

DELIVERING ON BUDGET FY2009-10: A SET OF IMPLEMENTATION ISSUES

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Analyses and interpretations presented in this report remain responsibilities of the authors. Comments and feedback may be sent to <debapriya.bh@gmail.com>.

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DELIVERING ON BUDGET FY2009-10: A SET OF IMPLEMENTATION ISSUES

1. INTRODUCTION

The newly elected government proposed its first budget on 11 June 2009 with a view to support a trajectory of moderate growth, reduced poverty through employment generation and expansion of safety nets, low price level and to tackle the impact of the global financial crisis. The Centre for Policy Dialogue (CPD) in its budget reaction pointed out that addressing these objectives will entail designing of a set of appropriate budgetary measures, but will depend much more on the efficacy of their delivery.¹ Furthermore, such delivery will need a coherent, coordinated, consistent and committed participation of the total government machinery and all other development actors and stakeholders. It was encouraging to see that the Finance Minister publicly agreed with the analysts that implementation of the budget would be the most important challenge. In his post-budget press briefing on 12 June 2009, the Finance Minister stated: “While drawing up the budget, we knew its execution was going to pose a huge challenge”².

In this context the present study seeks to facilitate an early kick-off of budget implementation in FY10 and to complement the continuing monitoring process by the government. The study is based on analysis of secondary data, government policy documents and media reports. Interviews with the knowledgeable people were also carried out to generate insights. Along with selective econometric exercise, academic literature was reviewed to strengthen the analysis.

Promoting economic growth is the primary objective of the budget implementation; conversely growth itself is a key determinant of successful implementation of budget. In this context, the paper sets off by exploring the growth prospect for FY10 and its linkages with implementation of the budget. Resource mobilisation is one of the two pillars of a budgetary framework; subsequent two sections, thus, highlight the issues related to revenue mobilisation from domestic source and foreign assistance inflow. On the expenditure side, a select set of expenditure issues relating to the revenue expenditures have been examined, besides reviewing the challenges of Annual Development Plan (ADP) delivery. As mainstreaming of the Public-Private Partnership (PPP) has been one of the distinguishing features of the budget, a separate section has been devoted to the theme. The penultimate section of the paper brings the resource and expenditure sides together and discusses the issues relating to budget deficit and its financing. The paper then rounds up with a set of possible scenarios along with a few concluding observations.

2. GROWTH PROSPECT AND BUDGET IMPLEMENTATION

Growth Prospect. In a year of democratic transition, uncertainties both in terms of policy making and policy continuity, volatility in domestic economy and global financial meltdown, a

¹ CPD. (2009a). *An Analysis of the National Budget for FY2009-10*. Dhaka: Centre for Policy Dialogue.

<http://cpd.org.bd/downloads/CPD%20Budget%20Response%20FY10.pdf>

² See The Daily Star on 13 June 2009. <http://www.thedailystar.net/newDesign/news-details.php?nid=92336> (accessed on 10 August 2009).

growth rate of 5.9 per cent was recorded during FY09. This has been considered to be respectable. A robust performance in the agricultural sector (growth rates of agricultural sector and crop-sector were 4.7 per cent and 5.2 per cent respectively) and high export growth were the highlights of the preceding fiscal year (FY09). With the apprehension of late entry and exit in the impact cycle of the global meltdown, the GDP growth target for FY10 was initially set at 5.5 per cent. Compared to the almost 6 per cent growth in the volatile year of FY09 and considering the emergence of “silver lining” in the global economy and proposed counter-cyclical expansionary fiscal stance, the target was termed “rather conservative” by CPD in its reactions to the national budget for FY10. Such a characterisation was also informed by the high level ambition espoused by the election manifesto of the ruling coalition. The Finance Minister, however, in his post-budget press briefing on 12 June 2009 mentioned that the GDP growth rate in FY10 will be between 5.5 – 6.0 per cent³. Later, the Monetary Policy Statement of the Bangladesh Bank pitched the GDP growth in FY10 “in the range of 5.5 to 6.0 per cent” as “projected conservatively” and expected that it may “outperform” given some positive developments at home and abroad⁴. Such a reassessment of the growth outlook for FY10 is well appreciated.

Sectoral Composition. Given the structural composition of the GDP, achieving a growth target of 5.5 per cent usually does not require an exceptional performance.⁵ However, to attain a 6 per cent growth and beyond, the sectors of the economy are required to demonstrate comparatively an above-average performance. Unfortunately the government’s projections on sectoral GDP growth targets for FY10 are not available. In Table 1, we tried to project the sectoral GDP growth target in view of the aggregate target of around 6 per cent.

The central bank in its recent MPS has mentioned that it aim to pursue monetary policy to attain 4 per cent growth in agriculture sector. In the backdrop of high benchmark of agricultural production (4.7 per cent in FY09), attaining such a target will be pretty challenging. It is rather expected that, in the event of continuation of policy support and given absence of any natural disaster affecting the crop sector other than the impact of drought during ongoing Aman, a near 3.5 per cent growth in this sector may be realistic.

TABLE 1: A PROJECTION OF SECTORAL GROWTH TARGETS

Sector	Growth FY09	Growth FY10*
Agricultural Sector	4.7	3.5
Industry	5.9	6.5 - 7.0
Service Sector	6.3	6.5
GDP	5.9	6.0 -6.3

*Sectoral growth rates are projected in view of GDP growth target

Source: Authors’ projection and Ministry of Finance⁶

The average growth rate of industrial sector⁷ during this decade (FY01-FY09) has been around 7.5 per cent. It can be expected that FY09’s below par performance by industrial sector (at 5.9 per cent) will continue during the first half of this fiscal year. Following global

³ *ibid.*

⁴ Bangladesh Bank. (2009). *Monetary Policy Statement*. Dhaka: Bangladesh Bank.

⁵ CPD. (2009a). *An Analysis of the National Budget for FY2009-10*. Dhaka: Centre for Policy Dialogue.

<http://cpd.org.bd/downloads/CPD%20Budget%20Response%20FY10.pdf>

⁶ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

⁷ Includes mining & quarrying, manufacturing, electricity, gas & water and construction.

economic recovery, it may revert to its trend growth in the second half of FY10. However, in view of the rather discouraging investment scenario in the domestic front, the industrial growth at the end of the year may very well stay below its trend, but is expected to beat last year's growth. Thus, according to our best judgement, between 6.5 per cent to 7.0 per cent growth may be anticipated for this sector in FY10. But manufacturing growth at the margin will determine GDP growth beyond 5.5 per cent.

Historically, steady performance by the services sector has been underpinned by moderate achievements in the real sectors. An average growth of the service sector during FY01-FY09 (6.5 per cent), given the expected performance by the other two, may be secured and hence the targeted growth rate for GDP.

Growth-Investment Nexus. One may recall that, CPD identified that energising investment would be the one of the crucial challenges for Bangladesh economy during FY10⁸. Investment target, as stated in the budget suggests that the government is expecting a decrease in the investment rate (as a percentage of GDP) from 24.2 per cent in FY09 to 23.6 per cent in FY10 (see Table 2). A significant enhancement in public investment (in terms of ADP) would thus imply a rather depressing FY10 for private investment as it is going to decline further as percentage of GDP (from 19.6 per cent in FY09). This would imply either a complete contradiction to the expectation expressed in the budget about private investment or apriori acceptance of less than full delivery of ADP.

TABLE 2: GROWTH-INVESTMENT FRAMEWORK FOR FY10

Indicator	FY09 (Provisional)	FY10 (Projected)
Real GDP Growth (%)	5.9	5.5 - 6.0
Gross Investment (as % of GDP)	24.2	23.7
Incremental Capital-Output Ratio (ICOR)	4.1	4.3 - 4.0
Annual Development Programme (as % of GDP)	3.7	4.4

Source: Authors' calculation based on Medium Term Macroeconomic Framework (MTMF)⁹

The incremental capital output ratio (ICOR) is also projected to increase to 4.3 in FY10 given the growth target would remain at 5.5 per cent, hence a further deceleration of capital productivity has been projected. To achieve a 6 per cent growth, with the same level of investment, capital productivity in terms of ICOR requires an improvement to 4.0. Thus, in order to achieve target growth rate, a significant upward movement may required to take place regarding investment flow – both public and private. In the absence of adequate investment flow, capital productivity has to increase through better capacity utilisation and/or technological upgradation. These, on their own, will also define the revenue collection prospect.

Determinations of Domestic Resource Mobilisation. It is not only the expenditure side of a budget that influences aggregate economic outcome such as GDP growth; GDP growth performance, from the other side, may also determine potential for domestic resource mobilisation. We have carried out a quantitative analysis for understanding the determinants of total tax revenue in Bangladesh. A time series regression is estimated

⁸ CPD. (2009b). *Bangladesh Economy in FY2008-09 An Interim Review of Macroeconomic Performance*. Dhaka: Centre for Policy Dialogue.

⁹ Ministry of Finance. (2009b). *Medium-Term Budgetary Framework (MTBF) 2009-10 to 2011-12*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

considering (ln of) total tax revenue collection as the dependent variable during time-period of FY81 to FY08. Apart from the basic determinants of resource mobilisation (e.g. per capita income) for any country, to capture the effects of institutional measures initiated in revenue collection efforts, two dummy variables for value added tax (VAT) and large tax-payers unit (LTU) were introduced. Although, no serial correlation was found using *Durbin-Watson* test; we followed standard procedure in time series analysis by running the Prais-Winsten correction. Prais-Winsten uses the generalised least-squares method to estimate the parameters in a linear regression model in which the errors are serially correlated. However, there are no significant changes in the results are found.

TABLE 3: DETERMINANTS OF RESOURCE MOBILIZATION IN BANGLADESH

Variables	Model I	Model II
	OLS	Prais-Winsten
Per Capita Income (ln)	0.78*** (0.01)	0.76*** (0.19)
Public Investment as % of GDP	0.17* (0.09)	0.18** (0.08)
Import (log)	0.15* (0.08)	0.13* (0.07)
Share of Modern Sector in GDP	0.01 (0.02)	0.02 (0.02)
VAT Dummy (1= Introduction of VAT and 0=otherwise)	0.24*** (0.04)	0.25*** (0.04)
LTU Dummy (1= Introduction of LTU and 0=otherwise)	0.09** (0.04)	0.10*** (0.04)
Constant	-2.60*** (0.83)	-2.64*** (0.78)
R-Squared	0.99	0.99
Durbin-Watson Statistics	1.96	1.90
Number of Observations	28	28

Source: Authors' estimation

Note: 1. ***, ** and * denote significance level at 1 per cent, 5 per cent and 10 per cent respectively.

2. Figures within the parentheses are the standard errors

The time series regression results, as reported in Table 3, suggest the following:

- a) Per capita income has the highest influence on the level of resource mobilisation in Bangladesh. Accordingly, one per cent increase in per capita income would result around 0.8 per cent increase in tax collection. Findings from several other studies – both cross-country and country-specific – also confirm this result.¹⁰
- b) Investment in the private sector is largely related to import and destined to modern sector of the economy. Thus excluding investment in private sector, we consider the public investment only, as a determinant of tax revenue mobilisation. It is found that public sector investment in Bangladesh, in turn, contributes to the tax revenue generation.

