Credit guarantee scheme holds the key to successful implementation of stimulus packages

SELIM RF HUSSAIN

The government has allotted more than Tk 1 lakh crore, which is 3.7 per cent of the GDP, under 19 different 'stimulus packages', to mitigate the economic effects of the coronavirus pandemic and kickstart our economic recovery.

The Bangladesh Bank (BB), has also taken various policy measures to enhance the banking sector's liquidity and support the roll-out of these stimulus packages and many other customer-friendly initiatives.

These government stimulus packages are extraordinary initiatives, the effective implementation of which, we believe, will contribute strongly to the recovery of the Bangladesh economy.

The majority of the stimulus packages are designed to be delivered to affected enterprises in form of credit (or loans) at subsidised rates.

The BB will lend funds under the stimulus package to banks, who, in turn, will be responsible for the roll-out of the loans to individual customers.

In other words, the banking sector will take on board all customer credit risk.

This pandemic comes at a time when Bangladesh's banking sector is already reeling from the effects of many years of high unproductive loans and tight liquidity.

On top of it all, the BB imposed a 9 per cent lending rate cap from April 1, which resulted in banks losing between 20 per cent to 35 per cent of their customer lending interest income.

The lending rate cap gives the banking sector little or no room to implement any commercial risk premium in loan pricing and there is justifiable apprehension that, in this environment, few banks will have any risk appetite for the inherently riskier cottage, micro, small and medium enterprise (CMSME) business segment.

What can help here is a credit guarantee scheme (CGS), which provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on loans made to different client segments in case of a default, typically in return for a fee.

The CGS is particularly used to encourage banks to lend to comparatively riskier segments such as the CMSME.

Most countries in the world have some sort of CGS for CMSMEs and these schemes have invariably been very effective in exponentially growing CMSME credit in those countries.

A look around South and South East Asia, not to mention more developed countries, will give one a pretty clear idea as to how the CGS is used to encourage banks to get into and then grow the CMSME business.

The banking sector has been asking for a CGS for many years now and, in the current circumstances, the need for such a scheme appears even more relevant.

It is reliably learnt that the World Bank is now offering a $300 million support to the BB to form a CGS for CSMEs.

The central bank has recently put together a first cut CGS and has shared the same with relevant stakeholders for their feedback. It is expected that a CGS will be rolled out shortly.

An effective CGS will be key to the overall growth of the CMSME segment in Bangladesh and, in particular, the successful implementation of the government's CMSME stimulus package.

Of course, the CGS must be designed such that the overall proposition is commercially viable and easily accessible by both the end user customers and the participating banks.

A poorly designed CGS will not be accepted or executed by relevant stakeholders and will not serve any purpose.

We believe this is a very opportune moment to share Brac Bank's many years of experience in the Bangladesh CMSME segment and our ideas on how an effective CGS should be designed. The CGS should: 1. Clearly define eligibility and qualification criteria for Financial Institutions (lenders) & CMSMEs.

i) Focus on the micro, cottage and small segment with special incentives for women-owned businesses.

ii) Cover both the working capital (i.e. operational expenditure) and longer-term investment (capital expenditure). It is difficult to differentiate between capital and working expenditure in a CMSME entrepreneur and one should not try to do so. Access to credit is most important for the CMSME entrepreneur and he/she will know how to utilise the funds.

iii) Not be restricted by sector classifications, all sectors of the CMSME segment (manufacturing, service and trading) should be equally covered iv) Accommodate the re-structuring and re-scheduling of bank loans for better portfolio management.

2. Ensure that CGS is customer- and bank-friendly and can be quickly rolled out.

i) There are two main approaches to a CGS: the individual approach (guarantees provided on a 'loan by loan' basis) and the portfolio approach (banks are allowed to report guarantees on a portfolio basis). We strongly recommend that the portfolio approach is used in Bangladesh because it will allow the bank to respond quickly and reach a larger number of smaller ticket SME borrowers. The size and scale of the Bangladesh CMSME segment are such that a 'loan by loan' approach is impractical ii) The loan ticket size of SME borrowers in Bangladesh ranges between Tk 5 lakh and Tk 1 crore. The CGS should accommodate this range of SME loans.

