

Bangladesh Economic Update

Growth, Tax, Inflation and Consumers

July, 2010



উন্নয়ন অন্বেষণ
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Growth, Tax, Inflation and Consumers

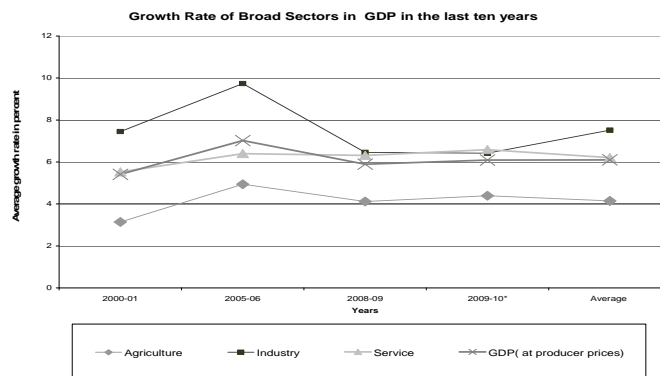
The current update investigates the nature of the growth and tax and subsidy policies relating to real sectors such as agriculture and industry, in the backdrop of the passage of the National Budget for the financial year 2010-2011. This is important as the current government aspires to secure 8 per cent growth rate by 2013. An analysis on the nature of growth is warranted since the jump for growth from 4 per cent to 6 per cent required almost two decades, while the current government wants to achieve another two percent spike within the span of five years.

The update also provides an analysis on the price movements in view of the forthcoming month of Ramadan. In this scrutiny, efforts are made to build scenarios on the pressures of prices, based upon data of five years. This also leads to have understanding on the future inflationary pressure, a challenge the country currently facing.

1. Nature of growth and implications on consumers

Bangladesh achieved an average gross domestic product (GDP) growth of 5.84 percent at constant price in the last decade. The average growth rate of GDP in the 80's and 90's was close to 3.7 per cent while in the present decade, it achieved a growth of 6.11 percent. However, growth rate in real sectors - industrial and agricultural - shows that both sectors have achieved a growth rate of 4.94 and 9.74per cent in FY2005-06, and later it followed a declining trend. Despite such declining trend of the real sectors, the GDP maintained an average growth close to six percent from 2006 including this fiscal year. Hence, a question arises and that is “what is the source of this growth?”

Figure1 – GDP growth rate of major sectors



Despite such declining trend of the real sectors, the GDP maintained an average growth close to six percent from 2006 including this fiscal year. Hence, a question arises and that is “what is the source of this growth?”

Source: Bangladesh Bureau of Statistics and Finance division. *MTMF projection

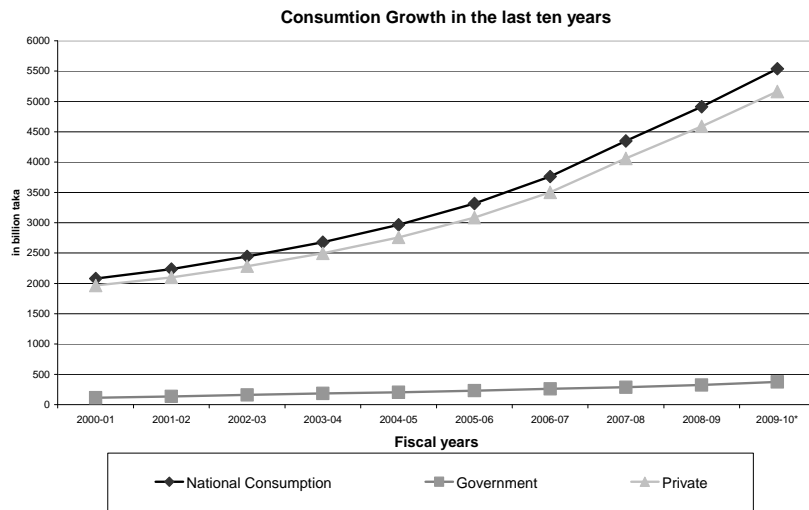
Industrial and agricultural growth rate suddenly declined while GDP is growing at a constant pace (Figure 1). Thus, the future sustainability of this growth becomes questionable and the future target of achieving 8 per cent GDP growth requires a thorough investigation.

The GDP at producer's price achieved a growth rate from 5.41 per cent to 7.02 per cent in the year 2005-06 but started to decline to 6 per cent on an average until now because industry and agriculture have not been able to support it. The Medium Term Monetary Framework of the government in the last fiscal year has projected a growth rate of 4.39 percent in agricultural sector and 6.42 per cent in the industrial sector. This might not be achieved due to shocks including flooding, power crisis.

1.1 – Share of consumption in the last decade

The reason behind this distinct state of growth lies in the consumption behavior of the economy. For the last twelve years, on an average, 80 per cent share of the GDP came from the consumption. On an average, the growth rate of consumption was 9.29 per cent from 2000-01 to 2005-06, it had a rapid increase of 47.44 per cent and the growth rate at present is 13.70 per cent. Thus, growth in consumption is fueling the growth in GDP.

Figure 2 – Consumption growth in the last 10 years



The reason behind this distinct state of growth lies in the consumption behavior of the economy.

The private consumption on an average had a growth rate of 10.92 percent, whereas the government consumption increased by 20 percent at a growth of 13.26 percent.

