A Pre-Budget Analysis of Major Economic Challenges

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 2016-17. The Update presents a thorough scrutiny of the challenges that the economy has undergone during FY 2016-17 and should take into consideration while declaring the budget for FY 2017-18. 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 2017-18. The Update cautions the authority against the poor implementation status of 2016-17 budget, and calls for far-sighted actions toward formulating 2017-18 budget.

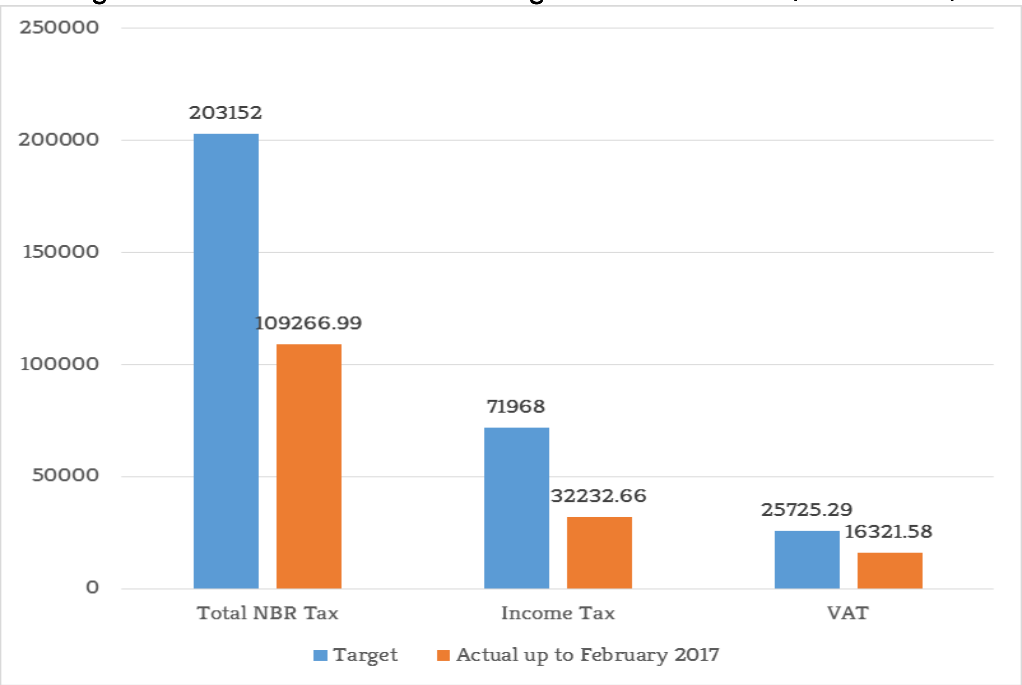
In identifying the major economic challenges as regards the national budget 2017-18, the Update first notes that waning capacity of the authority in implementing budget is looming large. Second, both the collection of revenue and implementation of expenditure, especially Annual Development Program (ADP), have fell short of target in the current fiscal year. Third, the private investment stagnates, and public investment lacks quality resulting in cost escalation in projects. In addition, upsurge in illicit capital outflows bars capital formation in the economy. Fourth, Inadequate spending on social sector is likely to limit improvements in human development. Higher allocations for health, education and social security are indispensable to sustainable development. Fifth, underperformance in external sector causes worry as current account balance records continual deficit and inflow of remittance declines substantially in recent times. Sixth, Recapitalization of state-owned commercial banks does not pays off as institutional fragility intensifies in the banking sector resulting in meteoric rise in the default loans.
Finally, jobless growth menaces the fiscal discipline. Youth unemployment takes its toll on the economy by limiting its capacity to capitalize on once-in-a-lifetime demographic dividend.

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.

2. Revenue Mobilization and Fiscal Management

The collection of tax revenue lags far behind the target set in the budget 2016-17. Only 53.79 percent of the total target of National Board of Revenue (NBR) tax revenue has been collected during the first eight months of the current fiscal year. In FY 2016-17, the target of the collection of revenue was set at Tk. 242752 crore, whereas the actual amount of revenue collection has stood at Tk. 82987.57 crore during the first half of the current fiscal year, representing only 34.19 percent of the target compared to 37.05 percent in the previous fiscal year.