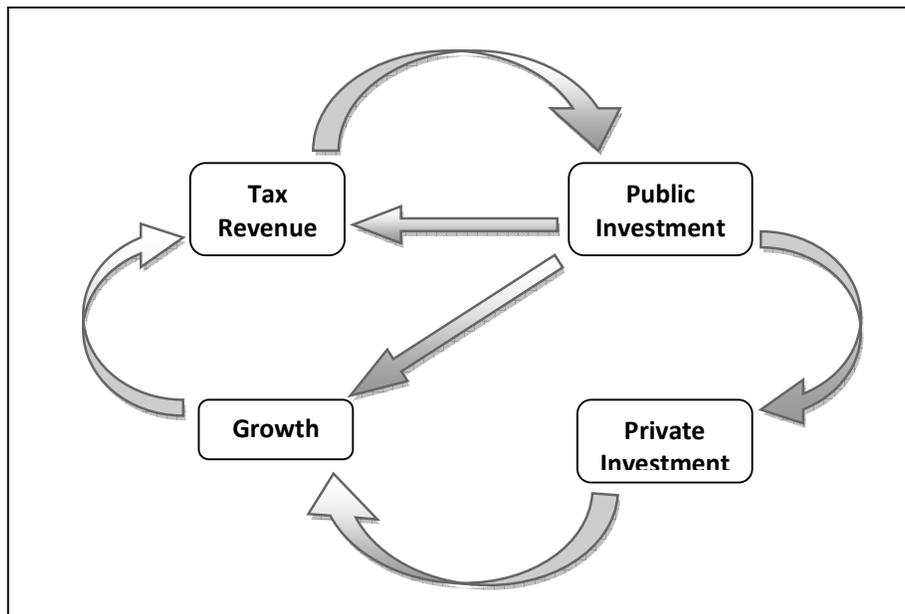
¹⁰ Bahl, R.W. (1971). *A Regression Approach to Tax Effort and Tax Ratio Analysis*. IMF Staff Papers, Vol. 18, No. 3, November, pp. 570-612.

Chelliah, R.J. (1971). *Trends in Taxation in Developing Countries*. IMF Staff Papers, Vol. 18, No. 2, July, pp. 254-325.

Rasheed, F. (2006). *An Analysis of the Tax Buoyancy Rates in Pakistan*. College of Management Sciences. PAF-Karachi Institute of Economics & Technology. Market Forces October 2006, Vol. 2. No. 3.

- c) Relationship between tax revenue collection and import is also found positively significant. This corroborates the relatively high dependence of tax collection on import-related sources.
- d) Influence of the share of modern sector, as a proxy of the economy's structure, is found correctly with positive sign, but insignificant.
- e) Different institutional measures taken by the governments at different time have also positive impact on revenue generation, although the introduction of Value-Added Tax (VAT) in FY91 has much larger influence compared to the introduction of Large Tax-Payer's Unit (LTU) in FY03.

Figure1: Investment-Growth-Public Finance Cycle



Source: Authors

Thus, implementation of the budget, on one hand, has a critical role in attaining GDP growth target for the economy; at the same time, the time series analysis confirms that the performance of the economy will also determine, to a large extent, the implementation of the proposed budget. In fact, from this result one can illustrate an interrelated macroeconomic framework in the fiscal context. One may also recall, in Bangladesh, public investment creates a “crowding in” effect for private investment¹¹, given excess liquidity in the financial system – an incidence prevailing at present circumstances. Thus, public investment along with the private counterpart can facilitate the economic growth. Economic growth and also higher public investment, as is found, accordingly have a positive effect on revenue mobilisation. Consequently, the incremental revenue will be utilised for development financing. This “Investment-Growth-Public Finance Cycle” has an important policy implication (see Figure 1). This also reemphasises the need for energising investment to foster economic growth; not only from the expenditure side, but also from the revenue mobilisation perspective of budget implementation.

¹¹ Majumder, M. A. (2007). *Does Public Borrowing Crowd-out Private Investment? The Bangladesh Evidence*. Working Paper Series WP 0708. Policy Analysis Unit (PAU). Dhaka: Bangladesh Bank.

3. DOMESTIC RESOURCE MOBILISATION

a. Overall Revenue Targets

Total Revenue. Overall growth target in revenue earnings for FY10 has been set at 15.7 per cent and achievement will depend on the performance of all the basic three revenue components, viz. NBR tax¹², non-NBR tax¹³, and non-tax¹⁴. As trend analysis reveals (see Table 4), barring FY08, such growth in total revenue was never achieved over the last 17 years. It should be mentioned that FY08 was an exceptional year for revenue mobilisation, as high growth rates for all the three revenue components were observed. Against an average growth of 13.8 per cent during FY02-FY06, a 24.9 per cent growth in total revenue collection was achieved in FY08.

TABLE 4: REVENUE GROWTH TREND OVER THE LAST TWO DECADES (per cent)

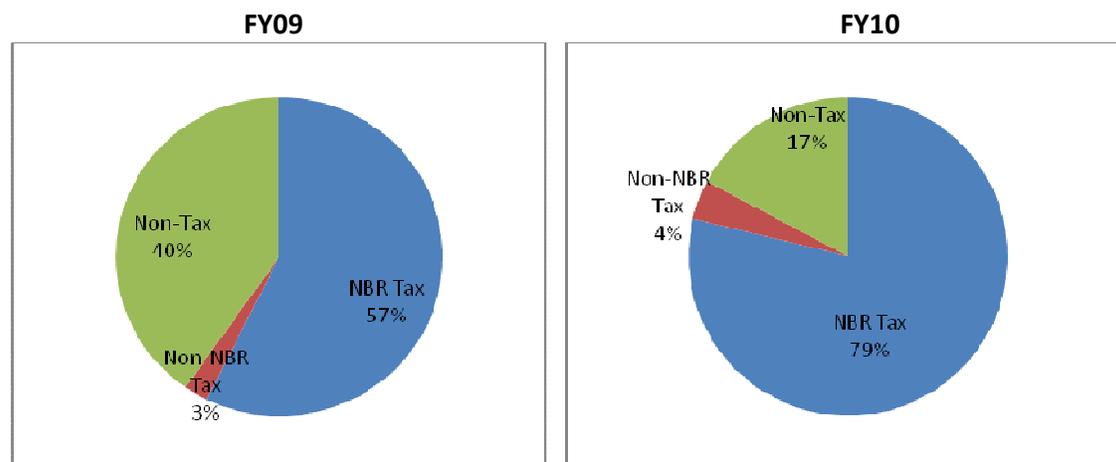
Components	FY92-FY96	FY97-FY01	FY02-FY06	FY07	FY08	FY09*	FY10 B
Total Revenue	14.1	8.5	13.8	8.6	24.9	14.8	15.7
Total Tax	13.2	10.4	12.5	10.0	27.3	--	16.2
NBR Tax	13.2	10.8	12.7	9.5	27.4	10.7	16.1
Non-NBR Tax	13.5	5.0	9.0	21.6	24.6	17.3	17.0
Non-Tax	18.8	5.3	20.9	2.7	14.1	9.7	13.6

Source: Authors' estimate based on MoF data¹⁵.

* Growth rates of FY09 are for Jul-Mar period (Jul-Jun for NBR tax) over the same period of FY08

Therefore, compared to the historical trend, total revenue growth target for FY10 remains to be on the high side, but in comparison to FY08 – it is on the low side. To achieve this aggregate target, an overwhelming responsibility has been put on the NBR as it has to provide about 78.8 per cent of the total incremental revenue. The rest is to come from non-NBR tax (4.0 per cent) and non-tax (17.2 per cent) components. Whereas in FY09 the relative contributions were more balanced (see Figure 2).

FIGURE 2: INCREMENTAL CONTRIBUTION OF SOURCES IN REVENUE GROWTH BY SOURCES (FY09 AND FY10)



Source: MoF and NBR¹⁶

¹² Includes income tax, VAT, import duty, supplementary duty, electricity and others.

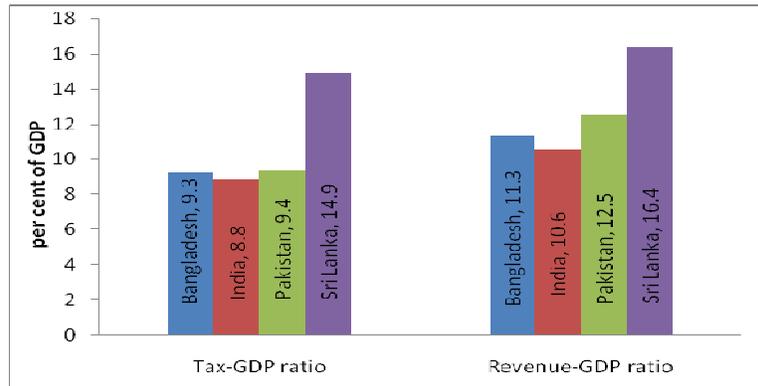
¹³ Includes narcotics & liquor, vehicles, land, stamp.

¹⁴ Includes dividend & profit, post office & railway, interest/fees/tolls and other receipts.

¹⁵ <http://www.mof.gov.bd/en/>

Tax Revenue. Total tax revenue (NBR tax and non-NBR tax) is targeted to increase by 16.2 per cent in FY10, which will be higher than its trend growth over the last several years (excluding FY08). This high growth target for total tax revenue is largely based on the high expectations from the NBR in FY10, particularly on account of income tax. However, even if the total tax revenue target is achieved, tax-GDP ratio of Bangladesh will reach at 11.6 per cent, remaining unfavorable compared to most of its neighbors (Figure 3).

FIGURE 3: TAX-GDP AND REVENUE-GDP RATIO IN SOUTH ASIAN COUNTRIES (FY09)



Source: Budget Documents and Economic Reviews of the respective countries

* Revised budget estimates for FY09 (actual FY09 figure for India)

Note: India's ratio low because it is only for federal taxes. The state taxes are included, the ratio goes up significantly.

NBR Tax. Average growth of NBR tax, for the period between FY02 and FY06 has been 12.7 per cent. FY07 posted a small growth of only 9.5 per cent. After a robust performance in the following year (posting 27.4 per cent growth) a small growth of 10.7 per cent was recorded in FY09. It needs to be borne in mind that one of the important factors behind the higher revenue growth achieved in FY08 was due to import growth (in value terms) and high commodity prices in the international markets at that time. Vigorous administrative drive to increase revenue coverage and strict monitoring to avoid evasion by the then Caretaker Government (CTG) were other contributing factors. In the backdrop of much lower level of international prices of commodities and associated slowdown in import, duty collection in recent months along with return to business-as-usual situation in administrative proceedings, it appears that attaining the 16.1 per cent growth target for the NBR in FY10 could be quite uphill.

Non-NBR Tax. For the non-NBR tax component, a growth target of 17.0 per cent has been set for FY10. Notwithstanding the fact that average growth during FY02-FY06 was rather low at 9.0 per cent, high growth was achieved in two consecutive years – FY07 (21.6 per cent) and FY08 (24.8 per cent) and was sustained, to an extent, during the first three quarters of FY09 (17.3 per cent during July-March period). Therefore, the target of non-NBR tax collection for FY10 appears to be an achievable one.

Non-Tax Revenue. As Table 1 indicates, growth trend of non-tax revenue was volatile over the years compared to other revenue components. Against high average growth of 20.9 per cent for the period FY02-FY06, only 2.7 per cent growth was achieved in FY07. However,

¹⁶ <http://www.nbr-bd.org/>; <http://www.mof.gov.bd/en/>

FY08 posted a growth of 14.1 per cent¹⁷ and even after the corporatization of the T&T Board, during the July-March period of FY09 a respectable 9.7 per cent growth was recorded. From this perspective, growth target for non-tax revenue (13.6 per cent) in FY10 appears to be conservative and thus should be overachieved.

The fact remains that overall revenue growth target (15.7 per cent) for FY10 is well above the average growth achieved in the past years (barring FY08, which was an extraordinary year in terms of revenue mobilisation in all aspects). Achievement of this target will hinge on strengthened administrative efforts in avoiding leakages and bringing in more eligible people within the tax net, and energizing the revenue-sensitive sectors of the domestic economy. According to media reports, as of March 2009 Tk 6,542 crore revenue was stuck-up in judicial process due to litigations. Special efforts should be initiated to expedite these cases not only to collect dues, but also to send a signal to the litigants.