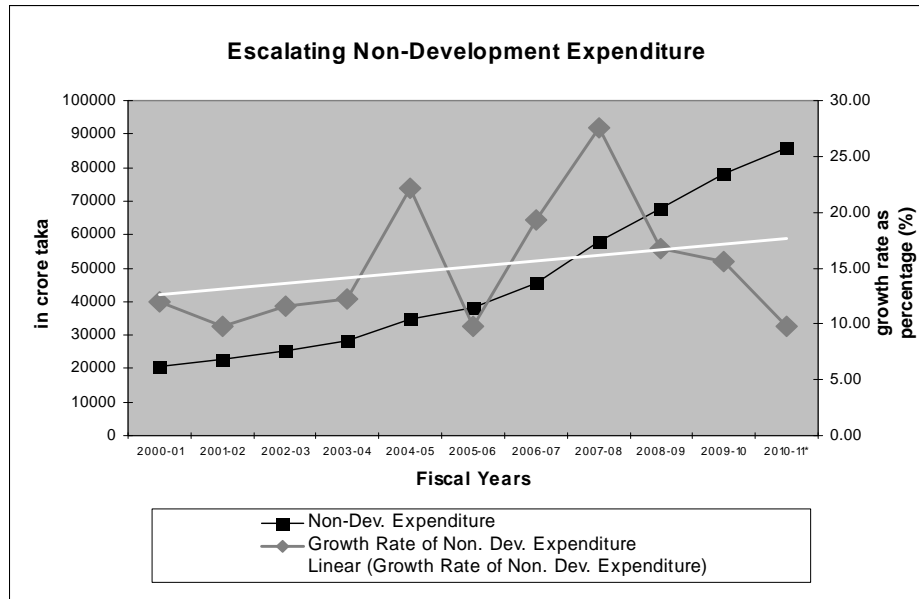
Source: Bangladesh Bureau of Statistics and Finance division. *MTMF projection

The private consumption on an average had a growth rate of 10.92 percent, whereas the government consumption increased by 20 percent at a growth of 13.26 percent (Figure – 2). As 80 percent of the GDP is spent on consumption, the savings situation is compressed and the resources for further growth are lagging behind. Thus, the economy is sacrificing the future consumption for the sake of present consumption and the opportunity cost of increasing the future growth is escalating.

1.2 – Consumption stimulated by the expansion of pay and allowances

The increased government consumption is the effect of its decision of giving enhanced pay and allowances. However, this policy to stimulate the economy by increasing expenditure has other counter effects, which will be described later. The increased government expenditure thus expanded the growth of non-development expenditure, which has experienced an average growth rate of 15.13 per cent in the present decade.

Figure 3 – The non-development expenditure during the last 10 years



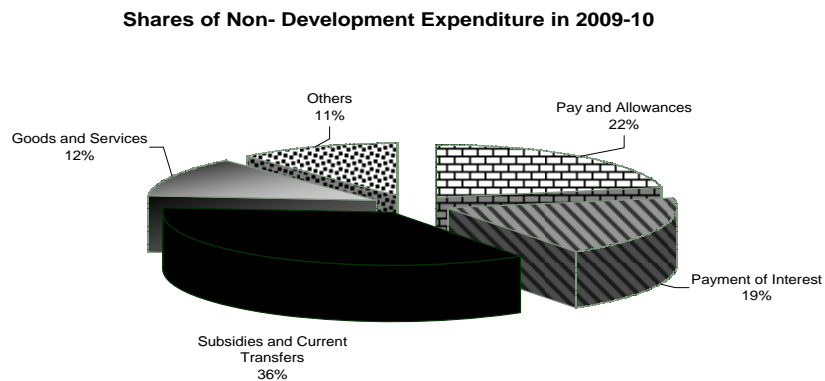
Source: Author's calculation based on Bangladesh Economic Review 2010.

The increased government expenditure thus expanded the growth of non-development expenditure, which has experienced an average growth rate of 15.13 per cent in the present decade.

The volume of non-development expenditure is ever increasing (Figure 3). The growth rate has some fluctuations but on an average, it follows an increase of Tk. 50 lakh 30 thousand per fiscal year.

The reasons behind the augmented non-development expenditure can be divided into spending structure of three major components. These are: 1) subsidy and current transfer, 2) pay and allowances and 3) payment of Interest.

Figure 4 – Major shares of non-development expenditure



Source – Ministry of Finance

The growth rate has some fluctuations but on an average, it follows an increase of Tk. 50 lakh 30 thousand per fiscal year.

With an average growth of 12.42 per cent for the last ten years, these spending for the employees have paved the way for GDP growth whereas firms have produced consumption goods and services to meet the demand.

On an average, during the last ten years, the growth rate of pay and allowance is 12.56 per cent close to the growth rate of total revenue generation, which is 14.25 per cent.

The increasing growth rate of pay and allowances have an influence over inflation

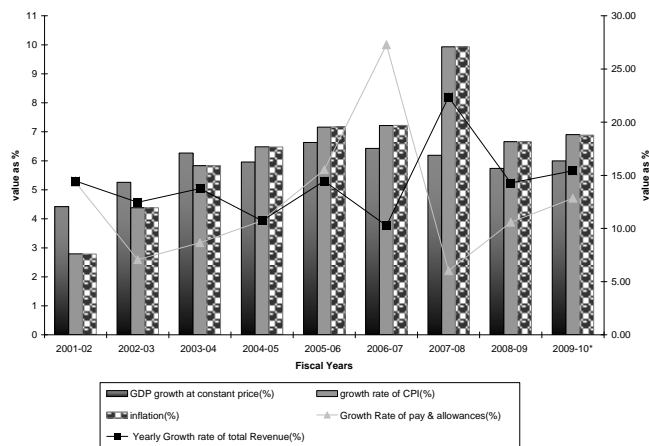
This situation indicates that growth rate of pay and allowances creates expectations among the producers that in the next year there will be more disposable income available to the consumers and thus they raise the average prices of their goods.