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



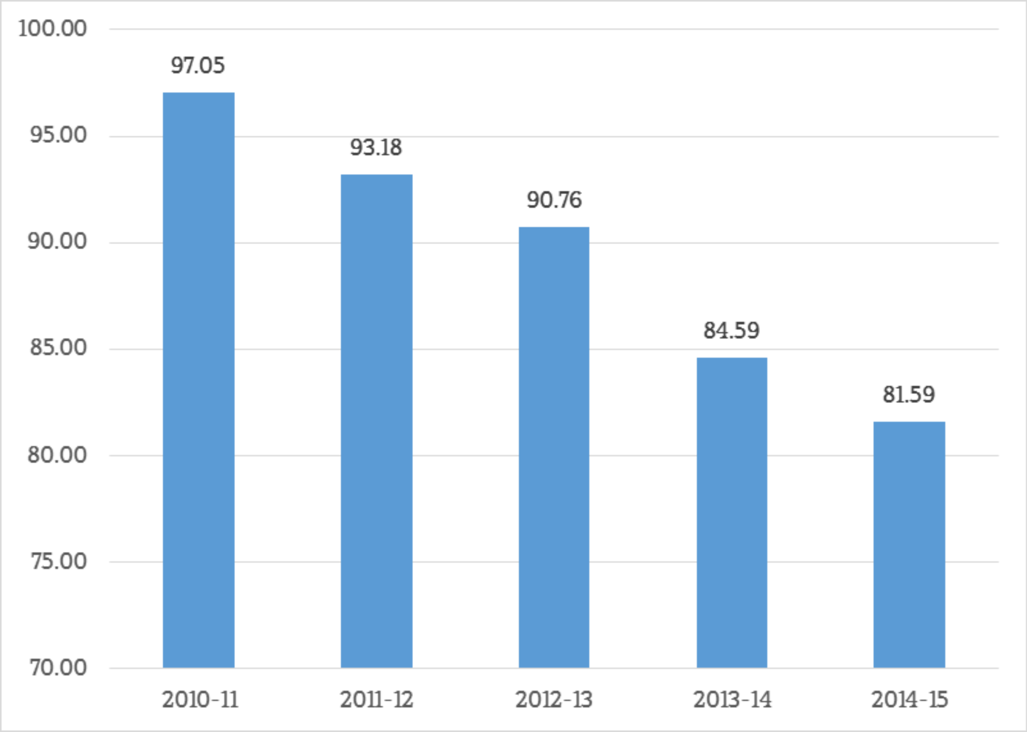
Source: Ministry of Finance, 2016b

Tax-GDP ratio of a country shows the financial capability of the government to finance its expenditure. Low tax-GDP ratio implies stringent 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.

3. Government Expenditure

It is found that the status of budget implementation is on the decline since FY 2010-11. Of the total budget outlay, 97.05 percent was implemented in FY 2010-11, whereas the rate subsequently decreased to 93.18 percent, 90.76 percent, 84.59 percent, and 81.59 percent in FY 2011-12, FY 2012-13, FY 2013-14, and FY 2014-15 respectively.

Figure 2: Budget Implementation Status (in percent)



Source: Ministry of Finance, 2016a

However, only 33.7 percent of the total government expenditure has been implemented during the first six months of FY 2016-17 while only 54.56

percent of the total annual development program (ADP) has been implemented during the July-April period of the current fiscal year. The total government expenditure has stood at Tk. 114730 crore during the first half and total ADP stood at 65083 crore during the first eight months of FY 2016-17 against the whole fiscal year's target of Tk. 340605 crore and Tk. 110700 crore respectively.

Figure 3: ADP Implementation Status

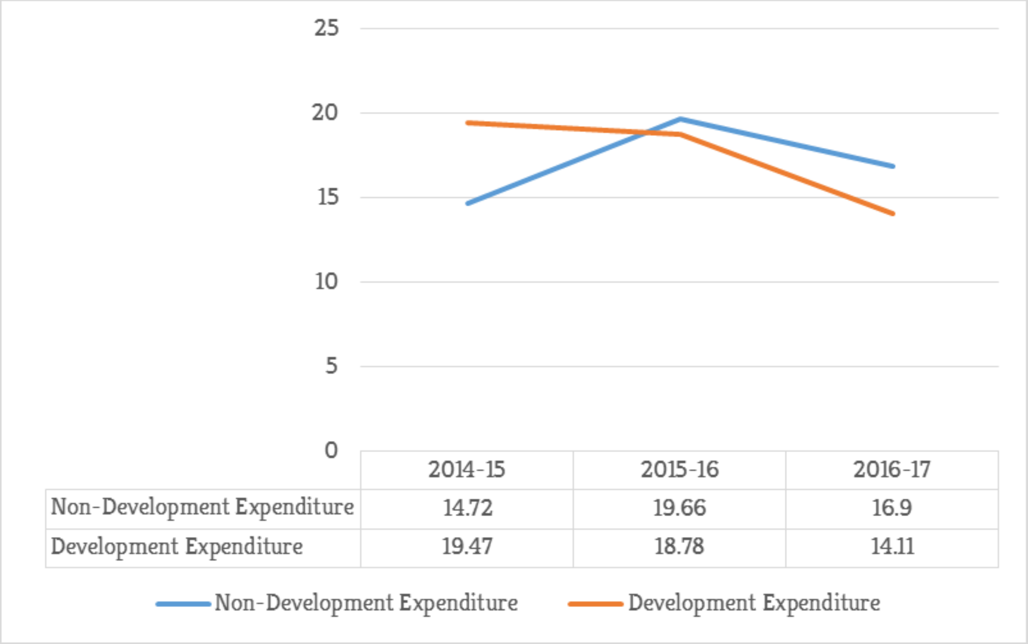
Source: Ministry of Planning, 2017

It is however important to note that while the rate of growth in non-development expenditure has stood at nearly 17 percent in the budget of FY 2016-17 compared to the budget of previous fiscal year, the rate of growth in development expenditure stood at 14 percent in the budget of FY 2016-17 compared to that of FY 2014-15.

Meanwhile, only 30.7 percent of the total non-development budget has been implemented during the first six months of FY 2015-16 while only 34 percent of the total annual development program (ADP) has been implemented during the first eight 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.

