Budget shows fault lines

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Mahmood Ali underlined the need for raising the tax-to-GDP ratio to 10 percent from 8 percent now and upskilling workers going abroad for jobs at the beginning of his speech. But he was conspicuously silent on the runaway banking sector that counted Tk 182,000 crore in non-performing loans, the highest ever.

His path is laden with moral hazard. The government has once again allowed both individuals and companies to whiten black money by paying a 15 percent tax without facing scrutiny. It undermines the government's fight against deep-rooted corruption at a time when excesses by former government officials are in full view.

"The measures such as 'anti-corruption committees' in every metropolis, district, and upazila and 'public hearing' sessions on corruption in government and semi-government offices seem trivial, if not laughable," said Zahid Hussain, former lead economist of the World Bank's Dhaka office.

One of the key concerns is that the government plans to borrow about Tk 137,000 crore from domestic banks to finance its development spending. This is likely to increase the risk of a crowding-out effect as deposits in the banking sector are likely to grow only by Tk 160,000 crore over the next fiscal year.

"In other words, such borrowing targets will raise fiscal dominance in the overall macroeconomic management and will create pressure for the government to resort to central bank financing if such goals are aggressively pursued," said Ashikur Rahman, principal economist at the Policy Research Institute. "It is advisable to rationalise its borrowing target from the banking sector."

TAX PAIN DEEPENS

While the cost of living is high, lower-income families see no light at the end of the tunnel. The minimum tax-free limit remains unchanged in the most difficult times. The burden complicated by increased VAT rates feels heavier when people desperately seek a cushion from unrelenting inflation.

The minister increased the maximum tax rate to 30 percent from 25 percent now for individual payers, "distributing the burden equitably so that higher income individuals pay a larger share of their income or wealth as income tax than lower-income individuals." The corporate tax rate was lowered by 2.5 percentage points, but analysts questioned the benefits given to companies.

The government introduced a prospective tax system in Bangladesh to help expand trade and boost local and foreign investment. The demand for the new system was long-standing, though. It will create some tax predictability. For that, the proposed tax rate for fiscal 2024-25 will be retained for the 2025-26 assessment year. Currently, the country follows a retrospective tax regime.

"I believe that through a prospective tax system, taxpayers can do proper tax planning and help increase tax compliance," the minister said.

The government finally seems to be waking up to the burden of foreign debt. Bangladesh is facing pressure from two sides simultaneously: capital outflows outstrip inflows of funds. That increases the deficit in financial accounts on the one hand and creates the burden of repayment of foreign loans on the other. The interest payment for foreign loans exceeded $1 billion for the first time. The government now fears if the forecast that the interest rate will decline in the United States and other developed nations goes wrong, the trend of higher payment will continue in the future as well. Bangladesh now estimates that the interest payment for foreign loans will swell to $1.86 billion in FY25.

The new budget provides clarity on what's going on in the economy. But the minister shied away from explaining if the crisis reached gale-force intensity and the worst would be over soon.

Are we survivors of the crisis struggling to pick up the pieces? A period of uncertainty creates panic. We expected more than the sense of how we got into this mess. We wanted a roadmap of how to get out of this.

His silence is deafening.

Tax burden to get heavier, life even harder

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There is some good news for individuals, however.

For example, there will be no spike in the amount of minimum tax for FY25. The minimum tax applicable to individual taxpayers in Dhaka North, Dhaka South and Chittagong city corporations will be Tk 5,000. For other cities, it will be Tk 4,000.

For areas outside city corporations, a taxpayer will have to pay Tk 3,000 in tax if their total tax liability stands below the amount.

There will be some breathing space for taxpayers who earn between Tk 11 lakh and Tk 21 lakh.

The wealthy will need to pay higher taxes on their incomes since the NBR seeks to reinstate a 30 percent tax rate on high-income earners after a gap of four years.

Those taking home more than Tk 43 lakh annually will face a 30 percent tax.

However, the rich will also receive some relief since they will not have to pay any additional surcharge on their wealth. The rate of the surcharge tax remains unchanged.

There is also good news for the holders of undeclared wealth, both individuals and corporates. They are again going to enjoy full amnesty and no government agencies will raise any questions about the sources of their wealth.

However, they will have to pay a 15 percent tax on cash, bank deposits, financial securities, or any other forms of wealth. Furthermore, they will have to count a specific tax on properties -- land, buildings, flats, or commercial spaces -- to whiten their wealth.

