscal year neither has projects relating to gas exploration nor includes an allocation for intensive gas exploration and expedited work plan. The Bangladesh Petroleum Exploration and Production Company (Bapex) plans to add up to 300 million cubic feet of gas per day to the national grid by 2023 through its short-term exploration programme by drilling 22 wells in designated areas as well as in areas of other production companies. The ongoing exploration programme must be implemented at the earliest with necessary fiscal support. The upcoming national budget must include an allocation for the exploration of natural gas as a solution to LNG subsidy.

4) Promoting clean energy could ultimately help the power and energy sector out of the subsidy burden: Existing fiscal and monetary policies are highly discriminatory in promoting renewable energy in the country. Promoting clean energy in Bangladesh will not be possible unless fossil-fuel-based energy infrastructure is not discouraged by withdrawing fiscal and budgetary support (e.g., carbon tax, carbon cap). This transformation towards clean energy can only occur by providing fiscal and budgetary support to renewable energy producers through tax breaks, subsidies and cash incentives. Hence, the government needs to take measures such as reduction of custom duty and VAT on renewable energy-related technologies and types of machinery, and, even subsiding clean energy-based projects and initiatives to create a level playing field. The Renewable Energy Policy 2008 provides renewable energy project investors in public and private sectors exemption from corporate income tax for 5 years. They should be provided 10 years of tax holiday as fiscal support.

5.2 Fiscal Incentives for the Export Sector

In the national budget for FY 2022-23, significant fiscal incentives were allocated for the export sector, like those in earlier fiscal years. The number of items eligible for different export cash incentives increased to 43 this year. Among them, eight items were given 20 per cent cash incentives, six were given 15 per cent cash incentives, and one was given 12 per cent cash incentives (Annex Table 5.1). RMG products were made eligible for multiple kinds of cash incentives: a) 5 per cent if product exported with locally procured raw materials; b) 4 per cent if raw materials were imported for the exported products; c) an additional 4 per cent if exported to non-traditional markets that include all the countries except the EU, Canada, the UK and the US;

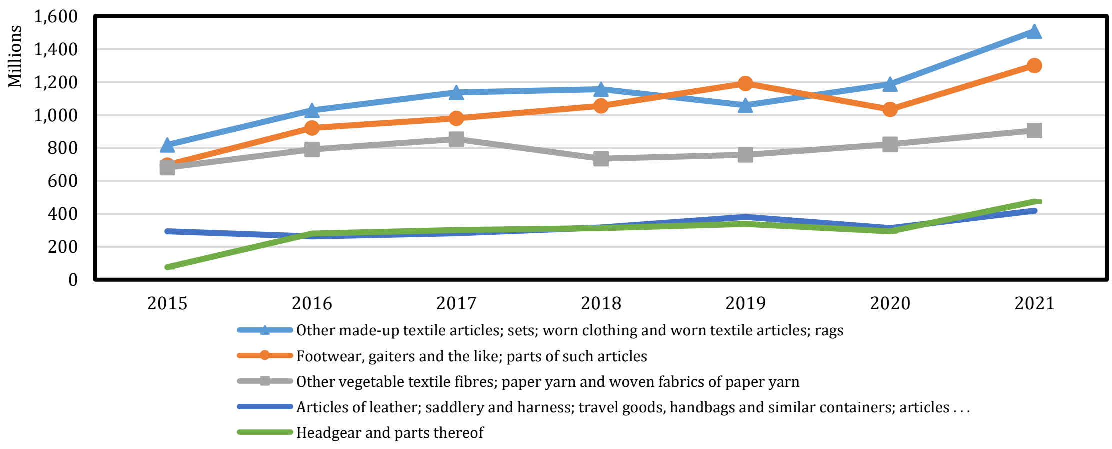
d) 1 per cent additional cash incentive for all the RMG product. Besides, all the exporting products were made eligible for 1 per cent cash subsidy.

Fiscal incentives for export products and jute goods have been consistently increasing in line with the rise in the export of different export products. During FY 2021-22, a total of Tk 9,000 crore (including for Jute) was spent as incentive to the export sector (according to Ministry of Finance). Given the overwhelming dominance of RMG products in the overall structure of export, the majority share of export cash incentives was allocated to the RMG sector. Majority of export cash incentives have been in effect without any specific time period over a long period. Uncertainty remains over the real effectiveness of these incentives in promoting the export of these products in traditional and non-traditional markets (such as a negative relation between cash incentives and export performance for Nepal found by Paudel et al., 2020). Moreover, cash incentives only for targeted potential RMG and non-RMG products need to be considered to promote export diversification. Hence, a major overhauling in the structure of cash incentives for the export sector is needed targeting the future outlook of the country's export. Under the current circumstance, the government could consider the following recommendations for the allocation of export subsidies in the upcoming budget:

1) A detailed study on the assessment of the effectiveness of cash incentives for export needs to be undertaken: The Ministry of Commerce, with the support of the Bangladesh Trade and Tariff Commission, should undertake a detailed study to assess the effectiveness of cash incentives for export products. Such a study should help assess whether the cash incentives were able to achieve the targets, identify the demand for existing cash incentives, and identify the requirement for cash incentives for new and emerging products. It will also assist in redistributing the cash incentives for promoting intra-RMG and non-RMG diversification.

2) Give more priority to non-RMG sectors for providing export cash incentives: Although the rate of cash incentive for RMG is lower than the many non-RMG products, given that RMG industry exports the highest amount, the sector also gets the highest amount of cash incentives. Besides RMG sector enjoys other fiscal and non-fiscal benefits. In view of promoting export diversification, the national budget for FY 2023-24 may consider shifting a portion of RMG cash incentives to non-RMG products that have higher export potential. Figure 5.2.1 shows the export trend some of the top-growing non-RMG sectors in recent times.

Figure 5.2.1: Export trend of some key non-RMG product (in million USD)



Source: ITC Trade Map (2023).

3) Allocate more subsidy for non-cotton textiles: The increase in global demand for blended fabrics and apparel at the consumer level has led to an increase in the demand for non-cotton textiles as well. However, Bangladeshi textile still has a limited capacity to produce non-cotton textiles (manmade fibre, synthetic fibre, polyester etc.). As a result, woven apparel makers need to depend on imports to meet around 60% of the demand for non-cotton fabrics. The budget of the current fiscal year (FY 2022-23) did not allocate any dedicated subsidy for non-cotton fabrics. Providing special cash incentives for exporting non-cotton products in the national budget for FY2023-24 would enhance export outside cotton-based products.

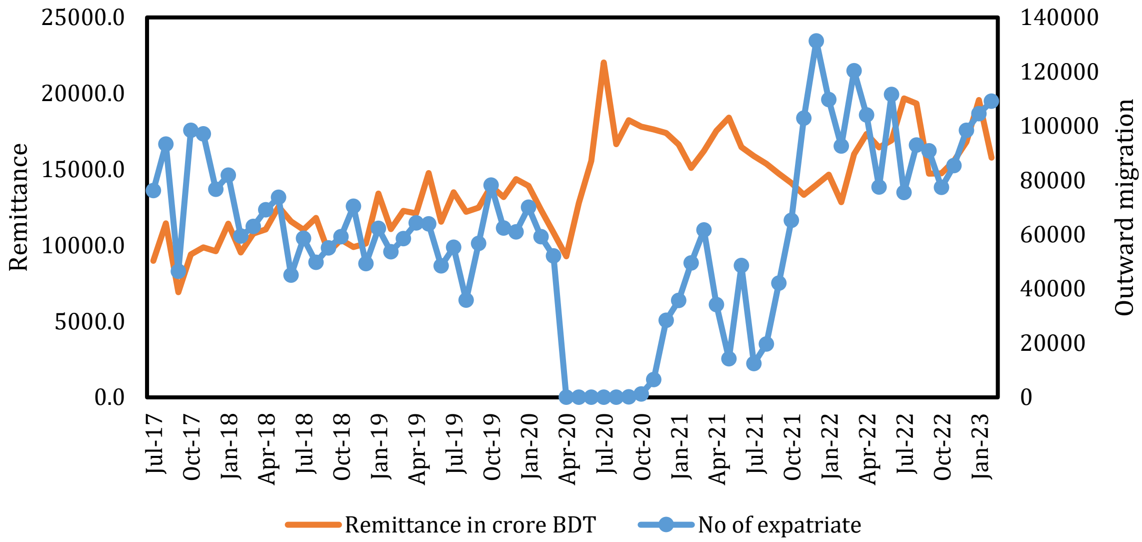
4) Find out strategies to gradually withdraw traditional cash incentives for export: After Bangladesh graduates from the LDC category in 2026, it cannot provide cash incentives for export in its current form as per World Trade Organisation (WTO) rule. Hence, the government needs to gradually reduce subsidies from the export sector to let it be prepared for the post-LDC scenario. While direct export subsidy gradually needs to be reduced, at the same time, innovative incentive schemes (such as subsidy for skill and technology upgradation, active labour market programmes, social safety net programmes, health insurance and support for ease of doing business etc.) needs to prioritise for supporting the export industry.

