With the Budget for fiscal year 2009-10 announced, The Daily Star presents a special analysis by former Advisor for Finance and Planning to the caretaker government, Mr. Mirza Azizul Islam.

An analytical dissection of FY10 budget proposals

MIRZA AZIZUL ISLAM

THE finance minister placed his budget proposals for the fiscal year 2009-10 before the parliament on June 11. The proposals have already ignited fairly extensive discussions in the various television talk shows, in some of which I also participated. Additionally, a number of articles have been published in the print media. Nevertheless, the scope for a more systematic dissection of the proposals in light of the development priorities of the country has not been exhausted.

How different is the FY10 budget?

One question that I invariably faced both before and after presenting the two budgets of the caretaker government was how different was the budget compared to the past ones. I faced the same question from the media about FY10 budget proposals as well. My consistent answer has been that year-to-year changes in the budget are, of necessity, incremental.

The reasons are: (a) The basic structure of the economy, which influences revenue mobilisation measures, does not change overnight; (b) there exists a high degree of consensus on the broad development objectives of the country -- these are: acceleration of growth, faster reduction of poverty, employment creation and redressing of various forms of inequality, including regional inequality; (c) there is also a large measure of consensus on sectoral priorities; (d) the competence and commitment of the administration to mobilise revenues and effectively utilise allocated resources also constrain any drastic change.

There are always year-to-year changes in specific details arising from the need to deal with somewhat transient changes in domestic and global economic circumstances. Any comparison between budgets should, therefore, be logically based on the overall framework, which is formulated to accomplish the development objectives noted above. The following table is pertinent in this regard.

Selected indicators of comparison between FY09 and FY10 budgets

Macro indicators	FY09	FY10
Total expenditure (% of GDP)	16.3	16.5
Growth of total expenditure (1% over the previous budget)	14.7	13.8
Annual Development Program (ADP) (% of total expenditure)	25.6	26.7
Total domestic revenue (% of GDP)	11.3	11.6
Overall deficit, excluding grants (% of GDP)	5.0	5.0
Sources of finance (% of total expenditure)		
i)NBR tax revenue	54.5	53.6
ii)Non-NBR tax revenue	2.3	2.6
iii)Non-tax revenue	12.6	13.6
iv)Domestic borrowing	17.0	18.1
v)Foreign loans and grants	13.6	12.1
Expenditure allocations by major sectors (% of ADP)		
Local Government and Rural Development	21.2	22.6
Transport and Communications	12.7	15.2
Energy and Power	15.7	13.5
Education and Information Technology	12.8	13.0
Agriculture	8.5	7.5
Health	8.9	9.7
Total	79.8	81.5

At this point I should like to emphasise that the comparison should be in terms of budget proposals. At several points in his statement, the finance minister has compared his proposals with the revised budget of the preceding year. This tantamounts to comparing apples and oranges. It is the original budget which reflects policy-makers' perception -- not the revised budget which is largely reflective of actual implementation.

It will be seen from the above numbers that there is a considerable similarity between FY09 and FY10 budgets in terms of some key macro indicators, sources of finance and expenditure allocation by major sectors. However, attention of readers is drawn to some relatively substantial differences and their implications in subsequent analysis.

Is FY10 budget over-ambitious?

Some analysts have criticised the proposed budget on the ground that it is over-ambitious, while others (eg. CPD) have contended that it is conservative. Each of these points of view can be justified, depending on the criterion applied to make the judgment. These differences relate primarily to: (a) Total expenditure envisaged, (b) size of ADP, and (c) revenue target.

There are some who argue that the budget is over-ambitious because it proposes a record level of government expenditure: Tk. 1,13,819 crores. They do not seem to appreciate that most economic variables grow in absolute terms with time. In that sense, every budget sets a new record. A logical judgement on the issue has to be guided by reference to a reasonable standard.

Total expenditure proposed in FY10 budget amounts to 16.5 percent of GDP, a modest icrease of 0.2 percent over FY09 budget. The level of public expenditure as a proportion of GDP in Bangladesh has been historically the lowest among all Asia-Pacific countries, with the exceptions of Hong Kong and Singapore, both of which have much smaller population and much higher per capita income.