Apparently, based on household income and expenditure data, there is enough scope to expand the tax base of Bangladesh with only around 7.5 lakh tax payers as against over 70 lakh potential tax payers. A drive to penetrate the newly emerging activities in the urban areas to bring them under the tax net would be critical in this regard. While there are provisions for tax collection from agricultural income, this sector is yet to contribute much since tax administration has not effectively reached the rural economy. Activities in the peri-urban areas also largely remain outside the tax net. Tax offices at the Upazilla level need to be set up to explore untapped revenue that could be earned from the peri-urban and rural economy.

b. Growth Target for Income Tax

Of the total Tk 10,281 crore incremental revenue to be generated in FY10 over FY09, 29.4 per cent is targeted to come from higher income tax collection. Thus, success in achieving revenue target will largely depend on expanding the base of personal income tax, since the rates have been kept at the previous levels (other than corporate tax, which has been reduced by 2.5 per cent for the financial institutes).

As can be seen from the trends of the last ten years as depicted in Table 5, commendable success has been achieved by the NBR in mobilising income tax with growth rates averaging 18.3 per cent during FY97-FY01 and 15.6 per cent during FY02-FY06. As a result of the NBR drive to tap tax dodgers coupled with the government's anticorruption drive, income tax growth achieved in FY08 was as high as 34.7 per cent.

TABLE 5: GROWTH TRENDS IN INCOME TAX COLLECTION OVER THE LAST DECADE (per cent)

	FY92- FY96	FY97- FY01	FY02- FY06	FY07	FY08	FY09	FY10 B
Income Tax Collection	7.1	18.3	15.6	21.8	34.7	18.3	19.2

Source: NBR and Budget Documents FY10¹⁸

¹⁷ FY07 figures for non-tax revenue were later revised upwards in December, 2008 (FY09), putting the growth figure at 21.5 per cent for FY07 and negative (-) 3.6 per cent for FY08.

¹⁸ National Board of Revenue. (2009). *Annual Report 2008*. Dhaka: National Board of Revenue.

<http://www.nbr-bd.org/>; <http://www.mof.gov.bd/en/>

Attaining the growth target for income tax set for FY10 (19.2 per cent) will still be a major task and needs to be based on multitude of efforts. The government has announced its plan to conduct a new tax survey to bring in at least 4 lakh new tax payers under the tax net within the current fiscal year (FY10). This effort needs to be supplemented with strict surveillance to prevent tax evasion. It is worthwhile to remember that the government's ability to provide public goods and services, such as law and order, also affects people's inclination to voluntary compliance with tax provisions.

It may be noted here that around 1.5 lakhs government employees are within the total income tax coverage (i.e. about 20 per cent), who gets the amount refunded at the end of the year, making effective number of taxpayers to be around 6 lakhs. The government is currently considering discontinuing the refunding provision for its employees from the current fiscal year, which may contribute towards attaining the income tax collection target, partly offsetting the potential loss from lower profitability of the companies in this era of economic depression (and also reduce the burden of implementing the higher pay scale).

c. Lower Corporate Tax Rate

As has been mentioned earlier, the targeted growth in revenue collection is largely based on growth in income tax collection, including corporate tax. Corporate tax is the largest contributor within total income tax accounting for about 60 per cent. During adoption of the budget in the parliament, corporate tax rate for financial institutions has been reduced to 42.5 per cent from the previous rate of 45 per cent. Positive relationship between lower tax rate and sectoral growth being a medium to long-term phenomenon, revenue collection may suffer in the short-term (in FY10) due to this discount. The new rate is estimated to result in about Tk 550 crore less revenue for the current fiscal year.

Expansion of the Large Taxpayers Unit (LTU) should be given due priority in minimising any potential revenue loss occurring from the lower rate. LTU contributes over 37 per cent of the total income tax collection and includes 981 taxpayers, 281 of which are companies. The government has targeted Tk 6,000 crore to be mobilised from them, Tk 1,100 crore more than what was achieved of it in the last year, with majority of the additional revenue to come from the companies. However, many of these companies have already registered losses (55 companies) and 9 of them are not functioning at all, while another nine are enjoying tax holidays. Global developments will make its mark on the income and profitability of these companies and the revenue earned from them. Thus, effectiveness of the government's effort to stimulate investments in the country will have great implications for revenue prospects, particularly in FY10.

d. Growth Target for VAT

As Table 6 shows that a 13.2 per cent growth target has been set for VAT collection in FY10, implying about a quarter of the incremental revenue of FY10 is set to come from increased VAT collection. This growth target, however, appears achievable in the background of 14.2 per cent average growth achieved during FY02-FY06. Although FY07 posted a lower growth of 11.5 per cent, as was the case for income tax, FY08 was an exceptional year in terms growth in VAT collection (34.5 per cent), while the rate subsequently slowed down to 13.9 per cent in the following year (FY09).

TABLE 6: GROWTH TRENDS IN VAT COLLECTION (FY93 – FY10) (in per cent)

	FY93-FY96	FY97-FY01	FY02-FY06	FY07	FY08	FY09	FY10 B
Total VAT	23.1	10.8	14.2	11.5	28.2	13.9	13.2
VAT Import	20.0	7.8	10.0	7.2	34.5	8.2	NA
VAT Domestic	32.1	15.9	19.2	15.4	22.9	19.2	NA

Source: NBR and Budget Documents FY10¹⁹

Given the uncertainties afflicting global economic situation in the coming year including volatility of prices, VAT collection at the import stage may suffer in FY10. Since around 50 per cent of the total VAT collection in Bangladesh comes at the import stage, one needs to be energetic in mobilising VAT at the domestic level so as to offset any fall in the former. At the same time, challenge will be there to cover the loss arising from withdrawal of VAT from a number of products and from professions (e.g. medical doctors)²⁰. A time-bound approach in implementation of the decision to compulsory installation of ECR (Electronic Cash Register) by all sales units should also be prioritised. Efforts undertaken in the last two years, such as legal action against VAT dodgers and mass drive to collect VAT from retail stores should be continued to meet the VAT collection target. There is also a need to reconcile the income tax and VAT figures of business establishments.

e. Revenue Implications of the Global Economic Crisis

Fall in commodity prices in international markets during FY09 resulted in a fall in import duty collection in Bangladesh (Figure 4). Month-on-month comparison as presented in Figure 3, clearly bears it out as growth rate in import duty collection fell from 35.7 per cent to (-) 27.9 per cent between the month of July, FY09 and June, FY09. It is to be noted that the annual growth target for import duty collection of 13.1 per cent for FY09 was later revised at a negative (-) 0.3 per cent in view of the monthly progress. Table 7 reveals that at the end of the fiscal year even the targeted level of negative growth was not achieved and settled with a negative (-) 2.8 per cent growth. In-take of total import related duties was also lower than the targeted growth of 5.1 per cent (originally targeted at 13.5 per cent for FY09, later revised at 7.4 per cent).

TABLE 7: GROWTH TREND IN IMPORT DUTY COLLECTION (FY93 – FY10) (in per cent)

	FY92-FY96	FY97-FY01	FY02-FY06	FY07	FY08	FY09	FY10 B
Import Duty	10.0	6.7	9.2	4.2	17.7	-2.8	11.8

Source: NBR and MoF²¹

¹⁹ National Board of Revenue. (2009). *Annual Report 2008*. Dhaka: National Board of Revenue.

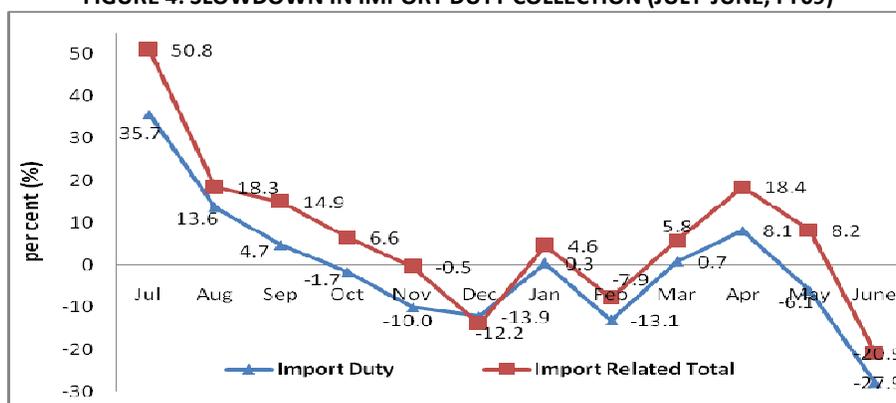
<http://www.nbr-bd.org/>; <http://www.mof.gov.bd/en/>

²⁰ At the manufacturing stage, electricity, cancer preventive drugs, hard board, electric generator, refrigerator, motor cycle, solar panel and goods carrier trailer have been exempted from VAT in the budget for FY10. At the same time, internet service provided to educational institutions, specialized doctors and maize (corn) seeds at the trade stage have been exempted from VAT.

²¹ National Board of Revenue. (2009). *Annual Report 2008*. Dhaka: National Board of Revenue.

<http://www.nbr-bd.org/>; <http://www.mof.gov.bd/en/>

FIGURE 4: SLOWDOWN IN IMPORT DUTY COLLECTION (JULY-JUNE, FY09)



Source: NBR²²

Import duty and other import related duties together constitute over 40 per cent of the total NBR revenue collection in Bangladesh (34 per cent of the total revenue). Thus, developments in the global economic crisis may have significant implications for revenue collection in FY10. However, as various projections indicate, the second half of FY10 may experience some global economic healing and there are already signs of upward movement of prices in the international market. Fuel prices recently reached around US\$70, which was as low as US\$40 in December 2008. According to the recent World Economic Outlook (April, 2009) of the IMF, fuel prices may stand higher in the second half of FY10 compared to the current levels. IMF also projects a higher Commodity Price Index for 2010 (120.6) compared to that of 2009 (107.9), indicating a rise in average commodity prices in the coming year. Therefore, assuming that the budget FY10 is based on May/June (2009) prices (which was the case for Budget FY09), duties collected at the import stage may increase and positively contribute to realisation import duty collection target in FY10.

Having said that, it also needs to be mentioned that growth target for import duty collection in FY10 is well above the recent trend (only exception being FY08). At the same time, even if the free fall is over, global economic recovery could be a “U” shaped phenomenon, rather than a “V” shaped one, according to apprehensions of many. Therefore, achieving 11.8 per cent growth in import duty collection could be one of the major challenges facing by the government in the effort to mobilise revenue in FY10.

f. The New Duty Structure

The proposed duty structure marks reduction in duties on import of industrial raw materials from 7 per cent to 5 per cent. There is, however, an effort to balance the loss from the reduction with increased duties on imports of finished/luxury goods (cars, air conditions etc.). At the same time, 5 per cent Regulatory Duty has been imposed on milk powder and on luxury items having customs duty (CD) of 25 per cent.

CPD estimates show that the current duty structure, if applied on FY08 imports, would have resulted in 5.65 per cent additional revenue in FY08. This implies that the new duty structure would achieve an import duty growth of 5.6 per cent even with a zero growth in imports. Assuming a 13 per cent growth in imports for FY10, as has been projected in the

²² <http://www.nbr-bd.org/>

MTMF, it is estimated that earnings from imports in FY10 would be near about 11.2 per cent higher than FY09. While the favorable duty structure should help in increasing import related duties, this will also depend on the growth of imports and movement of prices in the international market.

g. Provision for Legalising Undisclosed Income

The budget for FY10 maintains provision for legalising undisclosed income. Major concerns emerges from three aspects of its design – i) no differentiation between legally earned and illegally earned income, ii) tax to be paid at 10 per cent, lower than minimum rate of regular income tax and iii) no penalty rates are applicable. In fact, in cases where undisclosed money is to be legalised through investments in flats or houses, the applicable rate may even be lower than 1 per cent. These aspects of the provision may discourage regular tax payers, with negative implications for revenue mobilisation.