5.3 Cash incentive for Inward Remittance

The government introduced cash incentives in FY 2019-20 to enhance the inward flow of remittance.[9] Over the years, the amount of cash incentives has been on the rise because of the rising inward flow of remittance in the country – from Tk 30.6 billion in FY 2020 to Tk 50 billion in FY 2021-22. Since a record number of workers have immigrated in FY 2022-23 (up to February 2023) and will continue in the coming months, the resulting rise in the flow of remittance in the formal channel would push for further requirements of cash incentives. However, the trend shows that the inward flow of remittance in every month has remained within a limit indicating a part of the remittance is likely to be sent to the country through the informal channel (Figure 5.3.1). While this informal flow partly reduces the pressure of cash incentives, but the formal channel deprives of getting the highly essential foreign currency. Hence, it is important to ensure the flow of remittance through formal banking channels in full in order to contribute to strengthening the country's forex reserve.

[9] To encourage the remitters, the government introduced 2.0 per cent cash incentives over remitted earnings through formal channel during July, 2019. Later in January, 2022, the government has raised the rate of incentives by 0.5 percentage points to 2.5 per cent. Additionally, the government has withdrawn the mandatory provision for submitting the supporting documents particularly documents validate earning abroad against remittances exceeding the amount of USD 5,000 (MoF, 2022a).

Figure 5.3.1: Remittance earnings (in crore BDT) and outward migration



Source: Author's calculation based on data from Bangladesh Bank, 2023.

Since the introduction of cash incentives on workers' remittances in FY 2019-2020, the government has spent a total of Tk 15,442 crore. However, the disbursement would be high if a part of the remittance is not channelled informally. According to the national dailies, the Criminal Investigation Department (CID) has found that hundi traders laundered Tk 75,000 crore in 2021 through different mobile financial service operators. This amount of hundi stands at around 35.7 per cent of the remitted amount through the formal channels. The central bank has taken some measures to prevent hundi transactions while law enforcement agencies have initiated legal actions against hundi traders. A high margin in the exchange rate between USD and BDT pushed the workers to use the informal channel. Hence, reducing the gap between the official and informal exchange rates needs to be considered.

The government may consider the following budget recommendations as part of subsidy rationalisation and subsidy management.

1) Introduce the market-based exchange rate with a view to reducing the exchange rate gaps: The government may consider introducing market-based exchange rates between USD and BDT. At present exchange rate against USD is BDT 113 (as of 25 March 2023), while the remittance exchange rate is Tk 107 (as of 22 March 2023). Such a measure would reduce the demand for cash incentives for inward remittance as the exchange rate would be considerably higher – above the 2.5 per cent cash incentives provided at present. This would reduce the demand for using the informal channel to remit forex abroad.

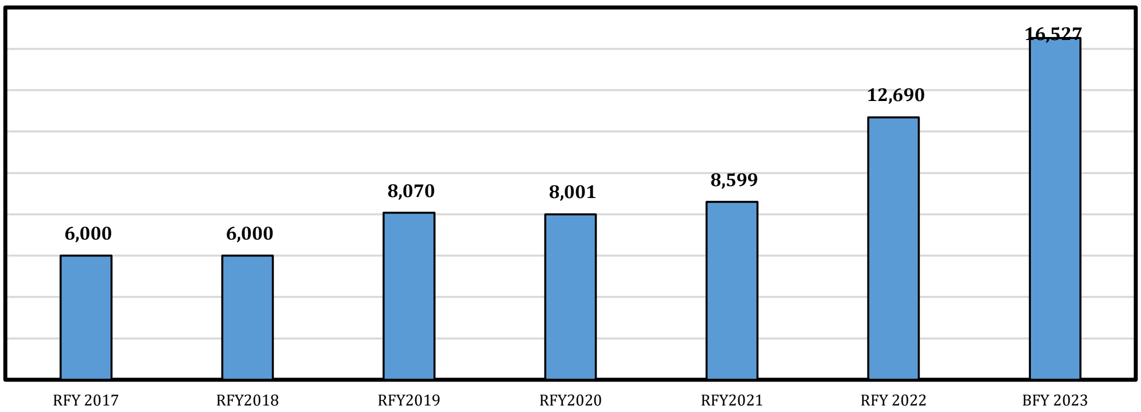
2) Preventing the hundi business by strengthening operations in the banking channel as well by the Police: The hundi business takes place in broad daylight where the illegal agents are known to the community. The central bank, commercial banks and law enforcement agencies should work hard to trace, track and identify these agents and hand them over to law enforcement agencies. It has been observed that the remittance inflow in 2022 and 2023 has decreased from Saudi Arabia, Kuwait, Oman, Bahrain, and Malaysia compared to the earlier years (FY2019 to FY2021). Perhaps this can be related due to the hundi transactions in those countries. Therefore, the Bangladesh Bank and other government organisations related to the prevention of antilaundering must be more vigilant in tracking and prosecuting hundi operators. The central bank has anti-money laundering guidelines to detect and prevent this activity which should be strictly implemented.

3) Proactive role of embassy and consulate at migrant destination countries: The government has an established network in foreign countries where a number of labour attaché are available for ensuring the welfare of the migrant workers. In this regard, labour attaché can play a proactive role in terms of encouraging migrant workers to remit money through formal channels. Necessary allocations should be made for the Ministry of Foreign Affairs and Ministry of Expatriates' Welfare and Overseas Employment (MoEWOE) to increase the number of labour attaché or to take initiatives to source services from private agencies to meet the demand of the migrant workers in the destination countries. The services will include awareness against the hundi transaction and promoting formal remittance channels, and benefits for migrant workers for remitting money through formal channels.

5.4 Subsidy in Agriculture

The agriculture sector has been one of the biggest subsidy recipients in the national budget. For the current fiscal year (FY 2022-23), a total of Tk 16,527 crore was proposed as subsidy for the agriculture sector, which was not only Tk 4,000 crore higher than the previous year's (FY 2021-22) revised allocation but also the highest ever budget allocation for agriculture subsidy (Figure 5.4.1). In fact, despite this highest allocation for subsidy – in view of the increased import cost of fertiliser – the allocated amount was found to be inadequate. According to media reports, an additional Tk 40,247 crore was required to fulfil the subsidy requirement for fertiliser.[10] However, only an additional Tk 10,000 crore was allocated against the increased demand in the revised budget of the current fiscal year (FY 2022-23) – which took the total allocation to Tk 26,527 crore.

Figure 5.4.1: Allocation of subsidy for agriculture sector (in Tk crore)



Source: Ministry of Finance.

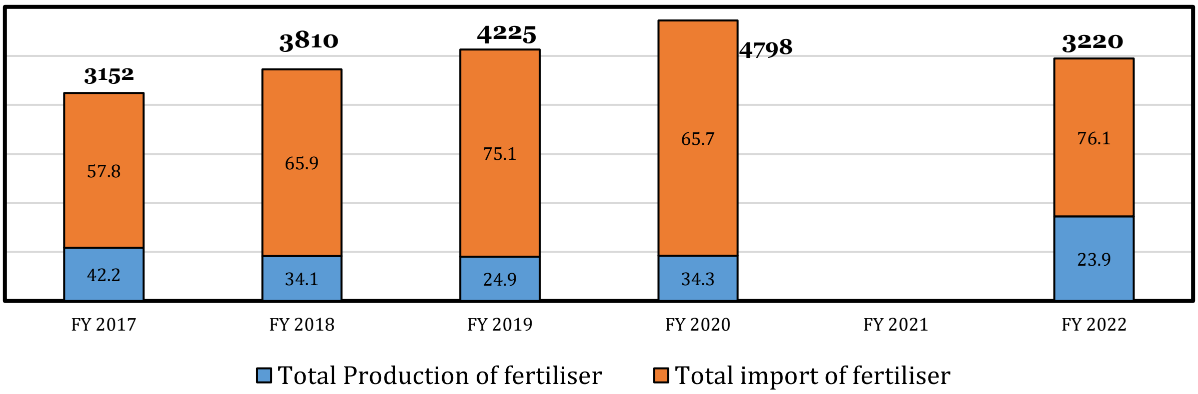
As usual, the lion's share of the agriculture subsidy was allocated for fertiliser. In addition, the current fiscal year's (FY 2022-23) budget proposed to continue providing incentives for agriculture mechanisation, rehabilitation aid, rebate on the electricity bills for the electricity use

[10] https://www.tbsnews.net/economy/subsidy-burden-balloons-war-604090

in irrigation pumps (20 per cent), subsidised interest rate credit for farmers (at 4 per cent interest), and cash incentive for export of agriculture products (20 per cent).

