

**Expenditure on Social Sector vis-à-vis Public
Spending: An Assessment**
Bangladesh Economic Update
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Acknowledgement

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1. INTRODUCTION

The current issue of Bangladesh Economic Update aims at assessing the trend of public spending in connection with the allocations for social development – improvement in education, health, social security and welfare, and housing. The Update finds that on the one hand public spending assumes an increasing trend in Bangladesh, but yet the country lags far behind other developing countries in accumulating the public spending up to the mark in order to expedite economic growth and accelerate the declining rate of poverty. On the other hand, allocations of public spending for social sectors as percentage of the total program spending¹ have recently undergone decreasing trends signaling inadequate investments in social development and posing challenges to the formation of human capital in the country.

The Update puts particular emphasis on the necessity of an effective fiscal management system that would help the government increase public spending and thus channel adequate resources to such sectors as education, health, social security and welfare, and housing, thereby ensuring the provision of public services and facilitating the formation of human capital in Bangladesh.

Public spending in social sector is generally considered to play an important role in the economic development of a country by maintaining law and order, providing economic infrastructure, harmonising conflicts between private and social interests, increasing labor productivity through education and health and enhancing export industries (Khalifa 2001). It influences every sphere of citizens' lives – work, transportation, health care, recreation, and educational facilities.

2. PUBLIC SPENDING AND DEVELOPMENT: SOME PREFATORY REMARKS²

Public spending can affect growth and poverty reduction in two ways: it can raise the overall growth performance of the economy, and it can increase the

¹ Total program Spending = Total Spending – (Domestic and External Interest Payment + Structural Adjustment Cost + Net Loan & Advances + Net Food Account).

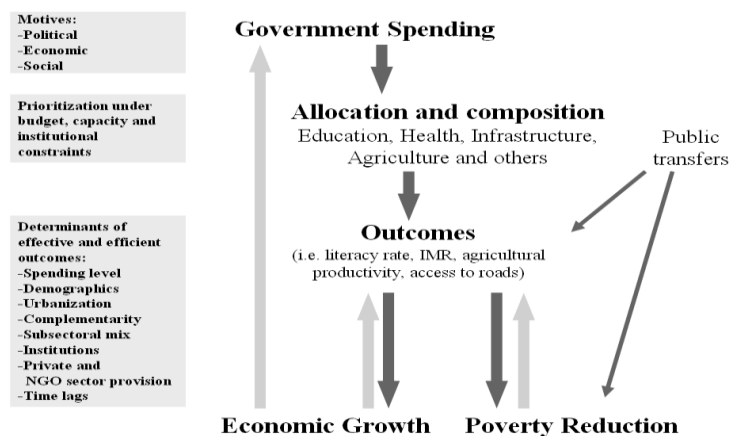
² This section draws heavily on Wilhelm and Fiestas (2005).

chance of the poor to contribute to the growth process (mainly by strengthening human capabilities and reducing transaction costs). Both types of expenditures may reduce poverty, but in the case of more growth oriented expenditures, the poverty impact is usually more indirect. For both types of expenditures, the impact on poverty levels is likely to be experienced with a time lag. The critical challenge is how to strike the right balance between spending that focuses primarily on growth and spending that aims at reducing poverty. While there is no clear answer to this question, it may be useful to review recent thinking and experience with public spending.

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The 1990s brought a new paradigm for fighting poverty (World Bank, 1990) with emphasis on strengthening capabilities of the poor and an increased focus on the non-income dimensions of poverty. Public intervention was supposed to follow a twofold strategy, promoting labor-intensive growth and investment in human capital via primary health care, primary education and targeted social spending to reduce poverty, thus, avoiding a tradeoff between growth and poverty reduction. The experience of the East Asian Miracle economies with their high investment in human capital (first, universal primary education, followed by the increasing availability of secondary education and skill building) resonated well with this view (World Bank, 1993). Later in the decade, public investment in infrastructure was emphasised as a means for poverty reduction by facilitating access to markets and reducing the high transactions costs of poor households (World Bank, 1994).

