CHAPTER 4

FISCAL POLICY AND FISCAL MANAGEMENT

Sound fiscal policy is fundamental to maintaining macroeconomic stability and fostering economic growth. The Government has continued its reform programmes to streamline public expenditure management and revenue administration. These reform programmes have direct influence on determining government fiscal policies.

Preparation and implementation of sound fiscal policy is one of the most important tasks of the government. Excess of expenditure over revenue collection (fiscal deficit) may have adverse impact on other sectors of the economy. Prudent fiscal management is therefore of immense importance in the overall economic management of the Government.

Government Receipts

Tax revenue is the main source of the government revenue income. In FY 1995-96, revenue/GDP ratio was 9.22 percent, which rose to 10.21 percent in FY2001-02. In FY 2005-06, the revenue/GDP ratio rose to 10.78 percent. Analysis of the data indicates that total revenue collection as percentage of GDP is increasing gradually.

Tax revenue accounts for 80 percent of total Government revenue. Table 4.1 shows tax and non-tax revenue receipts and tax-GDP ratio over the past decade.

Table 4.1: Revenue Receipts

Particulars	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Total Revenue	15333	17385	19020	19767	20074	24342	27893	31120	35400	39200	44868
Tax Revenue	12124	14261	15390	16167	16079	19778	21332	24950	28300	31950	36175
Non-tax Revenue	3209	3124	3630	3600	3995	4564	6561	6170	7100	7250	8693
As percentage of Gross Domestic Products (GDP)											
Total Revenue	9.22	9.62	9.5	9.0	8.47	9.6	10.21	10.35	10.63	10.57	10.78
Tax Revenue	7.29	7.89	7.69	7.36	6.78	7.8	7.81	8.30	8.5	8.62	8.69
Non-tax Revenue	1.93	1.73	1.81	1.64	1.69	1.8	2.4	2.05	2.13	1.96	2.09

Source: Finance Division, National Board of Revenue and BBS. Figures are based on revised budget.

Tax Management

Determination of tax policy of the Government and its implementation is reposed on the National Board of Revenue (NBR). During FY 2005-06, various steps have been taken to rationalise direct and indirect taxes to achieve accelerated economic growth aimed at reducing poverty, infusing more dynamism in the agriculture sector, expansion of export-oriented industries and exports, development of domestic industries, enhancing industrial productivity and creation of employment opportunities.

Box 4.1 Measures under Direct and Indirect Tax system for FY 2005-06

Direct Taxes:

- Agro-based industries have been exempted from taxes up to 30 June 2006, with the objective of developing rural economy;
- Income from hospitals (formed under Companies Act), computer software businesses, fish firming, poultry firming, cattle firming have been exempted from taxes up to 30 June 2006;
- Structure of the income-tax rate in respect of individual and corporate tax-payers has been rationalised;
- Regulations relating to self-assessment procedure have been consolidated to prevent tax-evasion by taking the advantage of this procedure; Submission of income tax return and life-style form for any TIN-holder has been made compulsory;
- Amount of penalty has been increased for not submitting the income tax return in time;
- Exemption of tax has been extended to resident and non-resident pension-holders;
- Facilities have been extended to companies engaged in the production processes of all kinds of jute products and textile related products to pay income taxes at a reduced rate of 15% up to 30 June 2006.
- Capital gain form transfer of share of a private Ltd. Co. has been reduced to 10%;
- Authority has been given to the Director General of Central Intelligence Cell (CIC) to exercise the power of Income Tax Authority;
- Tax has been reduced to 10% on interest for all approved securities;
- Deduction of tax on interest of saving instrument has been withdrawn;
- Advance income tax @ 10% has been imposed on dividend making it taxable in the hand of shareholders;
- Deduction of tax @ 4% has been imposed on freight charged of resident on ocean going ships as final settlement of tax liability;
- Deduction of tax @ 0.25% has been imposed on total export proceeds of knitwear and readymade garments;
- Deduction of tax @ 0.015% has been imposed on the transaction value of shares for member of stock exchange;
- Collection of tax at source from person engaged in real estate business has been imposed @ 175/-square meter for sale of apartments and @ 2.5% on deed value of a land;
- To avoid double taxation Bangladesh has already signed agreement with 24 countries.

