CHAPTER 4

FISCAL POLICY AND FISCAL MANAGEMENT

Sound fiscal policy is fundamental to maintaining macroeconomic stability, fostering economic growth and accelerating poverty reduction in a country. The main objective of the fiscal policy in Bangladesh is to enhance the effectiveness of public expenditure by channelling resources to appropriate direction and attain faster growth and poverty reduction by mobilising larger amount of revenues. Commensurate with this objective, the present Government has continued its reform programmes to streamline public expenditure management and revenue administration.

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 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	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Total Revenue	15008	15333	17385	19020	19767	20074	24342	27893	31120	35400	39200
Tax Revenue	12054	12124	14261	15390	16167	16079	19778	21332	24950	28300	31950
Non-tax Revenue	2954	3209	3124	3630	3600	3995	4564	6561	6170	7100	7250
As percentage of Gross Domestic Products (GDP)											
Total Revenue	9.84	9.22	9.62	9.5	9.0	8.47	9.6	10.21	10.35	10.63	10.64
Tax Revenue	7.9	7.29	7.89	7.69	7.36	6.78	7.8	7.81	8.30	8.5	8.67
Non-tax Revenue	1.94	1.93	1.73	1.81	1.64	1.69	1.8	2.4	2.05	2.13	1.97

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

Review of the revenue collection indicates a slight shortfall in collection against the targets during FY 2001-02, FY 2002-03, FY 2003-04 and FY 2004-05. In FY 2001-02, the actual collection was Tk. 27893 crore against the target of Tk.28456 crore, indicating that the actual collection was 2 percent less than the target. In FY 2002-03, the target of revenue collection was Tk.31120 against which the actual collection stood at Tk.30875 crore, showing that actual collection was 0.79 percent less than the target. In FY 2003-04, the target of revenue collection was Tk. 35400 crore against which the actual revenue collection stood at Tk.33713 crore (95.24 percent of the target). According to the revised budget of FY 2004-05, the target of revenue collection was Tk.39200 crore against which the actual revenue collection up to June 2005 stood at Tk.38255[1] crore, which was 13.47 percent higher than that of the same period of the previous year. Though the collection of revenue is slightly lower than the target, over the last decade revenue GDP ratio has been consistently growing save it few years. In FY 1994-95, revenue/GDP ratio was 9.84 percent, which rose to 10.21 percent in FY2001-02. These ratios rose to 10.35

[1] Figures for tax revenue are taken from NBR. In case of non-NBR tax and non-tax revenue, figures are taken from budgeting information system of Finance Division.

percent and 10.63 percent of GDP in FY 2002-03 and FY 2003-04 respectively. In FY 2004-05 the revenue/GDP rose to 10.64 percent. In order to increase the tax/GDP ratio, it is essential to introduce computer technology in tandem with an efficient and neutral tax administration. Analysis of the data indicates that total revenue collection as percentage of GDP has crossed the two-digit figure only since FY 2001-02. Gradual increase in revenue/GDP ratio augurs well for the economy.

Tax Management

Determination of tax policy of the Government and its implementation is reposed on the National Board of Revenue (NBR). During FY 2004-05, 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 Tax system for FY 2004-05

- Agro-based industries have been exempted from taxes up to 30 June 2006, with the objective of developing rural economy;
- 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 has been made compulsory for all TIN holders irrespective of their classifications;
- Submission of life-style form for any TIN-holder has been made compulsory;
- Amount of penalty has been enhanced for not submitting the income tax return in time;
- Exemption of tax has been extended to resident and non-resident pension-holders; and
- Facilities have been extended to companies engaged in the production processes of all kinds of jute products to pay income taxes at a reduced rate of 15% up to 30 June 2006.

