Major Economic Challenges: A Pre-Budget Analysis

Bangladesh Economic Update

April 2015

উন্নয়ন অন্বেষণ
UNNAYAN ONNESHAN

Bangladesh Economic Update
Volume 6, No.04, April 2015

Acknowledgement
Bangladesh Economic Update is a monthly publication of the Economic Policy Unit of Unnayan Onneshan, a multidisciplinary research organisation based in Dhaka, Bangladesh. The report has been prepared by **Ebney Ayaj Rana** . The Update has been copy edited by **Abid Feroz Khan**.

For orders and request, please contact:
UNNAYAN ONNESHAN
16/2, Indira Road, Farmgate Dhaka-1215, Bangladesh
Tell: + (880-2) 58150684, 9110636
Fax: + (880-2) 58155804
E-mail: info@unnayan.org
Web: www.unnayan.org

i. INTRODUCTION

The current issue of Bangladesh Economic Update identifies ten major economic challenges causing shortfall in growth in gross domestic product (GDP) vis-à-vis target, slack private investment, and shortfall in collection of revenue vis-à-vis target.

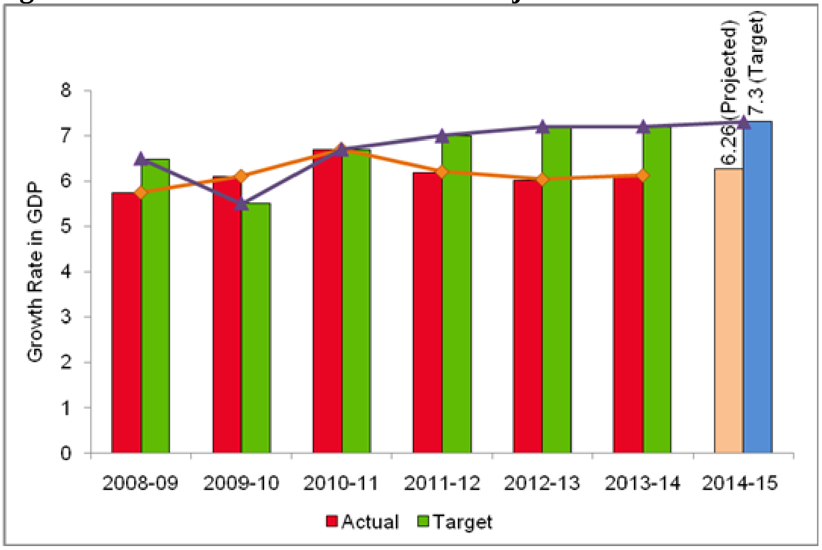
The current issue of Bangladesh Economic Update identifies ten major economic challenges causing shortfall in growth in gross domestic product (GDP) vis-à-vis target, slack private investment, and shortfall in collection of revenue vis-à-vis target. The Update presents a thorough scrutiny of the challenges that the economy has undergone during FY 2014-15 and should take into consideration while declaring the budget for FY2015-16. The Update, however, also presents a critical analysis of the trends of selected economic indicators with respect to three overarching policy issues – expansion of productive capacity, effective provision of social services to the citizens, and sustainable development – that must be taken account of before setting off for the formulation of national budget 2015-16. Finally, the Update attempts to develop an institutional reform measure that specifying the functions and responsibilities of the administrative structure of current fiscal management would confirm the effectiveness of economic management in the country through enhanced capabilities and greater accountability of responsible authorities.

1. GROWTH IN GDP

The target of rate of growth in GDP has been being set over seven percent in recent years, whereas the actual has been sticking to around six percent. The slow rate of growth in GDP can however be ascribed to mainly three issues – stagnant private investment, shortfall in revenue collection and low implementation of ADP along with lack of infrastructural developments.

The GDP is growing at a decelerating rate. In FY 2011-12 the growth rate in GDP was 6.52 percent where it became 6.01 and 6.12 percent in FY 2012-13 and FY 2013-14 implying a decrease by 0.4 percentage point from FY 2011-12 to FY 2013-14. During these periods, the targeted rates of growth, however, were 7 percent, 7.2 percent and 7.3 percent respectively. So the difference between the actual and target is quite clear. Taking the account of the trends of growth from FY 2005-06, the rate of growth is projected to be 6.16 percent and 6.23 percent in FY 2014-15 and 2015-16 respectively.

Figure 1: Actual Growth in GDP and Projection



Source: Ministry of Finance, 2014

Not only in the budget but also in the MTTF for 2015-17, projection of growth rate diverges from real situation. A great mismatch exists between the projection and actual rate of growth by MTMF which has been revised five times during the regime of current government.