Figure 4: Rate of Increase in Non-Development and Development Expenditure



	2014-15	2015-16	2016-17
Non-Development Expenditure	14.72	19.66	16.9
Development Expenditure	19.47	18.78	14.11

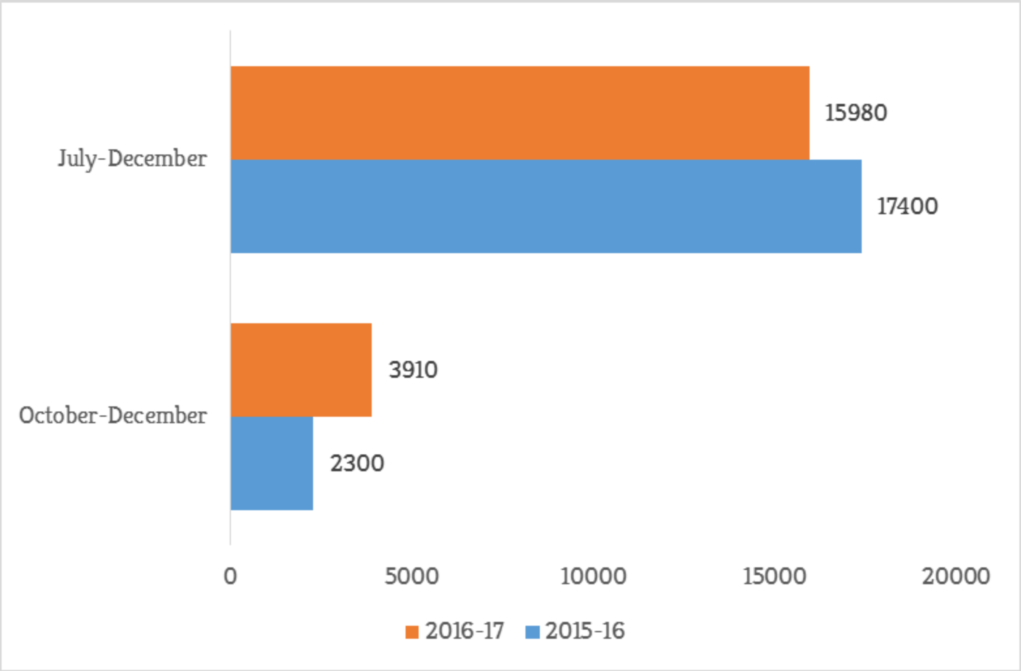
Source: Ministry of Finance, 2016a

4. Fiscal Deficit

In terms of fiscal deficit, it is found that overall fiscal deficit stood at Tk. 3910 crore during second quarter of the current fiscal year (representing 0.2 percent of GDP) compared to Tk. 2300 crore (representing 0.13 percent of GDP) in the corresponding period of the previous fiscal year. However, the total fiscal deficit in the first half of FY 2016-17 stood at Tk. 15980 crore (0.8 percent of GDP), compared to Tk. 17400 crore (1.0 percent of GDP) in first half of FY 2015-16.

The country's quest for self-reliance based upon domestic resource mobilization has been marred by the policy shift towards 'debt-financed-debt-trapped development financing.' The current year witnessed the same level of debt dependence due to failure in providing strategic direction in overhauling the domestic resource mobilization to expand and increase the tax base.

Figure 5: Trends in Fiscal Deficit



Source: Bangladesh Bank, 2016b

In reference to the surplus in overall budget balance and resultant negative financing during the first half of the FY 2015-16 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. In financing deficit, it is found that in the first seven months of the current fiscal year, total foreign aid decreased to USD 1464.88 million from USD 1754.92 million in the corresponding period of FY 2015-16, a 16.53 percent decline, due to a substantial decline in grants. For instance, grant receipts fell by 45.03 percent in FY 2015-16 compared to FY 2014-15, finds the think tank.

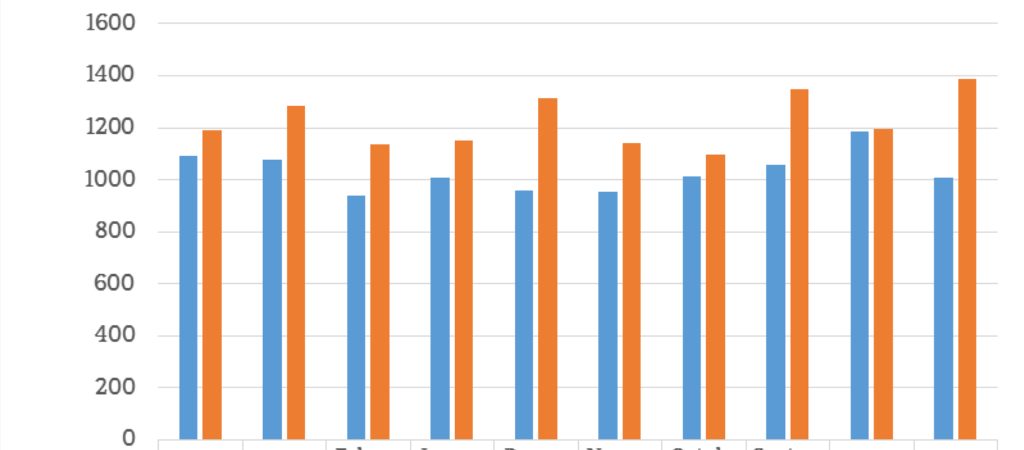
5. Inflows of Remittance

Remittance receipts decreased by 16.03 percent during the July-April period of FY 2016-17 and stood at USD 10287.23 million compared to USD 12250.83

million in the corresponding period of the previous fiscal year. On year-on-year basis, remittance receipts also decreased by 8.27 percent in April 2017 compared to April 2016.