3. Issue partial guarantees that comply with prudential regulation and provide capital relief to lenders.

i) The CGS should mitigate banks' risk through the guarantee coverage ratio, which is usually expressed as a percentage of the underlying loan exposure. The guarantee coverage ratio should be high enough to actively encourage banks to participate. In the current economic condition, the guarantee coverage ratio should not be lower than 80 per cent.

ii) CGS should also set a cap on the maximum amount claims that will be accepted by the CGS. Our experience, and the portfolio health of the banking sector's current CMSME segment, suggests a cap of 30 per cent is appropriate for normal times. In the current pandemic situation, the BB could even consider extending the CGS up to 50 per cent. iii) The CGS should provide capital relief to the banks for the proportion of the underlying loan exposure covered by the guarantee.

iv) The CGS should not impose new credit assessment requirements (e.g. 2/3 years' financial, business length, etc.); it should rely on the bank's internal credit assessment system.

v) The loans guaranteed by the CGS should comply with the prudential regulations for loan loss classification.

vi) CGS should allow lenders to exclude the portion of the loan guaranteed by CGS during loan loss provisioning.

4. Set a transparent and consistent risk-based pricing policy to ensure that the guarantee programme is financially sustainable and attractive for both SMEs and lenders.

i) The pricing should be variable and should promote prudent credit culture across the financial industry by offering lower fees to banks with lower default loans.

ii) CGS fees should be commercially viable, and no more than 00.5 per cent for banks with low default loans. Higher guarantee fees will make the CGS unattractive to lenders.

iii) The CGS should allow financial institutions to reimburse the credit guarantee fees from the borrowers (SMEs) themselves.

5. Design an efficient, clearly documented, and transparent claim management process providing incentives for loan loss recovery, and be aligned with the local legal and regulatory framework.

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Plastic goods makers demand VAT exemption on low-cost wares

STAR BUSINESS REPORT

Plastic makers yesterday voiced their displeasure about the lack of incentives for them in the proposed budget for fiscal 2020-21.

EYE ON BUDGET

The government has not withdrawn the value-added tax on plastic-made dishes, jugs, mugs, bowls, glasses, dishwashers, baskets, buckets, soap trays, garbage baskets, hand fans and spice trays, which were mainly used by financially insolvent people who were now unable to pay higher prices thanks to the present crisis, said the Bangladesh Plastic Goods Manufacturers and Exporters Association (BPGMEA).

Therefore, the association demanded VAT exemption for products like tiffin carriers and water bottles.

Md Jashim Uddin, president of the BPGMEA, though thanked the government for continuing the provision of VAT exemption in the VAT act and maintaining the turnover tax facility.

"Congratulations to the present government for exempting VAT on environmentally friendly plastic granules that are being produced by recycling plastic waste," he said.

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Dairy farms demand higher tariffs on dried milk to boost local industry

STAR BUSINESS REPORT

Dairy farm companies have urged the government to increase customs tariffs on bulk imports of powdered milk to protect the expanding sector, said the Bangladesh Dairy Farmers' Association (BDFA).

This plea comes soon after the government announced its revenue collection plan for the next fiscal year, beginning on July 1, last Thursday.

EYE ON BUDGET

"Importing milk powder in bulk is responsible for hurting the local dairy sector and so, it is really a matter of regret that higher import duties have not been levied on this type product," said Mohammad Shah Emran, secretary general of the Bangladesh Dairy Farmers' Association (BDFA), during a press conference at the Dhaka Reporters Unity yesterday.

The amount of milk powder imported annually has gone up every year since fiscal 2016-17 to meet the country's supply deficit despite the increase in local production.

Bangladesh imported 150 lakh tonnes of milk powder for Tk 2,800 crore in fiscal 2018-19, the same year that 99 lakh tonnes of the dried dairy product were produced locally, according to data from the Bangladesh Bureau of Statistics (BBS) and Department of Livestock.

During the first nine months of the current fiscal year, dried milk imports declined 5 per cent year-on-year to 106 lakh tonnes. Imported milk powder is sold or used by various businesses such as hotels, bakeries and restaurants who can afford to pay increased prices or simply source it locally, the BDFA said while demanding a 100 per cent hike on import duties for the product.

The BDFA also asked the government to make livestock feed exempt from import tariffs to create more competition in the fodder market.

The association demanded that dairy farming be treated as a part of the agriculture sector so that companies can pay reduced electricity and water bills instead of being charged commercial rates.

The BDFA also wants the government to provide a 20-year-long tax benefit for investments in the dairy sector and support from the public sector to establish powdered milk manufacturing plants across the country.

Apparel exporters need more support to stay the course

EYE ON BUDGET

REFAYET ULLAH MIRDHA

Apparel exporters and textile millers demanded the government accommodate more measures in the proposed budget to recuperate exports and buck up job creation such that the sector can weather the looming economic storm unleashed by the pandemic.

Steps needed to revive exports are absent in the budget, and on top of that, source tax has been jacked up to 0.50 per cent from 0.25 per cent for the sector that fetches more than 84 per cent of the total export earnings, they said.

Garment manufacturers said they get some sort of incentive from the government every year but the support should have been extensive this year given the economic meltdown that is sweeping across the globe.

