Major Economic Challenges: A Pre-Budget Analysis

Bangladesh Economic Update
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1. INTRODUCTION

The current pre-budet issue of Bangladesh Economic Update identifies major economic challenges causing shortfall in growth in gross domestic product (GDP) vis-à-vis target in FY 2015-16. The Update presents a thorough scrutiny of the challenges that the economy has undergone during FY 2015-16 and should take into consideration while declaring the budget for FY2016-17. 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 2016-17. The Update calls for far-sighted actions toward formulating 2016-17 budget against the backdrop of poor implementation status of 2015-16 budget.

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In view of the current economic structure of Bangladesh, allocation of resources must be channelled efficiently into the productive sectors in order for the economy to get higher returns in terms of expanded productive capacity and resultant increased gross domestic product (GDP). Despite commendable progress in achieving growth in GDP, it is considered that the country has been missing the opportunities to capitalize on its resources and potentials to embark upon rising as a middle income country by 2021. In recent years, the low implementation status of the national budgets has, however, further accentuated the lack of political will induced shortfall in achieving targeted rate of economic growth in the country.

It is, however, argued that the current size of the economy demands larger national budgets, but the country's incapacity to efficiently implement the current budgets does not suggest a prospect of substantial increase in the size of national budgets in the coming years. In addition, in view of the poor implementation status of allocations for physical and social infrastructure, and high youth unemployment rate, particular emphasis must be put on the move toward expanding productive capacity in the economy through ensuring quality investment in physical and social infrastructure and thus creating job for the youth.

2. GROWTH IN GDP

The target of rate of growth in GDP has been 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.

Noting the current state of economy and development, and recent trend in growth in gross domestic product (GDP), it is doubted that government's recent estimation of 7.05 percent of growth in GDP is likely to be achieved at the end of the current fiscal year.

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. Noting the current state of economy and development, and recent trend in growth in gross domestic product (GDP), it is doubted that government's recent estimation of 7.05 percent of growth in GDP is likely to be achieved at the end of the current fiscal year.

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	6.51	

Source: Ministry of Finance, 2016

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.

3. COLLECTION OF REVENUE

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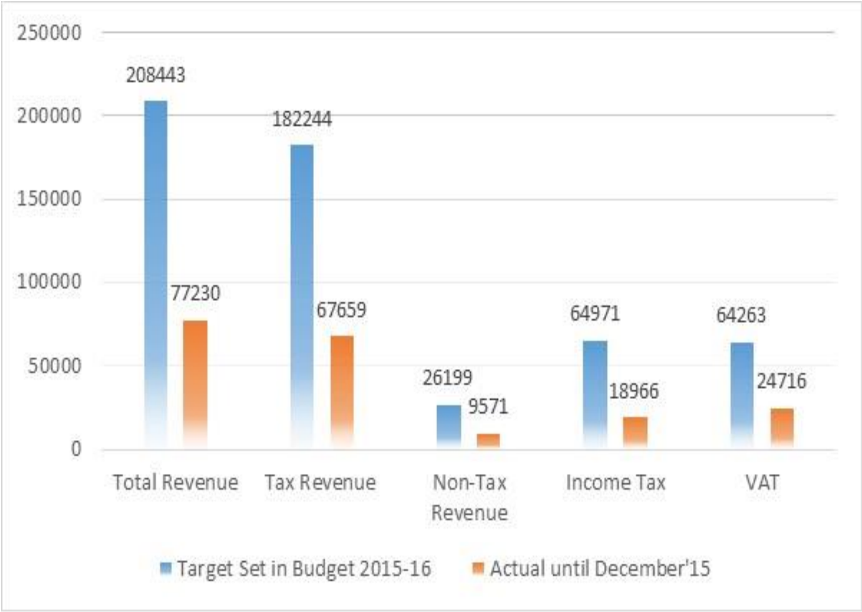
Figure 1: Collection of Revenue: Target vis-à-vis Actual (in crore Tk.)



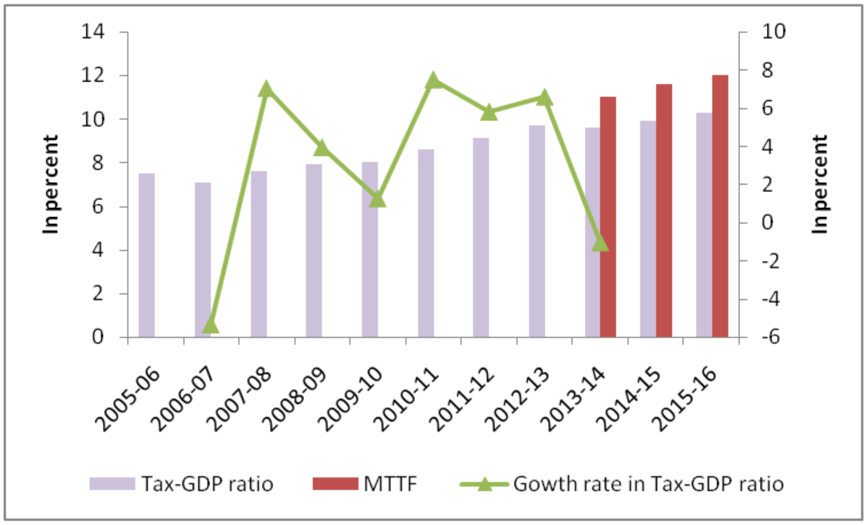
Source: Ministry of Finance, 2016

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. 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. To increase the contribution of tax in