Last year, a total amount of Tk. 17,047 crore was spent on the purpose of pay and allowances, which is almost 22 per cent of the non-development expenditure. However, subsidies and cash transfer has the largest portion about 36 per cent of the non-development expenditure but 13.47 per cent of it consists of pensions and gratuities (Figure 4). Thus, a significant portion of the government's revenue earning is spent on the payment purposes of its employees.

With an average growth of 12.42 per cent for the last ten years, these spending for the employees have paved the way for GDP growth whereas firms have produced consumption goods and services to meet the demand.

The growth of revenue generation and the growth of pay and allowances are moving side by side and thus influencing the consumption growth and anticipated inflation (Figure 5).

Figure 5 – Impact of growth of revenue and pay-allowances on cost of living



Source: Bangladesh Economic Review 2010, (* means provisional)

On an average, during the last ten years, the growth rate of pay and allowance is 12.56 per cent close to the growth rate of total revenue generation, which is 14.25 per cent. This indicates that government's expansion in maintenance expenditure is closely following its revenue generation process, thus support for development programmes are clutching. This phenomenon is reflected in the budgetary allocation as the share of the annual development programme (ADP) in total budget is squeezing.

The increasing growth rate of pay and allowances have an influence over inflation (Figure 5). Because if the growth rate of pay and allowances is high, there will be an average increase in consumer price index (CPI). For instance, inflation rate in FY2005-06 and FY2006-07 were closer to 7 per cent. But as in FY2006-07, the growth rate of pay and allowances increased to 27.28 per cent from the five years average of 11.26 per cent. In the next fiscal year, both the inflation and CPI growth rate were closer to 10 per cent. This situation indicates that growth rate of pay and allowances creates expectations among the producers that in the next year there will be more disposable income available to the consumers and thus they raise the average prices of their goods. Therefore, the consumers face the same standard of living at a higher cost because of expectation-based inflation.

1.3 – Continuous increment of consumption tax

As stated earlier, the government is following the expansionary fiscal policy as a tool of its growth by stimulating the aggregate expenditure and demand. One of the implications of this policy is that the consumers will be better off but the situation is opposite in this case. Because the government is using the value added tax as vital instrument of revenue generation and thus creating pressure on general people due to this indirect tax. The general consumers' disposable income face further reduction as government's dependency on the value added tax (VAT) as a source of revenue receipts increases.

Table 1 – Shares of Revenue Receipts and its growth:

<i>Fiscal Years</i>	<i>VAT as % of total Revenue</i>	<i>Vat as % of NBR</i>	<i>Growth rate of VAT (%)</i>	<i>Growth Rate of Tax (%)</i>
2001-2002	25.15	74.92	13.50	12.51
2002-2003	25.93	76.32	15.82	13.77
2003-2004	24.22	76.41	6.38	13.43
2004-2005	27.05	77.81	23.67	12.90
2005-2006	27.63	76.79	16.91	13.22
2006-2007	27.66	75.76	10.36	8.49
2007-2008	28.10	75.93	24.34	22.33
2008-2009	29.08	76.61	18.24	10.11
2009-2010	28.55	76.39	13.32	20.97
2010-2011(p)	29.18	78.18	18.85	18.90

Source: Authors' calculation based on Bangladesh Economic Review, 2010. (P for provisional)

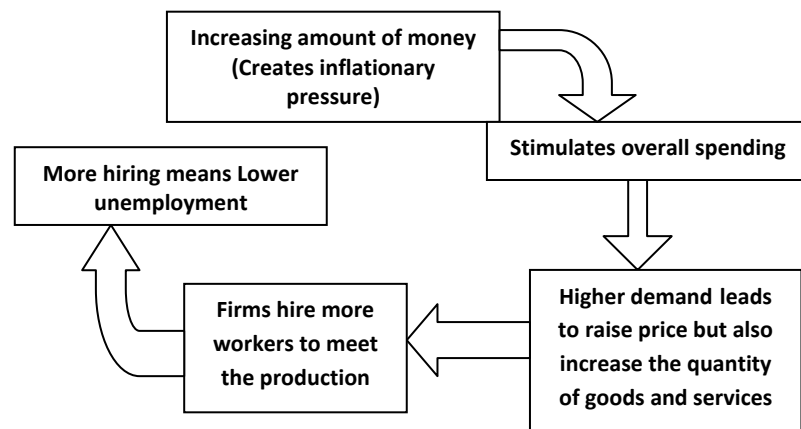
The growth rate of VAT has a rapid pace than all the other types of taxes and the growth rate of tax can be interpreted as the growth rate of VAT (Table - 1). The collection of VAT alone has a share of 29.18 per cent of the total revenue receipts in the current fiscal year. Thus the lower middle class and the poor consumers face the burden of indirect tax on them along with inflationary pressure.

The government to prop up the growth in GDP is escalating its expenditure while the consumers of lower income strata, including the poor face the burden of most of taxation along with inflationary pressure.