The amnesty will undoubtedly discourage compliant taxpayers.

Except for the firms that have already taken the initiative to carry out transactions through banks, there is no good news for listed corporate taxpayers.

A firm will qualify for a reduced tax rate if it uses the banking system while receiving funds and making expenses and investments above Tk 5 lakh in each transaction. Bank transfers are mandatory if annual transactions go past Tk 36 lakh.

The rule stays despite calls from firms to relax it. The NBR did not entertain the proposal because it wants to promote cashless transactions, formalise the economy, and collect more taxes. Roughly, half of the economy of Bangladesh is still informal.

As such, the tax authority wants to make it mandatory for hotels, restaurants, motels, hospitals, clinics, and diagnostic centres to furnish it with the proof of submission of returns, known as PSR, in order to obtain and renew licences.

They will face a penalty, which will be no less than Tk 20,000, if they fail to display the PSR in a prominent place within public view.

The good news for individual and corporate taxpayers is that the new tax rates will remain effective for two years, giving some predictability they have long demanded.

The NBR says it wants to retain the proposed tax rates for the years to facilitate the expansion of trade, improve investor confidence in the country's tax system, and encourage local and foreign investments.

The tax administration has termed it as a prospective tax system, saying it will enable taxpayers to do proper tax planning and ensure higher compliance, crucial to raising revenue collections and cutting the government's reliance on loans.

The NBR is going to bring back the 27.5 percent tax rate for the incomes generated by provident, gratuity, superannuation, and pension funds. It is 15 percent presently.

Cooperatives will bear a 20 percent tax rate on their incomes.

For FY25, the NBR has been given the task of collecting Tk 4.80 lakh crore through direct and indirect taxes. This is 11 percent higher than the original target set for FY24 and 17 percent more than the revised target for the outgoing financial year.

As usual, it will rely on indirect taxes such as VAT and supplementary duty, to reach the goal. Of course, the bid to increase SD on cigarettes and tobacco products is a laudable initiative in view of the health risks they pose.

In order to pull off the collection target, the administration has trimmed the list of exemptions.

For instance, visitors to amusement parks will face a 15 percent VAT in FY25, double the amount they are subjected to in FY24.

And if the new couple plan to buy a holiday package from a tour operator, they will have to accept higher costs because the VAT exemption for the tour operators' service is coming to an end. This means holidaymakers will have to count a 15 percent VAT.

If the couple shelve the plan of holidaymaking and choose instead to take a short ride on the metro rail, a new attraction, they will face higher ticket fares as the NBR is set to lift the VAT exemption on ticket prices, making commuting less cheerful from July 1.

Solutions not offered

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"The domestic borrowing target of Tk 160,900 crore will exacerbate pressure on the taka and dollar liquidity in the banking system and hinder the possibility of achieving the ambitious 6.75 percent GDP growth target. Nor will it help soften inflation," he said.

Fahmida Khatun, executive director of the Centre for Policy Dialogue, said changes in the tax rates seem positive.

"But 2.5 percent of the budget shortfall will come from bank loans. In that case, it will be more difficult for businessmen to get bank loans."

In her opinion, the medium-term macroeconomic indicators given in the budget are not realistic. The targets for GDP, investment, inflation, and foreign exchange do not reflect the reality. These are attempts to meet IMF targets.

"Overall, given the challenges against which the budget was announced, we expected this budget to be quite innovative, creative and bold, but it did not happen. A traditional budget cannot provide any solutions in challenging times," she said.

M Masrur Reaz, chairman of Policy Exchange of Bangladesh, said the highest priority of the budget should be stabilisation of the macroeconomic challenges.

From that perspective, the size of the budget is okay. But at a time when inflationary pressure is already biting both citizens and businesses hard, increase in tax rates is not the right step.

"Increasing tax rate does not allow or does not often lead to increase in revenue. Rather, increasing tax base, addressing leakage, reducing tax expenditure, finding new sources of tax are required to increase tax revenue. But we don't see that effort," he added.

Salehuddin Ahmed, former governor of Bangladesh Bank, said there are three major challenges right now -- higher inflation, shrinking foreign reserves, and energy crisis.

"These three challenges are affecting our overall economy. As a result, the macroeconomy is very unstable. In this scenario, I think the size of the budget is realistic. But whatever the size, I have some questions about government spending."

The budget deficit is huge, which means the cost should have been reduced, he said.