GDP the collection of tax must be accelerated through proper management in tax collection and 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 2: Tax-GDP Ratio



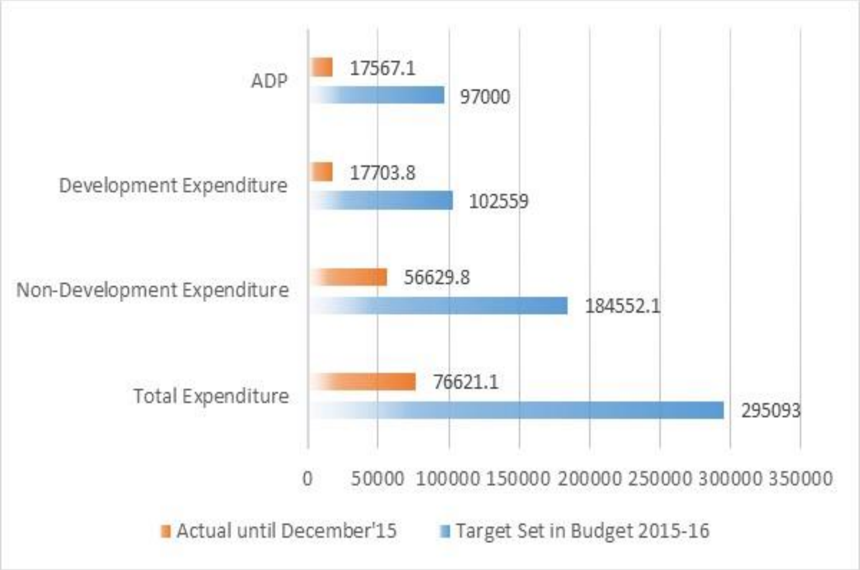
Source: Ministry of Finance, 2016

Only 30.7 percent of the total non-development budget has been implemented during the first six months of FY 2015-16 while only 41 percent of the total annual development program (ADP) has been implemented during the first nine months of the current fiscal year.

4. GOVERNMENT EXPENDITURE

Only 30.7 percent of the total non-development budget has been implemented during the first six months of FY 2015-16 while only 41 percent of the total annual development program (ADP) has been implemented during the first nine months of the current fiscal year. However, the National Economic Council has recently been revised the development budget at Tk. 91000 crore from Tk. 97000 crore. The actual amounts of non-development expenditure and development expenditure have stood at Tk. 56629.8 crore and Tk. 17703.8 crore during the first half of FY 2015-16 against the whole fiscal year's target of Tk. 184552.1 crore and Tk. 102559 crore respectively, representing only 30.7 percent and 17.3 percent of respective targets. 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 3: Implementation of Government Expenditure (in crore Tk.)



Source: Ministry of Finance, 2016

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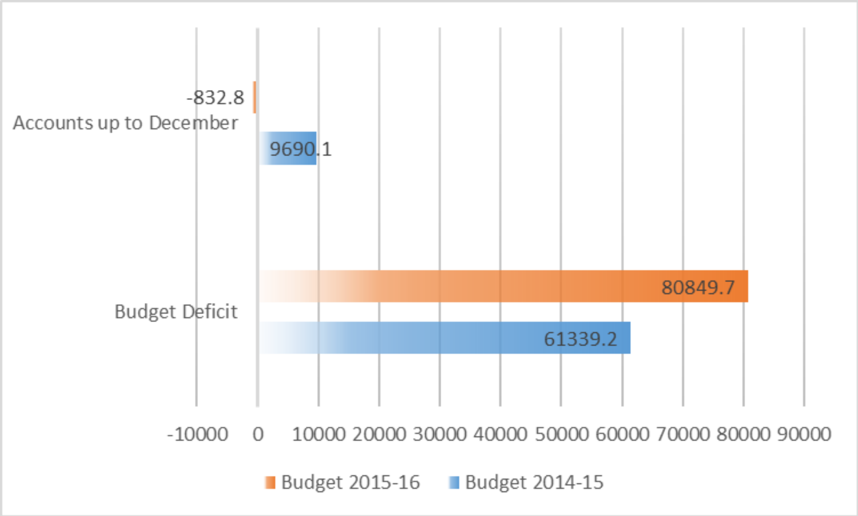
5. BUDGET DEFICIT

Against the target of Tk. 80857 crore in FY 2015-16, the actual budget deficit has become Tk. –832.8 crore, meaning that there exists surplus in the budget balance.

