

State of Bangladesh economy in 2003-04: First interim report

The first interim report (July-December 2003) on 'State of the Bangladesh Economy in the Fiscal Year 2003-2004' has been prepared by the Centre for Policy Dialogue (CPD) under its programme titled Independent Review of Bangladesh's Development (IRBD). The Daily Star has decided to publish the paper in four instalments.

Part 1 1.Introduction

Towards the end of 1990s, the macro-economic balances of the Bangladesh economy were confronting the twin pressures emanating from fiscal deficit and balance of payment (BOP). At a structural level, the economy had plateaued in terms of the upward movement in the domestic savings rate and gross private investment rate (as percent of GDP). In spite of robust growth of the agriculture sector, private investment, particularly in the manufacturing sector was decelerating. However the price-level continued to remain low and stable.

The new incumbent government which took office in October 2001, during the first two years (2001-02 and 2002-03) of its tenure was thus engaged, on a priority basis, in strengthening the macro-economic co-ordinates of the economy through fiscal consolidation and strengthening of the BOP. The government also appreciated the need to stimulate investment. The Independent Review of Bangladesh's Development (IRBD) prepared by the Centre for Policy Dialogue (CPD) in its latest edition noted that in FY03 the fiscal balance experienced some consolidation and the country's balance of payment improved further; however, the signs of investment stagnation still remain manifest.

In this context, CPD in its review of National Budget for FY04 pointed out in June, 2004 that the performance of the economy in the current fiscal year will depend on the following four critical factors:

- (i) Full and faithful implementation of the ADP promoting emphasis on the quality of the projects;
- (ii) Resurgence of exports and gradual diversification of the commodity basket;
- (iii) Higher inflow of private investment in manufacturing activities, particularly in import-

competing sectors; and
(iv) Ability to provide supportive credit and monetary policy to fiscal measures by maintaining stability of the exchange rate and price index as well as reducing the cost of capital.

CPD's budget review for FY04 in conclusion pointed out that "without significant alleviation of the micro-level impediments to investment, ranging from enhancing the efficiency of public utilities and the financial system, measures to improve the security for life and property, addressing the dysfunctional judicial process and tackling pervasive corruption, the anticipated supply-side response will be hardly forthcoming".

Recently the present government has entered into the third and, possibly, the defining year of its tenure. Common wisdom about the political cycle of Bangladesh tells us that successive governments are prone to undertake a series of energetic reform measures during the first couple of years of the regime which invariably run out of steam as the next national election approaches. From this perspective, FY04 has to be "the year of the big push" for the government in order to avert the setting in of the mid-term inertia.

As one looks back to the first six months of the current fiscal year, one can identify a number of issues which distinguish the period. These issues include energetic measures in the financial sector, and intensive bilateral, regional and multilateral trade negotiations, and fresh movements (bubbles!) in the capital market. But these positive movements were paralleled by such developments as the rise in price of essential consumer goods, seasonal employment and income deprivation (Monga) in the Northern districts and the emerging paralysis in the privatisation process.

In order to generate for a proper understanding of the current state of economic affairs, this paper puts under scrutiny some recent trends in the Bangladesh economy, particularly in the areas of public finance, monetary policy, real economy and the external sector.

2.Public Finance

In the area of public finance it will useful to analyse the current trends in revenue generation, public expenditure including the Annual

Development Programme (ADP) and financing of the budget deficit.

2.1 Revenue Earning

The National Board of Revenue (NBR) commands about three-quarter of total revenue generation in Bangladesh. Non-NBR taxes account for another 4 percent of the total revenue, while the remainder (20 percent) comes from non-tax revenues. In the recent years, NBR has been more or less fulfilling its budgetary targets, whereas non-NBR revenue and non-tax collection were systematically lagging behind.

Total revenue collection in FY03 was equivalent to about 10.4 percent of the GDP. Achievement of the target for FY04 may take this parameter to about 11 percent of GDP, which is still quite low by all cross-country standards.

The NBR target for FY04 is Tk. 27,750 crores implying a 16.8 percent annual growth. Analysis of information on revenue collection under NBR during the period July-November, 2003 reveals that total revenue growth was 9.74 percent resulting in almost the full realisation of the temporal target.

However, a disaggregated analysis reveals that growth of total internal trade-related revenue was higher (12.1 percent) than that of total import-related revenue (8.1 percent). In the backdrop high import growth in the recent months (discussed later) non-fulfilment of target (around 4 percent shortfall) for collection of import duty comes as a surprise. It is further contradictory that the Supplementary Duty (Import) collection recorded the highest growth (39.6 percent) which is tagged with core duty collection. The revenue collection growth for VAT (Local) 16.6 percent, and Supplementary Duty (Local) 14.2 percent. A decomposition of imports and the tariff structure analysis may put some light on the matter and confusion may be removed.