The garment and textile millers want the government to double cash incentive on export receipts from all destinations to 2 per cent at least for the time being, which, they said, would help them meet their match in the global market.

"The budget is as usual unless some concrete steps are taken to revitalise garment exports," said Mahmud Hasan Khan Babu, managing director of Rising Group, an apparel exporter.

Considering the time and the overall business situation, the garment sector deserves a reduction in source tax to 0.25 per cent and an increase in cash incentive to 2 per cent, he said.

"We see a grim picture in work orders at least for the next three months as most Western retailers did not reopen their outlets to the full. So we need support to stay the course," said Fazlul Hoque, managing director of Plummy Fashions, another leading exporter.

Hoque said many of the garment manufacturers cannot borrow from the government-announced stimulus funds because of stringent conditions.

If the conditions are relaxed at least for the micro, cottage, small and medium enterprises, many factories would survive the pandemic-induced recession, he added.

"The finance minister should have planned something big for the garment sector," said Shahidul Haque Mukul, managing director of Adams Apparels.

For instance, he said, the government could have announced more cash incentive on exports to the EU and the US, the two big markets that take about 80 per cent of Bangladesh's total garment shipment.

"This was not the right time to increase source tax," said MA Jabbar, managing director of DBL Group, another top apparel exporter of the country.

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Foreign firms' finished steel product imports must be taxed

Steel building makers demand

EYE ON BUDGET

JAGARAN CHAKMA

Local steel building makers yesterday urged the government to impose a duty on the import of finished steel products by foreign companies to safeguard the domestic industry.

They also wanted the introduction of a uniform duty on the import of pre-fabricated raw materials of steel building products in the final budget for the incoming fiscal year.

The Steel Building Manufacturers Association (SBMA) of Bangladesh made the demands through a virtual post-budget press conference from its office on Pragati Sarani in Dhaka.

The duty-free benefit, which foreign companies enjoy for import of finished steel products for the establishment of factories inside economic zones, should be withdrawn, said Jowher Rizvi, SBMA president.

They bring in steel products from abroad although local manufacturers have been

producing such products of global standards inside Bangladesh for a long time, he said.

Some foreign companies have been importing surplus finished steel goods exploiting the duty-free benefit and supplying those products to the open market, creating unfair competition for the local manufacturers, he said.

There are 30 local prefabricated or infrastructure steel makers in Bangladesh, each manufacturing specific items and directly contributing to the country's infrastructure development.

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Investment amnesty for black money will discourage honest taxpayers

Says Sanem in its reaction to proposed budget for fiscal 2020-21

EYE ON BUDGET

STAR BUSINESS REPORT

The South Asian Network on Economic Modelling (Sanem), a non-profit research organisation, has criticised the move to give investment amnesty for black money, saying the step that had failed earlier to draw a significant response will discourage the compliant taxpayers.

"The government hurt the honest taxpayers," said Selim Raihan, executive director of Sanem, at a webinar on Saturday on Sanem's budget review for fiscal 2020-21.

"Allowing the scope of whitening the black money is anti-constitutional. The black money holders are very smart and they know where they will keep the money."

The government has been giving this chance for the last few years, but this initiative brought no success, said Raihan, also an economics professor at Dhaka University. However, he commended the increased allocation for health, education, agriculture and social protection.

The finance minister proposed allocating Tk 29,247 crore for the health services division and the health education and family welfare division for fiscal 2020-21, up 13.67 per cent from a year earlier.

The government has set aside Tk 95,574 crore in the social safety net programmes, which is 16.83 per cent of the total budget and 3.01 per cent of the country's gross domestic product. In last year's revised budget, the allocation was Tk 81,865 crore.

Raihan acknowledged the challenges of designing a budget in the current context of Covid-19. However, he said the proposed budget is not Covid-19 responsive to the extent that it was required to be.

Given the record, there is a reason to be sceptical about the proper implementation of the budget, he said.

In that regard, regular updates should be given on the implementation of these allocations, especially in the case of the health sector.

Also, a high-powered expert committee might be able to make proper utilisation of the increased allocation for the health sector, he said.

"While the budget does not address the mismanagement, corruption and institutional weaknesses existing in the health sector, availability and accessibility of COVID-19 vaccines have also been left out of the discussion."

He further explained that the budget focuses on the garment sector too much and the other export-oriented sectors have not been given importance in the same manner.

The health management system in Bangladesh is too weak to bring in massive changes overnight.

Raihan suggested bringing the private hospitals under accountability.

Regarding the deficit target of 6 per cent, he said it will not be a problem. There is even scope to widen the deficit for the next two years.

He recommended reducing dependency on bank borrowings for meeting the deficit financing needs as the banks are in a vulnerable situation now.

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