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## Massive borrowing raises govt's repayment liability

By Inam Ahmed

For a stable macroeconomic situation, a right fiscal management is vital. The government ways and means to strike a balance among domestic revenue collection, domestic borrowing and foreign financing can actually determine the health of the economy.

In the last few years, the developments in these sectors show an alarming trend that has increased the government's interest payment liability drastically. At the same time, the government has failed to achieve its tax-GDP ratio targets set in the Fifth Five-Year Plan.

In 1990-91, 60 per cent of the total public expenditure was financed by domestic resources. The share of domestic resources in expenditure financing further increased to 70 per cent in 1994-95 and 1995-96. But then it stagnated.

At the same time, net foreign financing started declining from as high as 37.7 per cent of the total financing in 1990-91 to only 18.38 per cent in 1997-98. This stood in contrast to the increase in total expenditure.

"As a consequence of this phenomenon - a decline in both domestic resources and foreign aid - domestic borrowing inevitably increased," says Dr Omar Haider Chowdhury, Senior Research Director of the Bangladesh Institute of Development Studies (BIDS).

The net domestic borrowing, which was 5.8 per cent of the total expenditure in 1990-91, decreased to 1.62 per cent in 1992-93. But then it shot up again to 12 per cent in 1997-98, he points out.

"Domestic borrowing from bank and non-bank sources had decreased the investment-worthy capital and the question of whether to channel fund to private sector or public sector became prominent," Dr Chowdhury says. "If the economy has to be private sector-driven, then the fund will also have to be diverted there."

In 1991-92, VAT's contribution to revenue collection was 12.67 per cent. This increased to 31 per cent in 1994-95 and virtually stagnated there. At the same time, all other forms of

taxes stagnated. "The fall-out of this situation is reflected in the incremental increase of supplementary tax on an ad hoc basis," says the researcher who specialises in fiscal studies.

The share of supplementary tax in revenue collection rose from 1.7 per cent in 1991-92 to 16 per cent in 1997-98. The people in general had to suffer for the government's failure in tax collection as much of the

supplementary tax had been slapped on items like petroleum.

The borrowing from the banks had also affected the inflation rate, which climbed from 4.56 per cent in 1991-92 to 6.63 per cent in 1997-98. At the same time, the share of interest payment rose from 8 per cent of the total expenditure in 1990-91 to 11 per cent in 1997-98. In almost every year, the government had to pay more in inter-

est payment than it had estimated. For example, in 1996-97 the amount to be paid as interest rose from the budgeted amount of Tk 744 crore to an actual Tk 1080 crore. In 1997-98, the budgeted amount for interest payment was Tk 1240 cr, which actually stood at Tk 1594 crore at the end of the year.

"This is eventually becoming a big burden as about 20 per cent of the revenue expenditure is being spent on domestic and foreign interest payments. In 1997-98, 16 per cent of the expenditure was spent on interest payment and this will further increase this year," says Dr Chowdhury.

"The country's macroeconomic stability comes under strains because of the financing weakness. In the early 1990s, the government was successful in more revenue generation which had restored the stability for a short period," says Dr Chowdhury.

In the next three to four years, the situation will further accentuate as tariff rates will go down considerably. "The government has failed to achieve its goals set in the Fifth Five-Year Plan. Although the plan was to increase the tax-GDP ratio by 0.5 per cent each year, it has, in fact, gone down from the bench year (1995-96) mark of 10 per cent to 9.5 per cent in 1997-98.

It was estimated that the tax revenue collection would have been increased by 20 per cent in 1997-98, but in reality, it rose by only 10 per cent. In light of the experience, the target for this year has been shortened to 10 per cent, but this is also unlikely to be met.

Considering the government-claimed 5.2 per cent GDP growth and 8 per cent inflation, the nominal GDP growth for this year would be 13 per cent. In that case, the tax-GDP ratio would further slide.

But to stick to the Fifth Five-Year Plan, the growth of tax collection has to be kept higher than GDP growth and this means the government has to take many unpleasant decisions to raise collection.



Hiroyuki Yoshino, President of Japan's Honda Motor Co. Ltd., smiles as atop its new scooter 'Giorno Crea Deluxe', featuring an idle stop system, during a press introduction at its head office in Tokyo. — AFP photo

## Tenders floated for selling out five SOEs

Privatisation Board (PB) has floated tender notices for the sellout of five state-owned enterprises to the private sector with a closing date for submitting bids on June 16, says UNB.