As a whole, collection by NBR depicts a business as usual scenario, since a 10 percent annual growth usually comes for the normal expansion of economic activities. Reorientation of the tax base, from preponderance of foreign trade related taxes to higher expansion of VAT (Local) is a welcome trend. However, the relatively modest growth (9 percent) in income tax collections, in spite of

various potential payee identification initiatives suggests that efforts to increase the role of direct taxes in total revenue is yet to show any sign of improvement.

2.2 Public Expenditure

Total public expenditure in FY03 accounted for about 14.6 percent of GDP, of which ADP commanded about 39 percent, whilst revenue and other expenditures accounted for about 61 percent.

If the target volume of public expenditure is realised in FY04, its share in GDP will increase to 15.9 percent without significantly changing the split between ADP and non-ADP heads. What is important to note is that public expenditure in FY04 is targeted to grow at a faster rate than revenue earning particularly through ADP expansion underwritten by a higher inflow of foreign aid. Notwithstanding such gains, the public expenditure ratio in Bangladesh remains quite low when in comparable countries the said share is around 20 percent of GDP.

2.3 Revenue Expenditure

The budgeted amount for revenue expenditure is about Tk. 29 thousand crores. Regrettably, real time data is usually not accessible for revenue expenditure till the end of the fiscal year.

However, the structural rigidities of the revenue expenditure portfolio are well known. Economic analysis of the composition of revenue expenditure indicates that only three heads account for more than 75 percent of the total.

These three heads include: Salary and allowances (about 26 percent), subsidies and transfers (27 percent), and debt servicing liability (more than 22 percent). For all practical purposes, allocation and spending practice in FY04 will not be significantly different from this trend.

In this connection, it may be noted that expenditure on account of defense services as a share of total revenue spending has secularly come down from its peak 18.2% in FY98 to 13.5% in FY03. In FY04, the allocation for defence services amounts to 12.2% of the total revenue expenditure.

Advisably, in FY04, revenue expenditure growth (14.5 percent)

has been kept below the revenue earning growth (16.2 percent). But experience suggests that while revenue expenditure routinely exceeds the budgetary limit, target for total revenue earning is often missed.

One of the positive aspects of the revenue expenditure portfolio for FY04 has been the higher allocation (more than 28 percent increase) for Operation and Maintenance an usually neglected area. On the other hand, in FY04 about 6.8 percent of the revenue budget was kept as a "Block Allocation" (an increase of Tk. 100 crores to Tk. 1700 crores) possibly for meeting an anticipated pay rise for government employees. Recent decision of the government to transfer a number of projects to revenue budget may also be underwritten by these unallocated resources.

Although the volume of domestic debt (currently 16% of the GDP) remains moderate trends in revenue expenditure composition reveal continuous rise in debt servicing liability (DSL) on account of domestic debt, whilst DSL for foreign loans may be expected to rise in the coming years given the nature of the recent aid inflow.

It may be recalled that interest payment on account of domestic debt has steadily increased from about 11% of revenue expenditure in FY98 to more than 18.2% in FY03. The target figure for the same in FY04 is about 18.85%. The recent increase in domestic DSL may be explained by the government's attempt to finance deficit through borrowing from non-banking sources which is costlier than the money from banking source, but is non-inflationary. On the other hand, debt servicing liability on account of foreign debt decreased from 5% of revenue expenditure in FY98 to about 3.8% in FY03. The projected figure for this in FY04 is about 3.37%.

2.4 Annual Development Programme

The ADP for FY03 was Tk. 19,200 crores which was later slashed down to Tk. 17,100 crores. In reality, the realised size of the ADP was to the last year tune of Tk. 15,297 crores, i.e. about 80 percent of the original target. The realised ADP figure for FY03 was only about 66.5 percent of the revenue expenditure.

The ADP target for FY04 has been fixed at Tk. 20,300 crores, i.e. an additional Tk. 5,000 crores has to be spent during the current fiscal year over its preceding benchmark. From experience of earlier periods, it is anticipated that the overall size of ADP will be reduced by around Tk. 4000 crore. In the discussions in wake of the National Budget FY04, some questions have been raised on the viability of this "ambitious target". In FY03, private investment as share of GDP actually decline from 16.78% to 16.49%, whereas the corresponding share of public investment increased from 6.37% to 6.72%.