However, continuing the same subsidy facilities for the upcoming fiscal year (FY 2023-2024) could be challenging. This would be mainly because of- a) the looming limited fiscal space in view of lower than the targeted revenue income in the current fiscal year; b) high pressure on foreign reserve; c) increased cost of import, including the increase in the US dollar price; and d) rising inflation etc.

Figure 5.4.2: Total (in '000 mt) and share of import and production of fertiliser in Bangladesh



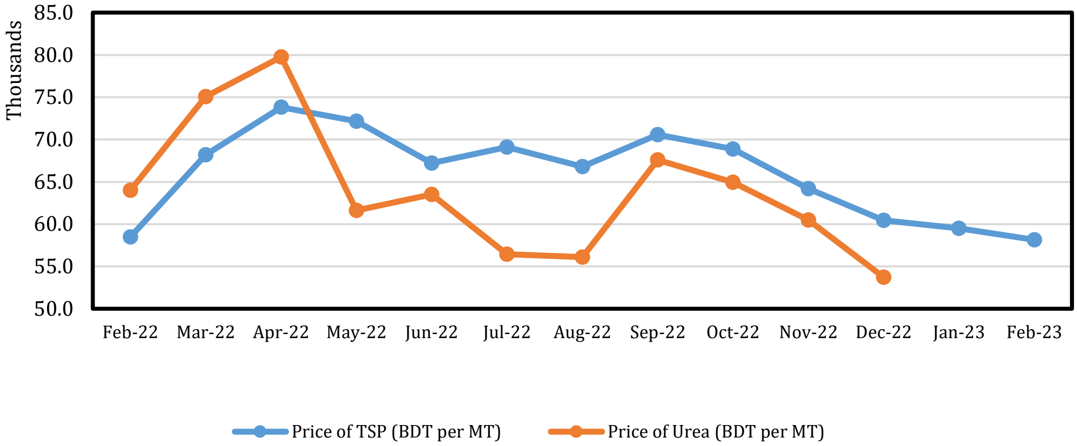
Source: Based on FPMU website data.

In view of the shortage of gas supply, the public fertiliser company (i.e., Shahjalal Fertiliser Company) have stopped their operation lately. On the other hand, the increase in the import cost has led to a decrease in the amount of fertiliser imported. Hence, after a consecutive rise in recent years, the fertiliser supply fell during FY 2021-22 (Figure 5.4.2).

Amid this challenging time, the following recommendations can be considered by the government for the upcoming budget in the area of agriculture subsidy:

1) Continue providing higher subsidy for fertiliser: Irrespective of the current fiscal space status and other challenges, the fertiliser subsidy must be continued in the FY 2023-24 to ensure food production gets the utmost priority in a time of uncertainty over the global food supply. Despite fiscal pressure (of the additional spending for fertiliser subsidy in the current fiscal year against limited allocation), the extent of the burden for subsidising fertiliser in the upcoming fiscal year (FY 2023-24) is expected to be slightly less than the current fiscal year. The reasons include- a) the recent decreasing trend of the price of fertilisers in the international market (despite an increase in the price of the US dollar) (Figure 5.4.3); b) the government has already increased the price of Urea by Tk 6 per kilogram in August 2022 (both at dealer and farmer levels); and c) the decrease in requirement of subsidies in other sectors, mainly in the energy sector (as per conditions set by IMF).

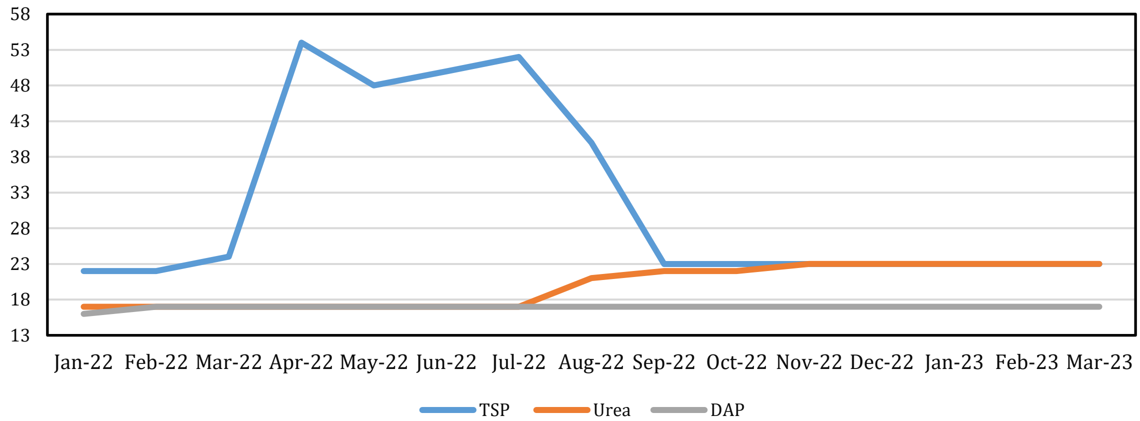
Figure 5.4.3: Global monthly price of fertilisers (BDT per mt)



Source: Based on World Bank.

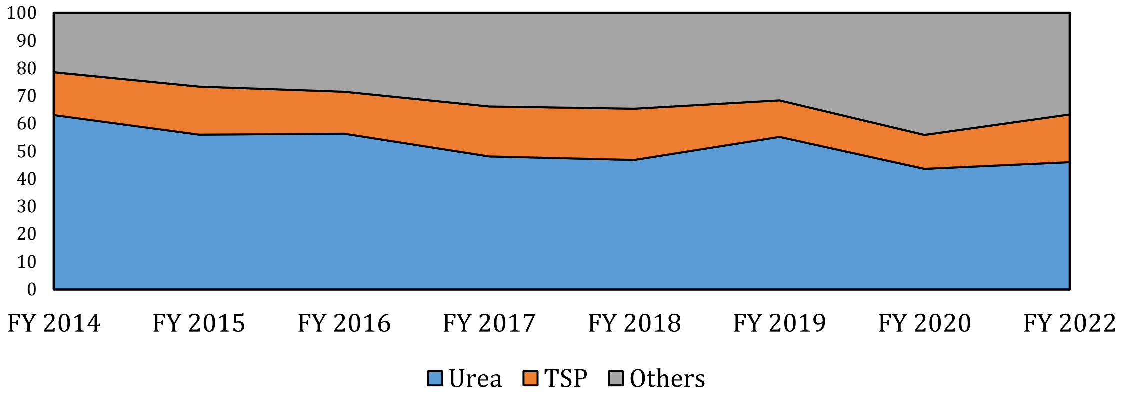
2) Go for more effective subsidy management: While the subsidy needs to be there for fertiliser, proper subsidy management can ease the fiscal burden and yield more benefits. Some of the areas need particular attention: a) the strengthening of market monitoring mechanism must be ensured in view of continuous allegations that farmers in many places are being unable to buy fertilisers at a subsidised price (Also reflected partly in Figure 5.4.4); b) higher allocation should be considered on promoting the use of balanced fertiliser so that the misuse of fertiliser gets decreased along with increases in the production (the Figure 5.4.5 indicates that share of the supply of fertiliser is still higher for urea alone); c) continue allocating a sizable share of fund for agricultural research targeting decrease the use of fertiliser and increase the use of technologies to enhance production.

Figure 5.4.4: National average monthly price of fertiliser (Tk per KG)



Source: DAE.

Figure 5.4.5: Share of market supply of different fertilisers (domestic production + import)



Source: FPMU.

3) Pursue scope of quick transformation to solar-based irrigation system from diesel-based irrigation system: Although the current fiscal year's budget enabled the facility of subsidised electricity price for irrigation, it could be difficult to carry on providing this subsidy in the coming year. Moreover, the government needs to comply with the conditionality of the IMF of lifting subsidy from diesel price. Hence, a distinct focus needs to be made on the quickest transformation of solar-based irrigation systems from diesel-based irrigation. In this regard, the target of transforming 200 diesel-based irrigation by 2023 to solar-based ones should be ensured. More importantly, a plan needs to take to transform 1.34 million diesel-based power pumps into solar-based ones by 2030.

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SECTION 6. FISCAL POLICY FOR MAXIMISING SOCIAL WELFARE

Fiscal policy is an important tool for correcting market failures and maximising social welfare. In a free market equilibrium, merit goods are under-produced and under-consumed. This deprives society of the positive externalities that are associated with merit goods. Hence the production and consumption of merit goods need to be encouraged through government interventions to maximise social welfare. Two of the most important merit goods are health and education. Often these are neglected sectors in developing and low-income countries. Analysis of the past fiscal policies of Bangladesh shows that neither health nor education have received any importance in the national budget.

6.1 Protecting public health through fiscal policy

The total budget allocation for the health sector increased only by 13 per cent, from BDT 32,731 in FY22 to BDT 36,864 in FY23, which was lower than the 14 per cent average annual increase in total budget allocation for the health sector between FY2011 and FY2022.