1.4 – Consequences of government policies on employment

The goal of expansionary fiscal policy is to close a recessionary gap, stimulate the economy, and decrease the unemployment rate. The government has been trying to exploit the short-run trade-off between inflation and unemployment by changing the amount of government spending and increasing the amount of money printing. Accordingly, the following flow chart should be the outcome of these policies:

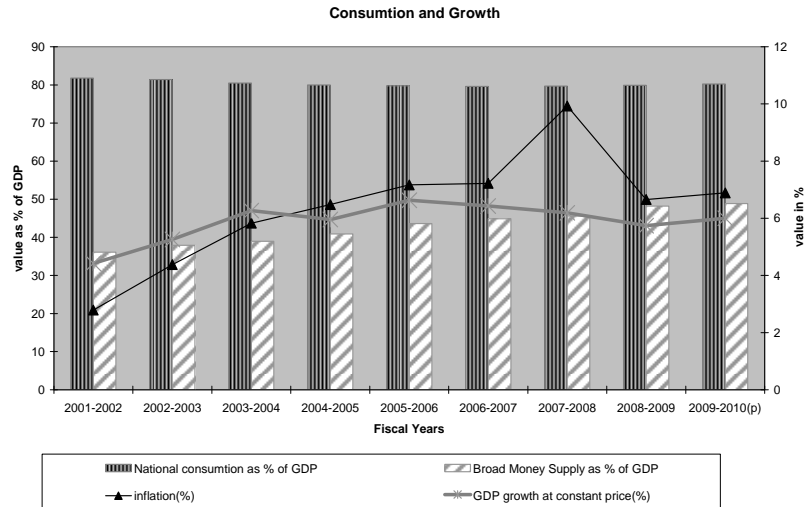
Flow chart 1 - Short Run Trade-Off between Inflation and Unemployment



The government is following the expansionary fiscal policy as a tool of its growth by stimulating the aggregate expenditure and demand. One of the implications of this policy is that the consumers will be better off but the situation is opposite in this case.

The effect of these policies shows that both the national consumption and broad money supply are increasing and thus inflationary pressure is following the same trend as an effect of their consequences (Figure 6).

Figure 6 – Government policy effect on boosting consumption



Source: Bangladesh economic Review 2010. (p for provisional)

The effect of these policies shows that both the national consumption and broad money supply are increasing and thus inflationary pressure is following the same trend as an effect of their consequences.

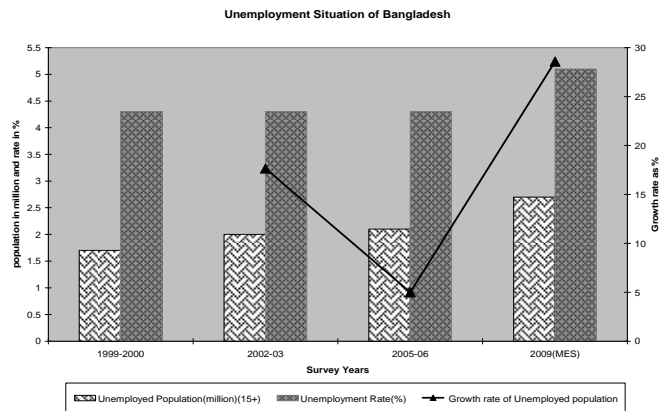
The increasing total consumption and the increment of broad money supply both are stimulating the GDP growth rate but inflation as the side-effect of it. So the general people are facing the burden of commodity price hike. Though the national consumption is contributing in the growth of GDP, but it is leaving an opposing effect on the consumers. So, broad money supply is playing its role as to increase the inflation through monetary phenomena.

Both the expansionary fiscal and monetary policy have achieved a target of maintaining level of economic growth but seriously failed to address another important problem. The problem is rise in unemployment. The supposed expansionary policy has not reduced unemployment.

The unemployed population has increased at a rate of 28.57 percent in the year 2009 according to the data of Monitoring of Employment Survey of the BBS than the previous labour force survey of 2005-06. Thus, the enlarged government spending and broad money supply have not been able to address one of the most important problems of the economy, the reduction in unemployment.

The increasing total consumption and the increment of broad money supply both are stimulating the GDP growth rate but inflation as the side-effect of it.

Figure 7 – Unemployment situation in Bangladesh

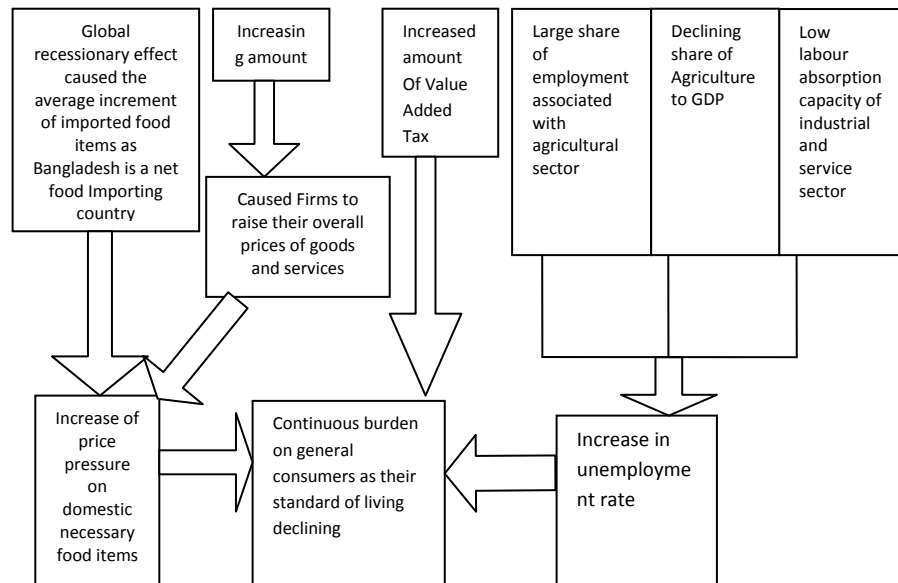


Source – Authors’ calculation based on Bangladesh Bureau of Statistics (BBS), Labour Force Survey 2005-06, Monitoring on Employment Survey 2009

1.5 – Impact on the consumers

This chart shows that as the consequences of government’s actions the consumers face three burdens. These are: value added tax, inflationary pressure and increased unemployment. These are lowering their standard of living and in some ways fueling poverty.