However, it needs to be pointed out that in the recent past the gross investment rate remained stable in spite of the deceleration of private investment thanks to moderate ADP growth. However in a recent speech before the Economic Cadre officers the Finance Minister pointed to the proliferation or useless projects and the padding of many projects with wasteful expenditure. It is thus not the overall size, but the quality of the projects included in the ADP which matters most. Furthermore, the capacity of the line ministries to absorb such incremental allocation of resources is open to doubt. Thus the operative issue which needs to be investigated is whether this increase in ADP expenditure actually constitutes growth generating investment.

The National Budget FY04 stated that a total number of 1176 projects will be included in the ADP, including 174 unapproved projects. Up to November, 2003, 24 projects have been approved and approximately Tk. 1100 crores has been allocated already to this end. It may be recalled that Tk. 2346 crores (about 12 percent of ADP) was allocated under the different ministries as "Block Allocation" in the budget for the current fiscal year. It was not immediately clear whether such flexibility in allocative decision will breed allocative indiscipline in course of time or that these projects will be purposefully designed and resources used more efficiently.

Foreign resources are expected to underwrite about 51 percent of the ADP outlay in FY04, while the balance is to come from domestic sources revenues surplus (36 percent) and bank borrowing (13 percent). Such a contribution of

bank borrowing may be compared with the 20.7 percent contributed by bank borrowing in 2000-2001 when the issue of rising dependence on bank financing was exposed to intense public debate.

Early information on ADP implementation suggests that a total amount of Tk. 2141 crores, i.e. about 10.6 percent of the total budget was spent during the first quarter of FY04 (July September). The overall utilization of ADP up to October, 2003 was 15%, in comparison with the utilization rate of FY02 (up to October, 2002) 16.5%. The first quarter of any fiscal year is usually a dull period from public expenditure point of view. This ratio compares almost equally with the same share for other years (with respect to actual ADP size). Financing through project aid (about 52 percent) during the first quarter was however relatively higher in pro-rata term. However, it needs to be pointed out that such a business-as-usual approach will not be helpful in realising the full annual target of the ADP in the current fiscal year.

In the ADP of FY04, a number of projects have been identified as "poverty alleviation projects", although the doubt remains about the content of those projects and how they are related to poverty alleviation. Out of Tk. 1175 crore, earmarked for "poverty alleviation projects", already Tk. 600 crore has been utilized.

In the past years one of primary criticisms of ADP budget management related to the tardy use of ADP allocations in the first nine months of the fiscal year and the subsequent rush by the line ministries to spend their budget allocations in the last quarter. This approach to project management directly contributes to the process of waste and corruption in the public expenditure process. There is a concern that the ADP management quality has been further deteriorated, which might increase the incidence of wastage of resources. Thus, acceleration of ADP implementation from the second rather than the fourth quarter of the fiscal year remains one of the major tasks for FY04 particularly for crowding-in private investment and improving quality of public utilities and social services.

2.5 Budget Deficit and Financing

The budget deficit has been

brought down sequentially during the last three years. In FY03, according to the latest estimate, the net budget deficit accounted for 3.4 percent of the GDP of which foreign financing accounted for 64 percent and the rest (36 percent) was from domestic sources.

The target for the net budget deficit has been fixed at a higher level in FY04 about 4.0 percent. It is expected that the incremental deficit will be largely financed by the enhanced flow of foreign aid, a larger part of which is loan.

Figures for the period July-September 2003 indicates that the government has to mobilise about Tk. 1908 crores to finance the fiscal deficit which is about 5.5 percent lower than the comparable figure for the preceding year. Domestic resources accounted for more than 81 percent of this amount the exclusive source being net borrowing through non-bank instruments. During this period the government held a negative balance in its favour in case of borrowing from the banking sector.

The relatively low level of the fiscal deficit during the first quarter of the fiscal year reinforces the revealed trend in ADP implementation. This is of course not immediately evident from what the government is doing with the large volume of budgetary support it has received from the international financial institutions (IFI) in the recent months. It seems that these resources are currently underwriting the increasing gap in the trade balance.

It should here be kept in mind that the concept of the fiscal deficit in aid dependent countries such as Bangladesh is a synthetic issue. The aggregate deficit in public expenditure is a structural aspect of aid dependence which accommodates the volume of foreign aid disbursed in a given year. The rise and fall in the fiscal deficit in any year reflects the efficacy and timing of aid disbursements rather than some significant improvement in macroeconomic management. Thus it is important to keep in mind whether inefficient aid utilisation is being falsely interpreted as improvement in fiscal deficit situation.

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