Figure 1: Relationship between government expenditure, economic growth, and poverty alleviation



Source: Wilhelm and Fiestas, 2005

The broad principles for guiding public expenditure allocations are based on the need to address market failure (public goods, externalities) to promote growth, and improve distribution and reduce poverty through public interventions (Fan and Coady 2004). The sources of market failure commonly identified in the literature are: the absence of competitive markets, the existence of positive or negative externalities in consumption and production, the undersupply of public goods by the market, imperfect information on production and consumption opportunities and coordination failures (Fan and Coady 2004; Paternostro et al. 2004; Fozzard 2001). However, the notion of what constitutes a public good may change over time (i.e., the provision of universal schooling by the state was established only in the 20th century, while prior to that the sector was dominated by mostly religious private providers), and what is considered a market failure may vary with country conditions (i.e., investment in utilities in poor countries).

Also, few expenditures fall nicely under one category (market failure) or another (improved distribution) and many have both an effect on growth and poverty reduction, particularly when the medium term impact of growth on poverty reduction is considered (i.e. primary education is a public good with significant positive externalities, and it also can redress asset inequality, when provided to children from poor households) (Datt and Ravallion 2002; Lundberg and Squire 2003). Where the poor are particularly hard hit by market failure, e.g. access to credit, “win-win” possibilities can arise, and government intervention may lead to both a more efficient and a more equitable allocation of resources.

Many studies have attempted to analyse the impact of government spending (education, health, infrastructure, agriculture, or a combination thereof) on economic growth and poverty reduction (Devarajan, Swaroop, and Zou 1997). Their results vary significantly in terms of the detected effect and efficiency of different expenditure categories in various countries, as the impact of public spending is limited by various factors and constraints.

3. THEORETICAL COMMENTS

A number of theoretical frameworks have been developed in order to comprehend the effect of public expenditure on growth. A brief account of the major theoretical

understandings is sketched in order to construct a framework for explaining the trend, and effect of the public expenditure especially social sector expenditure in Bangladesh.

Keynesian hypothesis (Keynes 1936), however, focused on the role of public expenditure in determining levels of income and distribution in the economy. In the Keynesian paradigm, economic growth is considered to occur as a result of rising public expenditure which is assumed as an independent exogenous variable to influence the economic growth. While Wagner's approach (Wagner 1883) suggests that causality runs from output to public expenditure, the Keynesian approach assumes that causality runs from public expenditure to output. Both the Wagner's hypothesis and Keynesian hypothesis are short-run phenomenon in which the causality testing approach helps to identify the short-run interaction between public expenditure and economic growth. Wagner's law contains six versions which have been empirically tested by different economists over the years.

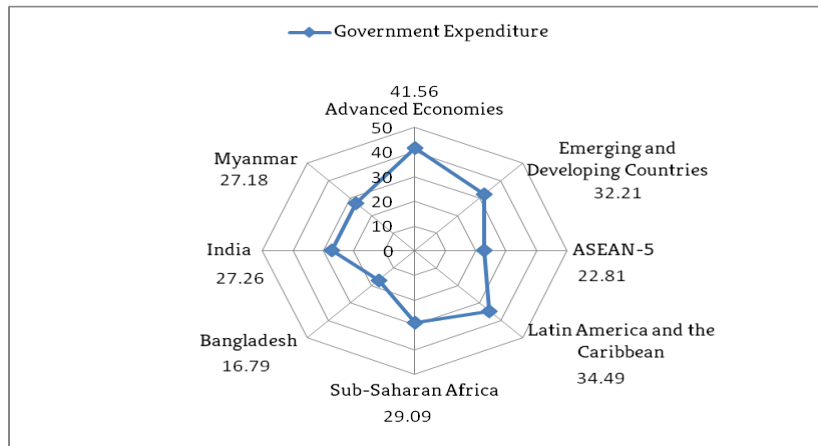
Wagner's hypothesis further emphasises that in the process of economic development, government economic activity increases vis-à-vis private economic activity. Wagner offered three reasons why this case would happen. Firstly, with the economic growth, industrialisation and modernisation would take place which will diminish the role of public sector for private one. This continuous diminishing share of the public sector in economic activity leads to more government expenditure for regulating the private sector. Secondly, the increase in real income would lead to more demand for basic infrastructure particularly education and health facilities. Wagner asserts that it is the government who provides these facilities to the public more efficiently than private sector. Thirdly, to remove monopolistic tendencies and to enhance efficiency in economy, the government should come forward and invest in particular sectors that will increase public expenditure and ensure the provision of public services.

Todaro (2003) explicates two effects of the public expenditure on education and health – social and individual. For example, the private or individual benefit of public spending on education is that a more educated student is considered to earn considerably more income through future modern sector employment than a less educated student while social benefits of education are the payoffs of the education to the whole society.

