8-PAGE, 4-COLOUR WORLD CUP SPECIAL EVERY DAY

The Daily Star

THIRD EDITION

TODAY'S ISSUE 28 PAGES

COMMITTED TO People's Right to Know

VOL XVI NO. 159 DHAKA SUNDAY JUNE 25, 2006

www.thedailystar.net

Manufacturing sector in this year's budget

The Finance Minister pronounced that the key objective of this budget is poverty reduction. Poverty reduction is only possible by the development of the manufacturing sector which is the basis of sustainable economic development.

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THE manufacturing sector is the base for the sustainable economic development of a nation. The contribution of the manufacturing sector to the GDP of Bangladesh was 17% in FY 2005-06. Out of fifteen sectors identified for computing national income, the contribution of the manufacturing sector is the highest. In FY 2005-06, the growth rate in the manufacturing sector is estimated to be 10.45%, which was 8.53% in the previous financial year. This trend in growth has accelerated the pace of economic development and made significant contribution towards achieving 6.7% GDP growth of FY 2005-06. In absolute figure the contribution of manufacturing sector to the GDP of FY 2006-07 would be 79,046 crore. The manufacturing sector has also been the highest job provider in recent years. Being the engine of economic development, the manufacturing sector deserves fiscal, monetary and infrastructure policies support of the Government.

The Finance Minister has proposed Tk. 69,740 crore budgets for FY2006-07. The size of the development budget is Tk. 26,000 crore out of which the following have been allocated for manufacturing sector:

- Tk.100 crore as refinancing scheme for Small and Medium Enterprises (SME) through Bangladesh Bank. World Bank and Asian Development Bank will also contribute Tk. 280 crore to the scheme.
- Tk.100 crore to equity development fund for the development of agro-product processing and software industries.
- Tk 100 crore for agro-based industries assistance programme.
- Tk. 20 crore to create skill development fund for the readymade garments workers.

Thus, the total allocation, including the contribution of World Bank and Asian Development Bank, for the manufacturing sector in FY 2006-07 stands at Tk. 600 crore which is only 2.30% of the proposed development budget. This 2.30 % allocation for the manufacturing sector in context of its 17% contribution to GDP is very negligible.

The manufacturing sector is a capital-intensive sector. Investment comes largely from domestic savings. Over the last two decades, commensurate with GDP growth, domestic savings marked substantial improvement. Sponsor, security market, bank and financial institutions are the prime source of capital for the manufacturing sector. An investor assesses the risk and returns of available avenues and decides on the best option.

Investment in the manufacturing sector is riskier than in any other sector. Generally, investor add risk premium to the rate of interest on long term government securities in arriving at expected rate of return for the assessment of the viability of investment in manufacturing sector. Accordingly, the cost of capital of a manufacturer also varies with the change in the rate of interest on government securities. Further, investment in savings certificates gives more fiscal benefits than the investment in manufacturing sector.

Marking a 16.87% increase, during the period from July to April 2006, the net official borrowing through sales of savings certificates reached to Tk.25,520 crore. During the period the investors encashed savings certificates worth Tk.89,860 crore against total sales of Tk.115,380 crore. Thus, overall sale of savings instruments of the period was 35% higher than the corresponding period of the previous year. The Government raised the rate of interest on different types of savings instruments by 1.5% at the beginning of 2006. The increase in Government borrowing through savings instruments coupled with interest rate acceleration has made credit for the manufacturing sector costlier. This will also hinder the capital inflow of the manufacturing sector from security market. The budgeted borrowing for FY 2006-07 was fixed conservatively at the current level. However, its impact upon the investment in manufacturing sector will remain negative unless the rate of interest on savings instruments is reduced.

Bank borrowing is the key source of finance for the manufacturing sector. The scope for borrowing, as well as cost of finance, is significantly influenced by Government borrowing. For FY 2005-06 the budgeted borrowing from the banking system was Tk. 3,446 crore. Superseding the budget by 46.17%, the Government revised the budget to Tk. 5,037 crore. This indicates that the borrowing from the banking system has gone out of the control of the Government. For FY2006-07 borrowing from the banking system remains unchanged. If the estimates and control are as weak as they were in FY2005-06, it will make bank borrowing very difficult for the manufacturing sector. The borrowing by Bangladesh Petroleum Corporation may create further stress upon the credit flow to manufacturing sector.

Deficit budget and bank borrowing are common practice in world economy. What is needed, is to keep the bank borrowing within a tolerable limit. Private sector credit flow has declined substantially in the second half of current fiscal year largely because of excessive borrowing by the Government from the banking system. Immediate measures are essential to correct the situation.

Power is an essential element for the manufacturing sector. For FY 2006-07, the Government has allocated Tk.100 crore for power rehabilitation programme, Tk.3,586 crore for the improvement of power generation, transmission and distribution and Tk. 100 crore for energy development fund to promote use of solar power and other renewable sources of energy. The manufacturing sector suffered huge production loss due to the power crisis this year. The budget allocation seems inadequate to bridge the shortage of power.