Table 1: Projection of MTMF and actual rate of growth

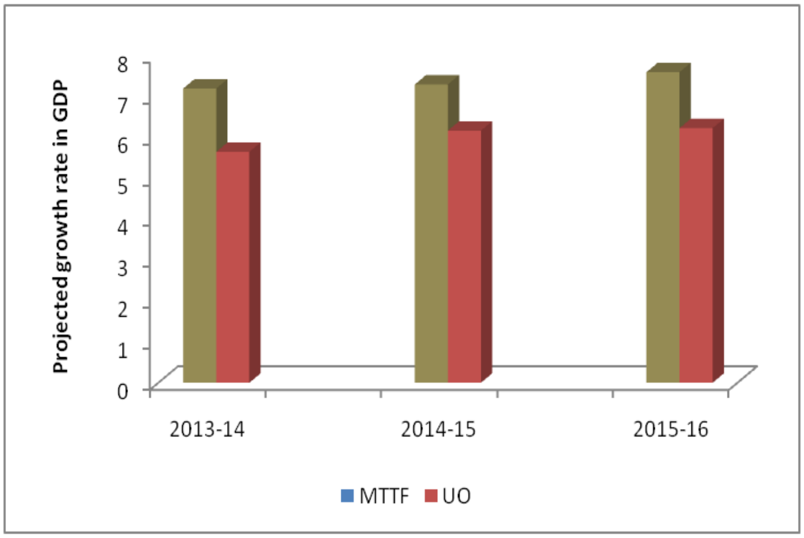
Component	MTMF	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
GDP Growth	MTMF 08-11	6.5	7.0	7.2					
	MTMF 09-12		5.5	6.0	6.5				
	MTMF 12-16			6.7	7.0	7.2	7.6	8	
	MTMF 13-17				7.0	7.2	7.6	8	
	MTMF 15-17					6.0 (Revised)	7.2	8	8.3
Actual Growth in GDP		5.74	6.07	6.71	6.23	6.01	6.12		

Source: Ministry of Finance, 2014

In FY 2013-14, the actual growth in GDP was 6.12 percent against the MTMF target of 7.2 percent. In FY 2012-13 the target was 7.2 percent where the actual growth rate was 6.03 percent implying 1.17 percentage point gap between the actual and the target.

In the sixth fiscal year of the present government (FY 2014-15), the MTMF targeted growth rate in GDP is 7.3 percent (one percentage point higher than the previous fiscal year) and 7.6 percent in FY 2015-16. Considering the current performance of the major indicators of the economy, projection shows that the government could not achieve its growth target in current fiscal year.

Figure 2: Comparison of real GDP growth projected by MTMF and UO



Source: Author's calculation based on Ministry of Finance, 2014

The rate of savings and investment to the GDP has remained stagnant over the years and the gap between savings and investment has assumed an increasing trend lately, suggesting that the government's macroeconomic strategies fall short of converting the savings into investment.

2. SAVING-INVESTMENT GAP

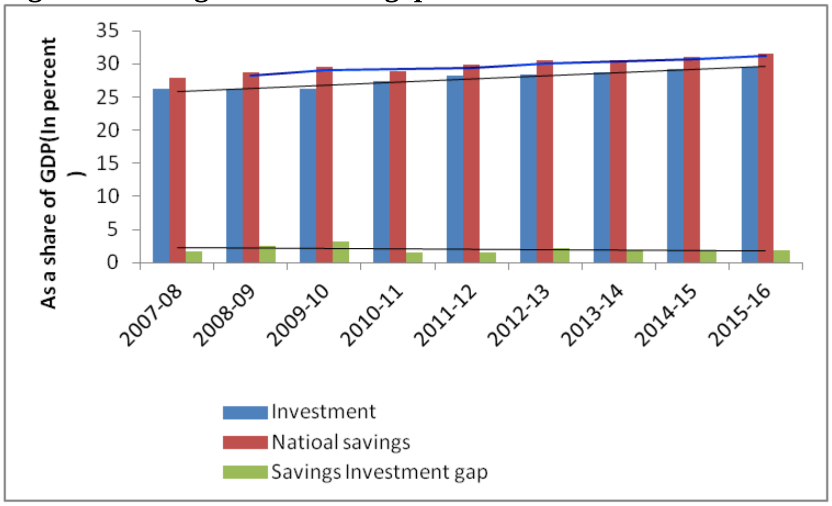
In an economy, savings and investment provide the most important economic link between the past, the present, and the future (Mukharji and Chowdhury, 2013). An adequate rate of national savings is essential to achieving higher investment and consequently higher economic growth. Of late, the rate of growth in GDP has been constrained as investment especially the private investment has not been increasing at a satisfactory rate.

The rate of savings and investment to the GDP has remained stagnant over the years and the gap between savings and investment has assumed an increasing trend lately, suggesting that the government's macroeconomic strategies fall short of converting the savings into investment. In Bangladesh, the gap between savings and investment prevails for a long time. In 2012-13 and 2013-14, the national savings were 30.53 percent and 30.54 percent respectively, whereas the investments were 28.39 percent and 28.69 percent of the GDP respectively, representing 2.14 and 1.85 percentage points gap between savings and investment. The private investment has been declining since FY 2011-12, although the public investment has been increasing. High interest rate, lack of available supply of electricity and gas, and political uncertainty in the country are causing the private investment to decline. In 2011-12, the private investment was 22.50 percent of GDP which reached 21.75 percent and 21.39 percent in 2012-13 and 2013-14 respectively.

