Budget: policy and institutional reforms

SADIQ AHMED

THE first thing that caught my eye when I reached Dhaka from Washington DC on Saturday morning was the text of Finance Minister AMA Muhith's FY 2014-15 budget speech published by The Daily Star in its June 6 edition. I also became aware of the ongoing public debate on the budget ahead of the parliamentary discussions. With no real opposition in parliament, the public debate has attained added significance. It is important though that the public debate should be a healthy one based on a careful review of facts and constructive in nature, rather than populist and confrontational. While I do not claim to have absorbed all the details of the budget and I see the need to do a bit more homework to check the facts and figures, I will nevertheless venture to share my first impressions to add to the public debate agenda and then follow through with a few more pieces once I have completed the background research.

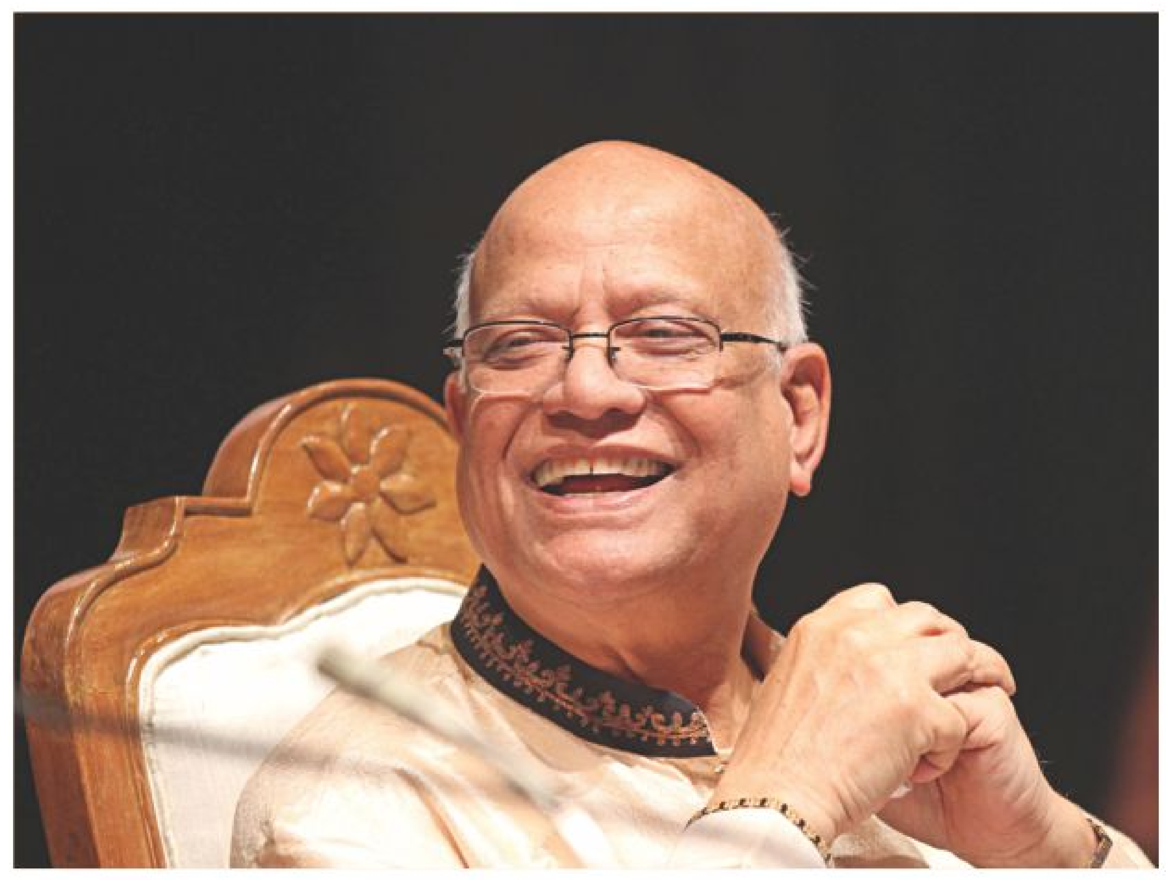
The annual national budget is usually the most explicit articulation of the government's latest economic thinking and policy intentions. It is, therefore, essential that we put careful attention to the underlying strategies and policies and not just the numbers. While the numbers need to be consistent with the underlying strategies and policies, sometimes they are not owing to the lack of adequate analytical capacities and institutional capabilities to generate the right data. It is important, therefore, to focus on both because just looking at numbers might be misleading. In this article I will focus on the strategy part and review the numbers in follow up pieces.