In addition to the curious opportunity of purchasing flats/houses, the provision allows investment of undisclosed money with a payment of 10 per cent tax in infrastructure development and in 44 industrial sectors along with the capital market. It would have been more logical to prioritize Thrust Sectors rather than an economy-wide scope for investments. At the same time, while the stock exchanges may attract increased capital flow, it is more likely that most of the disclosers will take advantage of the low effective rates applicable for purchasing flats/houses, which is also a highly profitable sector for investment. As a result, the provision might not contribute much to attract investments in the Thrust Sectors, or to higher revenue mobilisation.

It is to be noted that revenue earnings from undisclosed legal income gradually slowed down, amounting to Tk 105 crore in FY09; compared to Tk 803 crore in FY08. The number of people availing this facility also decreased in FY09 to 14,216 from 42,000 in the preceding year. This reflects that the nature of the provision is such that continuation of it over the years tends to reduce its incremental benefits. With no penalty rates and lower than minimum applied tax rate, outcomes of the provision in FY10 may not meet the expectations.

h. Administrative Capacity in Revenue Mobilisation

With a population of over 14 crore, Bangladesh has around 23 lakh registered income taxpayers Tax Identification Number (TIN) holders, among whom only about 7.5 lakh pay taxes on a regular basis. About 1.5 lakh government employees later get tax refund, making the number of effective taxpayers to around 6 lakh only). The Revenue-GDP ratio for FY09 (according to the revised targets) was only about 11.2 per cent. In light of growing development spending needs and the expansionary measures planned by the government in the budget for FY10, there is an urgent demand to strengthen the tax administration, particularly the NBR. The major issues that need immediate attention have been discussed below.

Manpower: Due to legal disputes, NBR has not been able to properly expand its manpower capacity since the mid-1980s. These disputes must be settled and an effective revenue administration, staffed with a well trained and motivated workforce must be developed to

realise the revenue objectives. It is estimated that there are currently eight thousand vacancies in different levels in NBR. Unless these vacancies are filled, it will be increasingly difficult to achieve the revenue targets.

Expansion of NBR to reach the untapped potential: In the last two decades, income levels in the Municipality and Upazilla areas have increased substantially. However, due to the lack of presence of tax officials at the peri-urban levels, collection of taxes from these areas has not increased.

Simplification and updating of income tax laws: In order to ensure clarity, transparency and predictability, the tax law must be made taxpayer-friendly and consider circumstances in Bangladesh. Many of the laws were written in the British era; the language and references have not been changed since. The last major amendment to the income tax laws were made in 1984 (Income Tax Ordinance 1984), as a result many of these laws are outdated and does not pertain to the horizontal economic expansion that has taken place in Bangladesh in the last two decades. These laws also do not always cover the shift away from foreign aid dependency towards a greater reliance on domestic resources which in theory should generate higher taxes

Cutting off Intermediaries: Promoting the use of 'self-assessment system' may significantly increase revenue of the government by bringing the tax payers in personal contact with the revenue administration without the help of intermediaries. Involvement of the intermediaries in the tax payment procedure often makes the willing taxpayers to shy away, leading to tax evasion. However, the system must be simple enough to be trusted by the general public and for their rights to be legally ensured.

Audit and Monitoring: Designing a fair, responsible, and effective enforcement mechanism that directly responds to changes in the economic environment and technological opportunities will minimize leakages from the system; e.g. under-invoicing to evade taxes. Monitoring the real estate sector is especially crucial in light of the 'black money-whitening' scheme being allowed by the government. There are approximately five lakh credit card holders in the country, the NBR should make an effort to ensure that the taxes on them are properly assessed. End-use data relating to money disclosed under the tax amnesty scheme has to properly maintained.

Modernization: Developing a modern IT-based tax administration will help to reduce corruption and improve transparency and efficiency of tax collection. NBR should undertake a programme to popularize online submission of tax returns. Ensuring the use of Electronic Cash Registers (ECR) and modernising customs facilities in the major ports and entrance points will also help increase the government's revenue. Using the National ID Card database could be helpful in expanding the tax net.

Increasing the effectiveness of NBR's organizational structure along functional lines, developing legal and regulatory systems and fostering an ethos of taxpayer service are some of the broader aspects that should be considered at the earliest.

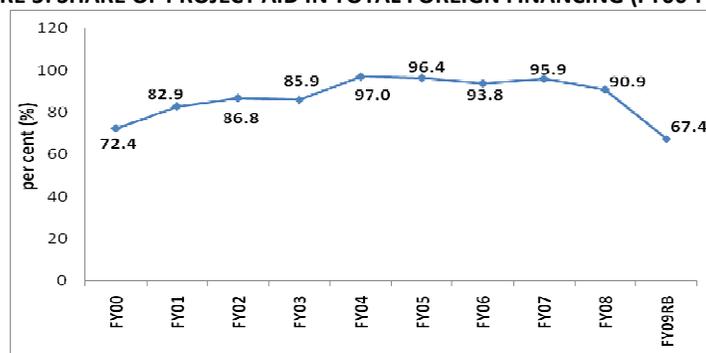
4. FOREIGN RESOURCE INFLOW

In order to underwrite the overall fiscal deficit, the budget for FY10 envisaged a gross foreign financing inflow of about US\$ 2.6 billion (Tk 18,345 crore). This amount is equivalent to around 40 per cent of the planned fiscal deficit for the current year (see later for details).

If the targeted foreign financing is realised, then this will be the highest ever inflow of foreign resources in a single year. Apart from its size, the nature and mode of this inflow will be of critical importance. While aiming for higher amount in meeting budgetary demands, crucial aspects of foreign financing in FY10, inter alia, will be the following: (i) share of budgetary support (compared to project aid), (ii) share of grants (as against loans), (iii) share of concessional low interest loans (vis-à-vis commercial loans/suppliers credit) and iv) aid conditionalities (including those relating to the Poverty Reduction Strategy Paper (PRSP) which currently remains in an ambivalent state).

Out of the projected total of US\$2.6 billion of foreign financing, US\$1.82 billion (about 70 per cent) is supposed to come as project aid. This would imply that about 26 per cent more project aid has to be disbursed in FY10 in comparison to that of in the FY09 (according to revised ADP). Therefore, the government needs to put in a vigorous effort to access the accumulated foreign aid pipeline which is around US\$7 billion. The government also needs to negotiate new projects to cater from the future foreign aid need. It may be recalled here that while overall foreign financing declined over the last two fiscal years (FY08 and FY09) due to low level of ADP implementation; the share of project aid in total foreign financing declined as well (see Figure 5). This happened because the CTG could successfully negotiate a large volume of budgetary support from the donors, the World Bank (WB) in particular. To maintain flexibility of fund use, the current government will also have to continue its efforts to access budgetary support not only from the multilateral sources (WB and ADB), but also from large bilateral donors (e.g. DFID).

FIGURE 5: SHARE OF PROJECT AID IN TOTAL FOREIGN FINANCING (FY00-FY09)



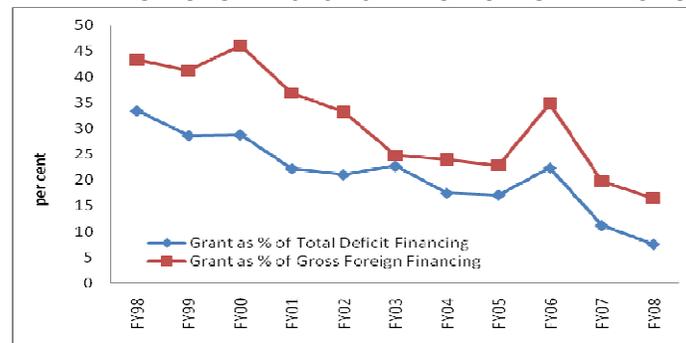
Source: BB and MoF²³

An overwhelming share (72.0 per cent) of the incremental foreign financing for FY10 is supposed to come as loans, while only 28.0 per cent of it as grants. While the share of grants in foreign financing had been on gradual decline in the recent past (see Figure 6), efforts to receive more foreign aid in the form of grants needs to be stepped up, particularly to keep debt servicing liability (DSL) sustainable. Although foreign DSL accounted for about 2 per cent of the revenue budget in FY09, the share may go up in the coming years. Indeed, in

²³ <http://www.bangladesh-bank.org/>; <http://www.mof.gov.bd/en/>

the context of various international assistance promises (particularly at the G20 meeting) in connection with mitigating adverse impact of global economic crisis on low income economies, Bangladesh needs to initiate proper processes to tap in such potential sources.

FIGURE 6: TREND IN INFLOW OF GRANTS AS A SHARE OF FOREIGN FINANCING (FY98 – FY08)



Source: MoF²⁴

Governments thrust on receiving higher foreign aid in FY10 is already visible from its requests sent to many multilateral and bilateral donors to fund different large-scale projects and support budgetary deficits. Some progress is also evident from the declarative statements so far made by the development partners. These include the announcement by the WB and the ADB to enhance assistance programme to Bangladesh by 20 per cent and 33 per cent respectively.

BOX 1: SOME RECENT COMMITMENTS BY MULTILATERAL AND BILATERAL DONORS

Recently the Asian Development Bank (ADB) committed for US\$200 million, the Japan government has assured of providing US\$100 million, the World Bank has assured of providing US\$200 million. ADB announced that it is going to increase the annual assistance package to Bangladesh by 33 per cent to US\$800 million annually during 2009-11. It is also considering the government's request for US\$500 million in aid from its special fund to tackle the adverse impact of the global financial crisis. ADB may also provide a further US\$76 million to help support SMEs in Bangladesh.

World Bank (WB) also recently approved US\$130 million worth of credit for Bangladesh to increase the country's access to electricity through installation of affordable solar home systems in rural areas and it has decided to increase aid by 20 per cent to US\$1.0 billion per annum for the next three years.

The government is also negotiating US\$4.7 billion assistance in the form of project aid with the Chinese government, expected to be realised over the next few years.

While commitments made by the donors in the current fiscal year looks promising in view of the large aid requirement for the year, a number of concerns is emerging as well. One particular concern relates to the government's willing to receive foreign financing high interest. Recently, Bangladesh has shown interest in receiving US\$500 million from the ADB which the multilateral donor has offered as commercial lending at a "LIBOR plus" rate.

²⁴ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.
<http://www.mof.gov.bd/en/>

Furthermore, the US\$4.7 billion assistance requested from the Chinese government consists of a number of projects and will possibly include “suppliers’ credit” components. Indeed, Bangladesh has refrained from taking such loans during the last few years due to high interest rate usually attached to them.

On the other hand, conditionalities of these assistance needs to be carefully scrutinised. It has been reported in the media that the government has embarked on a discussion to access IMF loans. It may be pointed out that IMF loans usually addresses balance of payment problems, which thankfully does not exist currently in Bangladesh. Loans offered by the IMF is to have lower interest rate (of 0.25 per cent). In the post-global crisis period IMF is also supposed to have relax some of its stringent conditionalities. However, one will have carefully look at the core conditionalities of the IMF so that they do not ultimately disrupt the implementation of the government’s economic programme and dissuade other donors.

5. SELECTED EXPENDITURE ISSUES

a. Implementation of the New Pay-scale

The Pay Commission in its initial recommendations made in April, 2009 proposed an average increment of 79.7 per cent for the government employees (see Table 8). Later in July, 2009 the Committee of the Secretaries revised the Pay Commission proposals and recommended an average 64.1 per cent rise. It will be pertinent to mention here that the last amendment in the government pay structure was made in May 2005 and took its retrospective effect from January 2005. Currently the proposed salary structure is awaiting approval of the cabinet. The new pay-scale is expected to be finalised after the *Eid-ul-Fitr* (but effective from July 2009).