Flow Chart 2 – Implications for current policy regimes on the consumers



The economy of Bangladesh is now at a muddled policy environment, where the growth generated from consumption is unstable as the real sectors are failing to support it and the consumers are at stake because of its consequences.

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Revenue, subsidy and real sectors

2.1 – Trend of tax collection

For the FY2010-2011, the target of revenue collection is set Tk. 92,847 crore, in which NBR tax collection target is Tk. 72,590 crore, non-NBR tax collection target is Tk. 3,452 crore and non-tax revenue is targeted to Tk. 16,805 crore. This broad range of tax collection is 14 per cent higher than the previous fiscal year's target. If the government is able to gain the targeted amount of tax, this will definitely increase revenue than the previous fiscal year.

This also indicates that the general people have to pay Tk. 13,636 crore more tax for the next fiscal year. The finance minister has declared not only the increase in tax net but also increase in the rate of tax in some sectors.

The general people have to pay Tk. 13,636 crore more tax for the next fiscal year.

The VAT collection has always been higher than the contribution of the income tax

The growth rate of income tax is 19.52 per cent whereas the growth rate VAT is 25.69 per cent.

The over all trend shows that the tax structure of Bangladesh is a regressive one since the taxation system is largely dependent on indirect taxes such as VAT.

Table 2 – Income tax and VAT as percentage of total revenue:

<i>Fiscal Years</i>	<i>Total Revenue (in crore Tk.)</i>	<i>Income Tax (in crore Tk.)</i>	<i>% of total revenue</i>	<i>VAT (in crore Tk.)</i>	<i>% of total revenue</i>
<i>2001-2002</i>	27670	4100	14.82	6960	25.15
<i>2002-2003</i>	31120	4788	15.38	8071	25.93
<i>2003-2004</i>	35400	5270	14.89	8575	24.22
<i>2004-2005</i>	39200	5850	14.92	10605	27.05
<i>2005-2006</i>	44868	6960	15.51	12398	27.63
<i>2006-2007</i>	49472	8924	18.04	13683	27.66
<i>2007-2008</i>	60539	11005	18.18	17013	28.10
<i>2008-2009</i>	69183	13538	19.57	20116	29.08
<i>2009-2010</i>	79848	16560	20.74	22795	28.55
<i>2010-2011(p)</i>	92847	21005	22.62	27092	29.18

Source: Bangladesh Economic Review 2010

The VAT collection has always been higher than the contribution of the income tax (Table 2). But this trend has increased from FY2004-05. The growth rate of income tax is 19.52 per cent whereas the growth rate VAT is 25.69 per cent.

The over all trend shows that the tax structure of Bangladesh is a regressive one since the taxation system is largely dependent on indirect taxes such as VAT.

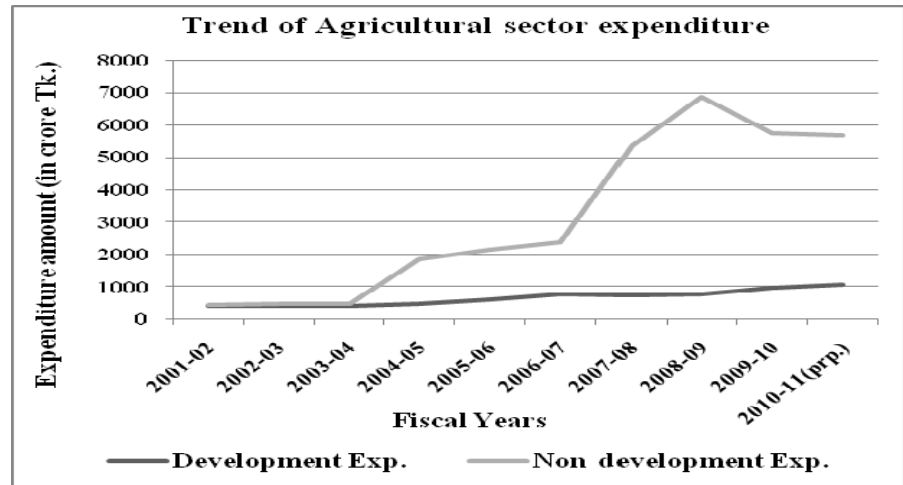
There is also a structural problem in tax collection. The tax net is not expanding. The source and the amount of tax collected every year remains almost the same. The government is also not having any specific information on how many people are there with high income. As the government has not been able to establish effective monitoring or information system, there is a tendency of tax evasion.

On the other side, the government has declared to increase 5 lakh TIN holders. That is, total 22 lakh TIN number holders will be increased to 27 lakh. But, only about 6 lakh TIN holders pay regular taxes.

2.2 – Subsidy in Agriculture

In FY2009-10, the government allocated Tk. 5965 crore for agriculture sector, of which Tk. 5076 crore was earmarked for the non-development sector which is 85 per cent of the total budget the Ministry. Similarly, 56 per cent was allocated for non-development sector for the Ministry of Fisheries and Livestock and 69 per cent for the Ministry of Forest.