Allocation for the health sector as a share of the total budget has increased from 5.42 per cent in FY22 to 5.44 per cent in FY23. However, this was lower than the allocation of 6.18 per cent of budget in FY2010 when there was no pandemic. Actual expenditure increased by 24 per cent from BDT 17,513 crore in FY20 to BDT 21,647 crore in FY21. In Bangladesh, the budget allocation for the health sector has been less than 1 per cent of Gross Domestic Product (GDP) for the past 13 years indicating that healthcare was never a priority sector for the government. On the contrary, in 2017 at least 30 Least Developed Countries (LDCs) spent more than 1 per cent of GDP on health (World Bank, 2022). On top of this, out-of-pocket expenditure on health in Bangladesh is not only the highest in South Asia, but also increasing over time.

In this context, it is necessary to not only increase the budget allocation and budget utilisation of the health sector, but also implement a number of fiscal measures to promote improved public health and in turn maximise welfare for society. In the following exposition, fiscal measures for a few selected items are suggested.

6.1.1 Tax on tobacco and related products

In Bangladesh, the cigarette industry's pricing encourages purchase of relatively cheaper cigarettes. The complicated tiered tobacco tax framework supports differential pricing. Such differential pricing defeats the intended purpose of taxation as a tool for achieving beneficial public health outcomes. Hence Bangladesh's tobacco tax structure needs to be streamlined. Cigarette affordability should be reduced as a result of tax-induced price increases. For tobacco and tobacco-related products, the government should eliminate the tiers of taxation and replace them with a single system. Additionally, a specific tax, which is fixed per pack, should be implemented instead of an ad valorem tax, which is determined as a percentage of retail price. The government will find it much easier to administer a uniform specific excise system of taxes on tobacco. It would also let the government relinquish jurisdiction over the administration of cigarette recommended retail price (RRPs), which is putting strain on the tax authorities. The government lacks the resources to monitor and enforce RRPs across the country. The cigarette industry capitalises on this lack of monitoring to maximise their profits. Hence, it is suggested that the government lets the market establish the relevant price and collect tax revenue through a sufficiently high uniform specific tax that is unrelated to the tobacco product's price and only reliant on the number of sales.

We propose a uniform specific excise duty of BDT 10 per cigarette stick on all cigarettes to be implemented in FY2024 (Table 6.1). Such a uniform specific tax on all cigarettes should be increased by at least BDT 5 per stick each year, to account for annual inflation and income growth.

Table 6.1: Proposed tax structure for cigarettes (per pack of 10 cigarettes)

Current tax structure for cigarettes in FY23						CPD's recommendation				
	Retail price		SD				Retail price		Specific excise duty	
Tier	Pack of 10 (in BDT)	Per stick (in BDT)	Per pack of 10 (in per cent)	Per pack of 10 (in BDT)	Per stick (in BDT)	Tier	Per pack of 10 (in BDT)	Per stick (in BDT)	Per pack of 10 (in BDT)	Per stick (in BDT)
Low	40+	4.0	57	22.80	2.28	Universal	Market based	Market based	100	10
Medium	65+	6.5	65	42.25	4.22					
High	111+	11.1	65	72.15	7.21					
Premium	142+	14.2	65	92.30	9.23					

Source: CPD compilation data from the Ministry of Finance (Kamal, 2021).

In line with the proposed tax structure for cigarettes, the tax structure for Bidi, Jarda, and Gul should also be reformed. This will protect low-income groups from health hazards and reduce the burden of health expenditure on the government. Instead of the current tier classification of Bidi into filtered and non-filtered, and additional groupings based on the size of the pack, we propose specific excise tax of BDT 3 per stick for all Bidi to be implemented in FY2024 and allow the price of Bidi to be determined by the market (Table 6.2). Such a uniform specific tax on all Bidi should be increased by at least BDT 1 each year, to account for annual inflation and income growth.

Table 6.2: Proposed tax structure for Bidi

Current tax structure in FY2023						Proposed tax structure in FY2024				
	Retail price		SD				Retail price		Specific excise duty	
Type of bidi	Per pack (in BDT)	Per stick (in BDT)	Per pack (in per cent)	Per pack (in BDT)	Per stick (in BDT)	Type of bidi	Per pack (in BDT)	Per stick	Per pack (in BDT)	Per stick (in BDT)
Non-filtered 25 stick handmade bidi	18	0.72	30	5.40	0.22	All	Market based	Market based	75	3
Non-filtered 12 stick handmade bidi	9	1.33	30	2.70	0.23				36	
Non-filtered 8 stick handmade bidi	6	1.33	30	1.80	0.23				24	
Filtered 20 stick handmade bidi	19	1.05	40	7.60	0.38				60	
Filtered 10 stick handmade bidi	10	1.00	40	4.00	0.40				30	

Source: CPD compilation data from the Ministry of Finance (Kamal, 2021).

Finally, the existing tax structure on Jarda and Gul should also be reformulated in cognisance of the severe health risks posed by the long-term consumption of such items. We propose a BDT 6 specific excise duty on per gram (gm) of Jarda and Gul to be implemented in FY2024, and to allow the price of Jarda and Gul to be determined by the market (Table 6.3). Such a specific tax on Jarda and Gul should be increased by at least BDT 1 each year, to account for annual inflation and income growth.

Table 6.3: Proposed tax structure for Jarda and Gul

Current tax structure in FY2023						Proposed tax structure in FY2024				
	Retail price		SD				Retail price		Specific excise duty	
Type of product	Per 10gm (in BDT)	Per gm (in BDT)	Per 10 gm (in per cent)	Per 10 gm (in BDT)	Per gm (in BDT)	Type of product	Per 10gm (in BDT)	Per gm (in BDT)	Per 10gm (in BDT)	Per gm (in BDT)
10gm jarda	40	4	55	22	2.2	10gm jarda	Market based	Market based	60	6
10gm gul	20	2	55	11	1.1	10gm gul				

Source: CPD compilation data from the Ministry of Finance (Kamal, 2021).

The Health Development Surcharge Management Policy 2017, states that 1 per cent surcharge must be charged from tobacco companies in Bangladesh which is also in accordance to the WHO Framework Convention on Tobacco Control (FCTC) to which Bangladesh is a ratified member (NTCC, 2017). The Statutory Regulatory Order (SRO) by Bangladesh government further details the proper utilisation of the fund accrued through the Health Development Surcharge. CPD believes the Health Development Surcharge must be increased further to empower the National Tobacco Control Cell (NTCC) in furthering the objectives and meeting the goal of a tobacco free Bangladesh by 2040. In this connection, we propose that that the Health Development Surcharge on cigarettes and other tobacco products to be increased from 1 per cent to 5 per cent, and the VAT on cigarettes and other tobacco products to be increased from 15 per cent to 20 cent in FY2024.

Table 6.5: Proposed Health Development Surcharge and VAT on cigarettes and other tobacco products

	Current Tax Structure for FY2023		Proposed Tax Structure for FY2024	
	Health Development Surcharge (in per cent)	VAT (in per cent)	Health Development Surcharge (in per cent)	VAT (in per cent)
Cigarettes	1	15	5	20
Biri	1	15	5	20
Jarda	1	15	5	20
Gul	1	15	5	20

Source: CPD compilation.

CPD believes that to achieve a tobacco free Bangladesh by 2040, corporate taxes should be increased incrementally. On the contrary we find that the effective tax rate of the largest tobacco company in Bangladesh decreased by around 1 percentage point in 2022 (British American Tobacco Bangladesh, 2022). In the budget for FY2023, companies manufacturing tobacco products were subject 45 per cent corporate tax, which was the same rate of corporate tax as non-publicly traded mobile operator companies. Since companies manufacturing tobacco products are directly causing severe public health hazards, it is necessary to ensure that such companies pay corporate tax at a rate which is above the corporate tax rate for all other types of companies.

Therefore, in addition to the aforementioned tax reforms, we also propose that the corporate tax on all companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, and gul, to be increased from 45 per cent in FY2023 to 50 per cent in FY2024, and the associated surcharge to be increased from 2.5 per cent in FY2023 to 5 per cent in FY2024 (Table 6.4).

Table 6.4: Corporate tax on tobacco product manufacturing companies

Type of company	Current tax structure in FY2023		Proposed tax structure for FY2024		Proposed tax structure for FY2026	
	Corporate tax (in per cent)	Surcharge (in per cent)	Corporate tax (in per cent)	Surcharge (in per cent)	Corporate tax (in per cent)	Surcharge (in per cent)
All companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, and gul	45	2.5	50	5	55	7.5

Source: CPD compilation data from the Ministry of Finance (Kamal, 2021).