Indications are that the government is going for an average 65 per cent increase in salaries for the government employees, this would create an additional fiscal burden of about Tk 3,500 crore in FY2009-10. Full implementation will take place over a period of two year, as only the salary increase is planned to be implemented in the current year and increase in bonuses and other allowances are to take effect from the next year. In the overall context of resource context, the most important issue will relate to inflationary impact of the decision and its management. Concern will also be there for the middle income salaried people outside the government sector if such increases are not endorsed by the private sector.

How the final salary structure of the government balances the trade off between rewarding high level positions and ensuring a sense of equity for the low paid ones,²⁵ will be the centre of attention. The proposed structure has already raised some concerns regarding the distribution of increments between the salary grades. According to the recommendations of the Secretaries’ Committee, the top grade (grade 1) will receive an increase of 73.9 per cent in their basic salaries. On the other hand, the bottom grade (grade 20) will have a 70.8 per cent increment. Average increment for the first class gazetted officers will be 68.0 per cent, while for the rest (2nd to 4th class) it will average at 60.9 per cent.

²⁵ According to the current pay-scale ratio between grades 20 and 1 is 1:9.6, whereas ratio in the proposed pay-scale by secretary committee was 1:9.8.

TABLE 8: CURRENT AND PROPOSED PAY STRUCTURES (BASIC) FOR THE GOVERNMENT EMPLOYEES

Grade	Present Scale	Rec of Pay Commission		Rec of Sec. Committee		Average Increment (Rec of Sec. Com.)
		Proposed Scale	Proposed Increment	Proposed Scale	Proposed Increment	
1st Class	23000	45000	95.7	40000	73.9	68.0
	19300	37750	95.6	33500	73.6	
	16800	32600	94.0	29000	72.6	
	15000	28850	92.3	25750	71.7	
	13750	26230	90.8	22250	61.8	
	11000	20800	89.1	18500	68.2	
	9000	16900	87.8	15000	66.7	
	7400	13750	85.8	12000	62.2	
2nd Class	5100	9300	82.4	8000	56.9	56.9
3rd Class	4100	7000	70.7	6400	56.1	57.5
	3700	6400	73.0	5900	59.5	
	3500	6000	71.4	5500	57.1	
	3300	5600	69.7	5200	57.6	
	3100	5300	71.0	4900	58.1	
	3000	5000	66.7	4700	56.7	
4th Class	2850	4700	64.9	4500	57.9	67.0
	2600	4400	69.2	4400	69.2	
	2500	4200	68.0	4250	70.0	
	2400	4000	66.7	4100	70.8	
Ratio (Top and Bottom Grades)	1:9.6	1:11.3		1:9.8		

Source: Authors' calculation from *The Daily Star* 11 May 2009 and *The Daily Janakantha* 20 July 2009.

What may bother many is that the Pay Commission award is being implemented without concomitant reform of the public administration. Indeed the government will be well advised to revisit with retrospective the recommendations of the Public Administration Reform Committee (set up by the Awami League Government in 1996) while finalising the pay-scale and other benefits for the public servants.

b. Stimulus Package

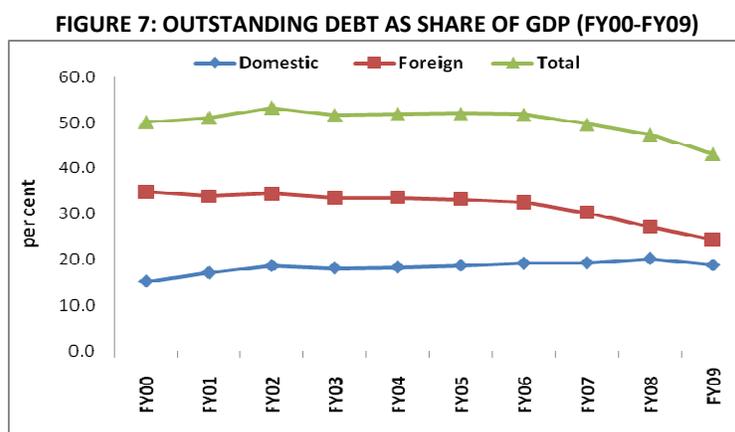
In order to counter the effects of the global financial crisis, the government declared its first “stimulus package” of Tk. 3,420 crore in April 2009. The fund, meant to be used over the last quarter of FY09, allocated Tk 450 crore in cash subsidies for the export industries most affected by the crisis. From the rest of the allocations, Tk. 1,500 crore was provided for agriculture, Tk 600 crore for the power sector, Tk 500 crore for re-capitalisation of agriculture loans, and Tk 374 crore for social safety net programmes. The disbursement procedure of these funds was also simplified. Presumptive payment of 75 per cent of the claim was to be made available “immediately”, while the settlement of the rest of the claim was to be done after audit scrutiny.

A provision of Tk 5000 crore has been made in the budget for FY10 as a “second Stimulus Package”. While details on the new package are not available yet, it has been announced that it will continue the policies set forth by the “first package”. As such, it is supposed to include a credit component as well as other fiscal support measures. Keeping in mind the poor implementation rate of public investment projects, the essential objective for the government should be to emphasize the timely disbursement of funds and realisation of the policy support to fully utilize resources provided in the stimulus packages. In this process,

the Ministry of Finance has to flexibly adjust its sectoral focus of support taking note of the impact of the global crisis on domestic economy.

c. Interest Payments and Debt Situation

Total public debt (domestic and foreign) as per cent of GDP followed an upward trend until FY94, when it reached a peak of 53.5 per cent of GDP. This has been on the decline since then and amounted to 43.2 per cent of GDP in FY09 (up to March). Outstanding foreign debt as per cent of GDP was 27.2 per cent in FY08 and 24.4 per cent in FY09 (up to March FY09) (Figure 7). On the other hand, outstanding domestic debt as per cent of GDP increased from 7.6 per cent on average in 90,s to 16.9 per cent in FY09. Even then, debt situation of Bangladesh fares much better than that of comparable economies. However, budget deficit has been on the rise in the recent years and consequently the debt situation may become a concern in the near future.



Source: MoF²⁶

Growth in interest payment is projected at 18.7 per cent in the budget for FY10; 20.6 per cent in domestic interest payments and 2.0 per cent in foreign interest payments. This could become a major concern as interest payment will claim the second highest share (13.9 per cent) in the budget for FY10, although this was marginally higher at 14.1 per cent in FY09. Domestic and foreign interest payments as a share of total budget will be 12.7 per cent and 1.2 per cent respectively in FY10 (19.8 per cent and 1.8 per cent of revenue expenditure respectively, see Table 9).

TABLE 9: SHARE OF INTEREST PAYMENT IN TOTAL REVENUE EXPENDITURE (FY97 – FY10)

	Average (FY97-FY01)	Average (FY02-FY06)	FY07	FY08	FY09 (Revised Budget)	FY10 (Budget)
Total Interest Payment	17.6	20.5	20.2	20.8	19.8	21.7
Domestic	12.9	16.8	17.3	18.5	17.9	19.8
Foreign	4.7	3.7	2.9	2.3	2.0	1.8

Source: MoF²⁷

²⁶ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

²⁷ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

<http://www.mof.gov.bd/en/>

Debt servicing liability as percentage of foreign exchange earnings (or total export earnings) also shows a gradual declining trend over the last decade (Table 10). However, concern may emerge (as mentioned in Section 3) with the fact that, to finance the deficit in FY10, the government has shown its intensions to go for commercial lending at high rate of interest along with conventional forms of foreign financing. While the debt financing as a whole may not be a cause for concern, currently as the composition of foreign financing is gradually shifting in favour of this loans may very well become an issue on the future.

TABLE 10: TRENDS IN FOREIGN DEBT SERVICING LIABILITY (FY00-FY08)

Fiscal Year	Total DS as % of total export earnings	Total DSL as % of total foreign exchange earnings
FY2000	10.7	7.2
FY2001	9.2	6.5
FY2002	9.8	6.3
FY2003	9.3	5.8
FY2004	7.7	4.9
FY2005	7.6	4.8
FY2006	6.4	4.1
FY2007	5.9	3.7
FY2008	5.5	3.6

Source: MoF²⁸

d. Subsidy and Transfers

Size of subsidy demand as dictated by international prices (particularly for food, fuel and fertilizer) has been a source of inconsistency between budgetary targets and actual expenditure of the government in Bangladesh. In FY08, actual subsidy requirement was 94.5 per cent higher than the original allocation. This was mainly due to increase in subsidy demand in the wake of substantial increases in food, fuel and fertilizer prices in the international market. Allocation for agricultural subsidy and Bangladesh Petroleum Corporation (BPC) had to be increased by Tk. 2,142 crore (152.8 per cent) and Tk. 4,117 crore (343.1 per cent) respectively in FY09 over FY08.

In FY09, the government had budgeted Tk. 13,641 crore for subsidy payments. Although, the information on the final amount of subsidies paid in the last fiscal year is not available, it is estimated that the actual payments will be considerably less than the original allocation. Decline in the prices of food and fuel had eased the pressure on subsidy requirement and this along with a favorable harvest of crops and low ADP implementation resulted in a lower than projected budget deficit.

While subsidy demand for FY10 will depend on the same factors as in FY08 and FY09, expectation of the government in this regard is not clear as the budget did not provide detailed information on allocations for subsidy payments. At the same time, how much of subsidy is being included in the stimulus packages is also not clear. The budget documents did not mention the major subsidy allocations such as that for BPC and Bangladesh Power Development Board (BPDB). Only the allocation for agriculture (Tk. 3,600 crore) has been

²⁸ Collated from, Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

mentioned in the budget. In order to facilitate effective monitoring of progress and ensure transparency of the budgetary process, information on subsidy allocations and their disbursements should be made public on a regular basis.

Allocations for safety net programmes in FY10 has been increased by 25.1 per cent over the revised budget of FY09. This allocation is approximately 15.2 per cent of the total budget and includes an employment generation programme for the hard core poor with an allocation of Tk. 1,176 crore. The implementation of these programmes will have an impact on the growth of total expenditure.

The *100 Day Employment Generation Programme* targeted the lean period for agriculture (between mid-September to mid-November). If the *Employment Generation Programme for the Hard Core Poor* which replaced the *100 Day Employment Generation Programme* targets the same period, the planning and co-ordination should be started at the earliest. The previous experience suggests, hurried implementation with insufficient time spent on planning may turn out as a major obstacle to the programme's success.

e. Contingent Liabilities

The FY10 budget will need to address the issue of contingent liabilities as the costs occurring from losses incurred by the state owned enterprises (SOEs) are yet to cease. In FY08, the overall cost to the government emanating from SOE operations was a staggering Tk. 9,982.9 crore; of which BPC accounted for Tk. 9,553.5 crore) from subsidisation of imported fuel at retail level. The estimated loss to the government (for all SOEs) in FY09 was rather low at Tk. 154.5 crore (April, 2009).

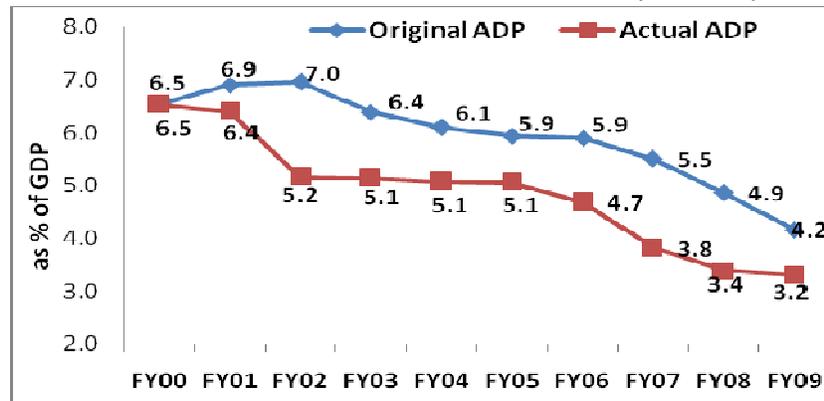
In FY09 Bangladesh Oil, Gas and Mineral Corporation (BOGMC) and BPDB also suffered major losses to the tune of Tk. 1,026.21 crore and Tk. 993.2 crore respectively. With the decision of the government not to privatise anymore SOEs in near future (not to say restructuring of some), the budget will have to be ready to absorb such costs. It also needs to be considered that comparatively low oil price prevailing in the international market may creepingly increase and again the government can be burdened with higher funding requirement for the BPC. Whatsoever, the bottom line is that the government needs to practice fiscal transparency regarding its contingent liabilities and make such figures public to give an objective picture of public liabilities.