Along the trend of savings and investment since FY 2007-08, the national savings might be 31.04 percent and 31.53 percent of the nominal GDP in FY 2014-15 and FY 2015-16 respectively and total investment might be 29.15 and 29.60 percent of the nominal GDP in 2014-15 and FY 2015-16 respectively. The savings-investment gap has increased sharply compared to the 2010-11 and it will continue further, if the existing policies prevail in future. The saving – investment gap might reach 1.89 percent and 1.92 percent of the nominal GDP in FY 2014-15 and FY 2015-16 respectively.

The savings-investment gap has increased sharply compared to the 2010-11 and it will continue further, if the existing policies prevail in future. The saving –investment gap might reach 1.89 percent and 1.92 percent of the nominal GDP in FY 2014-15 and FY 2015-16 respectively.

Figure 3: Savings- Investment gap



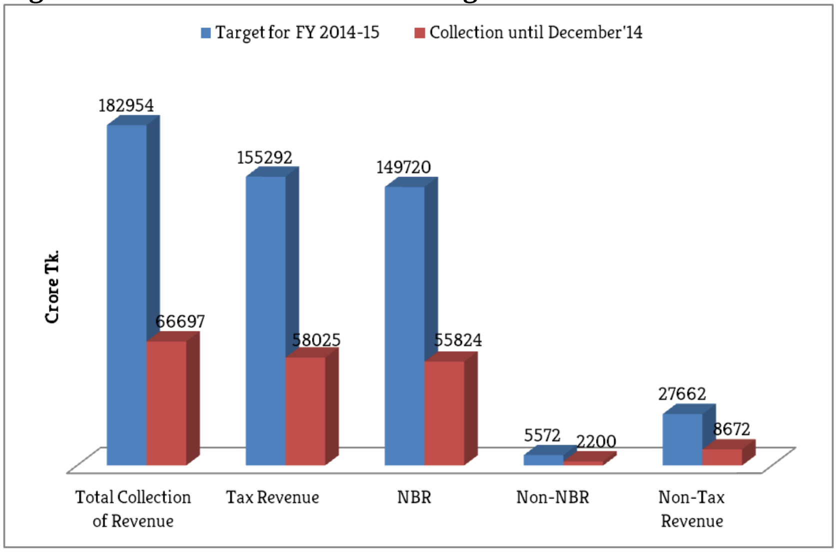
Source: Bangladesh Bank, 2014 and Ministry of Finance, 2014

3. COLLECTION OF REVENUE

In FY 2014-15, the target of the collection of revenue was set at Tk. 182954 crore, whereas the actual amount of revenue collection has stood at Tk. 66697 crore during the first half of the current fiscal year, representing only 36.5 percent of the target. In the same vein, the actual collections of tax revenue (both NBR and Non-NBR) and Non-tax revenue are not satisfactory in comparison with the target. The targets of tax revenue and non-tax were set at Tk. 155292 crore and 27662 crore respectively, while the targets of NBR and Non-NBR tax revenue were Tk. 149720 crore and Tk. 5572 crore respectively. The actual collections of tax revenue and non-tax revenue during the first half of FY 2014-15 have, however, been Tk. 58025 crore and Tk. 8672 crore representing 37.4 percent and 31.4 percent of the targets respectively. The collections of NBR and non-NBR revenue stood at Tk. 55824 crore and Tk. 2200 crore representing 37.3 percent and 39.5 percent during the same period of time.

The tax-GDP ratio is very low with about 10 percent of the GDP in Bangladesh, but keeps improving at a slow pace. Low per capita income, corruption and inefficiency in tax management system keep the tax collection low and unsatisfactory.

Figure 4: Collection of Revenue: Target vis-à-vis Actual



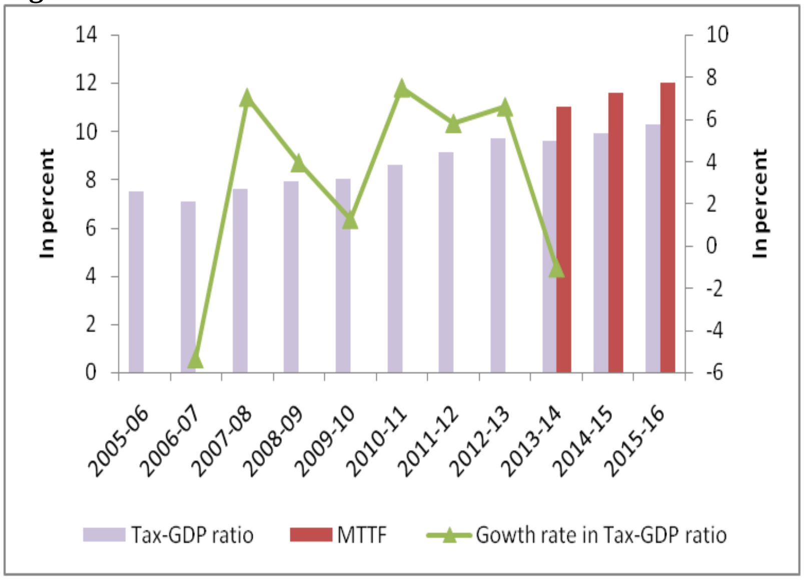
Source: Ministry of Finance, 2015

Tax–GDP ratio of a country shows the financial capability of the government to finance its expenditure. Low tax–GDP ratio implies strigent financial constraint for the government which shrunken the capital expenditure. To increase the contribution of tax in GDP the collection of tax must be accelerated through proper management in tax collection and The tax-GDP ratio is very low with about 10 percent of the GDP in Bangladesh, but keeps improving at a slow pace. Low per capita income, corruption and inefficiency in tax management system keep the tax collection low and unsatisfactory. tax policy reform.