Measures under Indirect Tax system

Customs duty

- Three tire duty rate of last Fiscal year (2004-2005) has remained unchanged in Fiscal year 2005-2006. After the Budget customs duty rate of 7.5% reduced to 6% and Custom duty rate of 15% reduced to 13%.
- 8 tire Supplementary duty rate of last Fiscal year has been reduced to 6 tires in Fiscal year 2005-2006. 8 tire SD rate was 15%, 25%, 30%, 35%, 60%, 90%, 250% and 350% which has been rearranged to 6 tire-20%, 35% 65%, 100%, 250%, 350%
- In FY 2005-2006 SD rate of Sugar is 20%, 3% AIT and 4% IDSC are exempted. The SD was withdrawn from 19.04.2006 from import stage.
- The specific duty of Mobile phone has been reduced from 1500.00Tk. to 300.00 Tk.
- The Custom Duty over 6% are exempted from some raw materials for Leather and Leather goods industries.
- Import duty and tax was reduced for the members of Bangladesh Textile Mills Association as well as the member of BGMEA, BKMEA, BLMEA and BTTLMA for several machinery parts and chemicals.

VAT:

- In order to increase domestic revenue in FY 2005-06 budget, 35% supplementary duty along with 15% VAT has been introduced on SIM card or similar commodities;
- To facilitate some industries and services , VAT has been exempted in some selected areas, such as-
  a. Iron, ore, petroleum bitumen, magnesium sulphates (fertiliser), zinc sulphates (fertiliser), di-sodium tetraborates (fertiliser), waste paper, infusion set with or without IV fluid bag etc. at the import level and all sorts of rice, chemical fertiliser, insecticides, fungicides, pesticides, anti-sprouting products, plant growth regulators, disinfectants etc. at the trading stage.
  b. For exporters- VAT on insurance, shipping agent, C&F agent, port and freight forwards both at import and export level has been exempted. Existing exemption of VAT for exporters at the rate of 80%, 80% and 60% on natural gas, electricity and WASA respectively have been extended to cover enterprises situated in EPZ and those engaged in deemed exports in the FY 2005-06.
  c. To provide health services at a lower cost to the masses VAT on homeopathic, ayurvedic, unani and herbel medicines at the production stage has been exempted.
- The duty drawback rates against VAT paid on different goods/services for 100% export oriented industries, deemed exporters and enterprises situated in EPZ have been revised; and

ÿdth8862• Revenue realisation monitoring and internal control mechanism have been strengthened.

Source: NBR

Revenue Collection Activities

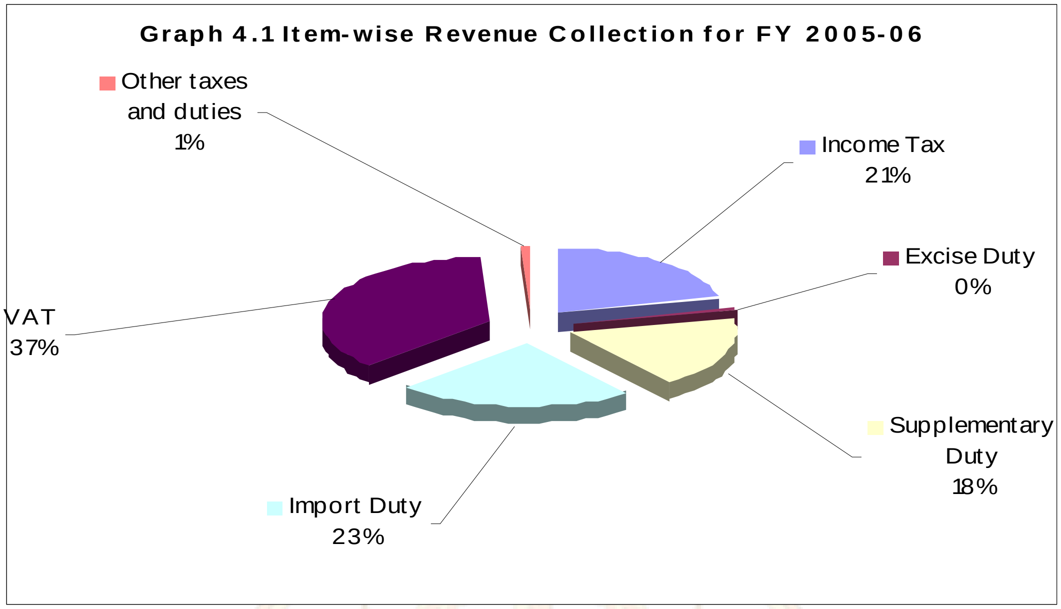
Analysis of revenue collection activities by items shows that the bulk of revenue collection comes from value added tax (VAT). Import duties occupy the second place in the row. Next positions are held by supplementary duty, income tax, other taxes and excise duty. Overall, the share of VAT in the total revenue collection is gradually increasing.