6. IMPLEMENTATION OF ANNUAL DEVELOPMENT PROGRAMME (ADP)

ADP allocation and implementation rates (Figure 8) (as percentage of GDP) have been on the decline over the last decade. Actual ADP was 92.8 per cent of the original ADP in FY01, 85.1 per cent in FY05 and 69.8 per cent in FY08. In FY09, 76.7 per cent of the original ADP allocation of Tk 25,600 crore was utilised (85.4 per cent of the revised allocation of Tk 23,000 crore), owing not to the improvement in implementation, rather to the fact that original ADP of FY09 was smaller than that of FY08 by Tk 900 crore. Following the usual trend, implementation of ADP has experienced a rushed spending during the last two/three months of FY09 (only 46.3 per cent of the original allocation was spent at the end of April 2009). This "last quarter syndrome" is often criticised as it affects quality of the projects. At the end, however, actual ADP spending in FY09 did not cross the cut-off mark of Tk 20,000

crore and ended up at Tk 19,646 crore.²⁹ This would imply an ADP-GDP ratio of only 3.19 per cent achieved in FY09, which is the lowest ever.

FIGURE 8: ORIGINAL AND ACTUAL ADP AS % OF GDP (FY00-FY09)

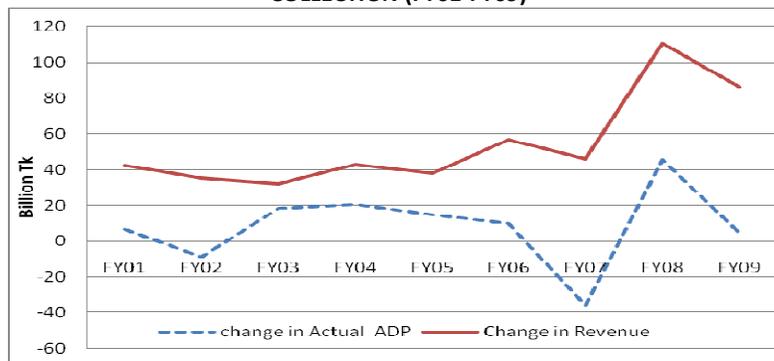


Source: MoF³⁰

Poor implementation of ADP seems to be a combined consequence of three factors (listed below in an ascending order in view of their importance- i) resource constraints, ii) unrealistic targeting, and iii) lack of implementation capacity.

Resource Constraints. Over the last decade or so, annual change in actual delivery of ADP has roughly flowed that trend in annual change of revenue earnings as shown by Figure 9³¹. An earlier CPD study³² indicated that implementation of ADP can be mostly explained by revenue collection. This indicates the possibility of resource constraints as a key factor determining the level of ADP implementation. This aspect is barely highlighted in policy analysis.

FIGURE 9: TREND OF CHANGE IN ACTUAL ADP AND CHANGE REVENUE COLLECTION (FY01-FY09)



Source: Authors' calculation based on MoF data³³

²⁹ CPD's projection for actual ADP implementation was Tk 19,500 crore. See CPD. (2009b). *Bangladesh Economy in FY2008-09 An Interim Review of Macroeconomic Performance*. Dhaka: Centre for Policy Dialogue.

³⁰ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

³¹ Out of nine observations (between FY01-FY09) seven times, changes in direction were similar.

³² See CPD. (2007). *State of the Bangladesh Economy in FY2005-06 and Outlook for FY2006-07*. Dhaka: Centre for Policy Dialogue.

³³ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

Unrealistic Targeting/Potential Investment Demand. A sizeable ADP of Tk 30,500 crore has been earmarked for FY10, with an ADP-GDP ratio target of 4.4 per cent. The issue of targeting emerges from the fact that size of ADP gradually increased irrespective of the stagnated implementation level. Between FY01 and FY08, actual ADP increased by only 13.9 per cent while the size of original ADP has increased by 51.4 per cent. This increase is a reflection of the potential investment demand of a developing economy. From the previous trend in ADP implementation over the last ten years, highest annual increase of 23.7 per cent in actual ADP was achieved in FY00, while the lowest was of (-)13.2 per cent in FY02 (averaging 5.8 per cent). Applying these figures over the actual ADP of FY09 (which is of Tk 19,646 crore), the best case scenario for FY10 would be of an actual ADP of about Tk 24,300 crore (3.5 per cent of the targeted GDP) i.e. about Tk. 6,200 crore less than the original. On the other hand, an ADP of Tk 20,800 crore (3.0 per cent of the targeted GDP and Tk. 9,700 crore less than the original) is a possibility if one considers the average increase of the last ten years. The budget analysis of CPD mentioned how size of ADP carries over the burden from the backlog of “expired” and/or “aged” projects. This issue may get further aggravated in the next fiscal year with the possibility of a higher gap that may be experienced between the targeted and actual ADP of FY10.

Lack of Implementation Capacity. Present low public investment to GDP ratio would call for immediate initiatives to strengthen administrative capacity. IMED traditionally conducts a survey on the ministries and divisions, which under performs compared to the overall achievement in ADP implementation. In FY00 and FY05, the number of such ministries and divisions were 30 and 45 respectively. At the end of the third quarter of FY09, the survey covered 25 ministries and divisions under the same criteria. Table 11 represents the ranking of major reasons behind poor ADP implementation as identified by the Implementation Monitoring and Evaluation Division (IMED) Survey in FY00, FY05 and FY09.

TABLE 11: RANKING OF PROBLEMS RELATED TO ADP IMPLEMENTATION BY VARIOUS MINISTRIES

Reason	Rank FY00	Rank FY05	Rank FY09Q3
Delay in Tender Process	5	3	1
Delay in Land Acquisition	5	13	2
Delay in Project Amendment	11	10	3
Delay in Fund Release	1	10	4
Lack of Manpower	1	7	5
Poor Planning	11	5	6
Delay in Procurement	5	1	7
Delay in Project Approval	8	2	7
Delay in Billing/Payments	14	10	7
Others ³⁴	3	7	10
Delay in Appointing Consultants	8	9	10
Legal Problems	8	14	12
Lack of Decision making Capacity	11	3	12
Lack of Sync with Donors	4	5	14
Allocation is Less than Required	14	14	14

Source: Authors' compilation from various IMED reports³⁵

Note: Same ranking depicts the problems have been reported equal number of times.

³⁴ Others include; delays due to natural disasters, delays due to increase in prices of materials, withdrawal of funds, delays due to lack of communication, no parliamentary sessions, authorities not being able to meet the necessary conditions etc.

³⁵ Implementation Monitoring and Evaluation Division. (2009). Progress Report on Implementation of Annual Development Programme 2008-09, Third Quarter (July-March). Dhaka: Ministry of Planning, Government of the People's Republic of Bangladesh.

Implementation Monitoring and Evaluation Division. (2005). Progress Report on Implementation of Annual Development Programme 2004-05. Dhaka: Ministry of Planning, Government of the People's Republic of Bangladesh.

In FY00, the top three causes of poor implementation related to (a) delay in fund release, (b) lack of manpower, and (c) lack of coordination with donors. In FY05 the corresponding factors were (a) delay in procurement, (b) delay in project approval, and (c) delay in tender processing. According to the most recent report of the IMED, the three reported problems of implementation from the top as reported by the ministries are (a) delay in tender processing, (b) delay in land procurement, and (c) delays caused by project amendment. One may observe a number of features emerging from these self-assessments of ministries and divisions. *Firstly*, resource availability, both in terms of financial and human capital, as a constraint to ADP implementation is losing its significance. *Secondly*, coordination with the donors' must have improved significantly, perhaps a positive outcome of initiatives like "Harmonization Action Plan". *Thirdly*, and most detrimentally, issues related to early stages of ADP implementation, such as "tender process" and "land acquisition", have emerged as the major bottlenecks. This implies that over time, vortex of the impediments has moved upstream. In other words, nowadays launching of the projects itself has become a challenge.

Addressing factors inducing such delay in setting ADP in motion (i.e. tendering, land acquisition and other procurements) could lead to some improvement in implementation capacity of the agencies, but delivering public investment could require a more comprehensive strategy. Earlier, Medium Term Budgetary Framework (MTBF) was initiated in view of facilitating better delivery of ADP. Nevertheless, under the MTBF greater involvement of the ministries in preparing their budget did not help in improving ADP implementation by them.³⁶

It is worthwhile to recall that, the Finance Minister in his budget speech expressed government's interest to undertake the following measures to improve ADP implementation.

- Establish Planning and Budget Wing/Branch in each Ministry.
- Faster approval of projects and strengthened monitoring.
- Strengthening of monitoring in 10 ministries with total ADP allocation of 78 per cent.
- Reform of project approval process.
- Both Public Procurement Regulation (PPR) and Public Procurement Act (PPA) to amended.
- Improving efficiency of project directors.
- Some of the major process to be monitored through Critical Path Method (CPM).

Earlier CPD had put forward a set of recommendations on ADP in its pre-budget proposal.³⁷ A number of the policy interests expressed in the budget speech have been in line with the

Implementation Monitoring and Evaluation Division. (2000). Progress Report on Implementation of Annual Development Programme 1999-00. Dhaka: Ministry of Planning, Government of the People's Republic of Bangladesh.

³⁶ Till date, 20 ministries are operative under MTBF.

³⁷ CPD. (2009c). *A Set of Proposals for the National Budget FY2009-10*. Dhaka: Centre for Policy Dialogue.

<http://cpd.org.bd/downloads/Proposals%20for%20the%20National%20Budget%20FY2009-10.pdf>

Also see Choudhury, S.R. (2009). *Improving ADP Implementation: Challenges and Way Forward*. [mimeo], a study recently initiated by CPD.

CPD's recommendations; however, revisiting those recommendations in this platform may be useful –

Action Plan. Prepare Project wise action plans for timely completion of all the ongoing projects. These action plans should be prepared by the respective project authorities and to be approved by the head of their implementing agencies. As these projects have already been duly approved by the competent authorities, these action plans should not require further approval of any higher authority, like ECNEC or Planning Commission.

These action plans should take into account the current status of implementation and should take a realistic view on what could be achieved during the remaining period of the project with the available resources. Due regard should be given to the available capacity in the project for implementation.

The plan should clearly spell out time bound monitorable actions and identify authorities responsible for implementation. Activities which are not implementable during the tenure of the project and are not of high priority may be dropped and resource allocated for those may be suitably surrendered or reappropriated.

The plan should give special attention to the procurement of goods and services and provide specific time bound actions for meeting the procurement requirements of the project.

The manpower requirements of the projects as per Development Project Proposals (DPP) should be fulfilled, vacant positions should be filled up immediately, specially the position of the Project Director (PD). Full time project director should be made available to all projects, unless DPP provides the deployment of a part time project director.

Each action plan should be prepared by the respective project authorities through a process of consultation with all the major key players involved in the implementation of the projects. Enhancing as far as possible the role of the local governments in the implementation of these action plans is also important.

Funds allocated for local governments such as Upazilla and Union Parishad in the ADP may be released upfront preferably in the first quarter of the FY, with first two quarters at a time so that these bodies can draw development schemes and start implementing them from the first quarter of the financial year. These schemes should be developed through local level planning in consultation with local stakeholders. Such schemes should be approved locally by the Upazilla Parishad and should not require any approval or concurrence from any authority at Dhaka or at district head quarters.