In FY 2013-14, the tax was 9.6 percent of GDP where the target was set to 11 percent in MTTF; 1.4 percentage point less than the target. In current fiscal year, the target for Tax-GDP ratio is 11.6 percent.

Taking account of the annual growth rate in tax-GDP ratio from FY 2005-06 to FY 2013-14, it is projected that the Tax-GDP ratio might be 9.94 percent and 10.27 percent in FY 2014-15 and 2015-16 respectively.

Figure 5: Tax-GDP Ratio



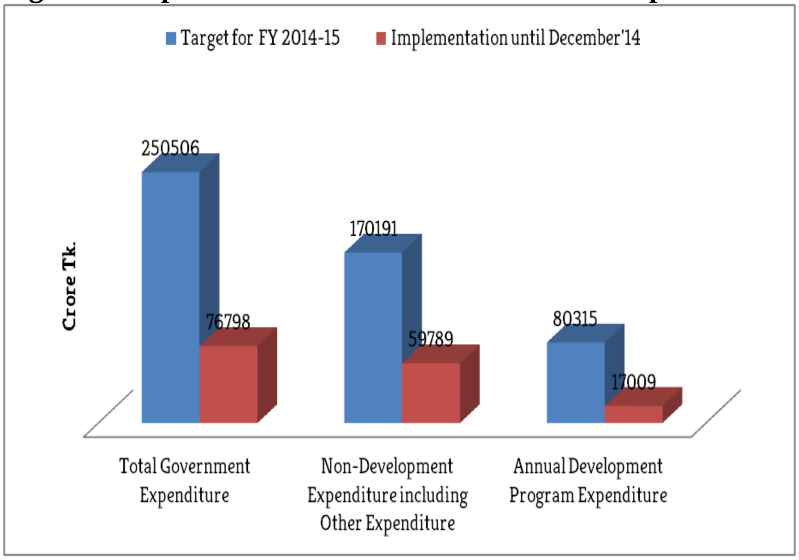
Source: Ministry of Finance, 2014

The target of total government expenditure was set at Tk. 250506 crore in the budget of FY 2014-15, while the targets of allocations for non-development expenditure and annual development program were Tk. 170191 crore and Tk. 80315 crore.

4. GOVERNMENT EXPENDITURE

The target of total government expenditure was set at Tk. 250506 crore in the budget of FY 2014-15, while the targets of allocations for non-development expenditure and annual development program were Tk. 170191 crore and Tk. 80315 crore. The implementation of government expenditure is, however, not satisfactory. The actual amount of total government expenditure has stood at Tk. 76798 crore during the July-December period of FU 2014-15, representing only 30.7 percent of the target set in the budget of FY 2014-15. In addition, the rate of growth in actual government expenditure for the first half of current fiscal year has become negative 0.1 percent in comparison with the government expenditure during the corresponding period of the previous fiscal year. However, the actual amount of non-development expenditure and ADP expenditure has stood at Tk. 59789 crore and Tk. 17009 crore during the first half of FY 2014-15, representing only 35.1 percent and 21.2 percent of respective targets.

Figure 6: Implementation Status of Government Expenditure



Source: Ministry of Finance, 2015

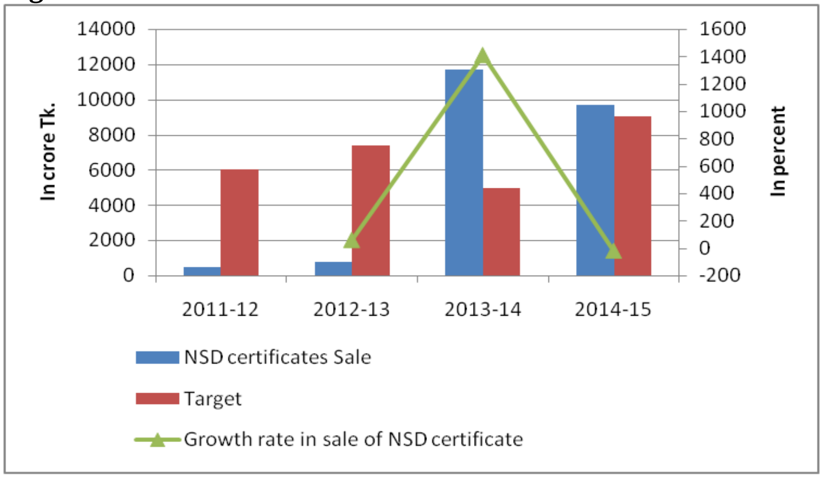
5. BUDGET DEFICIT AND DEFICIT FINANCING

The budget deficit was targeted at Tk. 67552 crore in FY 2014-15, which was assumed to be financed by Tk. 24275 crore from foreign sources, Tk. 43277 crore from domestic sources (Tk. 31221 crore from banking system and Tk. 12056 crore from non-bank sources).