Source: NBR

Box 4.2: Measures under Indirect Tax system for FY2004-05

Customs duty

- Tariff slabs have been reduced from the four such as 7.5%, 15%, 22.5% and 30% in FY2003-04 to three such as 7.5%, 15% and 25% in FY 2004-05. The highest rate has been reduced from 30% to 25%;
- Supplementary duties have been lowered from eight slabs such as 10%, 15%, 25%, 30%, 40%, 50%, 60% and 75% in FY 2003-04 to six slabs such as 15%, 25%, 30%, 35%, 60% and 90% in FY 2004-05;
- Advance income tax has been withdrawn from all kinds of fuel oil. Supplementary duty on kerosene has been reduced to 15% from 25%. As a result, weighted tariff rates on crude oil, kerosene and other fuel oil have been reduced to 9%, 25% and 10% respectively;
- Supplementary duty on sugar has been reduced to 15% from 30%;
- Tariff rate on any mobile set has been reduced to Tk. 1500, which earlier was Taka 3000 or Taka 4000 depending on the price of each set;
- Imported machinery of solar electricity, textile industries and poultry industries have been exempted from paying import duty, VAT and supplementary duties. Import duty has been reduced to 7.5% for chemical colour for textile industries;
- In order to facilitate better health services, imported instruments and machinery for setting up a Referral Hospital have been exempted from import duty, VAT and supplementary duties;
- Import duty and VAT have been waived for import of certain life-saving drugs;
- All kinds of duties on a number of essential chemical fertilizers for agriculture have been withdrawn at the import stage to reduce burden of farmers.

VAT

- In order to increase revenue collection from domestic sources, VAT network has been widened in FY 2004-05;
- To facilitate some industries and services , VAT has been exempted in some selected areas;
- In order to simplify the tax payment system, excise commodities have been brought under the VAT system (with same tax incidence) by rescinding Part-I of 'The Excise and Salt Act 1994' and 'Excises and Salt Rules, 1944'. On the other hand, the First Schedule of Part-I has been kept temporarily unchanged because of the different nature of the excise duty against bank accounts, and airline ticket taxes have been included in this context;
- In order to simplify the VAT collection and payment system, some amendments have been made in 'the VAT Act' and 'VAT Rules';
- For collection and payment of VAT at the business stage, some changes have been made in the VAT system, such as-
    a. VAT system has been widened up to retail business and at the same time, steps have been taken to make it simple through self-assessment of VAT and to make payment on annual basis accordingly;
    b. Steps have been taken to determine and collect VAT through active participation of business chambers/organisations for ensuring the collection of VAT from various businessmen;
    c. Measures have been taken to collect VAT in advance from commercial importers at stations. As a consequence, unequal competition in the market has been removed;
- A large taxpayer unit has been formed in the VAT system to avoid hassle of large taxpayer industries and service sectors and to provide better services to taxpayers. Efforts are underway to make it a full Commissionerate;
- In FY 2004-05, supplementary duty on cigarettes has been rationalised. As a result, up to March 2005 revenue collection from this item has increased by Tk. 173 crore over the same period of the previous year;
- VAT stamp/band roll system has been introduced to increase revenue from soft drink, mineral water and toilet soap. Following these measures, revenue collection from these three items during the first eight months of this fiscal year has increased by 92%, 79% and 6% respectively.
- In order to reduce tax incidence, tariff has been rationalised for fruit pulp, grinding spices in the case of agro-based products and ferro-manganese, silico-manganese, ferro-silicon in the case of industrial products.

Source: NBR.

Revenue Collection Activities

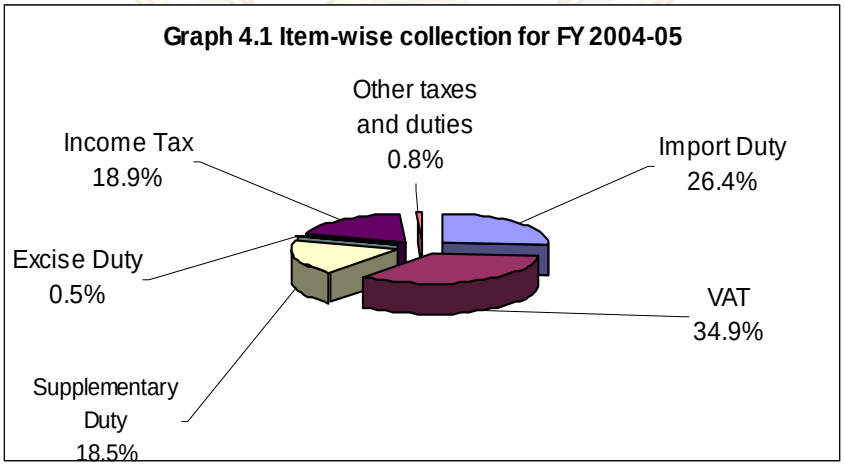
Analysis of revenue collection activities by items shows that the bulk of revenue collection comes from value added tax (VAT). Import duties occupy the second place in the row. Next positions are held by supplementary duty, income tax, other taxes and excise duty. Overall, the share of VAT in the total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