A large portion of expenditure on consumption, education and health in rural households is financed by remittance. Decrease in inflow of workers' remittance is therefore likely to exert an adverse impact on socioeconomic status of rural households.

Figure 6: Trend in Remittance (in Million USD)



	April	March	February	January	December	November	October	September	August	July
2016-17	1092.6	1077.5	940.75	1009.5	958.73	951.37	1011	1056.6	1183.6	1005.5
2015-16	1191.2	1285.6	1136.3	1150.6	1312.6	1142.5	1098.5	1349.1	1195	1389.6

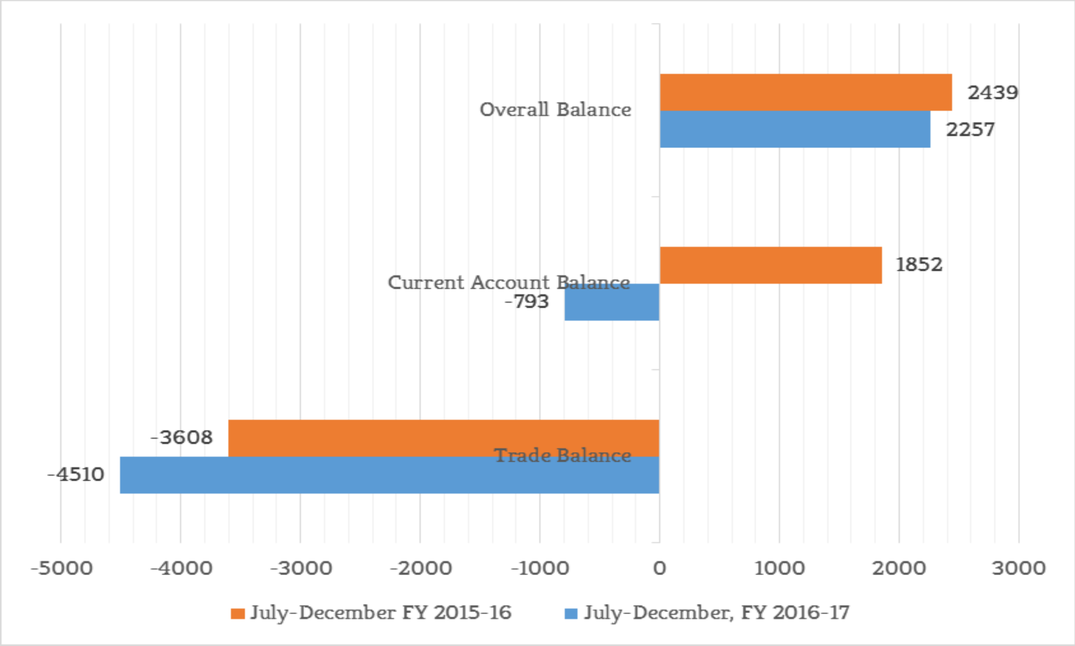
Source: Bangladesh Bank, 2016b

6. Overall External Sector Balance

With decline in inflow of remittance, rise in import payables along with shortfall in the primary income and income from the service sector, the current account balance exhibits a continuous deficit from the third month of the current fiscal year. From a surplus of USD 1852 million during July-December of FY 2015-16, the current account balance registered a deficit of USD 793 million during July-December of the current fiscal year. As a consequence, despite the surplus in financial account, surplus in overall balance decreased from USD 2439 million in the first half of FY 2015-16 to USD 2257 million in the corresponding period of FY 2016-17.

Trade balance recorded a deficit of USD 4.51 billion during July-December, 2016 as compared to the deficit of USD 3.61 billion during July-December, 2015. Current account balance continued with deficit during July-December 2016. Despite the current account deficit, financial account surplus of USD 2.70 billion contributed to an overall surplus of USD 2.26 billion in overall balances during July-December, 2016. The deficit in current account of July-December, 2016 was mainly due to the rise in import payables along with the shortfall in the primary income and income from the service sector as well as slow growth in remittance inflow.

Figure 7: State of balance of payments (in million USD)



Source: Bangladesh Bank, 2016b

Trade Balance recorded a deficit of USD 6274 million during FY 2015-16 as compared to the deficit of USD 6965 million during FY 2014-15. However, higher export earnings and an improvement in primary income and income from services contributed to a current account surplus of USD 3706 million during FY 2015-16 as compared to the surplus of USD 2875 million during FY 2014-15. Current account surplus along with a financial account surplus of USD 1610 million resulted in a surplus of USD 5036 million in overall balances during FY 2015-16 as compared to the surplus of USD 4373 million during FY 2014-15. The current account balance stood at USD 1406 million in FY 2013-14, whereas the balance became negative and stood at USD – 1645 million in FY 2014-15.