The budget deficit was targeted at Tk. 67552 crore in FY 2014-15, which was assumed to be financed by Tk. 24275 crore from foreign sources, Tk. 43277 crore from domestic sources (Tk. 31221 crore from banking system and Tk. 12056 crore from non-bank sources). The actual budget deficit has become Tk. 10101 crore during the first half of the current fiscal year, which has been financed by Tk. 1458 crore from foreign sources, Tk. 8646 crore from domestic sources (Tk. 5755 crore from banking system and Tk. 2891 crore from non-bank sources) It is, however, conspicuous that because of low implementation of budget, the budget deficit has also remained low during the first half of FY 2014-15.

Among the domestic sources, borrowing from the banking system does not increase much, whereas the borrowing from the non banking sources has increased drastically specially from selling the NSD certificates. Government plans to collect Tk. 9056 crore through NSD certificate in FY 2014-15, but in first five months of this fiscal year, NSD certificates with the value of Tk. 9677 crore have been sold which is 206.31 percent higher than that of same time period of the previous year and Tk. 621 crore higher than the target.

Figure 7: Sale of NSD certificate

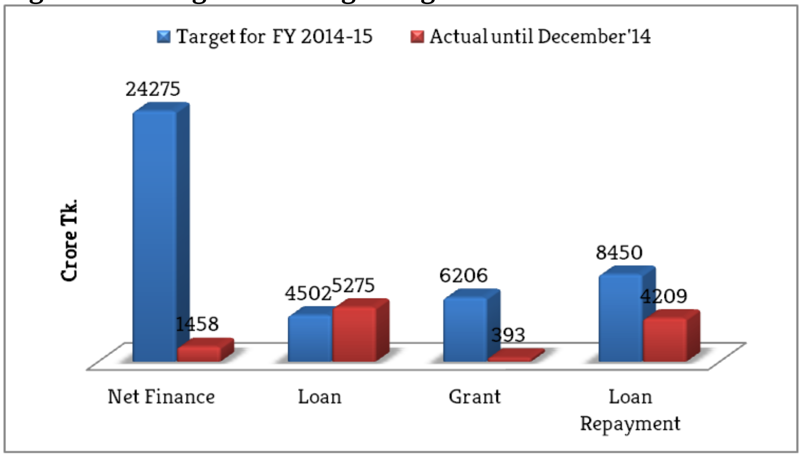


Source: Ministry of Finance, 2014

6. FOREIGN AID

Foreign grant has declined during the first half of the current fiscal year in comparison with the corresponding period of the previous fiscal year. Total foreign grant has stood at only Tk. 393 crore during July-December period of FY 2014-15 against the target of Tk. 6206 crore set in the budget of FY 2014-15 for the whole fiscal year, whereas the amount of foreign grant was Tk. 437 crore during July-December period of FY 2013-14. Foreign loan has stood at Tk. 5275 crore during the first half of the current fiscal year, which is even higher than the whole year's target of Tk. 4502 crore. This increase in foreign borrowing is likely to exert pressure on the economy as the repayment of foreign loan with interest causes the economy to incur a large amount of non-development expenditure every year.

Figure 8: Foreign Financing: Target and Actual



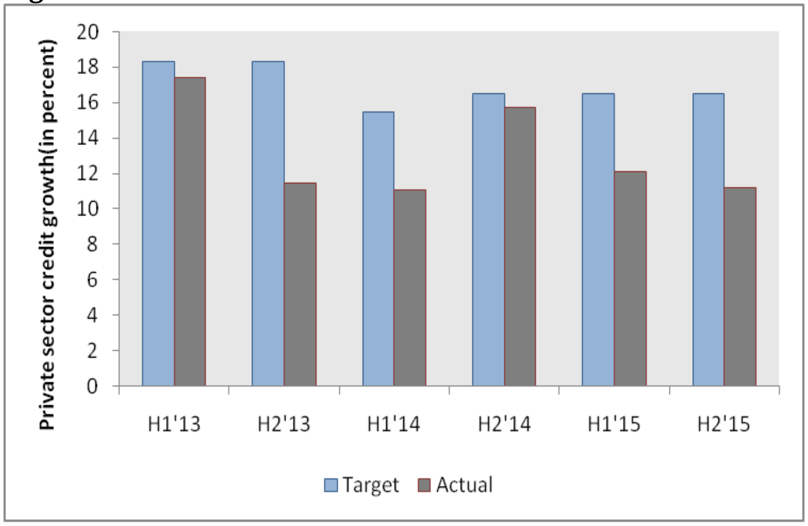
Source: Ministry of Finance, 2015

7. PRIVATE SECTOR CREDIT

The growth in private sector credit has fallen short of the target at the end of the first half of the FY 2014-15, signaling sluggishness in business activity in the economy.