In FY 2003-04, the total revenue collection under NBR amounted to Tk. 26192.90 crore. The collection was Tk. 2538.43 crore higher than that of the previous fiscal year implying 10.75 percent growth. In FY 2004-05, total revenue collection stood at Tk.29905.12 crore, which was Tk.3712.22 crore or 14.17 percent higher than that of the collection of the previous year. In FY 2005-06, total revenue collection stood at Tk. 33893.10 crore, which is Tk.3987.98 crore or 13.34 percent higher than the collection of the previous year. Item-wise tax collection between FY2003-04 and FY 2005-06 is presented in Table 4.2.

Table 4.2: Item wise Revenue Collection

Items of revenue collection	**FY 2003-04**	**FY 2004-05**	**FY 2005-06**
Import Duty	7087.53	7912.85	7825.27
VAT (at import level)	4397.86	5347.00	5885.70
Supplementary Duty (at import level)	1685.74	1853.46	1563.40
Total	**13171.13**	**15113.31**	**15274.37**
Excise Duty	158.71	144.39	161.16
VAT (Local)	4316.18	5111.43	6472.42
Supplementary Duty (Local)	3545.73	3702.81	4665.76
Total	8020.62	**8958.63**	**11299.34**
Income Tax	4707.36	5577.08	7141.56
Other taxes and duties	293.79	256.09	271.54
Grand Total	**26192.90**	**29905.12**	**33893.10**

Source: National Board of Revenue (NBR).



Public Expenditure

Public expenditure management is an important segment of the fiscal management of the Government. One important aspect of public expenditure management is to encourage the outlays on productive sector and restrain over unproductive outlays. The main objectives of public expenditure are to improve the living standard of the people, develop human resources and physical infrastructure and reduce poverty. Public expenditure at current prices and expenditure/GDP ratio over the last decade are presented in Table 4.3.

Table 4.3: Public Expenditure

(In crore Taka)

Particulars	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Public Expenditure (a+b+c)	23165	24082	25859	29779	34464	37399	40757	42075	47184	53903	64383
(a) Non-development expenditure	11712	12305	14232	16562	18195	20536	22700	25307	28390	33324	37333
(b) Development expenditure (ADP)[1]	9866	10886	10867	12325	15221	15901	15050	15271	16817	18771	24500
(c) Other expenditure[2]	1587	891	760	892	1048	962	3008	1497	1977	1808	2550
As percentage of Gross Domestic Products (GDP)											
Public Expenditure as percent of GDP (a+b+c)	13.93	13.33	12.92	13.55	14.54	14.75	14.92	14.00	14.17	15.01	15.47
(a) Non-development expenditure	7.04	6.81	7.11	7.54	7.67	8.10	8.31	8.42	8.53	8.99	8.97
(b) Development expenditure	5.93	6.02	5.43	5.61	6.42	6.27	5.51	5.08	5.05	5.53	5.89
(c) Other expenditure	0.95	0.49	0.38	0.41	0.44	0.38	1.10	0.50	0.59	0.49	0.61

[1] 'Actual expenditure' of Annual Development Programme (ADP) except financing from 'own source'.
[2] Capital expenditure, food expenditure, net lending and other development expenditures are included in 'other expenditure'.

Source: IMED, M/O Planning and Finance Division, M/O Finance.