In FY 2002-03, the total revenue collection under NBR amounted to Tk.23654.47. The collection was Tk.3450.36 crore higher than that of the previous fiscal year implying 17.07 percent growth. In FY 2003-04, total revenue collection stood at Tk.26192.90 crore, which was Tk.2538.43 crore or 10.73 percent higher than the collection of the previous year. In FY 2004-05, total revenue collection stood at Tk. 29988.66 crore, which is Tk.3795.76 crore or 14.49 percent higher than the collection of the previous year. Item-wise tax collection between FY2002-03 and FY 2004-05 is presented in Table 4.2.

Table 4.2: Item wise Revenue Collection

Items of revenue collection	FY 2002-03	FY 2003-04	FY 2004-05
Import Duty	6679.43	7087.53	7910.04
VAT (at import level)	4121.16	4397.86	5347.06
Supplementary Duty (at import level)	1271.08	1685.74	1853.50
Total	12071.67	13171.13	**15110.60**
Excise Duty	318.27	158.71	143.91
VAT (Local)	3660.26	4316.18	5106.35
Supplementary Duty (Local)	3138.89	3545.73	3702.94
Total	7117.42	8020.62	**8953.20**
Income Tax	4235.57	4707.36	5672.30
Other taxes and duties	229.81	293.79	252.56
Grand Total	**23654.47**	**26192.90**	**29988.66**

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 comprises mainly revenue expenditure and development outlays. Public expenditure in 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	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Public Expenditure (a+b+c)	22013	23165	24082	25859	29779	34464	37399	40757	42075	47184	53903
(a) Non-development expenditure	10145	11712	12305	14232	16562	18195	20536	22700	25307	28390	33324
(b) Development expenditure (ADP)[2]	10121	9866	10886	10867	12325	15221	15901	15050	15271	16817	18771
(c) Other expenditure[3]	1747	1587	891	760	892	1048	962	3008	1497	1977	1808
As percentage of Gross Domestic Products (GDP)											
Public Expenditure as percent of GDP (a+b+c)	14.43	13.93	13.33	12.92	13.55	14.54	14.75	14.92	14.00	14.17	14.63
(a) Non-development expenditure	6.65	7.04	6.81	7.11	7.54	7.67	8.10	8.31	8.42	8.53	9.04
(b) Development expenditure	6.64	5.93	6.02	5.43	5.61	6.42	6.27	5.51	5.08	5.05	5.09
(c) Other expenditure	1.15	0.95	0.49	0.38	0.41	0.44	0.38	1.10	0.50	0.59	0.49

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

It is evident from the above table that expenditure/GDP ratio fluctuated within a small range and maintained a reasonable limit.

Composition of Non-development Expenditure

Analysis of total non-development expenditure shows that in FY 2000-01 expenditure on pay and allowances was 31 percent of total non-development expenditure (Appendix Table 20). In FY 2001-02, FY 2002-03, FY 2003-04 and FY 2004-05 these ratios went down to 29, 28, 28 and 26 percent respectively. In FY 2000-01, the expenditure on subsidy and current transfer accounted for 27 percent of total non-development expenditure. In FY 2001-02, FY 2002-03, FY 2003-04 and FY 2004-05 the expenditure on subsidy and current transfer accounted for 26, 28, 29 and 31 percent of total non-development expenditure. In FY 2000-01, the share of interest payments on foreign and domestic loans on total non-development outlay was 20 percent. In FY 2001-02, 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 19.9, 22.0, 20.6 and 19.5 percent respectively.