7. Public Investment in Social Infrastructure

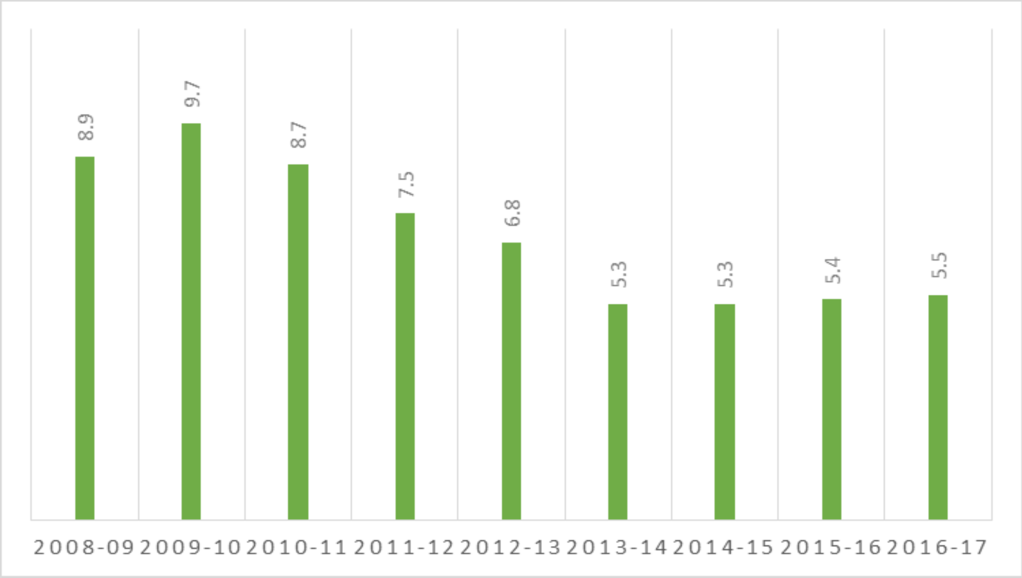
Development expenditure in health stood at 9.7 percent of the total development expenditure in FY 2009-10 compared to 8.7 percent in FY 2010-11, 7.5 percent in FY 2011-12, 6.8 percent in FY 2012-13, 5.3 percent in FY 2013-14, 5.3 percent in FY 2014-15, and 5.4 percent in FY 2015-16 and 5.5 percent in FY 2016-17. Development expenditure in education stood at 13 percent of the total development expenditure in FY 2009-10 compared to 12.8 percent in FY 2010-11, 12.4 percent in FY 2011-12, 13.1 percent in FY 2012-13, 13.5 percent in FY 2013-14, 15.4 percent in FY 2014-15, and 12.3 percent in FY 2015-16 and 15.3 percent in FY 2016-17. Declining finance is likely to create skill shortages in addition to deteriorating quality of education. Development expenditure on social security and welfare stood at 5.4 percent of the total development expenditure in FY 2009-10, whereas the allocation was 5.3 percent in FY 2010-11, 5.3 percent in FY 2011-12, 4.5 percent in FY 2012-13, 4.7 percent in FY 2013-14, 4.5 percent in FY 2014-15, and 3.8 percent in FY 2015-16 and 3.4 percent in FY 2016-17.

7.1. Public Investment in Health

In FY 2014-15, total amount allocated to this sector is Tk. 111.46 billion. The proposed allocation in health sector for FY 2014-15 is 4.45 percent of the proposed budget while it was 4.26 percent of the proposed budget in FY 2013-14. The rate of increase in allocation to this sector amounts to be 0.19 percentage point. Although this amount is higher than that of the previous year, it is still not sufficient to provide adequate health facility to the population as the doctor-population, doctor-nurse, nurse-population ratios are still far away from acceptable levels. Moreover, it is apparent that, in most of the fiscal year, the proposed budgetary allocation is reduced in the revised budget. For example, in the budget of FY 2013-14, the proposed allocation for health sector was Tk. 94.70 billion (including development and non-development budget). However, the allocation has been reduced to Tk. 85.49 billion in the revised budget for this sector. Additionally, reduction in the subsidy in health sector will make the situation more difficult to provide minimum health services to the poor people. However, the allocations of public spending for health as percentage of the total program spending have been on the decline in recent years.

However, development expenditure in health stood at 9.7 percent of the total development expenditure in FY 2009-10 compared to 8.7 percent in FY 2010-11, 7.5 percent in FY 2011-12, 6.8 percent in FY 2012-13, 5.3 percent in FY 2013-14, 5.3 percent in FY 2014-15, 5.4 percent in FY 2015-16 and 5.5 percent in FY 2016-17.

Figure 8: Development Expenditure on Health as Percentage of Total Development Expenditure



Source: Ministry of Finance, 2016a

As apart from other markets in part, health care services have some unique characteristics such as prevalence of uncertainty and risk, the problem of asymmetric information, restricted competition and widespread externalities. Bangladesh spends 3.4 % of GDP on health and less than 1% of the population is covered by an insurance scheme.