The government's perspective plan to increase the size of the government spending in relation to GDP in order to provide the basic economic and social services and improve the quality of public service delivery across the country has been remaining unachieved over the years.

Bangladesh, as argued earlier, lags far behind other developing as well as its neighboring countries in raising public spending adequately. The government's perspective plan to increase the size of the government spending in relation to GDP in order to provide the basic economic and social services and improve the quality of public service delivery across the country has been remaining unachieved over the years. In 2013, the public spending stood at 32.21 percent of GDP in the developing and emerging economies, whereas Bangladesh accumulated only 16.79 percent of its GDP as public spending. The volume of public spending is far lower in Bangladesh than in its two neighboring countries – India and Myanmar. The figure 2 shows that Bangladesh lags far behind the Sub-Saharan Africa in accumulating public spending. The volume of public spending in Sub-Saharan Africa reached 29.09 percent of its GDP in comparison with Bangladesh's 16.79 percent in 2013.

Figure 2: Volume of government expenditure as percentage of GDP in different countries



Source: Ministry of Finance, 2015

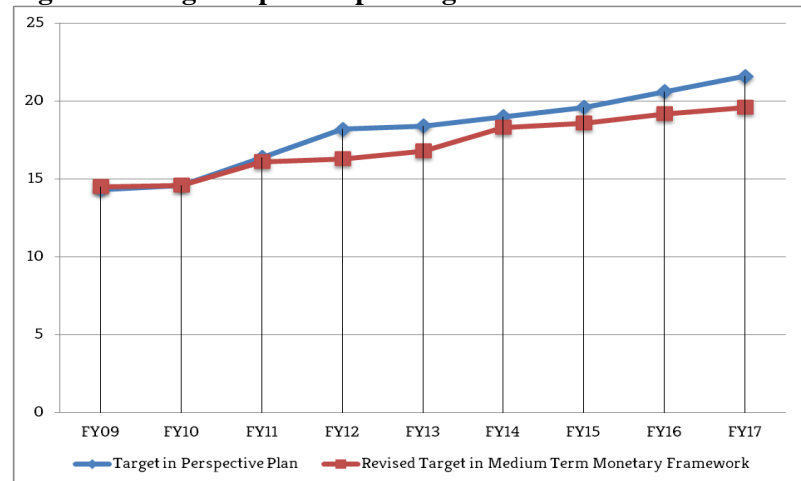
4. TOTAL PUBLIC SPENDING: TREND, SIZE, AND COMPOSITION

Public spending contributes to the Government's overall growth and poverty reduction efforts by offering suggestions about the efficient use of public resources and fiscally sustainable improvements in public services. This objective is served little. Public expenditure in Bangladesh is characterised by large amount of non development expenditure, small social spending, inadequate annual development programme, inefficient use of allocations.

In FY13, the actual government spending was 1.6 percentage point lower than the target level. Despite the initiation of vigorous reforms in the revenue sector, revenue mobilisation target could not be achieved since FY12.

In FY08, public expenditure was 16.6 per cent of GDP which was reduced to 14.5 per cent and 14.6 percent of GDP in FY09 and FY10 respectively as a consequence of global economic downturn but it was still higher than the target level set in the perspective plan. Since FY11, government expenditure has again started to pick up but grew at a slower pace compared to the targets due to slower growth in collection of government revenue. In FY13, the actual government spending was 1.6 percentage point lower than the target level. Despite the initiation of vigorous reforms in the revenue sector, revenue mobilisation target could not be achieved since FY12. As a result, government expenditure targets for the subsequent years are needed to be revised in line with revenue earnings. However, the government has revised the perspective targets and set the new targets of public spending at 18.6 percent, 19.2 percent, and 19.6 percent for FY15, FY16, and FY17 respectively, which also do not seem likely to be achieved amidst the current state of economy that is characterized by political standoff. In addition, the government intends to pursue a moderate consolidation path over the medium term to keep budget deficit within 5 per cent of GDP. In view of this, the government must therefore achieve its public expenditure targets set in the medium term macroeconomic policy statement.