In order to achieve the government's long-term goal of a tobacco-free Bangladesh, we also propose that the corporate tax on all on all companies manufacturing tobacco products, such as cigarette, bidi, chewing tobacco, jarda, to be increased to 55 per cent, and the associated surcharge to be increased to 7.5 per cent, in 2026 when Bangladesh graduates from the LDC group.

According to the latest report on national estimates of land use and production of Drugs and Narcotics from the Yearbook of Agricultural Statistics 2021, the tobacco industry used 99600.24 acres of fertile cultivable land to produce tobacco leaf in Bangladesh (BBS, 2022). The tobacco companies in Bangladesh are exploiting favourable agricultural policies to produce tobacco leaf in massive quantities and export it to other countries where such production of tobacco leaf is more restricted. The export of tobacco leaf from Bangladesh has almost doubled from 272 crore BDT in 2021 to 559 crore BDT in 2022 for one of the largest tobacco market shareholders of Bangladesh (British American Tobacco Bangladesh, 2022).

The local market of Bangladesh is experiencing a huge price hike of basic necessities such as rice, wheat and other food items. Since inflation has been severely cutting into the lives of marginalised people, it is important to acknowledge the opportunity cost of such high level of tobacco leaf production in Bangladesh. The government has unequivocally declared several times to utilise every inch of arable land in the country to ensure food security. However, in reality we find that vast quantity of arable land is being used for tobacco cultivation each year.

If 99600.24 acres of land which is currently being used for tobacco leaf production was used for Boro rice cultivation, assuming the average yield rate is independent of geographical location and technical knowledge of farmers, then 167,434.394 metric tonnes (MT) of additional Boro rice could be produced to meet the local demand. This additional quantity of Boro rice produced could meet the demand of additional 12.5 lakh people for a whole year. Alternatively, if the land was used for wheat production, then 133012.603 MT of additional wheat could be produced to meet the local demand. Similarly, the additional 133012.603 MT of wheat production could sustain the wheat demand of additional 1 crore 84 lakh people for a whole year. This is vital for a country which has a population of more than 165 million and is a net food importing country. Hence substituting the production of tobacco leaf with more productive major crops can reduce the stress on food imports. CPD believes the 25 per cent tax waived for tobacco companies operating at EPZs must be reinstated in FY2024.

Tobacco taxation policy will remain ineffective if we do not regulate the operations of the industry in the greater space of our society. The overall message behind such high tariffs must be so well-defined and precise that it must be reflected in every realm of social space. If the overall atmosphere is conducive to the tobacco companies, then high tax rates will fall short of achieving the primary goal. For instance, allowing the e-commerce site "Buy Here Now" to sell cigarettes online, sponsoring targeted events, and the National Board of Revenue (NBR) providing social recognition to tobacco companies and individuals related to the trade for amount of tax paid.

The business model of the tobacco industry is to innovate continuously and be one step ahead of the policy makers. The topic of e-cigarette is missing from the mainstream discussion of tobacco control. Electronic nicotine delivery systems (ENDS), of which electronic cigarettes are a common type, are devices that heat a liquid to create an aerosol that is inhaled by the user. The liquid contains nicotine and other chemicals that may be toxic to people's health (WHO). People passively exposed to e-cigarettes aerosol absorb nicotine (measured as cotinine), with one study showing levels comparable to passive smokers of conventional cigarettes. There is little research on direct health effects, but one study shows short-term pulmonary effects and evidence of cytotoxicity in animal and human in vitro test systems. (Marques & Sanz, 2021)

The demand for e-cigarette is rising at an alarming rate in Bangladesh. According to the data from Tobacconomics there's a 6.7 per cent adults of the country has used e-cigarettes (Tobacconomics, n.d.). The entire experience of nicotine consumption has been made more convenient by e-cigarettes. The innovation of e-cigarettes aimed to substitute all the qualities or attributes of cigarettes that were detested in society. For example, e-cigarettes avoid the foul smell of conventional cigarettes by utilising different artificially flavoured liquids to entice new customers. CPD believes there is no reason why e-cigarette or ENDS should not be treated in the same way as tobacco companies under the tax laws. CPD believes rather than imposing a complete ban on e-cigarettes or ENDS, the government can regulate the market and impose high taxes to discourage their consumption and generate revenue for the government.

6.1.2 A hard tax for soft drinks

Carbonated soft drinks and energy drinks are a significant health concern in Bangladesh. Such beverages have a substantial amount of sugar which is a major cause for obesity, diabetes, and tooth decay. Typically, a single can of a soft drink which is around 355 millilitres, contains 39 grams of sugar (Coca-Cola Company, n.d.). This is equivalent to roughly about 10 teaspoons of sugar while the World Health Organisation (WHO) recommends that adults should not consume more than 6 teaspoons of sugar daily to lead a healthy lifestyle (WHO, 2017). Currently, the beverage and carbonated industry is subjected to a 25 per cent SD for carbonated soft drinks, and 35 per cent SD for energy drinks with a 15 per cent VAT applicable for both (NBR, 2018). In Bangladesh, carbonated soft drinks and energy drinks are widely available, and hence it is necessary to decrease the consumption of such beverages in order to reduce the associated health risks.

Therefore, CPD recommends that the government should remove the supplementary duty on both soft drinks and energy drinks and replace it with a specific excise duty of BDT 0.10 per millilitre (ml) or BDT 100 per litre (l) on soft drinks and energy drinks produced in Bangladesh in the FY2024 (Table 6.5). Since sweetened beverages are a demerit good, placing a specific excise duty will reduce their consumption and provide the government with a substantial revenue. CPD also recommends that the government stops giving high degree of tariff protection to local manufacturers of Sugar Sweetened Beverages (SSB) through VAT exemption on raw materials imported (SRO148/2016). This will give respite to our shrinking fiscal space.

Furthermore, limiting sugary beverage intake will help Bangladesh minimise the risks of related diseases and health expenditures of the general population. This will also allow the economy to achieve SDG target 3.4 which aims to reduce non-communicable diseases by one-third by 2030 (UN, 2015). Additionally, we also propose that the VAT on soft drinks and energy drinks should be increased from 15 per cent in FY 2023 to 20 per cent in FY 2024.

Table 6.6: Proposed tax structure for soft drinks and energy drinks

	Current Tax Structure for FY2023		Proposed Tax Structure for FY2024	
Beverage	SD (in per cent)	VAT (in per cent)	Specific excise duty (BDT per litre)	VAT (in per cent)
Soft drinks	25	15	100	20
Energy drinks	35	15	100	20

Source: CPD's compilation based on data from the National Board of Revenue (NBR, 2018).

6.1.3 Tax on sanitary napkins – a gender tax harming women and girls

Menstrual hygiene is a fundamental right and need for women and girls all over the world. But this right is violated when menstrual hygiene products are subjected to all kinds of tax – Value Added Tax (VAT) and duties. The practice of safe hygiene is strongly connected to Sustainable Development Goal (SDG) 3 which aims to ensure good health and well-being for all (United Nations, 2015). Even though sanitary products are a necessity for women and girls to maintain proper hygiene, their price is beyond the reach of most women and girls from low-income groups of Bangladesh.

Locally produced sanitary napkins, towels, and similar sanitary products for women and girls in Bangladesh are subjected to high prices because of high incidence of tax including VAT, Customs Duties (CD), Supplementary Duty (SD), Regulatory Duty (RD), and Additional Tax (AT) on imports of raw materials. The imposition of local VAT on production and sometimes sales tax is also reflected in the price of these products (WaterAid, 2019). SD on imported raw materials, such as air laid paper is 20 per cent. Additionally, all raw materials used in the production of sanitary napkins were subjected to 15 per cent and 5 per cent, respectively in FY2022 (Bangladesh Customs, 2021). In the budget speech of FY2023, it initially proposed that the VAT and SD at local manufacturing stage on the production of sanitary napkin will be exempted to ensure health protection of women and girls (Kamal, 2021). However, such exemption was not implemented later.

We therefore propose that the total tax incidence (TTI) on imported raw materials used to produce sanitary napkins and diapers should be made zero by exempting all form of VAT, CD, SD AIT, RD and AT to ensure affordable sanitary napkins for women and girls from all levels of income. The TTI on imported sanitary napkins and diapers in FY2022 was 127.72 per cent, which we recommend to be reduced to 31.93 per cent. This is equivalent to one-fourth the existing value (Table 6.6). Given the importance of the product to women and girls it should receive tax exemption and should not be treated as other products.