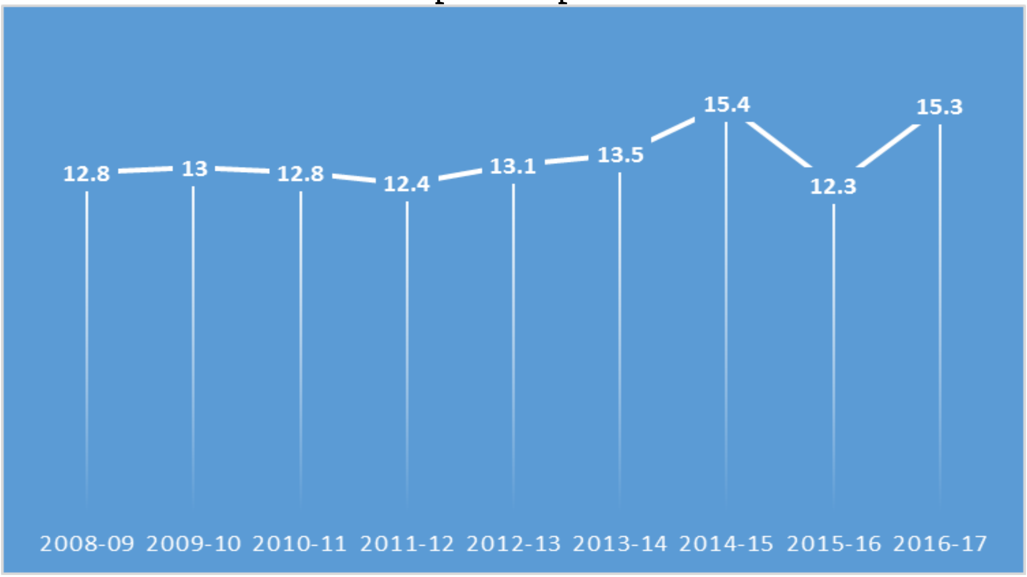
The health sector of Bangladesh has achieved significant progress in recent years. But still large numbers of households are being pushed into poverty, or those already impoverished are further burdened, both by ill-health and by excessive out-of-pocket payments for health care.

7.2. Public Investment in Education

It is needless to say that in order to improve the educational status of the population, large budgetary allocation is required. However, in the budget for FY 2014-15, the proposed allocation to this sector is Tk. 292.13 billion, which represents 16.42 percent increase compared to the previous fiscal year. Because of insufficient fund, the progress in education sector more or less has been limited to the increase of enrolment in primary education or to the increases of literacy rate. Moreover, the number of educated unemployed is on the rise as quality of education is not improving. It is to be noted here that the rate of increase in education budget was 27.73 percent between FY 2009-10 and FY 2010-11 and then it started to decline. Additionally, in most of the cases the proposed budgetary allocation has got negative revision during the period FY 2000-07 to FY 2012-13. The trend of allocations of public expenditure for education over the last few years has, however, been on the decline.

However, development expenditure in education stood at 13 percent of the total development expenditure in FY 2009-10 compared to 12.8 percent in FY 2010-11, 12.4 percent in FY 2011-12, 13.1 percent in FY 2012-13, 13.5 percent in FY 2013-14, 15.4 percent in FY 2014-15, 12.3 percent in FY 2015-16 and 15.3 percent in FY 2016-17.

Figure 9: Development Expenditure on Education as Percentage of Total Development Expenditure

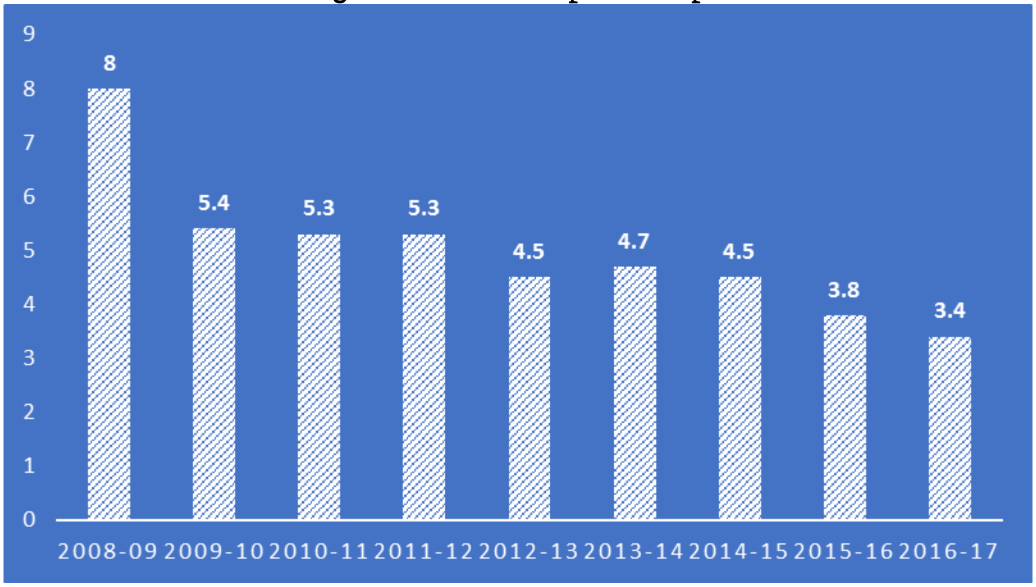


Source: Ministry of Finance, 2016a

7.3. Public Investment in Social Security and Welfare

The proposed allocation for the social safety-net and welfare sector is estimated at Tk. 139.74 billion in FY2014-15, which represents only 13 percent increase over the amount in the previous budget. The proposed allocation for the social security and welfare sector, which was Tk. 123.66 billion in FY 2013-14, was already considered to be inadequate for the population of the country as about three of every ten people are living under poverty line. Such low allocation was attributed to the diversion of expenditure from social sector to meet the rising payment on account of principal and interest for the high public borrowing to finance the budget deficit in the recent years. Moreover, in Bangladesh, social safety net programmes have been developed and evolved on adhoc basis. The major shortcoming of these SSNPs is that they are short-term in nature and only designed to address post-disasters situations. However, the allocations of public spending for social security and welfare as percentage of the total program spending have also been on the decline in recent years.