Figure 3: Target of public spending



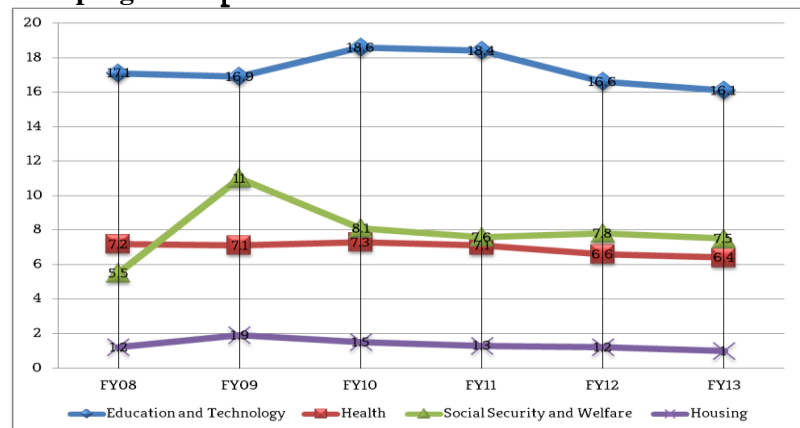
Source: Ministry of Finance, 2015

5. SOCIAL SECTOR SPENDING

Due to insufficient accumulation of public spending, the allocations for social sectors by which the government being obliged by the social contract between the state and the citizens provide social services – education, health, social security, and housing – to society are not up to the mark of ensuring the provision of public services throughout the country. Statistics show that the actual allocations of public spending for such sectors as education, health, social security and welfare, and housing has been on the decline since FY08. The Figure 4 demonstrates that the allocation for education and technology was 17.1 percent of the total program expenditure in FY08, whereas the allocation reduced during the subsequent years and stood at 16.1 percent in FY13. The allocations for health were in decline indicating the poor status of the provision of health services to society in the country. The health allocations stood at 7.2 percent, 7.1 percent, 7.3 percent, 7.1 percent, 6.6 percent, and 6.4 percent of the total program expenditure in FY08, FY09, FY10, FY11, and FY13 respectively. Along the same vein, the allocations for social security and welfare reduced from 11 percent in FY09 to 7.5 percent in FY13, signaling the system of social security and welfare to be very weak. The allocations for housing has always remained marginal causing housing planning particularly in urban areas to be ineffective, thereby creating unplanned and unsustainable urban and regional planning and development. The allocation for housing was 1.9 percent in FY09, whereas it reduced to 1.5 percent, 1.3 percent, 1.2 percent and 1 percent in FY10, FY11, FY12, and FY13 respectively.

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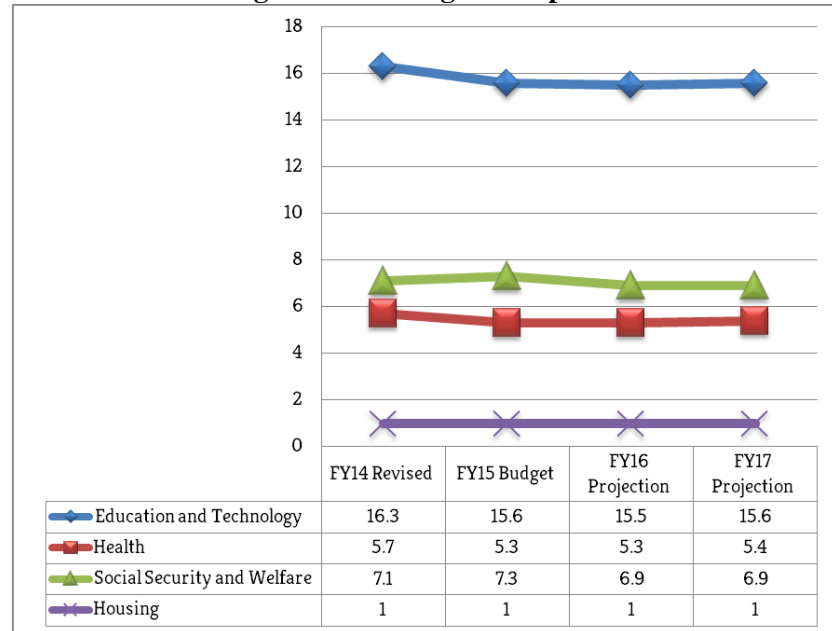
Figure 4: Actual spending on social sectors as percentage of total program expenditure



Source: Ministry of Finance, 2015

The picture of revised allocation for education, health, social security and welfare, and housing in FY14 and projected allocations in FY15, FY16, and FY17 is, however, much worrying. The revised allocation for health has reached 5.7 percent of the total program expenditure in FY14 representing a 0.7 percentage point decrease from the allocation in FY13. In addition, the projected allocations for health also assume a declining trend as well. As a result, the provision of health services to society will be a massive challenge for the government and may pose serious difficulty to the formation of human capital in the country. The projected allocations for education and social security also tend to assume declining trends implying the weak fiscal performance of the economy and insufficient provision of social services to society.