Figure 8 – Agriculture sector expenditure



Source: Bangladesh Economic Review 2010

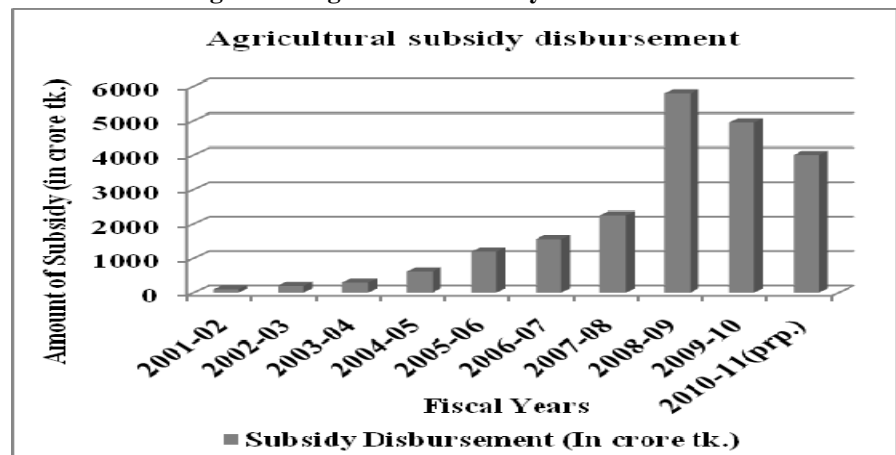
Similar trend is also found in the budget of FY 2010-2011. The allocation for the non-development sector is Tk. 5684 crore which is 84.35 per cent for Agriculture Ministry and 56 per cent for Ministry of Fishery and Animal Resources (Figure 8).

The subsidy in the agricultural sector has declined by 20 per cent compared to the budget of FY2009-2010 (Figure 9). In FY 2009-10, the total allocation for agricultural subsidy was Tk. 4950 crore while the current budget of FY2010-11 proposes Tk. 4000 crore. This indicates that decline in the subsidy of agriculture sector may hamper the development of this sector.

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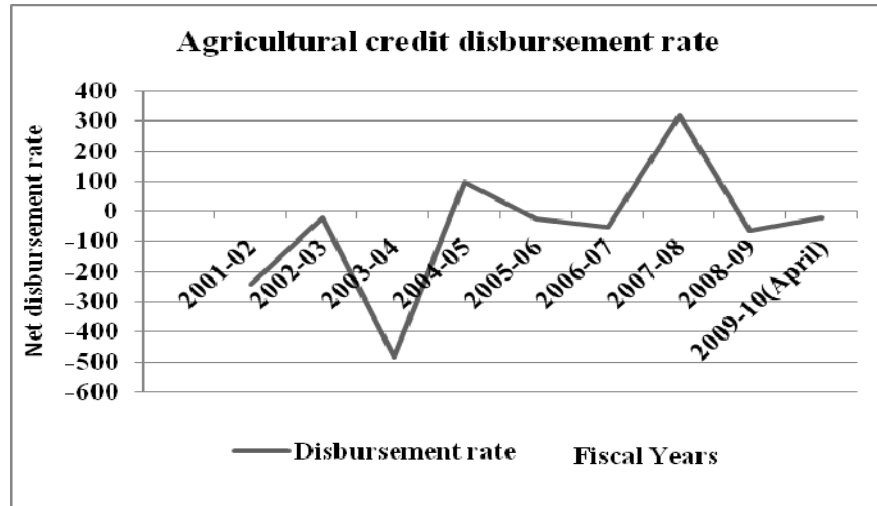
Figure 9 – Agricultural subsidy disbursement



Source: Bangladesh Economic Review 2010

The disbursement of agricultural credit is also a key factor for the development of this sector. But the disbursement of agricultural credit shows a high fluctuation (Figure 10).

Figure 10 – Agricultural credit disbursement rate



Source: Bangladesh Economic Review 2010

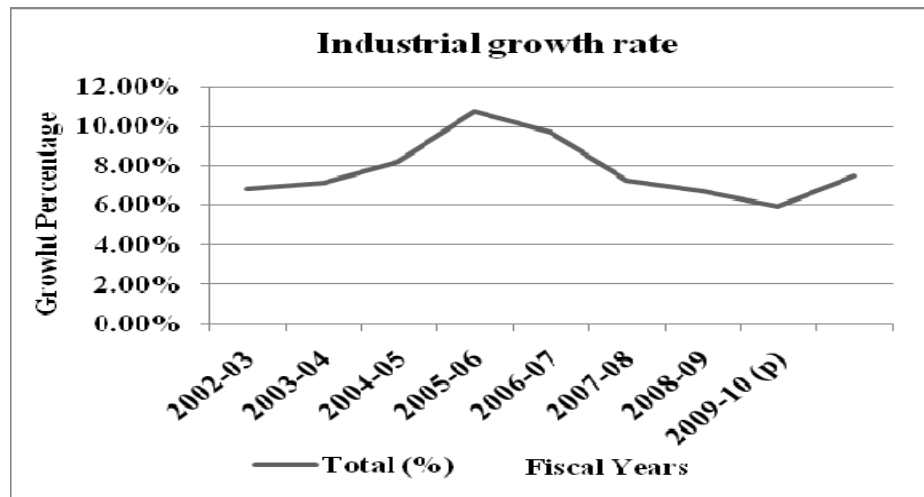
In previous FY2009-10, the allocation of budget for irrigation expansion was Tk. 427 crore. But in this FY2010-11, the allocation is made at a reduced amount of Tk. 300 crore which is 30.65 per cent lower compared to the previous year. As the government has reduced the budget allocation for the irrigation facility, this may hamper the crop production also.

2.3 – Condition of the industrial sector:

The growth of industrial sector has faced a serious decline of 45 per cent from the peak of FY2005-06 till now. But the growth rate of this sector is decreasing day by day (Figure 11).