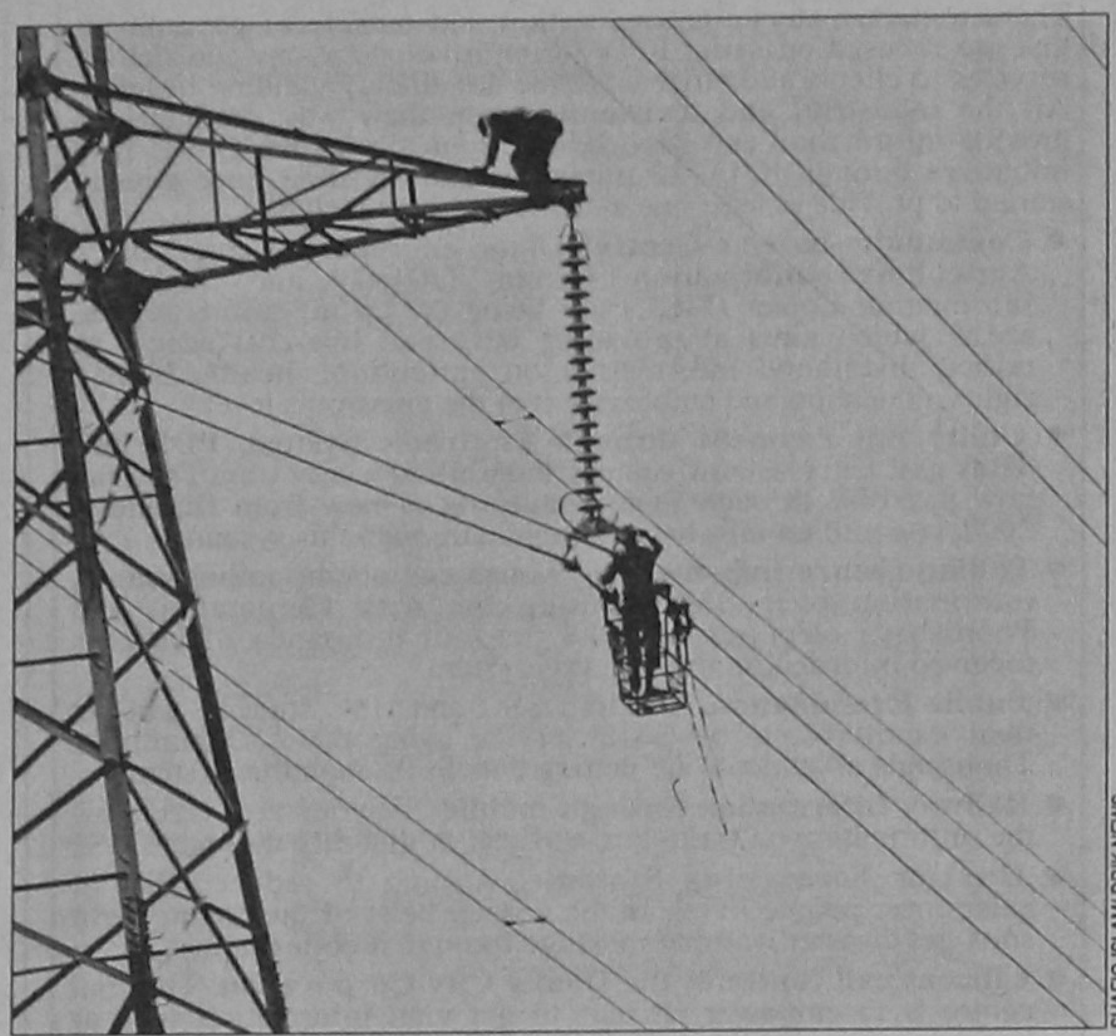
At the same time, Bangladesh has an urgent need for increasing public investment in sectors with strong positive externalities. The total expenditure target, therefore, cannot be considered overambitious, nor should it be considered unduly conservative, given the capacity limitations of public administration and the fact that revised estimates of the current fiscal year anticipate expenditure-GDP ratio of 15.3 percent.

Similar comments also apply to revenue target. Here again, the target revenue -- GDP ration of 11.6 percent -- represents a modest increase over the original FY09 budget. As in the case of expenditure, Bangladesh has the lowest revenue-GDP ratio in Asia-Pacific.

The size of ADP, however, is a different ball game. Here, the allocation in FY10 as proportion of total expenditure is 1.1 percent higher than it was in FY09. This translates into an absolute amount of Tk. 4,900 crores (the allocations being Tk. 30,500 crores and Tk. 25,600 crores in the respective years).