Table 6.7: Proposed tax structure on import of sanitary napkins and related raw materials

Current tax structure in in FY2023									**Proposed**
HS code	**Product description**	**CD (%)**	**SD (%)**	**VAT (%)**	**AIT (%)**	**RD (%)**	**AT (%)**	**TTI (%)**	**TTI (%)**
96190000	Sanitary towels (pads) and tampons, napkins and napkin liners for babies and similar items	25	45	15	5	3	5	127.72	31.93
48239094	Air laid paper imported by VAT registered sanitary napkin manufacturers	25	20	15	5	3	5	85.00	0
35052000	Glues based on starches, dextrins or other modified starches	5	0	15	5	15	5	49.00	0
35069110	Adhesives based on rubber or plastic (including artificial resins)	25	0	15	5	3	5	58.60	0
39069000	Acrylic polymers, in primary forms and other polyesters, in primary forms.	10	0	15	5	0	5	37.00	0
39199020	Performance tape or closure or side tape	25	0	15	5	0	5	55.00	0
39201020	Other plates, sheets, film, foil and ethylene imported by VAT registered personal hygiene products manufacturing industries	25	0	15	5	3	5	58.60	0
40021100	Latex of styrene-butadiene or carboxylate styrene-butadiene rubber	5	0	15	5	0	5	31.00	0
47032100	Semi-bleached or bleached coniferous chemical wood pulp, soda	0	0	15	0	0	5	20.00	0
48119090	Other paper, paperboard, cellulose wadding and webs of cellulose fibres	25	0	15	5	3	5	58.60	0
54024400	Other yarn, single, untwisted or with a twist not exceeding 50 turns per meter	5	0	15	5	0	5	31.00	0
56031110	Nonwovens, of man-made filaments, weighing less than or equal to 25 gram per square meter	25	0	15	5	3	5	58.60	0
63079000	Made up articles (including dress patterns)	25	0	15	5	3	5	58.60	0

Source: CPD compilation based on data from Bangladesh Customs (Bangladesh Customs, 2021).

6.1.4 Tax on medicines in view of Bangladesh's LDC graduation

In Bangladesh, the expenditure on pharmaceutical products and health services takes up large proportion of people's income every month. The out-of-pocket spending on healthcare as a share of current health expenditure increased from 61 per cent in 2000 to 72.68 per cent in 2019 (The World Bank, 2022). Moreover, the proportion of population pushed below the USD 1.90 poverty line due to out-of-pocket expenditure on healthcare increased from 2.84 per cent in 2005 to 6.98 per cent in 2016 (World Bank, 2021). Under the new VAT and Supplementary Duty Act-2012, the government-imposed 2.4 per cent VAT on pharmaceuticals including medicines at local trading stage and 15 per cent on import of pharmaceutical products and raw materials for production of medicines (GoB, 2019). Moreover, as an LDC, Bangladesh's pharmaceutical industry is currently enjoying the facilities under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) pharmaceutical waiver which provides an exemption from obligations to enforce patents along with data protection for pharmaceutical products. Unless Bangladesh gets an extension on the transition period of the TRIPS waiver after its graduation from the LDC group in 2026, the waiver would be withdrawn starting from 2026. So, Bangladesh will lose the LDC-specific international support measures under this agreement.

Therefore, we propose that the VAT on medicines should be exempted starting from FY2026 to ensure that medicines continue to be affordable to all even after the loss of TRIPS waiver in 2026. Beyond 2026, the government will need to implement a plan to protect the local pharmaceutical industry and help retain its competitiveness in the global market. This will also benefit the people from low-income groups to access medicines and other pharmaceutical products at an affordable price.

6.2 Fiscal policy for incentivising education

The education budget as a share of total budget decreased from 14 per cent in RBFY2015–16 to 11.7 per cent in RBFY2021–22. Additionally, the education budget as a share of GDP decreased from 1.9 per cent in RBFY2020–21 to 1.8 per cent in BFY2022–23. Education budget as a share of GDP has remained stagnant during recent fiscal years. Education budget utilisation has been decreasing over the years, especially for development expenditure.

Therefore, it is necessary to not only increase the budget allocation and budget utilisation of the education sector, but also implement a number of fiscal measures to promote improved education and in turn maximise welfare for society. In the following exposition, fiscal measures for English medium schools, imported books, and female education stipend are proposed.

6.2.1 Removal of existing taxes on education

The right to education is a basic human right and education should be made accessible and affordable for all individuals in a country. While the government has exempted Bengali medium schools, and later private universities, from paying VAT on tuition fees, the VAT on English medium schools continue to be at 5 per cent (NBR, 2019). It is often opined that English medium education is a luxury good and that students who study in English medium schools belong to affluent families and do not stay in the country in the long run. Obtaining education, irrespective of the source, is a basic right and should not be misconstrued as a luxury good. In their early days, English medium schools might have been suited for the privileged. However, in recent years, the dynamic has changed profusely. The number of English medium schools have proliferated over the years in Bangladesh. Many middle-income families are admitting their children to English medium schools to allow them to study in the international curriculum and gain a competitive edge in the labour market. Parents, presumably, prefer English medium education in order to provide their children with benefits that would not otherwise be available to them (Mousymi & Kusakabe, 2017). English medium schools are privatised and are not recognised to have a low tuition fee. Hence the VAT on tuition fees of English medium schools puts an extended burden on the parents of middle-income families. Therefore, CPD recommends that the VAT on the tuition fees for all academic institutions, including English medium schools, should be exempted in FY2024, and the exemption should remain in place for an indefinite period.

Additionally, since English medium schools, follow the international curriculum, the books assigned as a part of their syllabus are all imported books written by international authors. At present the TTI on foreign printed books is at 73.96 per cent. The total tax incidence includes 25 per cent as CD, 10 per cent as SD, 5 per cent as AIT, 15 per cent as VAT, and 3 per cent as RD. Such high duties on foreign books intended to provide children with quality education defeats the purpose of achieving the SDG four which aspires to "ensure inclusive and equitable quality education and promote lifelong learning and opportunities for all" (UN, 2015). As the syllabus is revised, during every academic year parents have to buy new books for their children studying in English medium schools, while bearing such a high tax incidence. This puts further strain on families' incomes, particularly those from middle-income households. Therefore, CPD recommends that all taxes and duties on foreign imported books should be exempted in FY2023 to ensure that education remains affordable for all.

6.2.2 Education stipend

The allocation to Stipends for Undergraduate and Postgraduate Level Students was decreased from BDT 96 crore in FY2021 to BDT 72 crore in FY2023. We propose an increase in the allocation for all education stipends to be implemented in the budget for FY2024 (Table 6.7).

Table 6.7: Proposed education stipend structure in FY2024

	Current stipend structure in FY2023			Proposed stipend structure in FY2024	
Name of stipend	**Number of beneficiaries (in crore)**	**Total budget allocation (in crore BDT)**	**Allocation per beneficiary per year (in BDT)**	**Total budget allocation (in crore BDT)**	**Allocation per beneficiary per year (in BDT)**
Student stipend for primary education level	1.400	1,900	1,357	8,400	6,000
Stipends for secondary, higher secondary and madrasah education level students	0.529	1,980	3,524	5,225	10,000
Stipends for undergraduate and postgraduate level students	0.0136	72	6,142	195	15,000
Stipends for students of technical education institutions	0.0612	343	5,935	834	15,000
Stipends for physically challenged students	0.010	96	9,564	200	20,000
Stipend for improving the livelihood of transgender, Bede and disadvantaged community	0.003	26	9,759	54	20,000
Total for stipend programmes	2.017	4,417		14,908	

Source: CPD compilation based on data from Ministry of Finance (MoF, 2022).

Our proposed stipend reform will benefit more than 2 crore students at all levels and cost the government an additional BDT 14,908 crore.

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SECTION 7. FISCAL MEASURES TO SUPPORT GREEN TRANSITION

Efforts to address global warming issues and make the transition to a green economy that benefits all stakeholders must include green fiscal measures. Reflecting externalities in pricing, coordinating government spending with environmental objectives, and increasing revenues are all ways in which such policies might help bring about the outcomes envisioned by the Paris Agreement (UN Environment Programme 2022). Investments of enormous scale are needed to meet global climate pledges. Reaching net-zero emissions in the energy sector alone would need annual investments of around USD 3.1 trillion to USD 8.2 trillion from now until 2050 (Lenaerts, Tagliapietra and Wolff 2022). The United Nations Environment Programme estimates that eliminating subsidies for fossil fuels might generate nearly USD 2.9 trillion per year by 2022, which could be invested towards achieving global climate targets (UN Environment Programme 2022).

Bangladesh can learn a lot from international programmes and projects already underway to combat climate change. The national budget should reflect the government's efforts to advance a green fiscal policy. The government has reason to prioritise green growth: by 2026, it will no longer be a least developed country (LDC), and it hopes to achieve upper middle-income status by 2031. As a result of this shift, environmental regulations will become stricter.