The implementation of these action plans should be started as early as possible, preferably from the beginning of the next financial year.

Monitoring Mechanism. A realistic monitoring mechanism may be designed for overseeing the timely implementation of the above mentioned action plans. Where feasible, the stakeholders outside the project, including the local government bodies, may be appropriately associated in the monitoring process.

The IMED should be strengthened substantively to ensure that implementation is adequately monitored, both in quantitative and qualitative terms. At present a technical assistance programme is in place to strengthen the IMED with support from the ADB and the Japan Government. The idea of establishing a result-based monitoring and evaluation knowledge management, training and research is being discussed along with further strengthening of human resources, as part of this capacity building project. Result-based monitoring (RBM) should be an integral part of IMED activities. Relevant staff of key line Ministries should also be adequately trained in RBM.

Ownership. For successful implementation of these action plans, availability of resources will not be a problem as they relate to approved ongoing projects for which resources have already been committed and in many cases budgeted through the Medium Term Budgetary Framework (MTBF). What will be needed is the strong ownership of the line ministries or implementing agencies. The top leadership in the government should see to it that such ownership does exist.

Procurement Policy. Whilst the 2006 Procurement Policy has addressed a number of key concerns, in recent years this policy has come under increasing criticism because of delays involved with compliance. The government has set up the Central Procurement Technical Unit (CPUT) to improve the public procurement policy in Bangladesh. The government is at present reviewing the policy with a view to expediting the procurement process. However, this should not be done at the cost of compromising the weaknesses suffered by earlier system (e.g. poor specifications, non-disclosure of selection criteria and rebidding without adequate grounds). The review work should be completed as soon as possible.

Problems related to land acquisition, displacement, rehabilitation and resettlement often lead to delays in project implementation. There is an obvious need for striking a fair balance between the need for land for development purposes and taking care of those whose land is acquired. In view of this, there is a need to promote rehabilitation and resettlement policies with least displacement alternatives and putting in place adequate rehabilitation packages.

Fund Release. Over centralisation and bottlenecks in fund release will need to be addressed. A common policy could be that once included in the ADP the projects should not require further approval by other agencies.

Sectoral Priority. Investment in energy generation should be given priority given its critical importance. Appropriate allocation will need to be made in the budget. Special monitoring mechanism will need to be developed for this sector. Synchronisation of various steps involved is important in this context. Finalisation of coal policy, exploitation of coal resources and coal-based electricity generation needs to be given priority in this context.

An incentive based program may be undertaken, where divisions or departments with successful completion of projects will be given priority in fund allocation.

Local Government. Lack of synergy between central and local authorities has been growing concerns for ADP implementation. The role of the associated stakeholders at the grassroots level must be clearly defined for the sake of enhancing ADP implementation.

Modalities will need to be developed to involve local governments in both design and formulation of projects and monitoring of their implementation. Dedicated committees may be constituted with participation of government officials, and representatives of beneficiaries and experts to monitor quality of implementation in key result areas and timeliness of implementation, particularly for major projects.

In this context, we can recall Prof Paul Krugman, the 2008 Nobel Prize winner in Economics, who has consistently argued in favour of “Keynesian solutions” and regulations³⁸. One may remember also that, Keynesian fiscal stimulus isn't simply spending; it is a spending with an eye to restoring equilibrium, and then recapturing enough to pay back this stimulus. But perhaps the most critical factor, in determining a poverty reducing growth, will depend on improving public investments – not only by its contribution in meeting the investment gap, but also in creating a conducive environment for private sectors to get more actively involved in the process. In a globalised economy, public investment has become more critical to creating good jobs, and ensuring the strength of the increasingly knowledge-based economy³⁹. It will be also vital from the perspective of global crisis and mitigating its impacts. Public investment, beginning with a program to rebuild public infrastructure, is ideally suited to new challenges of the post global financial crisis era⁴⁰. It is not only the fastest and most reliable way to create good jobs in the short run, but also the best way, in an economy with surplus capital, to stimulate new private investment and thus set off investment, innovation, and productivity growth.

7. INTRODUCTION OF PPP WITHIN THE BUDGETARY FRAMEWORK

Inadequate infrastructural services, particularly power and communication, remains major constraints for investments in Bangladesh. Historically it has been the primary responsibility of the public sector to finance and develop infrastructure projects through budgetary allocations. However, ever increasing demand for infrastructural facilities in the backdrop of inadequate investible resources has motivated the governments across the world during the past couple of decades to turn to the private sector to provide financial resources, innovative practices and technical expertise. This phenomenon has been styled as private-public partnership (PPP). Now over 30 countries around the world have such initiatives in place, including a number of emerging economies (e.g. China, India, Brazil, South Africa, Chile etc.)⁴¹. While a PPP component in the budget will be a new initiative for Bangladesh, PPP led projects operating in infrastructure building particularly in power generation through Independent Power Producers (IPP) has already been there for sometimes now.

³⁸See <http://krugman.blogs.nytimes.com/>

³⁹ Baldacci, Emanuele; Clements, Benedict; Gupta, Sanjeev and Cui, Qiang (2004) *Social Spending, Human Capital, and Growth in Developing Countries: Implications for Achieving the MDGs*. Working Paper No. WP/04/217. Washington, DC: International Monetary Fund.

⁴⁰ Schwartz, Bernard and Sherle Schwenninger. "Public Investment Works." *Journal of Economic Theory* (2008): 69-81.

⁴¹ European Commission. (2003). *Guidelines for Successful Public – Private Partnerships*. Brussels: Director General, Regional Policy.

Gawlick, S. (2004). *Public Private Partnership A Financier's Perspective*. Bangkok: Transportation and Tourism Division, UNESCAP.

Allocations. Most of the countries, however, have tended to go for PPPs in transport related infrastructure projects; Bangladesh is no exception. Until now, a number of mega projects have been placed under the new PPP initiative, all of those relate to transport and power sectors. Tk 2,500 crore (2.2% of the total budget) has been allocated for PPPs in the budget for FY2009-10 under three head, viz. Tk 100 crore for fund for technical assistance, Tk 300 crore for viability gap funding (VGF) as subsidy or seed money and the rest for an infrastructure investment fund as loan and equity participation. The position paper prepared by the Ministry of Finance hinted that in the future, a new fund, Bangladesh Infrastructure Investment Fund (BIIF) might be created. According to the preliminary estimates of MoF, an investment deficit worth Tk. 73,500 crore is projected for FY2009-10 in view of GDP growth target of 6 per cent and is expected to bridge the gap through PPP mechanism.

Institution. During the ongoing fiscal year, however, the major challenge will be to constitute a formal partnership framework, both in terms of institutional set-up and legal entity. The general experience is that it is mainly the line ministries which initiate PPPs. However, a number of countries have established dedicated “centres” or “departments” to assist in PPP related matters, e.g. *BOT Centre* in Philippines, *Private Infrastructure Investment Center of Korea (PICKO)*⁴². The government is expected to form a PPP cell under Finance Division and PPP budget management will be fully operational by September next. The MoF recently formed a seven-member “core group”, chaired by an Additional Secretary, to formulate three separate guidelines related to loan or equity fund, VGF and allocation for technical assistance and asked to submit draft regulations latest by August 30, 2009. As per the terms of reference core group will formulate eligibility criteria for getting allocation from each of the three funds, identify priority sectors for PPP allocation, conditions for resource disbursement, outline method and mechanism in sanctioning allocation and recommend the highest ceiling for government's allocation under the new initiative. It is also expected that the Infrastructure Investment Facilitation Centre (IIFC) will be assigned to conduct a study for the purpose of identifying immediate projects and formulating a roadmap accordingly.

Legal Framework. A comprehensive legal framework is a necessary pre-requisite for PPPs to be competently in place and function in the long run. Korea has provided the required legal support with the “Act on Private Participation in Infrastructure (2002)”, while in Philippines, “The Philippines BOT Law” enacted in 1993 is being followed. In Ireland, the legal coverage has been provided through State Authorities (Public Private Partnerships Arrangements). PPP initiatives in countries with incompatible legal framework had often failed to deliver the desired outputs. China and Turkey have faced such difficulties and efforts have been initiated by their respective governments to help overcome these obstacles⁴³. A high-powered *Reform Committee*, headed by Finance Division Secretary, is already engaged in finalisation of the regulatory framework to guide the PPP. In view of past experiences, the

⁴² European Commission. (2003). *Guidelines for Successful Public – Private Partnerships*. Brussels: Director General, Regional Policy.

⁴³ European Commission. (2003). *Guidelines for Successful Public – Private Partnerships*. Brussels: Director General, Regional Policy.

Gawlick, S. (2004). *Public Private Partnership A Financier's Perspective*. Bangkok: Transportation and Tourism Division, UNESCAP.

government will be well advised to formulate a “PPP Act” through the national parliament, after undertaking a substantive consultation with the business community and other stakeholders. Legal framework must be transparent and detailed to provide the private sector the necessary legal coverage to finance, build, operate and collect revenues or service payments from PPP projects. Issues relating to procurement regulations, land acquisition, risk and profit sharing, pricing of services and handover of the facilities are also to be covered adequately to avert future confusions and disputes. It is desirable that the proposed legal framework would also address the monitoring and dispute settlements mechanisms.

Issues for Discussion. In addition to the broad issues mentioned above, a number of critical questions must be addressed with regard to implementation of the PPP.

- I. *How the ongoing projects under the PPP approach will be integrated with the newly developed legal and institutional framework?* Currently 64 projects are being implemented under Infrastructure Development Company Ltd (IDCOL), Investment Promotion and Financing Facility (IPFF) and Infrastructure Investment Facilitation Center (IIFC). Management of these projects has to be vested in the new PPP set-up.
- II. The projected PPP led investment is more than double of the allocated ADP and the difference between the two may widen further in case of successful implementation of the PPP plan in medium term. *Considering the sluggish ADP utilisation record during the recent past, will it be used deliberately as an alternative mechanism to ease pressure on the ADP as an instrument to deliver energy, infrastructure, and social services?*
- III. *What will be the desired model(s) to be followed for the new PPP initiatives?* PPP can follow one or all of the existing models based on the type of the project - Build-Own-Operate (BOO), Build-Operate-Transfer (BOT) and Build-Own-Operate-Transfer (BOOT). The guideline on how a particular framework would be suggested for a particular project will be critical for success of the PPP approach.
- IV. The question of acquiring land is an important one, particularly in case of big projects like monorail, elevated express highway. Necessary laws have to be formulated and enacted in this regard. *What would be the guideline for determining price of the procured land? Will Public Procurement Act (PPA)-2006 and Public Procurement Rules (PPR)-2008 be applicable for PPP projects?*
- V. *What should be the tax incentives for PPP initiatives? Should there be a provision for differential fiscal treatments among the PPP projects?* The position paper on PPP⁴⁴ has proposed three sets of tax incentives – firstly, tax exemption to be given or minimum tax rate to be imposed on the amount invested; secondly, import tax at the lowest rate to be granted to capital items for PPP projects and thirdly, profit from operating/managing to be taxed at the lowest rate for a specific time period. It is a must that these proposed fiscal incentives are harmonised with the incentives granted to other FDI and export oriented investments and do not discriminate against other domestic investors.
- VI. Pricing of products could be one of the decisive factors for PPP. *What would be the pricing formula for the products of PPP projects?* Transparency and technical capacity will be the key for a win-win outcome in regard to pricing of the products.
- VII. *Will PPP act as a major incentive for FDI?* Despite a number of incentives being offered, FDI inflow in Bangladesh has not been promising compared to her neighbours. It is also

⁴⁴ Ministry of Finance. (2009c). *Invigorating Investment Initiative Through Public Private Partnership: A Position Paper*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

pertinent to determine, *whether provision for FDI-plus incentives will be kept for a FDI involved PPP project in contrast to other PPP or FDI proposals.*

- VIII. The financing of a PPP project will be the centre of the negotiation. *Can PPP projects be donor funded? Will the donor fund be treated as a loan to government or it will be a three-party agreement? Can capital market or foreign commercial loans be considered for PPP? Will stock-market listing be obligatory?*
- IX. *Will PPP be allowed in social sectors including health and education? How the access cost for the users will be determined in these projects. Will public finance be used for private profit here?*

Documentation. With regard to initiation of projects, documents will need to be developed to assist in partnership formulation and to define procedural guidelines in project activities. As every project is unique in its features, standardisation in full perhaps is not possible and cannot necessarily be applied in all PPPs. However, it is necessary to identify the amount and type of minimal information that needs to be included in every PPP project. Besides, a standardised PPP agreement matrix may be developed. This could reduce administrative costs and time for project development, which can sometimes constitute a significant part of total project costs and duration. Possibility of developing other standardised documents should be examined. Documentation regarding procurement could serve as a reference point with all its strong points and also the subsequent weaknesses that were observed.