The highest ever actual expenditure in the history of Bangladesh was Tk. 19,473 crores; even in current fiscal year the figure is likely to remain similar. To expect to achieve more than 50% increase in actual ADP expenditure appears well-nigh impossible. It is pertinent to quote the finance minister here: "Though the proposed ADP is quite ambitious we hope to implement it if we ensure effective supervision and monitoring."

I would be happy if the finance minister's hope turns out to be a reality. I would, however, like to make two observations: (i) The implementation of ADP involves a lot more than effective supervision and monitoring. It is connected with the much broader issues of transparency, accountability, commitment, competence and incentive (comprising both reward and punishment) system of public service. (ii) the sentence immediately following the above quotation from the finance minister's budget statement talks about the extreme importance of creation of domestic demand at this stage. The stated objective would be better served by shifting foreseeable unutilised ADP resources to the revenue budget, which can be disbursed much faster. This fact is also substantiated by the revised budget of FY09 as announced by the finance minister. The total reduction of expenditure in the revised budget is only about 6 percent whereas the cut in the revised ADP is more than 10 percent; and so-called non-development expenditure in the revised budget is, in fact, higher than in the original budget.



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Government borrowing

The FY10 budget postulates an increase of domestic borrowing, rising to 18.1 percent compared to 17.1 percent in FY09. The coresponding figures for foreign loans and grants are 12.1 percent and 13.6 percent. The government may wish to put in more determined efforts to increase the flow of foreign grants and loans, which involve less fiscal cost. However, this option is not necessarily less costly for the macro economy.

At any rate, I do not feel greatly concrned abouot increase in the level of domestic borrowing. A cursory examination of data does not lend credence to the supposedly pernicious effects of government borrowing in terms of crowding out private sector credit, higher interest rate and higher inflation rate. I hope to take up this issue for a more thorough examination in the near future.

Sectoral priorities

The shares of two sectors, agriculture and energy and power, have fallen in total expenditure in FY10 budget. This does not appear to be consistent with the finance minister's portrayal of the importance of these sectors in his budget statement. Ironically, the allocations for both of these sectors have declined not merely as proportions of total expenditure but also in absolute terms.

In the case of agriculture, the reduction has been justified on the ground of fall of international prices of fertiliser. The justification may be defensible as far as non-development expenditure is concerned, but the logic behind reduction of development expenditure needs to be clarified. It is heartening to observe that the finance minister has mentioned the Agricultural Endowment Research Fund set up by the caretaker government; this fund deserved to be topped up. No justification has been provided for reduction in allocation for energy and power.

Comments on some specific details

Stimulus package: The budget proposes Tk. 5,000 crore as a stimulus package. I endorse the proposal. However, insofar as the package is used for offering incentive to exporters, the objectives should be made clear. The objectives could be: (a) maintaining market share, (b) compensating for exporters' losses from sales in the international market, (c) maintaining the volume of sales, and (d) protecting employment in the relevant sector. The triggers for incentives and the calculation of incentive requirement will differ, depending on the objective to be accomplished. An ex-ante assessment of the likelihood of achieving whatever objective is chosen would also be needed.

Public-private parternership: As recognised in the budget statement, the concept is not new. However, the focussed emphasis is welcome. The full and effective utilisation of the allocation of Tk. 2,500 crores under this head will require fulfilment of some preconditions in terms of developing a comprehensive legal framework and a new institutional machinery.

Moreover, pricing of utility services and consequential subsidy requirements may turn out to be a major constraint in securing private sector participation. The capacity of the domestic private sector to raise required finance for large scale infrastructure projects is limited. Huge involvement of foreign investors in non-tradable sectors can cause pressure on the balance of payments. These considerations will have to be factored into decision-making.

Linking allocation to performance: This is easier said than done. Supposing that the concerned ministry fails to implement the current year's projects in the power sector, would it be either feasible or desirable to give zero allocation to this sector in the next budget?

Unified budget: I support the initiative. On many occasions I made the same points as mentioned in the budget statement.

District budget: I feel that the government should proceed with extreme caution in this matter. There should be a thorough analysis of the pros and cons of such an endeavour. At the technical level, revenues and beneficiaries of pubic expenditure cannot be identified by districts. Can all the revenues derived from the operation of Chittagong port be assigned to Chittagong district only? Should all the benefits of the proposed Padma Bridge be apportioned only between the two districts which the bridge will connect? Furthermore, the district budget may boost fissiparous tendencies.

Disinvestment of SOEs: According to the budget statement, no SOE will be disinvested without procuring alternative jobs for the displaced workers. This is a self-evident non-starter. It has no answer to such questions as who will secure these jobs, how and on what terms. In the interest of transparency, the finance minister could very well say that no SOE would be divested.