The Government has planed for the bifurcation of Chittagong customs house into two, one for import and other for export. This administrative reform would expedite the customs clearance procedure and be helpful to the manufacturing sector.

The Government has proposed the reduction of the rate of duty from 6% to 5%. This rate is applicable to imported basic raw material and machinery. The reduction will bring marginal improvement in the price of locally manufactured products. A further reduction in duty, coupled with the withdrawal of infrastructure development surcharge from basic raw material, could ensure meaningful support to the manufacturing sector. The rate of duty leviable on intermediate material was also ear marked for reduction from 13% to 12%. This would have mixed effect upon the manufacturing sector. This will dent the competitiveness of intermediate material manufacturer on the one hand and favour the consumer of such material on the other. The situation could be rectified by micro level review.

The Government has proposed reduction of supplementary duty from 35% and 25% to 20% and 15%. This reduction would be a blow to the local manufacturer of relevant items. Generally supplementary duty is applicable to luxury items and socially undesirable items. There is no ground for such reduction that follows the prescription of donor agencies.

The proposal for the withdrawal of import duty and AIT from capital machineries, their accessories and other input for poultry industries and machineries for the manufacturing of poultry feed, reduction in the import duties of certain basic raw material of plastics and melamine industries, enhancement of import duties of some plastic product like stopper, lid, cap etc, reduction of the import duty on diodes, transistors, semi conductor devise and compressors, withdrawal of special rebate facilities from IPS/UPS of a capacity not exceeding 2000 KVA, withdrawal of all duties and taxes from certain spares required by readymade garments, textiles, hosiery, label, terry towel industries and affluent treatment plant, withdrawal of all duties and taxes from synthetic filament tow, one of the basic raw materials of hosiery industry, withdrawal of the conditions for the exemption of duties and taxes on the machinery and spares and imposition of 15% supplementary duty on advertising materials, commercial catalogues etc would be supportive to the manufacturing sector.

The tax structure in the corporate sector remains unchanged. It is common understanding that the effective tax rate on business is much higher as legitimate expenditures are disallowed under the discretionary power given to tax administration.

The Government has proposed continuation of the tax concession to black money if it was invested in the purchase of land, apartment and car, whereas the Finance Act 2005 discontinued the facility for investment of such money in industry. Any scheme for the whitening of black money is immoral, and disappointing to honest taxpayers. However, prioritisation of non- productive sector for such benefit is not good for the manufacturing sector.

Continuation of the benefits for agro processing, jute and textile Industries up-till June 30, 2008 reduced tax rate of 15% for diamond cutting and polishing industries, provision for prompt disposal of tax and VAT cases, expansion of perquisite limit and its re-definition are welcome proposals for the manufacturing sector.

Unlike the trading and service sector, an entrepreneur has to wait for a long time to get returns from a manufacturing venture. Sometimes its takes years together to reach break-even point. The Government has proposed charging a minimum tax of half percent of turnover or Tk.5,000 whichever is higher. The provision is a distortion of the taxation system and will deter the development of the manufacturing sector. Apparently, the proposal is to catch the assesses, who evade tax by showing loss for years together. However, to address the genuine case of an honest manufacturer the proposal needs recasting. There should be a time limit for the continuation of loss.

Tax holiday, investment allowance on the plant and machinery and accelerated depreciation were the three core benefits traditionally offered by the Government to attract investors to the manufacturing sector. The tax holiday benefit was withdrawn from expansion unit by Finance Act 2002, from the backward linkage industry under common sponsor director by Finance Act 2003 and restricted to limited area by Finance Act 2005. Investment allowance and accelerated depreciation allowance for the expansion of tax holiday unit were also discontinued by Finance Act 2005. Thereafter accelerated depreciation is the only benefit left for the manufacturer.

Since depreciation is restricted to the cost of capital item, the benefit of accelerated depreciation is only the time value of deferred tax. This accelerated depreciation is also a substitute for tax holiday. Government has proposed to allow the benefits over a period of three years instead of first year. The proposal for squeezing this last benefit for investment in manufacturing sector is difficult to justify in context of the facilities available in competitive economies.

The Government has proposed some restriction on the overseas travelling of any company executive. Any expenditure by way of overseas travelling exceeding one percent of disclosed turnover shall be disallowed. Further, 50% of more than two overseas tour expenses of a director of a company shall be treated as deemed income. This will create mounting difficulties for the export-oriented manufacturer who needs frequent visit abroad to procure business.

The Finance Minister pronounced that the key objective of this budget is poverty reduction. Poverty reduction is only possible by the development of the manufacturing sector which is the basis of sustainable economic development. In view of the above, further considerations for the manufacturing sector are highly recommended to achieve the said objective.

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