Figure 5: Revised, Budgeted, and Projected Spending on Social Sectors as Percentage of Total Program Expenditure



Source: Ministry of Finance, 2015

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.

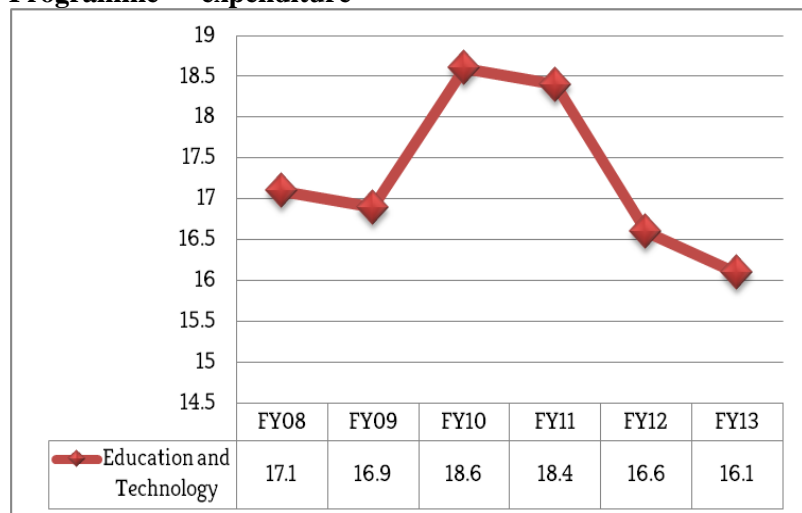
5.1. Education

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

The trend of allocations of public expenditure for education over the last few years has, however, been on the decline.

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 (Mustafiz, 2014). The trend of allocations of public expenditure for education over the last few years has, however, been on the decline. The Figure 6 shows the declining trend of allocation of public expenditure for education as percentage of the total programme expenditure.

Figure 6: Spending on Education as Percentage of Total Programme expenditure



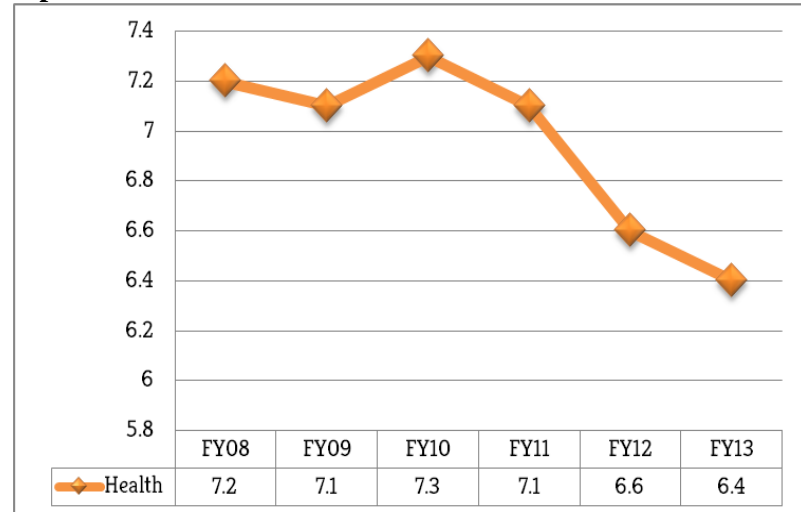
Source: Ministry of Finance, 2015

5.2. 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. The figure 7 demonstrates the recent declining trend of program spending allocations for health.

Figure 7: Spending on health as percentage of total programme expenditure



Source: Ministry of Finance, 2015

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.

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 (Cevik and Tasar 2013). 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.