Composition of Non-development Expenditure

Analysis of total non-development expenditure shows that in FY 2001-02, expenditure on pay and allowances was 30 percent of total non-development expenditure (Appendix Table 20). In FY 2002-03, FY 2003-04 and FY 2004-05 these ratios went down to 28.8, 27.9 and 26.3 percent respectively. In FY 2005-06, this has been estimated 26.5 percent. In FY 2001-02, the expenditure on subsidy and current transfer accounted for 26.1 percent of total non-development expenditure. In FY 2002-03, FY 2003-04 and FY 2004-05, the expenditure on subsidy and current transfer accounted for 28, 28.8 and 31.3 percent of total non-development expenditure respectively. It has been estimated 31.4 percent in FY 2005-06. In FY 2001-02, the share of interest payments on foreign and domestic loans on total non-development outlay was 19 percent. In FY 2002-03, FY 2003-04 and FY 2004-05, the shares of interest payments on foreign and domestic loans in total non-development outlay were 22.0, 20.6 and 19.5 percent respectively. It has been estimated 18.9 percent in FY 2005-06.

Composition of Annual Development (ADP) Expenditure

Actual expenditure against the revised allocation of ADP was around 90 percent over the last decade (Table 4.4). In FY2003-04, FY2004-05 and FY2005-06 it stood at 89, 92 and 91 percent respectively.

Table 4.4: Implementation of Annual Development Programme (ADP)

(In crore Taka)

Year	Original Allocation	Revised Allocation	Actual Expenditure	Expenditure as % of Revised Allocation
1991-92	7500	7150	6024	84.3
1992-93	8650	8121	6550	80.7
1993-94	9750	9600	8983	93.6
1994-95	11000	11150	10303	92.4
1995-96	12100	10447	10016	96.0
1996-97	12500	11700	11041	94.0
1997-98	12800	12200	11037	90.5
1998-99	13600	14000	12509	89.4
1999-00	15500	16500	15471	93.8
2000-01	17500	18200	16240	89.2
2001-02	19000	16000	14090	88.1
2002-03	19200	17100	15434	90.0
2003-04	20300	19000	16817	89.0
2004-05	22000	20500	18771	91.6
2005-06	24500	21500	19472	91.0

Source: IMED, Ministry of Planning. Data are based on revised ADP. p = Provisional.

Composition of Annual Development (ADP) Expenditure by Major Sectors

Increasing trend of allocation and expenditure in socio-economic and physical infrastructure sectors through ADP is fully consistent with the policy and strategy of the Government. Expenditure and its composition by major sectors are presented in Table 4.5.

Table 4.5: ADP Expenditure and its Composition by Major Sectors (%)

Sector	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Agriculture	4.5	5.0	4.5	4.9	4.7	4.5	4.4	3.74	4.04	3.62	4.91
Rural Development	6.8	8.4	8.2	10.1	12.2	12.2	11.1	10.09	13.83	14.27	19.07
Water Resources	5.6	8.2	8.1	7.0	6.9	6.1	5.4	4.29	4.04	2.44	2.64
Industries	1.5	1.4	0.8	0.8	1.7	3.3	1.9	1.14	2.74	2.42	1.66
Power	13.7	13.5	10.9	12.0	12.9	12.2	12.1	13.70	17.26	20.74	18.08
Gas, oil & natural resources	4.1	4.4	4.9	4.7	4.3	2.5	3.1	4.00	5.19	6.04	1.67
Transport	20.1	22.4	19.7	17.9	17.4	20.4	19.9	16.15	18.04	12.27	15.21
Communication	2.9	1.9	1.6	2.8	3.1	2.8	6.1	3.63	2.23	2.93	3.94
Physical planning & housing	4.6	5.4	5.1	5.4	7.0	7.5	6.6	5.61	5.91	6.03	6.29
Education & religion	13.0	13.2	12.9	13.5	12.8	13.3	14.2	13.88	12.28	13.70	14.49
Health & population	6.9	7.9	9.1	8.2	8.1	7.3	7.9	6.72	8.27	8.17	5.12
Other	16.4	8.1	14.1	12.8	9.1	7.8	7.4	17.00	6.24	7.38	6.94
Total ADP	100	100	100	100	100	100	100	100	100.0	100.0	100.0

Source: IMED, Ministry of Planning. Figures for 2005-06 are up to December 2005.

Budget Balance and Financing

Budget is formulated in the context of the national strategy for accelerated economic growth and poverty reduction. However, because of resource constraints, there exists a gap between Government revenue and expenditure. Table 4.6 below shows data on budget deficit and mode of its financing over the last decade.