In reference to the surplus in overall budget balance and resultant negative financing during the first half of the current fiscal year due to poor implementation of both development and non-development budgets, it is shown that against the target of Tk. 80857 crore in FY 2015-16, the actual budget deficit has become Tk. –832.8 crore, meaning that there exists surplus in the budget balance. 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.

Figure 4: Budget Balance (in crore Tk.)



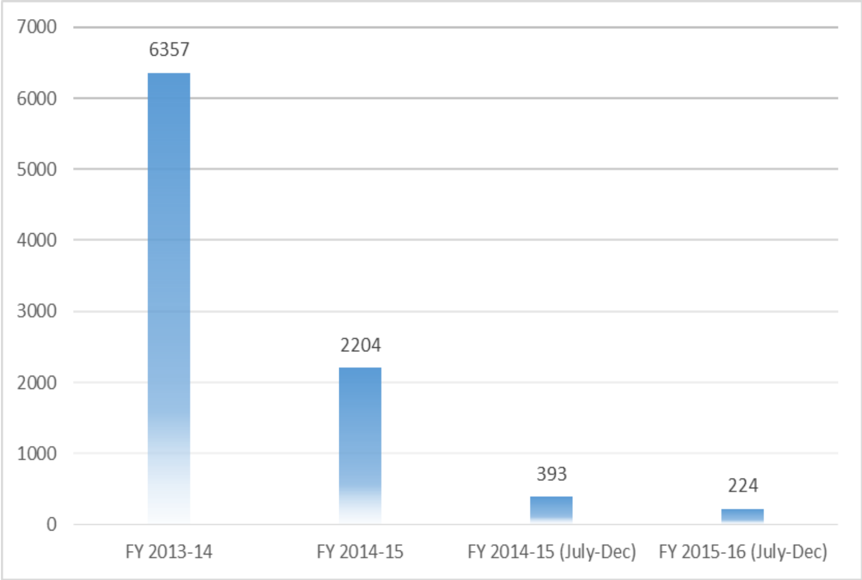
Source: Ministry of Finance, 2016

6. FOREIGN GRANTS

Foreign grant has declined during the first half of the current fiscal year in comparison with the corresponding period of the previous fiscal year.

Actual grant receipts fell by 65.3 percent in FY 15 compared to FY14. During July-December of FY16, grant receipt decreased by 43.0 percent to TK. 224 Crore against TK. 393 crore over the corresponding period of the last fiscal. 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 5: Trend in Foreign Grants (in crore Tk.)



Source: Ministry of Finance, 2016

7. REMITTANCE

Remittance receipts decreased by 1.76 percent and stood at USD11.06 billion during July-March 2015-16 compared with the same period of the previous year.

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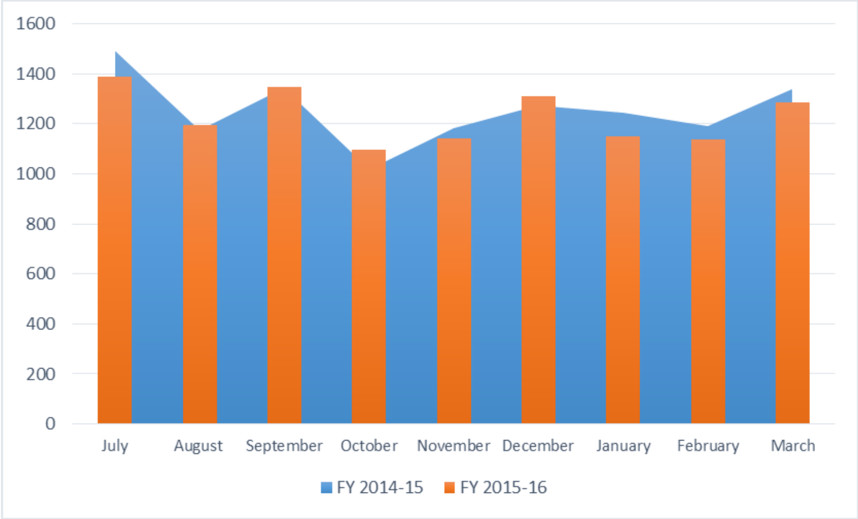
Figure 6: Trend in Remittance (in Million USD)