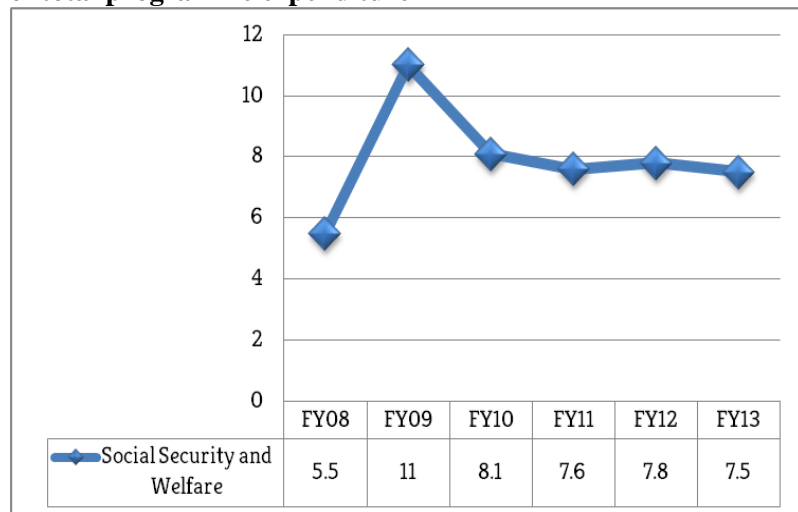
5.3. Social Security and Welfare

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

The major shortcoming of these SSNPs is that they are short-term in nature and only designed to address post-disasters situations.

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. The figure 8 demonstrates the recent declining trend of program spending allocations for social security and welfare.

Figure 8: Spending on social security and welfare as percentage of total programme expenditure

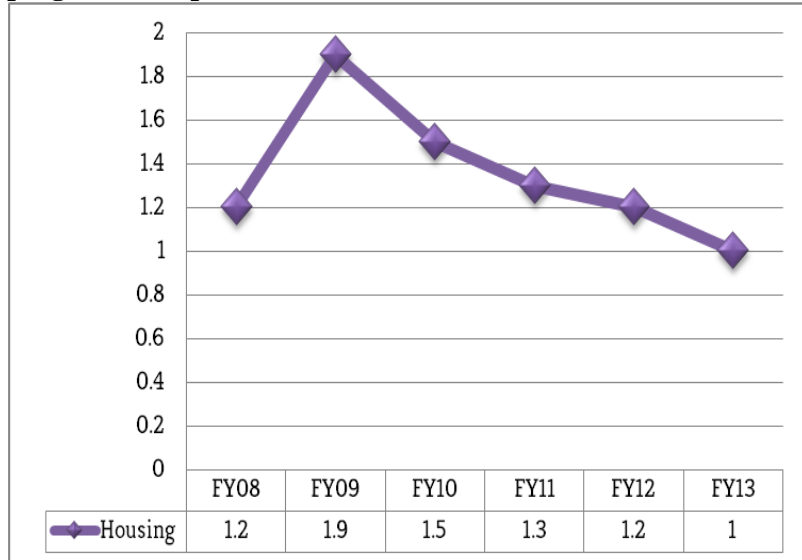


Source: Ministry of Finance, 2015

5.4. Housing

The lack of available and accessible housing finance has been identified as the most important hurdles in improving the housing conditions for middle and lower income households. The budgetary allocations for housing have remained stagnant over the recent years. Housing in urban areas particularly in Dhaka city with growing population due to migration from rural areas has become a major challenge for the government. The allocations of public spending for housing have been on the decline since FY09. The figure 9 shows that the public spending allocations for housing reached 1.9 percent of the total program expenditure in FY09 and then reduced to 1.5 percent, 1.3 percent, 1.2 percent, and 1 percent in FY10, FY11, FY12, and FY13 respectively.

Figure 9: Spending on housing as percentage of total programme expenditure



Source: Ministry of Finance, 2015

In pursuit of inclusive growth in the economy, Bangladesh has been lagging behind in terms of achieving the target of allocating resources for welfare programmes.

In pursuit of inclusive growth in the economy, Bangladesh has been lagging behind in terms of achieving the target of allocating resources for welfare programmes. Statistics suggest that the total transfer as percentage of GDP has been declining since FY09 although the allocation has slightly increased in FY14 in comparison with FY13, but yet the allocation in FY14 is much lower than those of the other previous fiscal years. Recent decelerated decline in the rate of poverty can, however, be attributed to the decreasing trend of transfer payments. The poor and marginalised section of society that benefits from the social safety net programs may undergo severe difficulty in living their lives at subsistence level. Table 1 evinces the declining trend of allocations for social safety net programmes over the recent years.