There is a strong trend towards increasing urbanisation in Bangladesh, even though the bulk of the population still lives in rural areas. As it continues along the road to prosperity, Bangladesh's economy is witnessing a period of profound structural upheaval. The environment may be harmed by structural change, which is good for development. The carbon footprints of individuals increase when more people move to urban areas. There may be serious negative effects on environmental quality when these greater footprints are added together. Urbanisation is associated with greater greenhouse gas emissions and higher annual average temperature change in Bangladesh (Murshed and Saadat 2018). In spite of the fact that metropolitan areas cover such only a small portion of the earth's surface, they are responsible for 75 per cent of the world's total greenhouse gas emissions (United Nations Environment Programme n.d.). It is estimated that urban areas worldwide have the potential to suffer a loss of 44 per cent of their gross domestic product (GDP), which is equal to USD 31 trillion, as a direct result of the destruction of biodiversity and the environment (World Economic Forum 2022). Air and plastic pollution are particularly severe in Bangladesh's major cities. In this analysis, we examine the issue of air and plastic pollution in Bangladesh and provide both immediate and long-term fiscal solutions to mitigate the problem.

7.1 Alarming state of air pollution in Dhaka and other cities

More industrialization leads to more urbanisation and increased energy use, both of which increase carbon dioxide emissions. One of the most significant environmental and climate-related challenges brought on by increased energy usage is air pollution. The PM 2.5 concentration in Bangladesh's air was 13.2 times higher than the World Health Organization's (WHO) safe air quality guideline as of 26 March 2023 (IQAir 2022).

According to its Nationally Determined Contribution (NDC), Bangladesh pledges to cut its GHG emissions by 6.73 percent across five sectors—electricity generation, transportation, industry, waste management, and land use—by the year 2030 (Ministry of Environment, Forest and Climate Change 2021). Bangladesh also plans to lower its greenhouse gas emissions by 15.12 per cent if supported by foreign financing and technology (Ministry of Environment, Forest and Climate Change 2021). The government of Bangladesh plans to cut transportation-related emissions by 12.30 per cent on its own by 2030, and by another 10.23 per cent with international assistance. The revised NDC states that Bangladesh needs USD 14.9 billion to achieve an unconditional commitment and USD 21.6 billion to meet a conditional commitment. Bangladesh needs to enact a number of tax and regulatory measures to reduce GHG emissions to meet these goals.

Bangladesh lacks a number of fiscal policies that might facilitate a green transformation. When it comes to encouraging green and sustainable production and consumption, just a handful of tax incentives and green funds are currently accessible. In 2008, a 15 percent VAT exemption was established for all renewable energy equipment and associated raw materials under the Renewable Energy Policy 2008. At the moment, however, SRO No. 141-Act/121/138-VAT only exempts the VAT on import and manufacturing of photovoltaic cells, solar modules, solar panels, and solar batteries up to 60 Amperes. Corporate income tax exemptions for renewable energy producers have been included in the renewable energy policy for a term of 5 years, with the possibility of extension. In the Finance Act of 2014, a new surcharge was established to help safeguard the environment. However, this environment protection surcharge (EPS) has not yet been completely implemented (Finance Division 2020). Two Bangladesh Bank funds currently support the green energy transition in Bangladesh: Refinance Scheme for bank and financial institutions, and Green Transformation Fund (GTF) for Export-oriented Industries (Bangladesh Bank 2020).

7.2 Plastic pollution getting out of hand

Disposable plastic is growing in popularity across the globe because of its versatility and inexpensive price, despite the harm it does to the environment and human health. Every day, 646 tonnes of plastic garbage are collected in Bangladesh, with 48 per cent sent to landfills, 37 per cent recycled, 12 per cent dumped into waterways, and 3 per cent littering urban areas (The World Bank 2021). There are 1,212 dump sites in Bangladesh that contribute between 24,032 and 36,047 tonnes of plastic waste annually to the country's rivers (The World Bank, 2021). Both plastic consumption and pollution have soared with rapid urbanisation. In metropolitan regions of Bangladesh, yearly per capita plastic use is projected to reach 9.0 kg in 2020, up from 3.0 kg in 2005. Mismanaged plastic trash in Bangladesh is mostly comprised of single-use items like shopping bags, packs, and wrappers (The World Bank n.d.). Dhaka has a plastic consumption rate that is three times higher than the national average for metropolitan regions. Urban flooding is exacerbated by the usage of single-use plastics, which clog drains. There are serious dangers to human health and the environment from using plastics designed for a single use.

Per capita plastic waste generated in Bangladesh was only 0.03 kg per day in 2010, compared to the global average of 0.19 kg per day (Jambeck, et al. 2015). However, 87 per cent of the plastic waste generated in Bangladesh was inadequately managed, which led to the country becoming the tenth largest contributor of mismanaged plastic waste in the world in 2010 (Jambeck, et al. 2015). The Ganges River, which runs through Bangladesh and into the Bay of Bengal, was estimated to be the second largest river source of plastic inputs into the ocean worldwide in 2015 (Lebreton, et al. 2017).

COVID-19 has led to a spike in unsustainable manufacture of single use plastics and synthetic materials which have been employed for creating personal protection equipment (PPE) such as body suits, masks and face shields. There has been an alarming increase in the usage of disposable plates, cups, and cutlery due to concerns about the spread of disease. Between 26 March 2020 and 25 April 2020, roughly 14,165 tonnes of single use plastic waste were produced in Bangladesh, which comprised 455 million surgical masks, 1,216 million polyethene hand gloves, 189 million surgical hand gloves and 49 million bottles of hand sanitizer (Environment and Sioial development Organisation 2020).

Bangladeshi policymakers have developed a number of initiatives throughout the years to combat environmental threats including pollution. Bangladeshi governments have taken action in the past to address the issue of plastic consumption. The use of plastic shopping bags was outlawed in Bangladesh in 2002 by a regulatory order issued under the 1995 Environment Act. However, the restriction was mostly ineffective since it was not strictly enforced. In 2010, the government implemented the Mandatory Jute Packaging Act, which was somewhat effective in lowering the country's plastic use. In 2010, the National 3R Strategy for Waste Management was created to provide guidelines on plastic reduction, reuse, and recycling. The Eighth Five Year Plan also called on local stakeholders like the Department of Environment, the Bangladesh Plastic Goods Manufacturers and Exporters Association, plastic manufacturers, research industries, and city corporations to actively participate in the implementation of the Extended Producer Responsibility (EPR) Policy in plastic management. Bangladesh has committed to a 30 per cent reduction in plastic waste by 2030 as part of its National Action Plan (The World Bank 2021). The country has set goals of lowering virgin material consumption by 50 per cent by 2030. It also aims to recycle 50 per cent of all plastics by 2025, with the goal of reaching a recycling rate of 80 per cent by 2030, and phasing out targeted single-use plastics by at least 90 per cent by 2026 (The World Bank 2021). The National Action Plan lays out in detail the measures and methods that will be used to achieve these objectives.

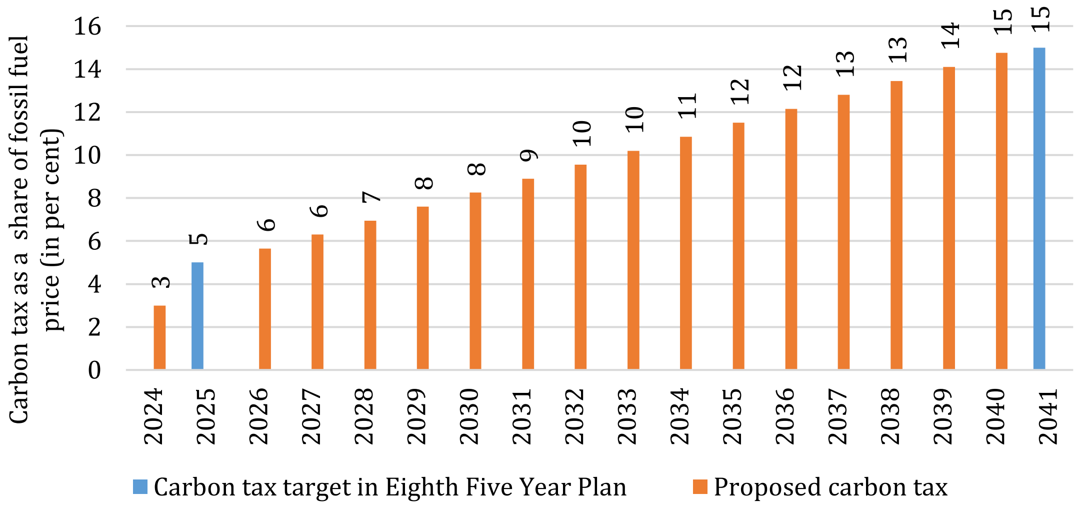
7.3 Budget recommendations for reducing air and plastic pollution

In light of the above, the government may adopt the following budgetary measures to minimise air and plastic pollution and support the greening of the economy:

- VAT exemption: The government should fully implement the commitments which it made in the *Renewable Energy Policy 2008.* Currently, VAT exemption exists on solar panels and batteries, but there are no exemptions on solar inverters which are a crucial component of solar power plants. Moreover, the import duty on inverters (HS 85044090) was raised to 37 per cent in the budget of FY2022. An extensive policy that considers VAT exemption on all types of equipment in a renewable power plant, especially solar power plants, should be considered from FY2024.
- Incentive tariff: An incentive tariff can be considered for electricity generated from renewables according to the *Renewable Energy Policy 2008*, which allows electricity generated from renewable sources to be priced 10 per cent higher than the highest purchase price of electricity generated from fossil fuel sources.
- Environment surcharge: The Finance Act of 2014 set a 1 per cent surcharge on the goods produced by industries polluting the environment. This environment protection surcharge should be implemented completely in FY2023.
- Introduce carbon tax: Bangladesh can implement a carbon tax equivalent to 3 per cent of the price of fossil fuels starting from FY2024, in order to gradually meet the government's target set out in the Eighth Five Year Plan which aims to implement a 5 per cent carbon tax on the

price of fossil fuels by 2025 and 15 per cent carbon tax on the price of fossil fuels by 2041 (Bangladesh Planning Commission 2020).