Figure 11 – Industrial growth rate

Source: Bangladesh Economic Review 2010, MTBF 2010-11

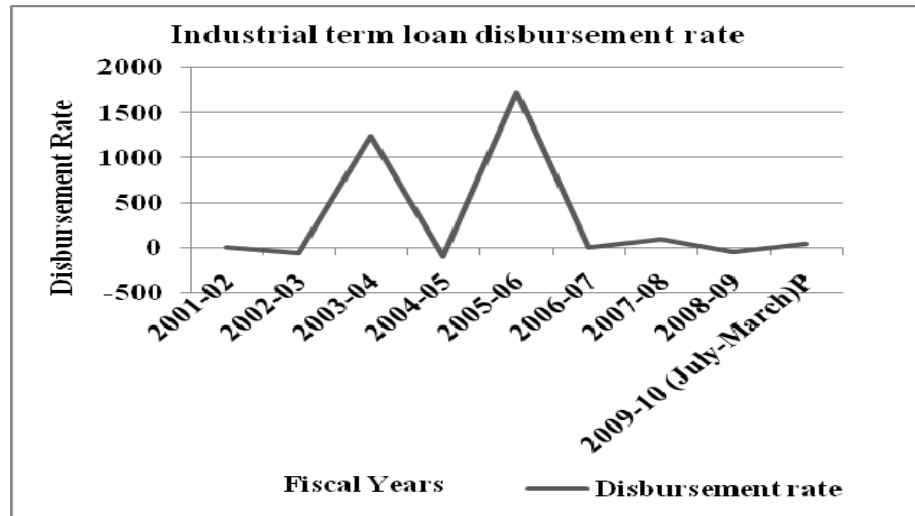


(p) – Provisional and (pr.) – Projected

The allocation of budget for irrigation expansion is made at a reduced amount of Tk. 300 crore which is 30.65 per cent lower compared to the previous year.

Besides, the growth of industrial sector also depends on the availability of industrial term loan. But in Bangladesh, the term loan disbursement rate has witnessed fluctuations, indicating the hamper of growth of the industrial sector (Figure 12).

Figure 12– Industrial term loan disbursement rate



Source: Bangladesh Economic Review 2010

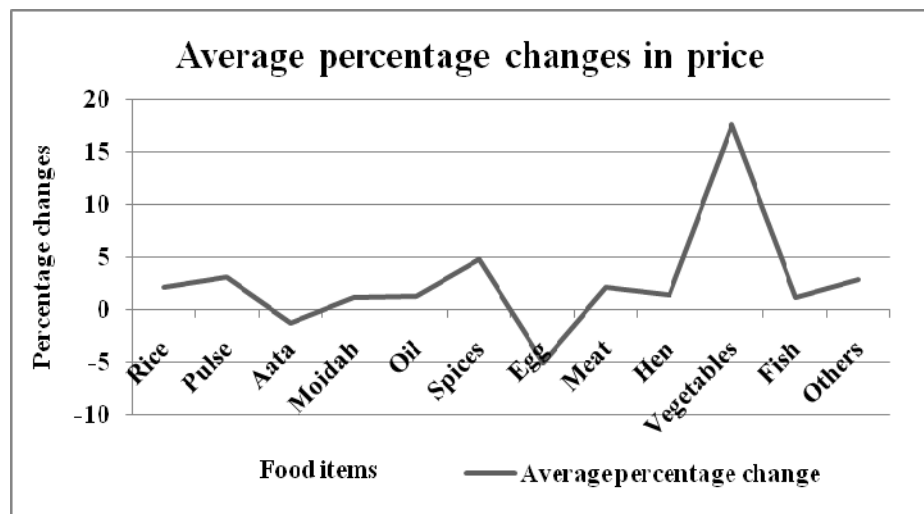
The government has declined import duty on all kinds of imported capital machineries and textile machineries. At the same time, the duty rate on all kinds of industrial raw-materials has been declined. These initiatives may help flourish the industrial sector.

Price Movement and Inflation

3.1 – Changes in commodity prices: pre and during Ramadan

Food inflation is a major concern. In the context of Bangladesh, the food price fluctuation before and during Ramadan period is observed phenomena.

Figure 13 – Average percentage change in price



Source: Author's calculation based on CAB Data sheet

[Note: For the analysis, the data of Consumer Association of Bangladesh (CAB) is analyzed as average percentage change over the last five years for the months before and during Ramadan]

The term loan disbursement rate has witnessed fluctuations, indicating the hamper of growth of the industrial sector.

In terms of non- coarse rice (Najir-shail), the average increase during the Ramadan period is 5.36 per cent. The coarse rice (BR-11 and BR-8) on an average increased by 1.36 during the months of Ramdan in the last five years. In case of pulse consumption, the price is seen to be higher for all categories. The price of Beef (2.48) increases more than that of mutton (1.76). On an average, price of both domestic (1.02) and farm (1.82) hens have increased by 1.43 per cent. On an average vegetables have increased by 17.2 per cent.

3.2 – Scenario of food inflation: Before Ramadan vs During Ramadan-

The food inflation (Monthly point-to-point basis) on average has increased during Ramadan period. The average percentage change of food inflation before and during Ramadan period is 15.09 for the last four years (Table – 4).