Table 4.6: Overall Budget Balance

(As percent of GDP)

Deficit/ financing	1994-95	1995-96	1996-97	1997-98	1998-99	1999- 00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Overall budget deficit (excluding foreign grants)	- 4.6	- 4.7	-3.7	-3.4	-4.6	- 6.1	-5.1	-4.7	-4.2*	-4.2*	-4.5*	-4.5
Overall budget deficit (including foreign grants)[3]	-2.2	-3.0	-2.0	-2.1	-3.2	-4.5	-4.1	-3.7	-3.4	-3.4	-3.7	-3.7
Net foreign financing[4]	3.8	2.8	2.8	2.3	2.5	2.5	2.0	2.1	2.3	2.4	2.4	2.4
Net domestic financing[5]	1.2	1.8	1.5	1.6	1.9	2.8	2.8	2.7	1.3	2.2	1.8	2.2

*According to actual outturn, the overall budget deficit in FY 2002-03, FY 2003-04 and FY 2004-05 stood at 3.5 , 3.4 and 3.5 percent of GDP respectively.

Source: Finance Division, M/O Finance, BBS and Bangladesh Bank.

Domestic Resources for ADP

The contribution of domestic resources towards financing of ADP shows an upward trend. Table 4.7 below shows the financing of ADP over the last decade.

Table 4.7: Quantum of Domestic Resources (according to revised budget) in Financing ADP

(In crore Taka)

	1994-95	1995-96	1996-97	1997-98	1998-99	1999- 00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Total Financing	11150	10447	11700	12200	14000	16500	18200	16000	17100	19000	20500	21500
Foreign Financing	6352	6033	5975	6679	8188	8274	8670	8215	8241	9410	10430	10700
Domestic Financing	4798	4414	5725	5521	5812	8226	9530	7785	8859	9590	10070	10800
Domestic financing as % of Total ADP allocation	43.03	42.25	48.93	45.25	41.51	49.85	52.36	48.66	51.81	50.47	49.12	50.23

Source: Finance Division, Ministry of Finance and Planning Commission.

[3] According to IMF, foreign grants are net receipts to Government, because it does not carry any liabilities to Government.

[4] Net foreign financing = (foreign borrowing + grants) - principal payment of foreign borrowing.

[5] Net domestic financing = Net borrowing from public + borrowing from banking system. {Net borrowing from public = Total sale of saving certificates - principal payments for saving certificates}. There exists difference between budget deficit and financing for check float and other errors & omission.

Public Debt Management

The Government resorts to borrowing for a variety of reasons. Included among them are:

- To meet unexpected expenditure in emergencies
- To increase production
- To defray expenditure for social safety net
- To increase investment
- To maintain macroeconomic stability
- To meet development expenditure