[2] 'Actual expenditure' of Annual Development Programme (ADP) except financing from 'own source'.

[3] Capital expenditure, food expenditure, net lending and other development expenditures are included in 'other expenditure'.

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 FY2002-03, FY2003-04 and FY2004-05 it stood at 90, 89 and 92 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
2004-05p	22000	20500	18771	91.6

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

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. In FY2000-01, expenditure on education, health and population was 20.6 percent of total ADP outlay. In FY 2001-02, FY2002-03, FY2003-04 and FY2004-05 these expenditures stood at 22.1, 20.6, 20.6 and 17.9 percent respectively of total ADP outlay. In FY2000-01, expenditure on energy, transport, communication and natural resources was 37.9 percent of total ADP outlay. In FY2001-02, FY2002-03, FY2003-04 and FY2004-05 expenditures in these sectors stood at around 41.2, 37.5, 42.7 and 43.2 percent respectively of total ADP expenditure.

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

Sector	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Agriculture	5.3	4.5	5.0	4.5	4.9	4.7	4.5	4.4	3.74	4.04	3.13
Rural Development	6.6	6.8	8.4	8.2	10.1	12.2	12.2	11.1	10.09	13.83	13.35
Water Resources	6.3	5.6	8.2	8.1	7.0	6.9	6.1	5.4	4.29	4.04	4.86
Industries	1.3	1.5	1.4	0.8	0.8	1.7	3.3	1.9	1.14	2.74	2.72
Power	14.8	13.7	13.5	10.9	12.0	12.9	12.2	12.1	13.70	17.26	16.98
Gas, oil & natural resources	2.3	4.1	4.4	4.9	4.7	4.3	2.5	3.1	4.00	5.19	4.50
Transport	18.9	20.1	22.4	19.7	17.9	17.4	20.4	19.9	16.15	18.04	16.15
Communication	4.4	2.9	1.9	1.6	2.8	3.1	2.8	6.1	3.63	2.23	5.59
Physical planning & housing	4.7	4.6	5.4	5.1	5.4	7.0	7.5	6.6	5.61	5.91	7.24
Education & religion	14.2	13.0	13.2	12.9	13.5	12.8	13.3	14.2	13.88	12.28	10.53
Health & population	8.2	6.9	7.9	9.1	8.2	8.1	7.3	7.9	6.72	8.27	7.40
Other	13.0	16.4	8.1	14.1	12.8	9.1	7.8	7.4	17.00	6.24	7.55
Total ADP	100	100	100	100	100	100	100	100	100	100.0	100.0

Source: IMED, Ministry of Planning. Figures for 2004-05 are provisional.

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	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999- 00	2000-01	2001-02	2002-03	2003-04	2004-05
Overall budget deficit (excluding foreign grants)	-5.8	- 4.6	- 4.7	-3.7	-3.4	-4.6	- 6.1	-5.1	-4.7	-4.2*	-4.2*	-4.5
Overall budget deficit (including foreign grants)[4]	-3.7	-2.2	-3.0	-2.0	-2.1	-3.2	-4.5	-4.1	-3.7	-3.4	-3.4	-3.7
Net foreign financing[5]	3.8	3.8	2.8	2.8	2.3	2.5	2.5	2.0	2.1	2.3	2.4	2.4
Net domestic financing[6]	1.1	0.7	1.8	1.5	1.6	1.9	2.8	2.8	2.6	1.9	1.8	1.8

*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.

Between FY 1993-94 and FY 1998-99, budget deficit (excluding foreign grants) remained by and large within the limit of 4.5 percent of GDP. Subsequently, budget deficit shot up because of the expansionary fiscal policy and in FY 1999-00, it rose to 6.1 percent of GDP. In FY 2000-01, it stood at 5.1 percent of GDP. In order to restore discipline in the fiscal sector, the present Government took a number of reform measures, which resulted in reduction of budget deficit to 4.7, 4.2, 4.2 and 4.5 percent of GDP in FY2001-02, FY2002-03, FY2003-04 and FY2004-05 respectively.