100 percent subvention to registered and primary community school teachers: This is a red herring. Many registered school teachers have not taken qualifying examination. They have successfully prevented successive governments from stopping subvention of unqualified teachers. Community school teachers will do the same.

Employment generation for the hardcore poor: This is a replacement of the 100-day empoyment guarantee scheme introduced by the caretaker governemnt and appears to be old wine in a new bottle with reduced allocation. The justification sketchily provided for replacement of the earlier program is "policy weaknesses of the program during implementation stage." How would it be ensured that the same types of weakness would not afflict the so-called new program?

National service: This initiative is fraught with grave risks, if implemented on the national scale. Who will provide jobs after three months of training: the government or the private sector? What happens if they cannot be absorbed after two years? Those who cannot be permanently absorbed will definitely go for movement to remain employed, whether productively engaged or not. This is also not an anti-poverty scheme. In all probability, the overwhelming majority of youths who complete HSC do not come from families below the poverty line.

Social safety net: The allocation for the social safety net programs overall has gone down to 15.2 percent of total expenditure from 16.9 percent in the previous budget. This represents an absolute increase of Tk. 68 crores only. There is a scope for increasing the allocation by reducing the size of ADP.

Climate change fund: This fund was set up in the last budget with Tk. 300 crore allocation. I am glad that FY10 budget proposes what is presumably an additional allocation of Tk. 700 crores towards the fund.

Treatment of undisclosed income: The finance minister lists establishment of social justice and equity as number one among the objecgtives of revenue raising for FY10 budget. Yet he proposes acceptance of undisclosed money without any question for a period of three years for investment in a broad range of sectors on payment of a highly concessional tax of 10 percent.

The proposal should be immediately withdrawn in consideration of the following: (i) The proposal is morally indefensible and involves inequitable, unjust and unfair treatment of honest taxpayers, (ii) it is likely to provide incentive for earning as much illegal income as possible within the amnesty period, (iii) the tax-payers will be discouraged from paying taxes in time because by dodging payment in the current year, they can avail of the concessional rate, (iv) it may encourage collusion between tax officials and tax-payers for evading payment, (v) its impact on investment is at best uncertain, because: (a) no one knows how much undisclosed income is there in the economy, (b) what part of such income is already circulating in the economy, and (c) presumably those who avail of the facility are not exempt from the purview of Anti-Money Laundering Act and foreign exchange regulations.

Mutatis mutandis, similar arguments also apply to the provision allowing purchase of flat or construction of house by paying tax at specific rate according to the measurement of the flat/house, without any question.

Other revenues measures

The budget proposals include many revenue measures which involve erosion of tax base or reduction of tax rates. The justification for many of these proposals is less than clear, taking into account the objectives of revenue raising identified in the budget statement. In view of the limitations of space, it is not possible to deal with then individually.

But, to cite one example, the duty on raw materials has been proposed to be reduced from 7 percent to 5 percent "in order to make our local industries more competitive both in local and international market." If our local industries cannot compete despite tremendous labour cost advantage, reduction of duty rates last year, and the considerable decline in international prices, it is highly unlikely that they will become competitive in consequence of the proposed reduction. Most likely, the government will lose revenue with no benefit in terms of enhanced competitiveness of existng industries or establishment of new industries.

My hunch is that revenue measures proposed in the budget will not be particularly helpful in enhancing revenue-GDP ratio, the need for which has been rightly and eloquently highlighted in the budget statement. I strongly feel that the finance minister should have taken at least a few measures to partially rid our tax system of what he legitimately calls "vicious exemption cycle."

Concluding observations

I welcome the broad contours of FY10 budget. It is pragmatic, yet justifiably somewhat ambitious. I would, however, urge that the finance minister revisits some of the proposals in light of the stated objectives before approval by the parliament. The areas that need reconsideration are: (i) the need for more determined efforts to mobilise external assistance, (ii) size of ADP, (iii) allocation to agriculture and energy and power, (iv) clarification of the objectives and criterion of disbursement of stimulus package, (v) development of a legal and institutional framework for allocation for public-private partnership,(vi) district budget,(vii) divestment of SOEs, (viii) national service, (ix) allocation for social safety net, (x) treatment of undisclosed income, and (xi) revenue measures which erode the tax base or reduce tax rates.

Mirza Azizul Islam, Ph.D., is former Adviser, to the Caretaker Government, Ministries of Finance and Planning.

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