Sources of Public Debt

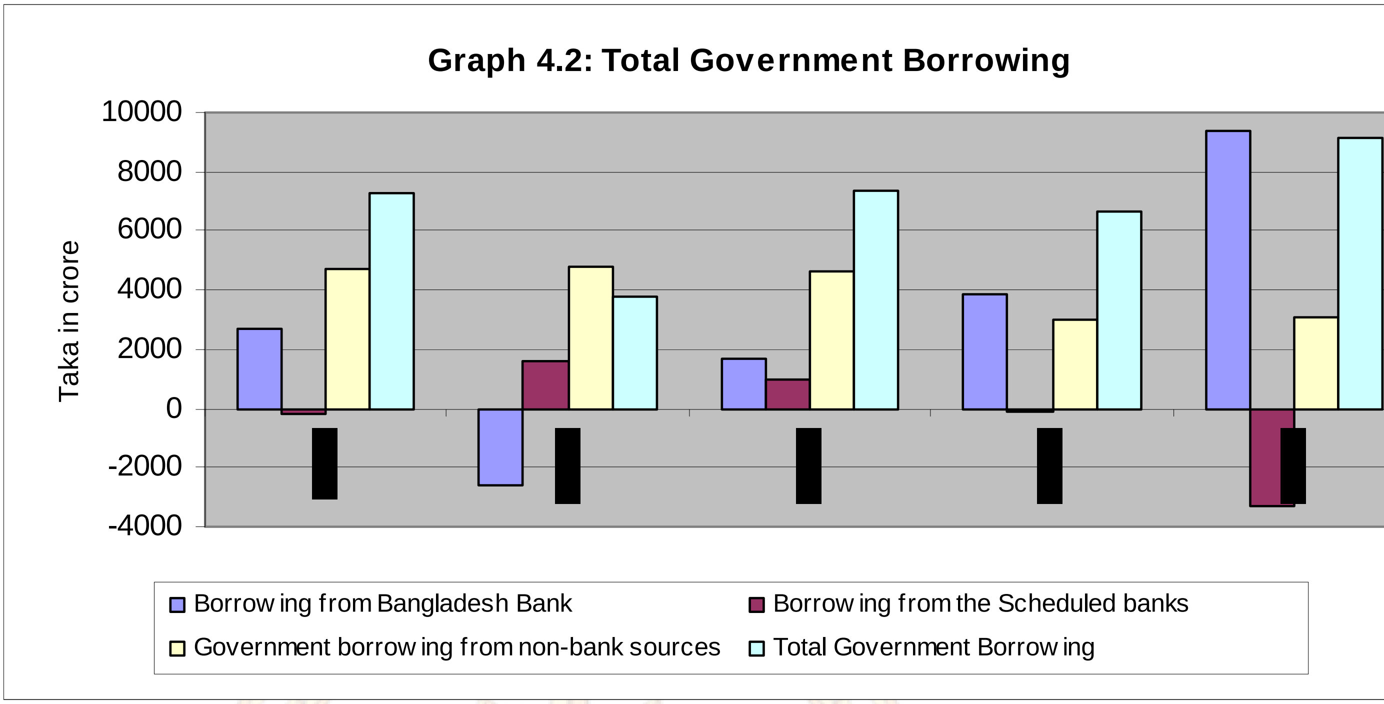
The Government borrows both from domestic and external sources. Table 4.8 shows year-wise Government borrowing (net) from domestic sources covering the period from FY 1990-91 through FY 2005-06. Source-wise Government borrowing over the past sixteen years has been presented in Graph 4.2.

Table 4.8: Net Government Borrowing from Domestic Sources 1990-91 to 2005-06

(Taka In crore)

Financial Year	Net Government borrowing from the banking system			Government borrowing from non-bank sources	Total Government borrowing	As percentage of GDP
	Borrowing from Bangladesh Bank	Borrowing from the Scheduled banks	Total Borrowing			
1	**2**	**3**	**4=2+3**	**5**	**6=4+5**	**7**
1990-91	-0.60	173.70	173.10	467.12	640.22	-
1991-92	-480.80	1918.60	1437.80	806.04	2243.84	1.9
1992-93	250.90	45.60	296.50	1157.50	1454.00	1.2
1993-94	-438.20	1198.10	759.90	751.30	1511.20	1.1
1994-95[R]	244.40	456.30	700.70	1098.20	1798.90	1.18
1995-96	1782.80	-86.60	1696.20	1597.00	3293.20	1.8
1996-97	1452.10	254.90	1707.00	947.42	2654.42	1.5
1997-98	806.60	448.20	1254.80	1905.17	3159.97	1.6
1998-99	1064.40	912.20	1976.60	2772.44	4749.04	1.9
1999-00	1738.10	1786.20	3524.30	3229.68	6753.98	2.8
2000-01	2009.30	895.10	2904.30	4208.42	7112.82	2.8
2001-02	2727.00	-158.60	2568.40	4711.47	7279.87	2.7
2002-03	-2589.70	1607.20	-982.50	4795.22	3812.72	1.3
2003-04[R]	1653.00	1016.10	2669.10	4658.90	7328.00	2.2
2004-05[R]	3826.70	-142.80	3683.90	2972.57	6656.47	1.8
2005-06	9351.80	-3310.40	6041.40	3103.23	9144.63	2.2

Source: National Savings Directorate (NSD) and Bangladesh Bank (BB).
R= Revised



Currently, the debt obligation of the Government is at a tolerable level. For financing budget deficit the Government has preferred concessional foreign borrowing to domestic borrowing because of the lower cost of foreign borrowing.