While PPP can play an important catalysing role in infrastructure projects, a broader partnership between the government and private sector in policy formulation and implementation can also help overcome slow policy implementation. If the government cannot improve its administrative efficiency and capacity for negotiation, the PPP concept would not succeed. As a starting point, when developing a PPP programme, government must clearly identify what to achieve from the particular PPP project. Government's PPP plan ought to be formulated within the following framework of goals –

- i. Reduce the cost and risk faced by government in providing services/infrastructure by transferring these responsibilities to the private sector;
- ii. Monitor the quality of the service/ infrastructure being delivered;
- iii. PPPs must focus on profit (value for money) to encourage private sector participation; and
- iv. Ensure that any PPP is in the public interest.

Government also must be fully committed and be ready to accept the inevitable consequences that PPPs will trim down and modify the role of government in the delivery of public services. However, the oversight function of the government will increase tremendously. Since citizens as a result are expected to get better services, the political dividend in the ultimate analysis is accrued to the government, in case of successful delivery of the PPP projects.

8. FINANCING OF BUDGET DEFICIT

Total deficit as a percentage of GDP has been targeted at 5 per cent for FY10 (Tk. 34,358 crore). While as a percentage of GDP the projected deficit for FY10 is identical to the

targeted deficit of FY09, in absolute terms this deficit would be 37.7 per cent higher than the revised estimate and 12.4 per cent higher than the original estimate for FY09 (Table 12). However, a usual low ADP implementation rate at the end of the fiscal year may bring the deficit-GDP ratio down to around 4 per cent, which would then approximate the revised estimates for FY09 (4.1 per cent of GDP). For several countries, empirical studies also found that the budget deficit has a significant positive impact on economic growth.⁴⁵ To support an employment friendly growth, perhaps it is advisable to accept a moderately high deficit that may result in desired outputs. Indeed, many economists do not regard deficit as a major cause for concern, but rather the gap between national investment and national savings⁴⁶, a persistent feature for Bangladesh economy. Deficit-GDP ratio for FY10 may not be much of a concern, although the modality of financing this deficit should be carefully chosen.

TABLE 12: TREND IN FINANCING OF BUDGET DEFICIT (FY92 – FY10) (in per cent)

Sources	FY92-FY96	FY97-FY01	FY02-FY06	FY07	FY08	FY09 RB	FY10 B
Net Foreign Financing	72.7	53.3	52.6	27.9	29.2	43.1	40.2
Grant	42.6	30.8	20.1	11.1	7.5	19.7	14.9
Loan	44.7	39.6	53.1	45.2	38.0	40.9	38.5
Ammortisation	14.7	17.2	20.7	28.5	16.4	17.6	13.2
Domestic Financing	27.3	46.7	47.4	72.1	70.8	56.9	59.8
Bank	10.9	21.9	17.8	41.4	61.3	42.9	48.8
Non-Bank	16.4	24.9	29.7	30.2	9.4	14.0	11.1

Source: MoF⁴⁷

As Table 12 depicts, between FY92 and FY08 foreign sources has made way to domestic sources in financing budget deficit. During FY92-FY96, net foreign sources accounted on average for about 73 per cent of financing the budget deficit, in FY08 it was as low as 29 per cent. Foreign financing, however, increased last year and is projected to be 40 per cent of total financing in FY10.

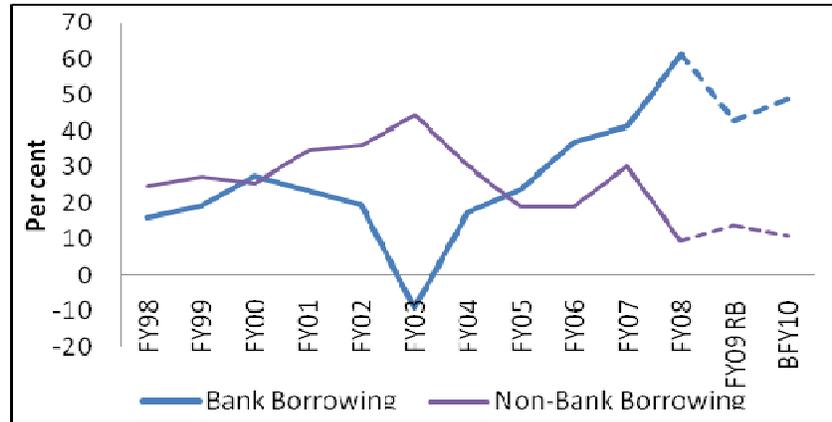
During the last few years, a compositional change in domestic sources is observed as well in financing deficits. Share of non-bank borrowing in total financing came down to 9.4 per cent in FY08 from 30.5 per cent in FY04 and share of bank borrowing increased significantly from 17.5 per cent to 61.3 per cent between this timeframe (see Figure 10). In financing the projected deficit of FY10, the budget has allocated 48.8 per cent share to bank borrowing.

⁴⁵ Al-Khedair, Saleh I. (1996), "The Impact of the Budget Deficit on Key Macroeconomic variables in the Major Industrial Countries", Florida Atlantic University.

⁴⁶ Baldacci, Emanuele; Clements, Benedict; Gupta, Sanjeev and Cui, Qiang (2004) *Social Spending, Human Capital, and Growth in Developing Countries: Implications for Achieving the MDGs*. Working Paper No. WP/04/217. Washington, DC: International Monetary Fund.

⁴⁷ <http://www.mof.gov.bd/en/>

FIGURE 10: SHARE OF DOMESTIC SOURCES IN DEFICIT FINANCING



Source: MoF⁴⁸

Higher borrowing from the banking system could create concerns of a crowding-out effect for the private sector. While the current high liquidity in the banking system (around Tk 30,000 crore) could counter such pressure to some extent, it is to be kept in mind that investment demand may also experience an upturn in FY10 as a response to global recovery, particularly in the second half, which could lead to higher credit demand from the private sector. At the same time, albeit bank borrowing is less costly compared to non-bank borrowing, higher inflationary effect is attached to it which may have a negative impact on price stability.

A major concern for FY10 (from the perspective of financing budget deficit) would be ensuring inflow of the projected high foreign financing target of USD 2.6 billion (in gross terms) which, if realised, would be the highest ever annual aid flow into Bangladesh. In net terms, the projected foreign financing in FY10 would be about US\$2 billion (around Tk 13,803 crore), which would be about 28.3 per cent higher compared to the revised projection for FY09. It is to be noted that higher foreign financing is targeted through incremental inflow of loans – programmed grant amount being only 4 per cent more than the revised projection of FY09, while programmed loan amount would be 29 per cent higher than that of FY09. Mobilising such a large amount of foreign aid will be a major challenge for the government and needs to be based on efforts to negotiate budgetary supports. One has to be mindful that if foreign financing targets are not realised, additional burden will be placed on domestic sources, further aggravating the issue of higher bank borrowing and consequent crowding-out effect on the credit availability for private sector.

9. CONCLUDING OBSERVATIONS

The paper has discussed issues relating to budget implementation from the macroeconomic perspectives. Having assessed the feasibility of the targets, taking insights from the historical trends and accounting for the emerging externalities, we now seek to draw up three possible scenarios depicting the budget outcomes for FY10. These three scenarios have been presented in Table 13.

⁴⁸ Ministry of Finance. (2009a). *Bangladesh Economic Review 2009*. Dhaka: MoF, Government of the People's Republic of Bangladesh.

<http://www.mof.gov.bd/en/>

TABLE 13: OUTCOME SCENARIOS FOR BUDGET FY10

	Budget FY10	High Case	Business As Usual	Low Case
Revenue Earnings (% growth)	15.7	16.8	13.5	10.1
NBR Tax	16.1	16.0	13.2	10.3
Non-NBR Tax	17.0	17.7	15.2	10.9
Non-Tax	13.6	19.7	14.4	9.2
ADP (% of GDP)	4.4	3.5	3.2	3.0
Deficit (% of GDP)	5.0	4.7	4.3	4.1
Financing of Deficit (% of GDP)				
Foreign	2.0	2.0	1.7	1.2
Domestic	3.0	2.7	2.6	2.9

Source: CPD Estimates and MoF⁴⁹

Under a *High Case* scenario, there are possibilities that resource mobilisation in FY10 may achieve the targets. There are revenue components (i.e. Non-NBR tax and non-tax) for which conservative targets have been set, revenue collection from these components may be surpassed. Foreign resources may be accessed as programmed resulting in less borrowing from domestic sources. However, even then, prevailing capacities will not ensure full delivery of the public investment programme. A near target deficit of about 4.7 per cent could be experienced in this case.

A *Business as Usual* performance of the public finance could lead to a shortfall of resource flow (particularly domestic resources) – adding another dimension to the weaknesses in implementing public investment programmes. In fact, a comparable ADP-GDP ratio to that of FY09 (3.2 per cent) is a possibility in this case. Fiscal deficit, by default, remains much less than programmed.

If the economy underperforms and develops into a *Low Case* scenario, which is a possibility if adverse impact of external factors become more prominent and prevailing investment stagnation does not improve, As a result both resource mobilisation and public investment may suffer to a great extent. Low delivery of NBR taxes will be the defining reason for resource shortfall. ADP implementation, underpinned by lower success in accessing project aid, could end up at a historical low level, i.e. about 3.0 per cent of GDP. Under such circumstances, fiscal deficit will decrease further with a marginally larger financing from domestic sources.

While we should strive for the *High Case* scenario, a *Business as Usual* performance would be the minimum expected outcome, particularly to ensure a threshold GDP growth of 5.5 per cent. A *Low Case* situation must be avoided.

A defining prerequisite for success will be a functioning and able development administration which is not haunted by any collusion of political and economic interest groups. As the Finance and the Planning ministries provide competent leadership and guidance, the line ministries will have to demonstrate adequate capacity to design, implement, manage and monitor their projects and programmes. At the same time, the line ministries should not be held back by overbearing centralised (often informal) decision

⁴⁹ <http://www.mof.gov.bd/en/>

making practices. Local government must be incorporated in the budget process so as to function as extensions of design and implementation mechanism.

A major challenge would be to keep the private sector engaged by way of ensuring a competitive environment, particularly in case of public procurements. NGO partnership in the outreach and service delivery process, characterised by proper accountability and transparency, will also be critical.

An informed monitoring mechanism endowed with real time data has to be an essential element of a successful implementation process. Introduction of the practice of quarterly reporting on the state of the economy to the national parliament will greatly service this need.

Finally, a full delivery of the budget cannot be expected without faithful implementation of the reform agenda mentioned in the budget speech by the Finance Minister⁵⁰. We need to be reminded of the fact that implementation of the budget remains contingent upon the overall state of good developmental governance of the country.

⁵⁰ http://www.mof.gov.bd/en/budget/09_10/speech/bs_09_10_en.pdf