The enterprises are Fish Export Limited and Star Jute Mills in Khulna, Bangladesh Textile Mills and Chittaranjan Cotton Mills in Narayanganj and Kalachapra Sugar Mills in Kishoreganj.

The enterprises have huge assets, including six acres of land and considerable amount of machinery.

The Fish Export Limited has an estimated annual processing capacity of 27 lakh pounds while Kalachapra Sugar Mills the capacity to produce 10,161 metric tons of sugar every year.

A Board spokesperson said more SOEs in the textile and engineering sectors would be sold out after the sellout of these enterprises.

"Interest of the private entrepreneurs in these enterprises seems to be very strong," said Privatisation Board Chairman Kazi Zafarullah.

He said the sellout of these enterprises offers the private investors a unique opportunity to get in on the ground of the country's privatisation process. Zafarullah said development of the private sector offers the best solution to many of the problems faced by the country's loss-making state enterprises and is seen as the key to the nation's economic growth, according to a press release.

## Open dialogue on privatisation at Sheraton today

An open dialogue on privatisation will be held with the participation of faculty members of Dhaka University at Sheraton Hotel today, says UNB.

DU Vice-Chancellor, Pro-Vice Chancellor, DUTA members, members of DU Senate, heads of departments, directors of institutes and hall provosts will take part in the dialogue.

Vice-Chancellor Prof A K Azad Chowdhury will be the key speaker in the dialogue to be chaired by Education Minister A S H Sadique.

State Minister for Jute A S M Faezul Huq, State Minister for Textiles A K M Zahangir Hossain will also attend the programme, said a press release yesterday.



Engineer Mosharrif Hossain, Minister for Civil Aviation & Tourism and Housing & Public Works, delivers inaugural address as chief guest in the launching ceremony of Holiday Homes Project of Nitol Group at a city hotel yesterday. Sitting in the dais (from left) M Mosharrif Hossain, Managing Director of Rapport Bangladesh Limited, Selima Ahmed, Director of Nitol Group, Mohammad Younus, Vice-Chairman of Islami Bank Bangladesh Limited, Abdul Matlub Ahmed, Chairman of Nitol Group and AK Faezul Huq, State Minister for Jute.

## Nitol Holiday Homes launched 30,000 new housing plots in city by 2000: Minister

Minister for Civil Aviation and Tourism, Housing and Public Works Engineer Mosharrif Hossain said yesterday that some 30,000 housing plots under 'Furbachal' housing area would be ready for allotment by the year 2000, reports BSS.

"Around 12,000 flats will be constructed soon for the low-income groups at Mirpur area on 168 acres of land to solve housing problem in the city," he said.

The minister was speaking at the launching ceremony of a private satellite town project, "Nitol Holiday Home," at Rajendrapur as the chief guest at a hotel here.

Presided over by Chairman of Nitol Group Abdul Matlub Ahmed, Executive President of Islami Bank M Kamal Uddin Chowdhury and Managing Director of Report Bangladesh Limited M Mosharrif Hossain also spoke on the occasion.

The minister said the present government has taken initiative to construct a total of

720 flats each having 1700 square feet and costing Taka 25 lakh.

"The flats, which would be constructed near the martyred intellectuals graveyard at Mirpur, will be distributed among people who are living abroad on priority basis," the minister said.

State Minister for Jute A K Faezul Huq was present at the function as special guest.

Mosharrif Hossain also said that a bill will be table in the Jatiya Sangsad to protect the natural lakes in Dhaka and throughout the country.

He said adequate measures will be taken to evict the illegal occupants in the city's posh Gulshan and Baridhara lakes.

"A law will be enacted to protect natural lakes across the country including those in Gulshan and Baridhara," he said.

He said the present government is keen to build apartments on abandoned property and on "khas" lands in partnership with public companies

like Nitol. "The government will provide different facilities including land requisition to the private developers to establish satellite towns in Dhaka and other divisional headquarters in the country," he said.

The minister said there is no alternative to establishing satellite towns for reducing housing problems in the city.

Public Works Minister also said the government will extend all-out cooperation to establish satellite towns where people will get facilities including school, prayer hall, health club, shopping complex, katcha bazar and parking area.

Faezul Huq sought all cooperation from people to solve housing problems in the Dhaka city.

He said the present government has already implemented "Asrayan" Project to rehabilitate the low income earning people in different areas in the country.

## SMEs need level playing field in terms of VAT

By Dr Zia U Ahmed and Asif M Touhid

Developing small and medium enterprises (SMEs) has always been in the cognizance of successive government as part of a broader vision to advance economic condition of Bangladesh as a whole.