Figure 7.1: Carbon tax as a share of fossil fuel price (in per cent), target and proposed



Source: CPD illustration based on targets set out in the Eighth Five Year Plan (Bangladesh Planning Commission 2020)

Such a carbon tax can bring two benefits for Bangladesh: i) a carbon tax will be a disincentive for fossil fuel-based power producers; and ii) the revenue collected from carbon tax can be utilised for the development of green energy in Bangladesh. Bangladesh has the potential to generate revenues equivalent of about 1 per cent of its GDP by charging USD 30 per tonne of carbon dioxide equivalent (World Bank 2022). The tax can be levied upstream, such as at the import level or on fossil fuel driven power producers, to make it easier to implement (World Bank 2022). Initially, the carbon tax may be levied on selected fossil fuels only. However, it would not be feasible to implement a carbon tax on liquified natural gas (LNG), as the country is already paying a lot for the import of LNG. In the long-term, the country can increase the rate of carbon tax and make it a large revenue stream to fuel green transition of the economy. A carbon tax for fossil fuel products in Bangladesh would reduce a substantial amount of carbon emissions and also yield tax revenues which could be utilised to invest in clean technologies and infrastructures that will help offset the loss of output from carbon taxes (Ahmed and Khondker 2018).

- Phase-out fossil fuel subsidies: The government should phase out fossil fuel subsidies starting from FY2024 in line with recommendations from the International Monetary Fund (IMF). Initially, all fossil fuels may be sold at the international market price and this price may be updated each month. Instead, the government can redirect the funds currently allocated to fossil fuel subsidies to the development of green energy.

- Feed-in tariff: A formal feed-in tariff policy exclusively for renewable energy needs to be implemented in FY2024 in order to promote renewable energy in Bangladesh. Currently, an informal version of the feed-in tariff policy exists in Bangladesh. However, such a mechanism does not exclusively promote renewable energy. A clear incentive package has to be present in the policy so that it reaches all types of potential renewable energy producers regardless of their generation capacity.

- In order to reduce air polluting originating from the transport sector, the government should reform the advance income tax (AIT) structure on private motor vehicles so that the AIT on fossil fuel driven motor vehicles is 5 per cent to 50 per cent higher than the AIT on hybrid and fully electric vehicles, depending on the size the vehicle's engine and electric motor.

Table 7.1: Proposed advance income tax structure for the owners of private motor cars in FY2024

Type and engine capacity or electric motor power of motor car	AIT for hybrid and fully electric vehicles (in BDT)	AIT for conventional fossil fuel vehicles (in BDT)
A car or a jeep, not exceeding 1500cc or 75kw	25,000	26,250
A car or a jeep, exceeding 1500cc or 75kw but not exceeding 2000cc or 100 kw	50,000	55,000
A car or a jeep, exceeding 2000cc or 100 kw but not exceeding 2500cc or 125 kw	75,000	90,000
A car or a jeep, exceeding 2500cc or 125 kw but not exceeding 3000cc or 150 kw	125,000	162,500
A car or a jeep, exceeding 3000cc or 150 kw but not exceeding 3500cc or 175 kw	150,000	210,000
A car or a jeep, exceeding 3500cc or 175 kw	200,000	300,000
A microbus	30,000	36,000

Source: CPD compilation

- In addition to the AIT on private motor vehicles, the government should also consider imposing an AIT on motorcycles from FY2024.

Table 7.2: Proposed advance income tax structure for the owners of motorcycles in FY2024

Type and engine capacity of motorcycle	Yearly AIT (in BDT)
A motorcycle with engine up to 100cc	1,500
A motorcycle with engine from 101cc to 150cc	3,000
A motorcycle with engine above 150cc	5,000

Source: CPD compilation.

- With the goal of reducing plastic pollution, the government should consider bringing single-use plastic products under taxation in FY2024. Such single-use plastic products may include: cutlery such as forks, knives, spoons, and chopsticks; plates; straws; beverage stirrers; sticks to be attached to and to support balloons; food containers made of expanded polystyrene; beverage containers made of expanded polystyrene; and cups for beverages made of expanded polystyrene. Initially, the plastic tax regime should assume a moderate stance and in subsequent years the tax regime could be made more stringent, and more single-use plastic products should be brought under the ambit of taxation.

- The budget for FY2024 should allocate additional funding for the Joint Rivers Commission to establish a bilateral plastic waste reduction initiative with India. The Government of India should also contribute to this initiative with funding, as well as technical and logistical support, in order to ensure the reduction of plastic waste in the 54 transboundary rivers shared between Bangladesh and India.

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SECTION 8. CONCLUSION

The national budget for FY2024 will be placed at a time when the country is facing formidable challenges in a number of areas. The adverse impacts of the rise in global commodity prices following the conflict in Ukraine started to be felt on many socio-economic correlates of Bangladesh just at a time when the economy was recuperating from the harshest effects of COVID-19. While these factors have certainly accentuated the macroeconomic situation of the country, they should not draw the attention away from the accumulated and embedded weaknesses within the Bangladesh economy.

As far as the trends during FY2023 are concerned, the major correlates exhibit signs of serious stress within the Bangladesh economy. This has been manifested in, inter alia, negative growth in revenue mobilisation, slow implementation of ADP, increased reliance on bank borrowing for deficit financing – particularly from the central bank, skyrocketing prices of essentials, declining liquidity situation of banks, deteriorating external sector balance and foreign exchange reserve. Amid these disquieting developments, perhaps the silver lining is that the global economic situation is slowly improving, and global commodity prices are on a downward trajectory.

In the current context, policymakers' scope of manoeuvring policy measures has become rather limited given the declining fiscal space. Given the current macroeconomic situation, pressure on policymakers to provide various tax reliefs and other incentives will be intensified. At the same time, demand for budgetary allocations towards various sectors will be increased. In this scenario, targeted fiscal measures geared towards catering the needs of the fixed-income earning and low-income population should take the centre stage. Such measures should be accompanied by monetary measures focusing on stability (e.g., market-based interest rates and exchange rates). Good governance and discipline are of paramount importance for these policies to bring forth their intended results. The reform measures proposed by the IMF might prove to be beneficial in this regard.

Proper acknowledgement of the current scenario should be at the forefront while formulating the budget for the next fiscal year. While it might be disincentivising for a political government to do so in an election year, as recent experience shows, failure in this regard will result in a macro-fiscal policy stance that does not meet the needs of the time. The budget for FY2024 should take cognisance of the emerging realities adequately, assess the available policy options diligently and formulate the measures accordingly. Further instability originating on account of policy missteps may be unwarranted in an election year.

ANNEX

Annex Table 5.1: Cash incentive for export products

Amount of proposed export cash incentives	Products
20%	Vegetables, fruits, agro processed food, active pharmaceutical ingredients, jute products; full halal meat and meat products, potato, carbon and jute particle board produced from jute; grain and vegetable seeds, agar and attar products.
15%	Light engineering products, leather goods, furniture, accumulator battery, Footwear and bags made from a mix of synthetics and fabrics, and rice.
12%	Jute final product mainly Hessian, Seking and CBC
10%	20 per cent ice-covered frozen shrimp; crust and finished leather, plastic products, paper and paper products, software, ITES and hardware, ships manufactured in factories located in Savar leather industry town and factories located outside Savar having their own ETP; pharmaceutical products; Handicrafts (from hogla, straw, sugarcane/coconut husks, leaves/shells, jute cloth for ready-made garments); Pulses, horns, horns of cows and buffaloes; Stomach Bottle-Flex; Polyester staples manufactured from PET bottle-flakes, export of photovoltaic modules, motorcycles, chemical products, razors and razor blades, ceramic products, hats, crabs and knickers, galvanised sheets; consumer electronics and electrical home and kitchen products
5%	Garments products locally procured with raw materials like yarn and fabrics
4%	Garments products
4% (additional)	Garments product (if exported to non-traditional market)
1%	For all the exported product
1% (additional)	For garments product only