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)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999- 00	2000-01	2001-02	2002-03	2003-04	2004-05
Total Financing	9600	11150	10447	11700	12200	14000	16500	18200	16000	17100	19000	20500
Foreign Financing	6160	6352	6033	5975	6679	8188	8274	8670	8215	8241	9410	10430
Domestic Financing	3440	4798	4414	5725	5521	5812	8226	9530	7785	8859	9590	10070
Domestic financing as % of Total ADP allocation	35.83	43.03	42.25	48.93	45.25	41.51	49.85	52.36	48.66	51.81	50.47	49.12

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

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

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

[6] 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. Analysis of domestic borrowing for several previous years (Table 4.8) shows some erratic trend of total Government borrowing from various domestic sources. This is especially true in the case of Government borrowing from banking system, which shows a wider fluctuation. The domestic borrowing, which stood at Tk.640.22 crore in FY 1990-91, rose to Tk. 6542.20 crore in FY 2004-05. Among domestic sources, the amount of borrowing from bank sources is higher than that from non-bank sources. In FY 1990-91, the borrowing from bank sources was Tk.173.10 crore while it stood at Tk.467.12 crore from non-bank sources. On the other hand, in FY 2004-05 borrowing from bank sources stood at Tk. 3683.90 crore while it stood at Tk.2858.30 crore from non-bank sources.

Table 4.8 shows year-wise Government borrowing (net) from domestic sources covering the period from FY 1990-91 through FY 20004-05. Source-wise Government borrowing over the past five years has been presented in Graph 4.2.

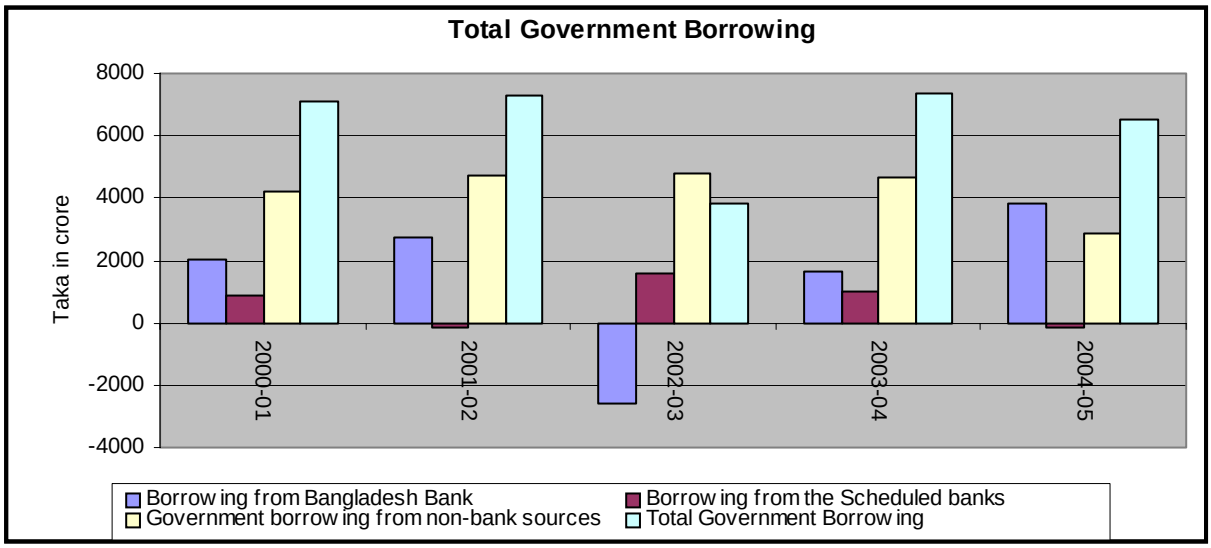
Table 4.8: Net Government Borrowing from Domestic Sources 1990-91 to 2004-05

(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	244.40	312.40	-68.00	1098.20	1030.20	0.7
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	1653.00	1016.10	2669.10	4659.00	7328.10	2.2
2004-05	3826.70	-142.80	3683.90	2858.30	6542.20	1.8

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

Graph 4.2 Total Government Borrowing



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. As a result, private sector investment has not suffered from crowding out effect.