Much thought and effort have been directed to this field to foster its growth both in terms of volume and output. Though focused guardianship of different government establishments achieved progress to a great extent, some constraints are however prevalent.

A number of economic reforms, deregulatory actions and other incentive programmes, even though aimed at benefiting SME growth, have inbred complexity and resulted in frequent policy shift by different government authorities.

The porous nature of the national border allows foreign goods to be smuggled through and challenges the government to take effective actions to promote products of domestic SMEs.

One of the areas in which the government can take promotional action is in the area of taxation, such as the Value Added Tax (VAT) on SME products.

This position paper presents some important issues relating to VAT and outlines our recommendations for resolving those issues so as to assist in promoting SMEs in general.

### Issues

Under the existing Value Added Tax Act, 1991 SMEs (other than cottage entrepreneurs) whose annual turnover does not exceed Tk 1.5 million are required to pay turnover tax at the rate of 4 per cent in lieu of 15 per cent VAT.

SMEs in their early stages of operation can enjoy this benefit. However, as they start to grow they cross the VAT exemption ceiling in a short time and face a sudden burden of 15 per cent VAT in addition to other taxes.

The ceiling presents itself to be too low for them as VAT adds substantially to their input cost. Large enterprises enjoy adequate cost saving due to economies of scale. On the other hand, marginal increase in turnover over the cutoff line results in significant increase in tax expenditure for the SMEs. This particular incident encourages human inclination towards tax evasive behaviour by manipulating accounts resulting in revenue loss for the

government. In addition, the long porous border of Bangladesh enables large volume of goods to be smuggled in. These smuggled products, which sell at lower market prices, pose a great threat to the local SME product market.

their growth that the cutoff line should be increased from the existing ceiling.

In addition, some changes in the existing tax structure, by introducing tax slabs and a gradual increase in tax rates, for enterprises having turnover more than the cutoff line could

### A hypothetical case

Proposed tax slabs on small and medium enterprises	
Annual Turnover	Tax Rate
Upto Tk 2 million	4% Turnover tax
Tk 2 million to Tk 3 million	5% Turnover tax
Above Tk 3 million	15% VAT

The reason behind the low prices of smuggled products is that their importers/smugglers avoid paying tariffs at the border and their producers pay VAT at a lower rate in their respective countries.

For example, in India, SMEs having an annual turnover lower than rupees 4 million are not subject to excise tax. These factors substantially reduce their input cost resulting in the absence of a level playing field for the local SME manufacturers.

### Recommendations

The cutoff line for tax increase in now on Tk 1.5 million. However, considering the impact of inflation we recommend that in the interest of maintain a level playing field for the SMEs and to promote

resolve the issue to a large extent.

The concept is to apply a progressive turnover based tax structure for different cutoff points measured in terms of total turnover.

Different proposed tax rate combinations and the consequential revenue impact have been shown in the annexes for review and consideration by the authority.

It is assumed that smaller enterprises mostly purchase their inputs from informal markets with no proper documentation, which is required for tax deduction during VAT calculation.

Although a good number of their raw materials are imported these small enterprises do not directly import their raw materials and, therefore, they

do not have documentation of VAT payment made on the raw materials.

The proposed structure should give the SMEs enough room to match their costs with revenue earnings. This would also tend to increase the government revenue earning in a way that SMEs would pay differentiated amount of tax (may be at a lower rate) rather than a flat rate of 4 per cent by adopting unfair means.

The total incident of tax evasion can be categorised in two types. First, enterprises who are around the cutoff line and second, enterprises who evade tax no matter what the tax rate slabs are.

By this proposed slabs, first group of enterprises would be persuaded to pay tax honestly as it does not add substantially to their input cost and enables them to grow without much tax hiccups.

It is important to mention here that this tax structure would also help the enterprises in the growth, as they can not afford to maintain formal accounting system in low scale of operation for it increases their fixed cost.

Enterprises operating around Tk 3 million annual turnover are large enough to maintain formal accounting procedure and purchase inputs from the formal market. Consequently, enterprises providing proper documentation should be subject to VAT from the Tk 3 million turnover point and enjoy tax benefits.