The growth in private sector credit has fallen short of the target at the end of the first half of the FY 2014-15, signaling sluggishness in business activity in the economy. The target of growth in private sector credit was set at 16.5 percent in the monetary policy statement announced by the central bank for the first half – July-December – of FY 2014-15, whereas the actual growth in private sector credit stood at 13.5 percent. The target of growth in private sector credit has, however, been set at 15.5 percent in the monetary policy statement announced for the second half of the current fiscal year. This target is also likely to remain unachieved if the current trend in the economic activities continues.

Figure 9: Growth in Private Sector Credit



Source: Bangladesh Bank, 2014

The central bank has been missing the target of private sector credit growth on continuous basis. Statistics suggest that the private sector credit growth has declined to 12.7 percent in November, 2014 from the targeted 16.5 percent in the MPS (July-December, 2014-15). Private sector credit growth declined to 17.4 percent from the targeted 18.3 percent in that MPS for H1, 2013 (July -December, 2012). Private sector credit growth declined to 11.43 percent in June 2013 from the targeted 18.3 percent in the MPS (January-June, 2013) due to weak physical infrastructure, inconvenient business environment as well as high interest rate lending. In the light of previous MPSs it can be assumed that the target might not be achieved if the present situation such as lack of physical infrastructure, high interest rate spread and political disturbances exist.

UNNAYAN ONNESHAN

8. EXTERNAL SECTOR: EXPORT AND IMPORT

The performance of external sector of the economy during the first half of the current fiscal year has been unsatisfactory due mainly to sluggish growth in the export. The total amount of export earning has stood at USD 14914.2 million during July-December period of the FY 2014-15, whereas the total export earning was USD 14685.8 million during the corresponding period of FY 2013-14, indicating only 1.6 percent growth in export during the first half of FY 2014-15 vis-à-vis the first half of FY 2013-14. One of the major reasons of decline in growth of export is that the rate of growth in Bangladesh's exports to US market has decreased by 4.6 percent during July-December period of FY 2014-15 in comparison with the corresponding period of FY 2013-14. However, the total import has stood at USD 22268.8 million during the first half of the current fiscal year, which is 18.3 percent higher than the total import during the corresponding period of the previous fiscal year.

Table 2: Growth in Export and Import

Sector	2014-15 (October–December)	July – December	
		2013-14	2014-15
Export (in million USD)	7219.1	14685.8	14914.2
Growth (in percent)	2.3	16.6	1.6
Import (in million USD)	11942.9	18594.1	22268.8
Growth (in percent)	24.4	13	18.3

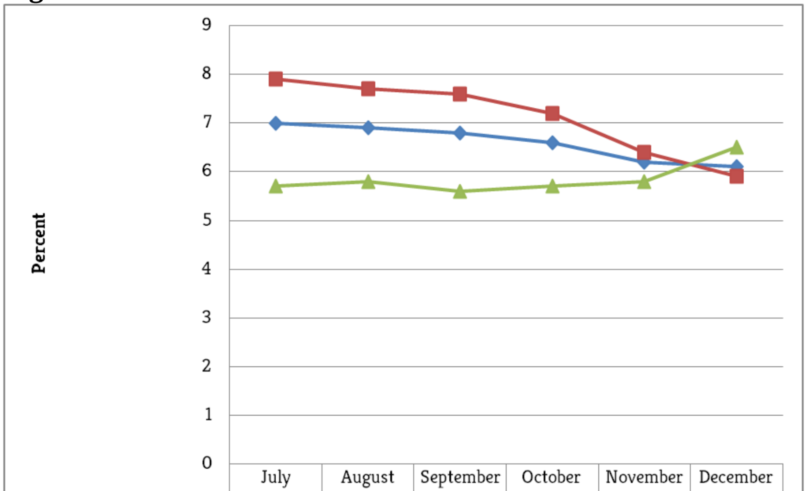
Source: Ministry of Finance, 2015

The rate of inflation on point-to-point basis has been on the decline since the beginning of the current fiscal year. However, the non-food inflation has been on the rise of late, although food inflation has been declining.

9. INFLATION

The rate of inflation on point-to-point basis has been on the decline since the beginning of the current fiscal year. However, the non-food inflation has been on the rise of late, although food inflation has been declining. Non food inflation has stood at 5.7 percent, 5.8 percent, and 6.5 percent in October, November, and December respectively, whereas food inflation was 7.2 percent, 6.4 percent and 5.9 percent in the three consecutive months respectively.

Figure 10: Trend in Inflation



	July	August	September	October	November	December
General Inflation	7	6.9	6.8	6.6	6.2	6.1
Food Inflation	7.9	7.7	7.6	7.2	6.4	5.9
Non-Food Inflation	5.7	5.8	5.6	5.7	5.8	6.5

Source: Ministry of Finance, 2015

In the MPS (July- December, 2014), the target for inflation rate was 6.5 percent where the actual rate of inflation was 6.11 percent at the end of December and average inflation reached 6.86 for the first half of the FY 2014-15. The average food and non-food inflation for the corresponding period reached 7.1 percent and 5.86 percent respectively. So achieving the inflation target of current MPS of 6.5 percent will be not very difficult if the present situation prevails.