Source: Bangladesh Bank, 2016

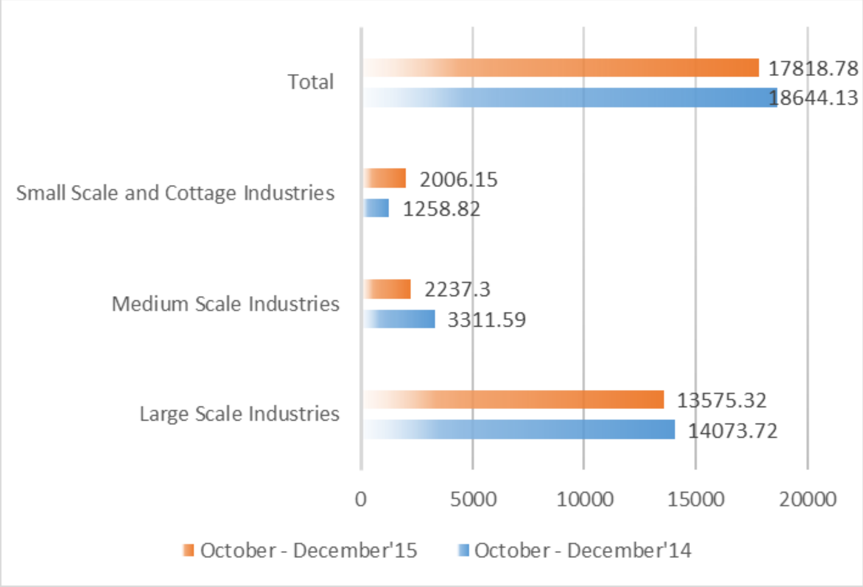
8. INDUSTRIAL TERM LOANS

The disbursement of total industrial term loans during October-December, 2015 decreased by 4.43 percent and stood at Tk.17818.78 crore as compared to Tk.18644.13 crore during October- December, 2014.

The disbursement of total industrial term loans during October-December, 2015 decreased by 4.43 percent and stood at Tk.17818.78 crore as compared to Tk.18644.13 crore during October- December, 2014. On the other hand, the recovery of industrial term loans increased slightly (0.18 percent) and stood at Tk.11945.52 crore during October-December, 2015 against Tk.11923.57 crore during the same period of the previous fiscal.

Outstanding amount of industrial term loans at the end of December, 2015 stood at Tk.134362.89 crore which is higher by 16.90 percent over the outstanding amount of last December.

Figure 7: Industrial Term Loan Disbursement (in crore Tk.)



Source: Bangladesh Bank, 2016

9. INFLATION

The twelve month average general inflation fell from 6.15 percent of February 2016 to 6.10 percent in March 2016. The average food inflation fell to 5.49 percent in March 2016 compared with 5.70 percent in February 2016, while the average non-food inflation rose to 7.03 percent in March 2016 from 6.84 percent of February 2016.

The point to point general inflation edged up slightly by 0.03 percentage points and stood at 5.65 percent in March 2016 from 5.62 percent in February 2016 mainly due to rise in the food inflation to 3.89 percent in March 2016 from 3.77 percent of February 2016.

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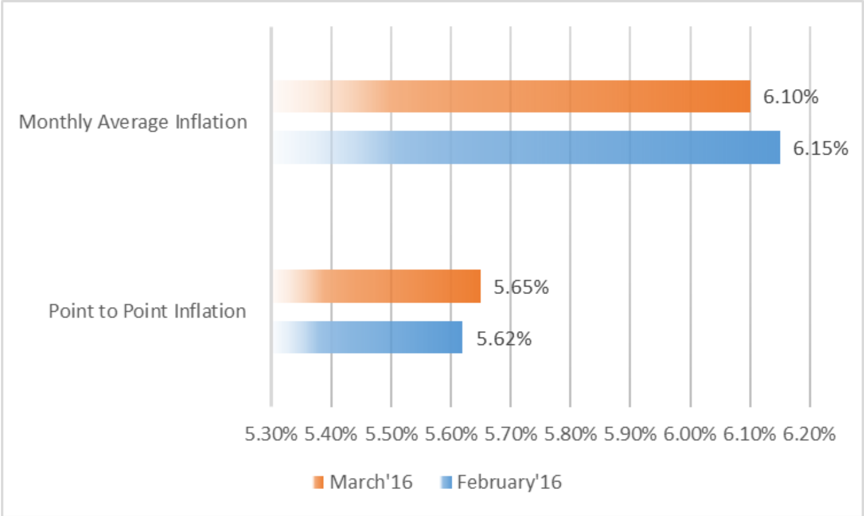
Figure 8: Inflation Rate



Source: Bangladesh Bank, 2016

10. CONCLUSIONS

It is finally emphasized that the proposed actions for FY 2016-17 should be able to bring about fiscal discipline in implementation of government expenditure on the one hand, and to increase income through reforming the tax system on the other.

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 characterized 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.

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.

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. It is finally emphasized that the proposed actions for FY 2016-17 should be able to bring about fiscal discipline in implementation of government expenditure on the one hand, and to increase income through reforming the tax system on the other.

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