"For example, what is the need for 1,258 projects under the Annual Development Programme? If the Annual Development Programme is cut down, the deficit will come down."

He said 40 percent of the budget will be spent for the administration. Besides, after spending on other less important sectors, it will be seen that there is no money for development.

BUSINESSES' REACTION

According to a number of businesspersons, considering the various global and domestic economic challenges, the proposed budget is time-befitting.

"In particular, the size of the budget is limited to Tk 7.97 lakh crore. The rate at which the budget has seen an increasing trend in the past few years has not been observed this time. This may give some relief to the taxpayers," said Asif Ibrahim, chairman of Chittagong Stock Exchange PLC.

He also said the revenue collection target (Tk 5.41 lakh crore) may be somewhat challenging due to the current macroeconomic crisis.

"The inflation control target has been fixed at 6.5 percent. But considering the current global economic situation, how inflation will be brought down from 9.30 percent is still not clear in the budget framework," he said.

FBCCI President Mahbubul Alam said the budget is realistic and implementable.

However, he called on the government to fix the personal tax limit at Tk 4.5 lakh instead of Tk 3.5 lakh.

Ashraf Ahmed, president, Dhaka Chamber of Commerce and Industry, said the government has tried to increase the revenue collection. "Import duty on almost 30 essential products has been reduced, which is a good move."

He hailed the government's bank borrowing target which, although still high, is almost 11.82 percent lower than the outgoing fiscal year.

Abdul Matlub Ahmad, former president of FBCCI, said there is no clear message in the budget to reduce the price of essentials to give relief to the common people from the inflationary pressure.

He stressed the need for subsidy on essential products, which is absent in the proposed budget.

Humayun Rashid, president of the International Business Forum of Bangladesh (IBFB), said the proposed budget does not address the high cost of doing business amid shortage of dollar due to shrinking forex reserves.

Syed Ershad Ahmed, president, American Chamber of Commerce in Bangladesh, stressed the need for revising individuals' tax-free income limit to provide a cushion against the rising inflation.

'Unethical, unjust and unacceptable'

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"As the country has been allowing the scope for years, many people are evading taxes and waiting for such opportunities. This is a huge loss for the economy," said Mustafizur.

Dr Iftekharuzzaman, executive director of the Transparency International Bangladesh, said the provision was unjustifiable.

"It is distinctly contradictory to the Constitution, which criminalises illegitimate income."

It further violates the constitution as it is discriminatory against honest income earners, who are subjected to up to 30 percent tax, he added.

As such, black money holders are practically being rewarded for corruption as they are being offered the rate of only 15 percent.

Echoing those sentiments, Muhammad Abdul Mazid, a former NBR chairman, said the provision is totally illogical.

"Honest taxpayers will be discouraged and will not want to come under the tax net. Such a provision will instigate corruption and deepen tax injustice."

This initiative will also not be politically helpful as the masses will believe that the ruling party is allowing the wrongdoers to continue with their misdeeds. "It's totally in contrast with the government's agenda," Mustafizur Rahman said.

Iftekharuzzaman added: "The provision is against the ruling party's lofty commitments contained in their manifesto in support of so-called zero tolerance against corruption often repeated by those in power, including the head of the government.

"In other words, the government is in reality advising people to be corrupt with a guarantee of impunity. The government should stop licencing corruption now and forever."

Additionally, the government wants to provide the opportunity for companies to correct any "errors" made while submitting their income tax returns.

Finance Minister Abul Hassan Mahmood Ali said the introduction of a data verification system created legal complications over the disclosure of undisclosed income and assets of various companies.

"In this situation, I propose to add a clause on tax incentives in the Income Tax Act with a view to providing taxpayers with an opportunity to correct this error in their income tax returns and to increase the flow of money into the mainstream economy," Ali said in his budget speech.

A leader of the Dhaka Chamber of Commerce and Industry opined that no illegal income should be legalised. However, if any reasonable issues remain, it should be taken into account.

There is no accurate data on how much black money there is in Bangladesh.

The Bangladesh Economic Association estimated that the accumulated amount would be Tk 13,253,500 crore, said Prof Aynul Islam, general secretary of the platform.

In a report published in April, the World Bank also criticised the existing government scope to legalise undisclosed wealth through investments, saying such policies demotivate honest and regular taxpayers and encourage tax evaders to continue their misdeeds.

"Also, these policies have failed to earn a significant amount of revenue."