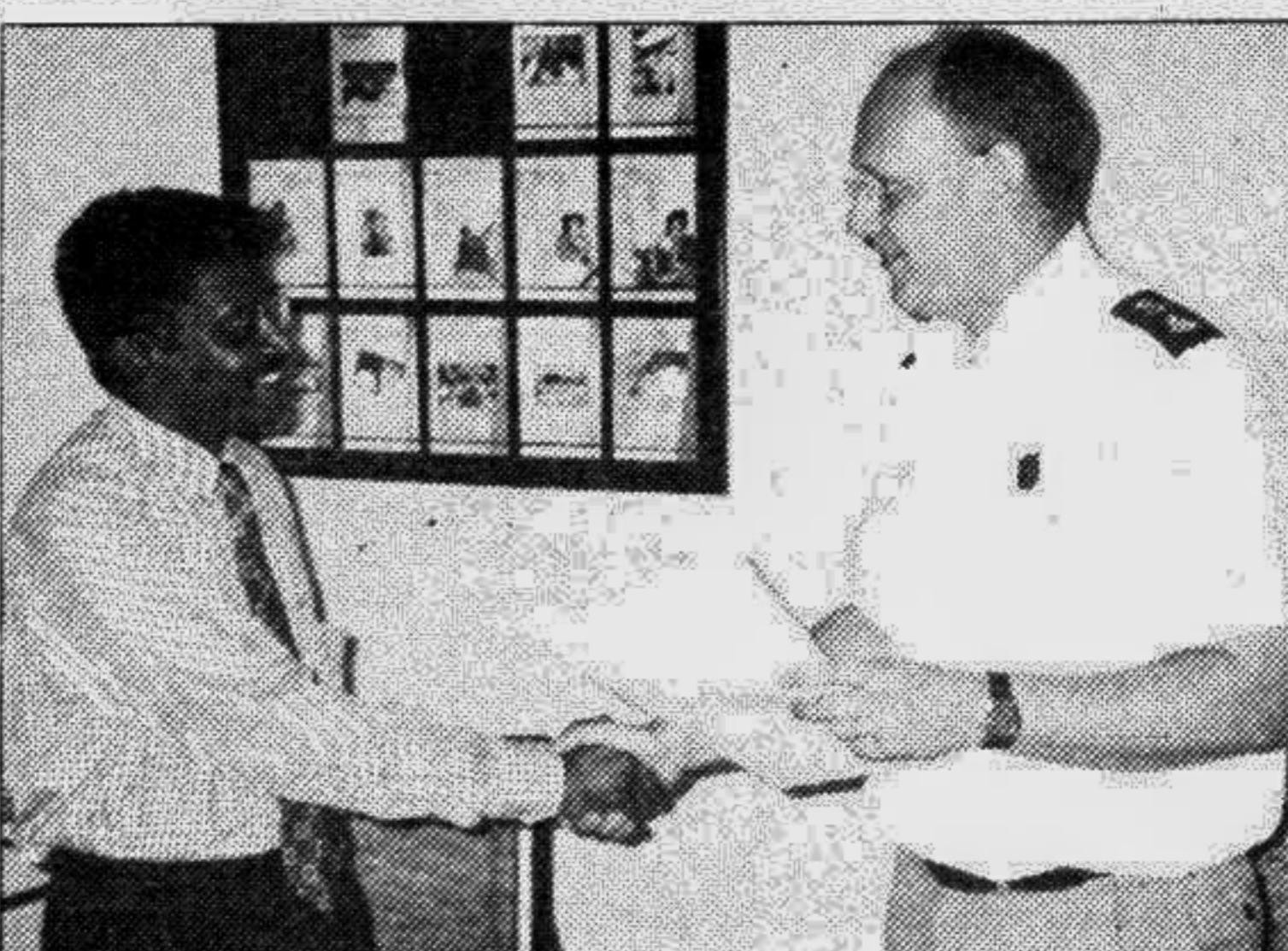
### Conclusion

Like other developing and developed countries, small and medium enterprises are considered important from the point of economic development and employment creation for vast skilled and semi-skilled labour force in Bangladesh.

The largest number of enterprises in Bangladesh fall in the category of SMEs, which offer an opportunity to create low cost employment opportunity for poor men and women.

Government policies aim to provide incentives to SMEs so the policy changes should also try to keep abreast with the dynamic changes taking place in the neighbouring countries to ensure a level playing field for our domestic small and medium producers.

(The authors are Team Leader and Assistant Policy Coordinator respectively of JOBS Programme, a USAID initiative for enterprise development).



Major Bo Brekke, Officer Commanding of The Salvation Army, Bangladesh, and Managing Director of Technics Computers Prabeer Sarker exchange documents after signing an accord to promote use of legal software in Bangladesh recently.



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