Figure 10: Development Expenditure on Social Security and Welfare as Percentage of Total Development Expenditure



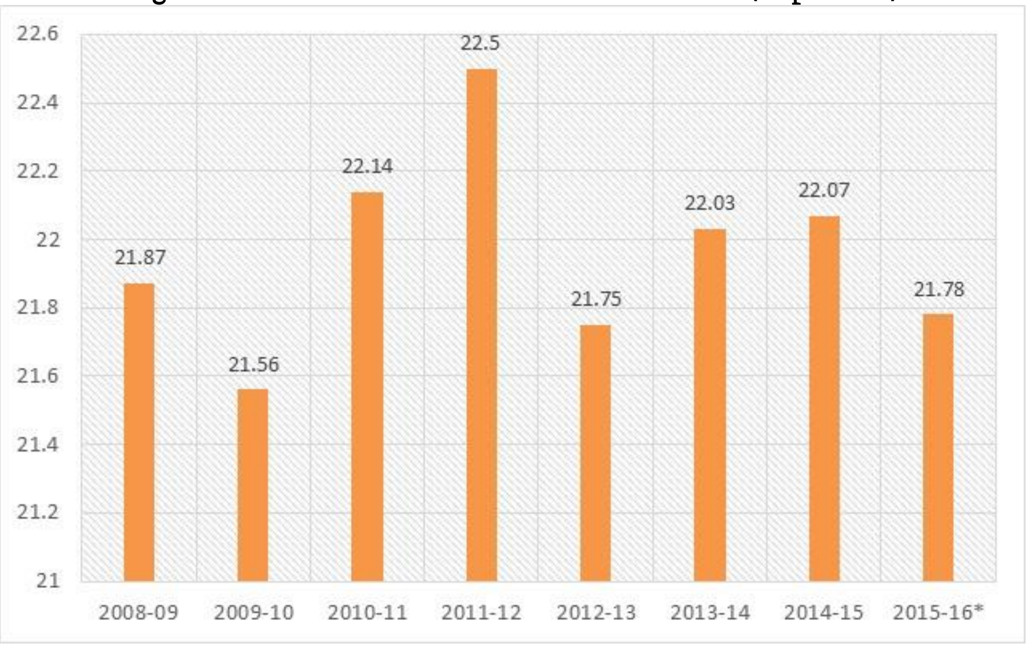
Source: Ministry of Finance, 2016a

However, development expenditure on social security and welfare stood at 5.4 percent of the total development expenditure in FY 2009-10, whereas the allocation was 5.3 percent in FY 2010-11, 5.3 percent in FY 2011-12, 4.5 percent in FY 2012-13, 4.7 percent in FY 2013-14, 4.5 percent in FY 2014-15, 3.8 percent in FY 2015-16 and 3.4 percent in FY 2016-17.

8. Private Investment, Capital Formation and Capital Flight

Not only the quantity, but also the quality of investment has not been satisfactory in the country. In comparison to countries like China and India which have posted rate of growth in double digit in the last decade, the investment is acting as a limiting factor for future growth prospect. In case of investment, the rate of total investment as percentage of GDP has been increasing, though the share of private investment has been on decreasing trend since the FY 2011-12. In FY 2011-12, total investment was 28.26 percent of GDP, whereas investment reached 28.39 percent, 28.69 percent, 28.97 and 29.38 percent in FY 2012-13, FY 2013-14, FY 2014-15, and FY 2015-16 respectively.

Figure 11: Private Investment as a share of GDP (in percent)