Figure 11: Rate of Inflation (Target and Actual)

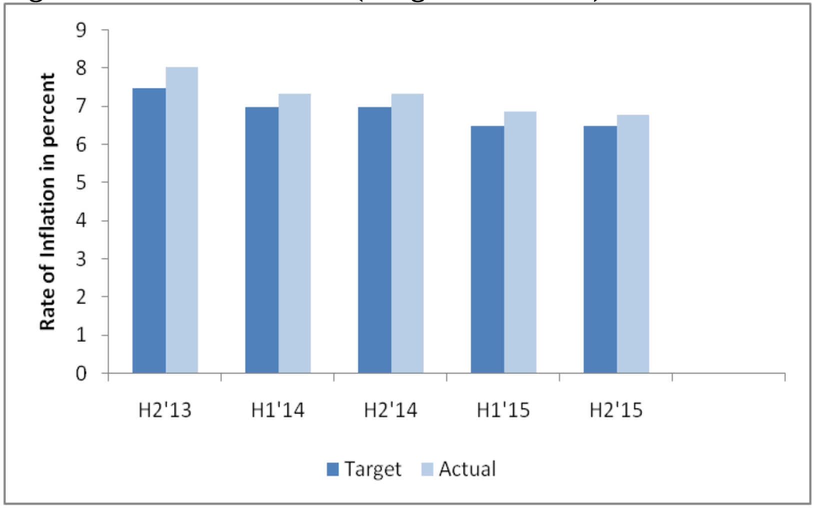
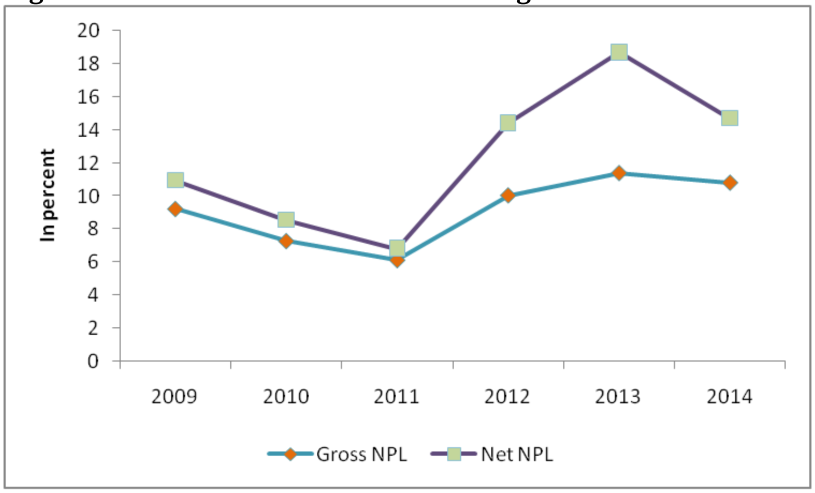


Figure: Bangladesh Bank, 2014

10. NON-PERFORMING LOAN

Non-performing loan both gross and net is increasing. Overall net non performing loan (NPL) increased to 3.9 percent in June 2014 from 3.4 percent in March 2014. At end of March 2014, Net NPL ratios for SCBs and SBs increased from 4.7 percent and 24.2 percent respectively at the end of March 2014 to 7.4 percent and 26.4 percent respectively at the end of June 2014.On the other hand gross non performing loan compared to the total loan increases from 10.5 to 10.8percent in April-June period of the FY 2013-14.

Figure 12: Gross and Net Non Performing Loan



Source: Bangladesh Bank, 2014

The extent of default loans increased in the third quarter due to tightening the loan classification guideline, sluggish business activities during the political uncertainty and interruption in energy supplies.

Loans that are not paid on time and are nominated as troubled assets by banks are classified loans. Classified loans are usually issued according to terms and regulations of the bank. The extent of default loans increased in the third quarter due to tightening the loan classification guideline, sluggish business activities during the political uncertainty and interruption in energy supplies. The percentage share of classified loan to total outstanding loan has been increasing in every year. At the end of September 2013, the percentage share of classified loan to total outstanding loan was 12.79 percent, whereas it stood 8.9 percent at the end of December, 2013 and then again increased to 10.5 at the end of March2014. The classified loans increased to 51340crore in the April-June quarter of 2014-15 from Tk.40590 crore of the October-December quarter of FY 2013-14 the total classified loan increased by 15.73 percent.

ii. INSTITUTIONAL REFORM

Taking account of the growing size of the economy and the current economic challenges discussed above, an institutional reform can be reckoned in order for the fiscal management to be carried out.