Old malaise flaring up

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use of the government's fiscal space.

Unfortunately, the fiscal space is getting increasingly squeezed. As a result, the government is resorting to huge borrowing from both domestic and foreign sources. Thus, debt management will be a major issue in FY25.

THE FAULT LINES

The national budget for the FY25 once again brings to the fore the fault lines of the country's recent development experiences.

First, over the last decade and a half, the growth trajectory was deprived of incremental private investment. The private investment-GDP ratio has remained stagnant at around 22-23 percent.

The medium-term budgetary framework (MTBF) puts the targets concerned for FY25 at a very ambitious level, i.e. more than 27 percent of the GDP.

The second fault line has been the stagnating revenue-GDP ratio, which remains less than 10 percent. Indeed, this indicator, including its tax component, has experienced a decline in recent years. However, due to the low level of implementation of public expenditure programmes, the budget deficit has remained manageable.

Although the budget deficit has been projected at 4.6 percent of the GDP, the net foreign financing of that would be around 40 percent. On the other hand, hardly any revenue surplus will be available to underwrite the Annual Development Plan (ADP).

The budget for FY25 has not been very ambitious in this regard as the revenue-GDP target has been set at a modest 9.7 percent.

The third fault line of the mid-term development trajectory emerged due to the marginal public investment in the health sector (less than 1 percent of the GDP), education sector (less than 2 per cent of the GDP), and social protection (less than 1 percent of the GDP).

Sadly, the budget for FY25 also fails to find additional resources for these sectors. This has happened due to overly physical infrastructure-driven public investment. This has been done in the pursuit of visible indicators of progress.

Unfortunately, the ADP allocations for FY25 does not indicate any rethink in this regard.

The fourth and final fault line in the ongoing national development efforts relates to growing inequality in the country. Increasing inequality is manifested in asset accumulation, income flow, and consumption of food and non-food goods and services.

The budget for FY25 does make a number of promises to ease the situation in the face of soaring inflation. These include tariff rationalisation for a set of consumables, increasing the number of social protection beneficiaries, and distributing food items under government management. But the revenue efforts are focused on indirect taxes affecting across income groups.

It seems all these fault lines are creating structural challenges for macro-economic management as well as implementation of public expenditure programmes.

Regrettably, the budget for FY25 does not make headway in this regard.

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Budget unlikely to make dent in soaring inflation

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stagnated or declined.

But that was hardly reflected in the budget.

Funds equivalent to about 2.43 percent of the GDP were allocated for social safety net schemes for FY25 compared to 2.52 percent in the current year.

Still, the allocated amount increased to Tk 136,026 crore from Tk 126,272 crore.

The government also increased the number of beneficiaries by around 4.5 lakh.

However, the allowance per person remained almost the same, with the sole exception being the programme for widows, which has been boosted from Tk 500 to Tk 550 per month.

And although the allotment rose by around Tk 10,000 crore, more than Tk 9,600 crore of that will have to be spent on pension management.

So, poor and marginalised people will not really benefit from this incremental increase, Razzaque said.

Furthermore, the government has targeted to raise Tk 137,500 crore from the banking sector to meet the budget deficit.

In the budget for the current year, the government had targeted to raise Tk 132,395 crore from the banking sector. However, it revised this to Tk 155,935 crore to meet its budget deficit amid lower revenue.

If the government similarly revises up the amount it borrows from the banking sector in FY25 and the central bank prints money to narrow the deficit, inflationary pressure may be fuelled.

The Consumer Price Index grew by an average of 9.73 percent in the first 11 months of the current fiscal while it was 8.64 percent during the same period a year prior, showed data of the Bangladesh Bureau of Statistics.

In fiscal 2022-23, the average inflation rate was 9.02 percent, far higher than the average of 6 percent in recent years.

Such elevated levels of inflation have forced many people to cut down on consumption.

The World Bank has projected that the decline in purchasing power has led to the inclusion of many among the new poor.

This means the country may witness challenges in reducing the poverty rate despite its previously stellar performance in this regard.

So, economists urged the government to cut spending and make effective the contractionary monetary policy, which was announced recently.

Some good news is that the government cut the source tax for rice, wheat, potato, onion, garlic, lentils, ginger, turmeric, dry chilli, pulses, flour and some other food items from 2 percent to 1 percent.

That should create the opportunity to reduce the prices of these products. However, whether the benefit will reach the consumers will depend on suppliers and producers that control the prices of these products.