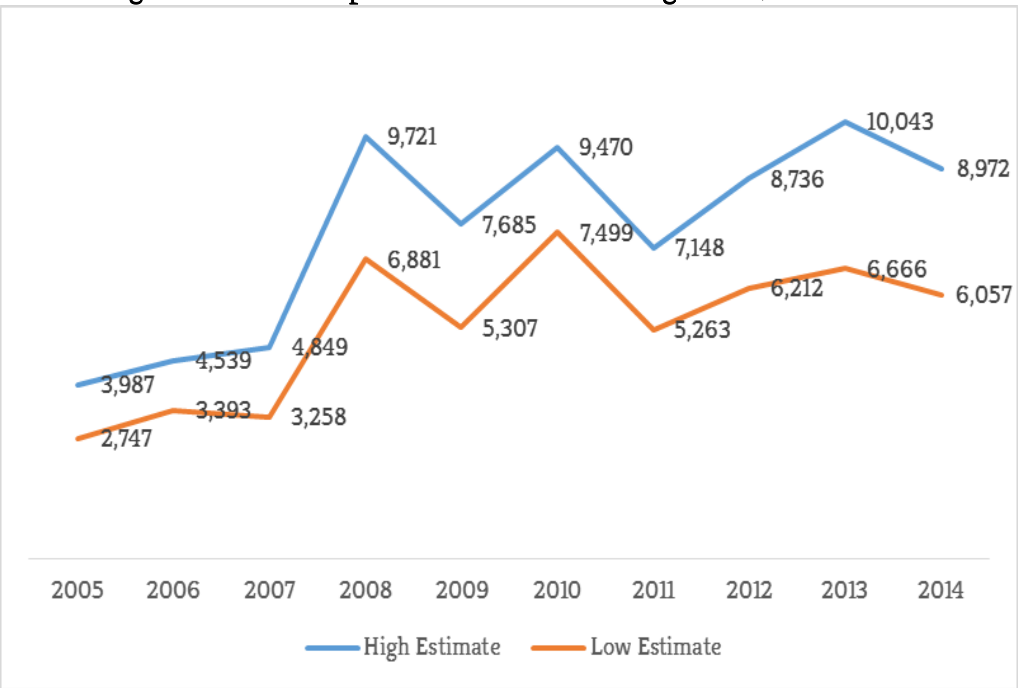
Source: Ministry of Finance, 2016b

The investment in private sector, however, occupies the primary role, which has traditionally accounted for more than 70 percent of total investment. While the investment in private sector has been stagnant since FY 2011-12, the investment in public sector has increased from 5.76 percent in FY 2011-12 to 6.64 percent in FY 2012-13, and then further increased to 6.55 percent in FY 2013-14, 6.90 percent in FY 2014-15, and 7.6 percent in FY 2015-16.

However, this increase could not raise the total rate significantly as the share of public sector in total investment is meager and is largely spent to meet the non-development expenditure. However, continuous sliding down of private investment from 21.75 percent in FY 2012-13 to 21.39 percent in FY 2013-14 to 22.07 percent in FY 2014-15 to 21.78 percent in FY 2015-16, increase in public investment from 6.64 percent in FY 2012-13 to 6.55 percent in FY 2013-14, to 6.90 percent in FY 2014-15 and to 7.6 percent in FY 2015-16 has failed to create much needed crowding in of private investment.

In addition, lack of adequate capital formation due to large scale illicit capital outflows every year causes national savings and investment not to rise significantly. Highest estimates by the Global Financial Integrity suggest that during the period of 2005 to 2014, illicit capital outflow amounted to USD 7.5 billion every year on average. As the latest count shows that the amount of illicit capital outflow from Bangladesh was USD 9 billion in 2014.

Figure 12: Illicit Capital Outflows from Bangladesh, 2005-2014



Source: Global Financial Integrity, 2017

9. Unemployment

The rate of unemployment in the country, particularly youth unemployment is rising at a significant rate. In addition, casual work constitutes almost two-thirds of wage employment in Bangladesh (International Labour Organization, 2016) With a growth rate of 3.88 percent (from 1995-96 to 2010), the number of total civilian labour force in 2010 increased to 57.1 million out of which 40.2 million was male and rest 16.9 million was female. In 1995-96, the total civilian labour force was 36.1 million out of which 30.7 million was male and only 5.4 million was female. A total of 34.8 million were employed and 1.4 million were unemployed in 1995-96, which increased to 54.5 million and 2.6 million respectively in 2010 (BBS, 2011). The number of unemployed population increased at an annual rate of 5.29 percent during the period of 2000-2010 and increased from 1.70 million in 2000 to 2.60 million in 2010 while 10.6 million people were day laborers who did not have job security. Taking this trend into account, it is calculated that the country needs to increase employment opportunities by two percent in order to enter the middle income group by 2021.

When underemployment is taken into account in assessing the status of the labor force in Bangladesh, the perception of the labor market significantly changes. The information on hours worked shows that a total of 10.99 million (which is about 20.31 percent of the employed labor of 54.1 million) were underemployed in 2010. This shows an extremely high level in the number of the people who work less than 35 hours per week. Also the information shows high incidence of underemployment in rural areas and among the female labor force. Another disappointing aspect is working poor. A large number of people, both in the formal and informal sector work at a wage rate far below the poverty line. While 32 percent of the population fall below the USD1.90-a-day international poverty line, 80 percent of the population falls below the USD 3.10-a day poverty line. And, there is very little difference between those 32 percent at the bottom, and those 48 percent just above them. These working poor are vulnerable to any shocks to the economy or to their personal life – they risk falling into extreme poverty.

10. Conclusions

In order to get rid of the outlined bottlenecks, the country has been waiting for a medium-term strategy that generates increment in the productive capacity and provides avenues for the poor to obtain an increased share. The adoption of such a growth strategy necessitates a prudent economic management. It warrants harmonisation of fiscal and monetary policy in order to stimulate the expansion of productive capacity and the fall in the rise of inflationary pressure.

A vigilant look into the falling investment demand is pressing since any further decline in the private investment is assumed to significantly slow down the pace of growth in the economy. The private domestic expenditure may be dampened, if a decline in expenditure happens. The growth of export as well as increased private investment should, therefore, be emphasised in order to escape further downturn in the economy. Macroeconomic stimuli are required to be initiated in order to ensure pro-poor growth through generating employment opportunities in the economy. Besides, an increased allocation of resources and implementation of development programmes in health and education sectors must be ensured, while the social safety net programs institutionalised into of a sustained system of social security.

The proposed actions in various macroeconomic plans and strategies are inadequate to bring fiscal discipline in the management of deficit, debt and subsidy one the one hand and to increase income in the absence of radical reforms in the tax system on the other. The regressive tax structure is ridden with low base, avoidance and evasion. There is huge missing of distributive justice, characterised by widening income, spatial and male-female inequalities, driven by jobless growth.

There is need for a pro-active state. As experienced in the recent past, policies that focus mainly on stabilisation, but pay little attention to proper allocation and distribution is more likely to even fail in stabilisation of the economy as well. Second, numerous un-coordinated seemingly less than effective programmes relating to social safety nets need to shift its emphasis on social protection through innovation in social policies. Third, given the vulnerabilities existing in the external sector, breaking into the high-value global supply chain has become important to the country.

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