Taking account of the growing size of the economy and the current economic challenges discussed above, an institutional reform can be reckoned in order for the fiscal management to be carried out. The current administrative structure of fiscal management does not seem to live up to the promises that the economy has been signaling of late. The structure has been characterised by lack of oversight and inefficient management due to complex division of functions and responsibilities. In order for the fiscal management to be more effective in the economy, the following reform measure, which is indicative of an efficient restructuring, and specifies the functions and responsibilities of administration, can be handy.

Functions	Public Finance Management	Revenue Division	Economic Relations Division	Social Security and Development Management Division	Banking Division	Productive Capacity Expansion Division
Political Responsibility	Minister of State	Minister of State	Minister of State	Minister of State	Minister of State	Minister of State
Parliamentary Oversight	Standing Committee	Standing Committee	Standing Committee	Standing Committee	Standing Committee	Standing Committee

The functions of the Ministry of Finance could be divided into six divisions, i.e. Public Finance Management Division, Revenue Division, Economic Relation Division, Social Security and Development Management Division, Banking Division, and Productive Capacity Expansion Division, while each of the divisions will be headed by a minister of state and overseen by a parliamentary standing committee. This restructuring of the current administration of fiscal management is presumed to confirm the effectiveness of economic management through enhanced capabilities and greater accountability of responsible authorities.

Like the fiscal policy, the monetary policy of the country has to be harmonised to ensure a high investment ratio.

iii. CONCLUSIONS

There is no alternative to increased revenue mobilisation to improve the fiscal balance of the country. First, the thrust of the tax reforms has to shift from the ad hocism to a structural one, comprising the principles of instituting progressive tax structure, avoidance of tax evasion and strengthening institutional capacity. For growth to continue the economy requires increased public expenditure in physical and socio-economic infrastructure. This is particularly required to have a structural shift from agriculture to industry and to service. Moreover, there is a need for an active fiscal policy with subsidies diverted towards the productive capacity and capability enhancing sectors.

Like the fiscal policy, the monetary policy of the country has to be harmonised to ensure a high investment ratio. Even if the central bank is assured that monetary pressure is causing the prices to go up, the central bank has to demonstrate its prudence by not resorting to across the board contraction of money supply rather choose a differential system to maintain the level of investment. If exigent, prudent, context specific and creative policies are pursued, the economy would march forward and the country may soon graduate out of its least development status.

References

Bangladesh Bank. 2014, Major Economic Indicators. November, 2014. Dhaka, Bangladesh: Bangladesh Bank.

Ministry of Finance. 2015, Budget 2014-15: "*Ditio prantik (July-December) porjonto bastobayon ogrogoti o ay-bayer gotidhara ebong samostik orthonoitik bishleson songkranto protibedon*." Dhaka, Bangladesh: Finance Division, Ministry of Finance, Government of Bangladesh.

Ministry of Finance. 2014, Bangladesh Economic Review, 2014. Dhaka, Bangladesh: Finance Division, Ministry of Finance, Government of Bangladesh.

Unnayan Onneshan. 2014, Long On Realities, Short On Targets, Bangladesh Economic Update Volume 5, No.6, June 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/Budget/Budget_FY_2014-15/Budget_FY_2014-15.pdf

Unnayan Onneshan. 2014, Banking Sector Caught in Trap, Bangladesh Economic Update Volume 5, No. 7, July 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/meu/MEU_July_2014/MEU_July_2014.pdf

Unnayan Onneshan. 2014, Monetary Policy Statement (July-December, 2014): A Rapid Assessment, Bangladesh Economic Update Volume 5, No.8, August 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/meu/MEU_August_2014/MEU_MPS_Au gust_2014.pdf

Unnayan Onneshan. 2014, External Sector: Current Trends, Bangladesh Economic Update Volume 5, No.10, September 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/index.php/publications/all-publications/recent-articles

Unnayan Onneshan. 2014, Debt and Deficit: Recent Trends, Bangladesh Economic Update Volume 5, No.11, October 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/meu/Meu_October_2014/MEU_October_2014.pdf

Unnayan Onneshan. 2014, Energy Security: Recent Trends and Challenges, Bangladesh Economic Update Volume 5, No.12, November 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/meu/MEU_Nov_2014/MEU_Nov_2014.pdf

Unnayan Onneshan. 2012, Half Yearly Assessment of Economy of Bangladesh, Bangladesh Economic Update Volume 3, No.12, December 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/index.php/publications/all-publications/recent-articles/86-half-yearlyassessment-of-the-economy-of-bangladesh

Unnayan Onneshan. 2013, Declining Growth: Mismatches in Fiscal and Monetary Management, Half Yearly Assessment of the Economy in Bangladesh, Bangladesh Economic Update Volume 5, No.11, October 2014. Dhaka: Unnayan Onneshan. Available at:
http://www.unnayan.org/reports/meu/December%202013/Halfyearly%20assessment_Dec%2020 13.pdf

UNNAYAN ONNESHAN
16/2 Indira Road, Farmgate
Dhaka-1215, Bangladesh
Tel.: +880 (2) 58150684, +880 (2) 9110636
Fax: +880 (2) 58155804
Email: info@unnayan.org
Web: www.unnayan.org