Table 1: Transfer payments

Items	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14
Total Transfer (as% GDP)	2.38	2.81	2.80	2.79	2.74	2.44	2.52
Of which Grants in aid	1.70	2.20	2.16	2.07	2.03	1.86	1.93
As % of Grants in Aid							
General Grants	3.59	2.33	20.55	30.25	32.47	30.45	26.22
MPO to Teacher	35.82	22.41	30.62	30.23	26.89	27.42	23.52
VGD	5.88	5.64	4.09	4.00	4.11	4.16	3.68
VGF	5.75	11.10	4.28	2.30	2.92	4.44	5.99
TR	4.38	4.55	6.75	3.88	6.88	7.76	6.74
GR	1.25	1.40	0.73	0.76	0.95	0.86	1.21
Other	43.33	52.56	32.98	28.58	25.79	24.91	32.64
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

[Note: VGD: Vulnerable Group Development, VGF: Vulnerable Group Feeding, TR: Test Relief, GR: Gratuitous Relief]

Source: Ministry of Finance 2015

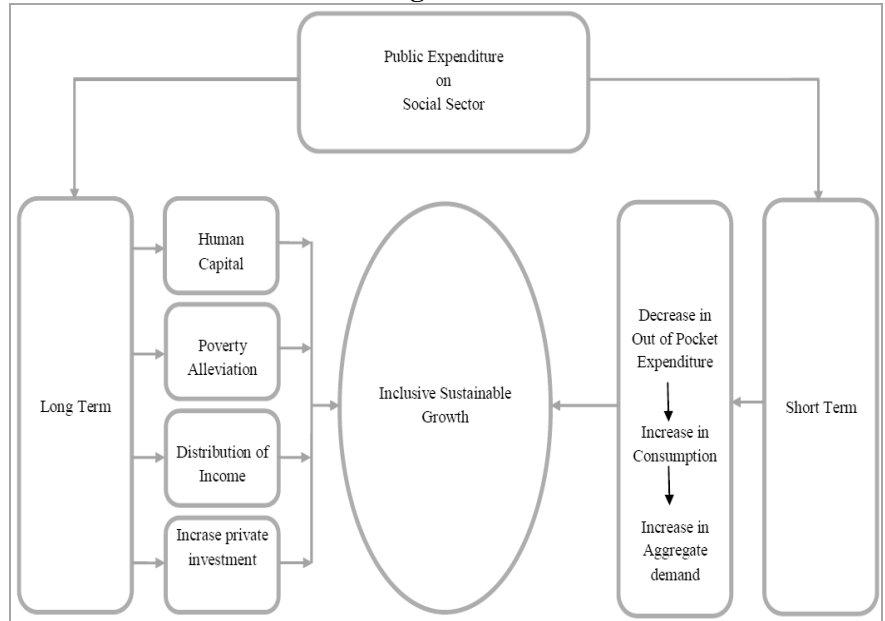
The major barrier to the challenge of unsustainable social development is, therefore, considered to be the insufficient government expenditure on providing social services throughout the country.

6. CONCLUSIONS

As demonstrated above, the allocations of public spending for social sectors – education, health, social security and welfare, and housing – have been on the decline in recent years signaling the trend in social development to be unsustainable. The projected allocations for social sectors in the medium term macroeconomic policy statement FY15 – FY17 are inadequate to keep the pace of social development, for which Bangladesh has been commended worldwide, in the coming years. The major barrier to the challenge of unsustainable social development is, therefore, considered to be the insufficient government expenditure on providing social services throughout the country. In addition, the absence of an effective social security system also hinders the path of social development exerting immense adverse impact on the low-income population particularly the poor and marginalized group in the society. It is, however, needless to say that the government must focus on raising public expenditure through increased collection of revenue and allocating sufficient resources for such sectors as education, health, social welfare, and housing in pursuit of achieving a sustainable trend in social development in the country. The development of an efficacious social security system is also pressing in order to ensure the provision of social services especially the health services to the public. Monitoring of the social safety net

programmes also needs to be carried out regularly in order to evaluate the effectiveness of the programs in empowering the poor and marginalised population of the country. The figure 10 illustrates how public expenditure on social sector is inextricably interlinked with inclusive sustainable growth both in short and long terms.

Figure 10: Relationship between public expenditure on social sector and inclusive sustainable growth



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