Table 4 – Percentage changes of food inflation

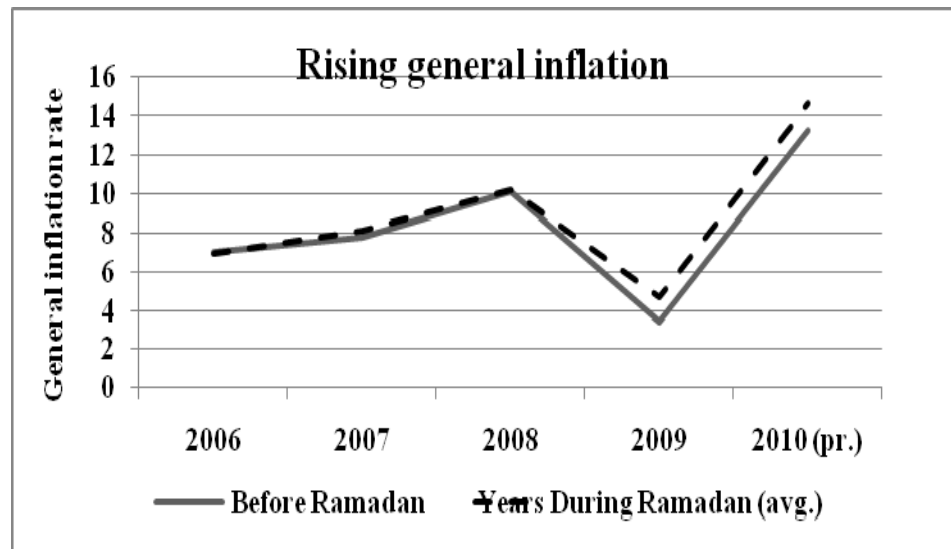
Years	Before Ramadan	During Ramadan (Avg.)	Percentage Change
2006	7.42	8.625	16.23
2007	11.62	11.42	-1.72
2008	12.36	12.07	-2.34
2009	3.34	4.95	48.2
<i>Average</i>			15.0925
2010 (pr.)	16	18.54	

Source: Bangladesh Bank.

Following the trend of the last four years in terms of food inflation, it might be projected that the food inflation in the coming Ramadan could be 18.54 per cent (Figure 14).

Considering the projected food inflation situation during the period of the Ramadan, the general level of inflation on monthly point to point basis might be 14.6.

Figure 14 – Rising general inflation



Source: Author's calculation based on Bangladesh Bank data

Following the trend of the last four years in terms of food inflation, it might be projected that the food inflation in the coming Ramadan could be 18.54 per cent.

Selected macro-economic indicators

	29 June '09		30 June '09		31 May '10		29 June '10		
Foreign exchange reserve (in million US\$)	7419.10		7470.96		10146.24		10752.82		
	29 June '09		30 June '09		31 May '10		29 June '10		
Taka-Dollar Exchange Rate (Average)	69.0600		69.0600		69.3212		69.4410		
	29 June '09		30 June '09		31 May '10		29 June '10		
Call money rate	1.11		1.00		4.70		3.28		
Weighted Average	1.11		1.00		4.70		3.28		
	May '09		July-May,08-09		May '10 _p		July-May,09-10 _R		FY 08-09
Wage earners Remittance (in million US\$)	895.30		8770.16		885.12		10077.32		9689.26
Annual percentage change	22.60		22.47		-1.14		14.90		22.42
	May '09		July-May,08-09		May '10 _p		July-May,09-10 _p		FY 08-09
Import (million US\$)	1739.20		20968.80		2119.70		21530.90		22507.00
Annual Percentage change	-18.80		18.83		21.88		2.68		4.06
	April '09		July-April,08-09		April '10 _p		July-April,09-10 _p		FY 08-09
Export (EPB) (million US\$)	1176.29		12816.11		1400.13		12940.05		15565.19
Annual Percentage change	-2.30		12.62		19.03		0.97		10.31
	May '09		July-May,08-09		May '10 _p		July-May,09-10 _p		FY 08-09
Tax Revenue (NBR) (in crore tk.)	4705.20		44706.04		5746.93		52656.23		52519.77
Annual Percentage change	13.15		26.06		22.14		17.78		10.72
Rate of inflation on the basis of CPI for National (Base-1995-96 = 100)	Dec. '07	June '08	Dec. '08	Mar '09	June '09	Sept. '09	Dec.'09	Feb '10	Mar '10
12 month average basis	9.11	9.94	8.90	7.69	6.66	5.15	5.42	5.95	6.26
Point-to-Point basis	11.59	10.04	6.03	5.04	2.25	4.60	8.51	9.06	8.78
Corresponding period	Dec '05	Dec '06	June '07	Mar. '08	June '08	Sept. '08	Dec.'08	Feb.'09	Mar. '09
12 month average basis	7.04	6.77	7.20	10.00	9.94	10.06	8.90	8.10	7.69
Point-to-Point basis	7.07	6.13	9.20	10.06	10.04	10.19	6.03	5.81	5.04
Agricultural Credit (in crore tk.)	April '09	May '09	July-May, 08-09		April '10	May '10	July-May '09-'10		FY '08-09
Disbursement*	822.09	621.01	8350.10		789.74	939.65	9888.97		9284.46
Recovery	615.51	773.59	7442.01		802.42	815.44	9041.67		8377.62
Industrial term loan (in crore tk.)	Oct.-Dec., '08-'09		Jan.-Mar, '08-'09	July-Mar, '08-'09	Oct.-Dec., '09-'10	Jan.-Mar '09-'10 _p	July-Mar. '09-'10 _p	FY '07-'08	FY '08-'09 _p
Disbursement	3989.58		4233.71	13174.22	7211.44	6212.86	18827.53	20150.82	19972.69
Recovery	3985.22		4188.32	11232.27	4782.06	4650.99	13205.40	13624.20	16302.48
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	
GDP growth rate (in per cent)	5.26	6.27	5.96	6.63	6.43	6.19	5.88	6.00	

Source: Unnayan Onneshan database based on Bangladesh Bank data.

Note: * = About 82% of the target for agricultural credit disbursement has been already achieved in the first 11 months of the current FY. R = Revised, P = Provisional