From a strategic perspective, the budget speech has a number of attractive features that I very much welcome and would like to congratulate the finance minister for laying them out as a part of the government's economic policy making. If these policies and institutional reforms are properly implemented, this will be a major milestone for Bangladesh. These include: 1)focus on decentralisation; 2)modernisation of land market; 3)raising public revenues by 4 percent of GDP over the next 5 years; 4)modernisation of the tax system through emphasis on a progressive income tax system; 5) renewed commitment to a prudent macroeconomic strategy that keeps budget deficit under control and maintains monetary discipline to bring down inflation rate to 6 percent; 6) emphasis on public-private partnership (PPP) for infrastructure financing; 7) emphasis on manufacturing exports; 8) strengthening infrastructure development; 9)adoption of the National Social Protection Strategy, and 10) adoption of a green tax.

The merit of each of these proposed policies and institutional reforms is hard to question. Many of these reforms were on the table for a long time. It is naturally heartening to see the government's willingness to adopt these reforms explicitly. The main issue is whether the government has done its homework on the implementation side.

In the spirit of being constructive, let me provide some ideas about how the government might go about implementing them.

Decentralisation is by far the most challenging reform. From my long association with the finance minister, I know it is close to his heart and he is passionate about it. But based on the results on the ground, it is not obvious that there is a full political buy-in at all levels of the government. The bottleneck has always been the sharing of power between the parliamentarians and the members of the local government. An added challenge is the decentralisation of fiscal powers. The government has taken the first step by establishing elected local governments. It now needs to go to the next step by legislating the devolution of spending and revenue authorities to local governments. The development of this legislation will require a lot of homework; but that can be easily acquired as there is



AMA Muhith

considerable international experience that Bangladesh can learn from. The main challenge is to get the buy-in from the political leadership. Once this huge hurdle is crossed, the issues of capacity building or training will come in. Many development partners are willing to provide technical assistance to implement this critical reform.

The modernisation of the land market is an essential pre-requisite for modernising the economy. Land has become a binding constraint for manufacturing as well as for housing. It is arguably also the biggest source of corruption and conflict. Hence the proposed policy to computerise land records, improve land survey and simplify land transactions is a most welcome initiative. However, implementation will require substantial background work and technical assistance. There is also a need to assign proper institutional responsibility, define a time line for implementation and monitor progress. Along with this, registration and recordation process has to be simplified and the associated fee rationalised to avoid land valuation problems. A start can be made by requesting technical assistance from one of the donor agencies.

The task of getting 4 percent of GDP additional tax revenues over a 5-year period is ambitious but not impossible. The government has already made some significant gains in revenue mobilisation over the past few years. This year's budget is significant in that it also aims to modernise the tax structure by increasing reliance on a progressive income tax system. This is a much needed reform and I whole-heartedly endorse it. For many years I have been writing on the subject pointing out the huge hole in the income tax system. In Bangladesh the top 10 percent of the population owns 35 percent of the national income while personal income taxes are a meager 1.5 percent of GDP. This is reflection of a serious governance problem in Bangladesh, where the rich and powerful do not pay their fair share of taxes. So, the attempt in this budget to cover a part of the hole through a range of measures including taxation of capital gains from land and stocks is very much welcome.

But the budget goes only a part of the way. There are still a number of areas where reforms are needed. The income tax measures have to be broadened substantially with a well articulated income and property tax reform. Without this broader reform, the 4 percent of GDP additional taxes will not likely materialise. Second, the budget continues to rely rather heavily on supplementary trade taxes that are not consistent with the objective of export diversification. These supplementary duties will have to be rationalised to reduce investment distortions. Third, the implementation of the NBR modernisation plan is very slow and needs to be substantially speeded up.

The prudent management of the macro economy has been a hallmark of Bangladesh's long-term development. So, the continued emphasis on this is welcome. Keeping the budget deficit at the 5 percent of GDP level is appropriate. Setting the inflation target at 6 percent is a smart move. However, there is a need to carefully watch the consistency of policies with these targets.

As the experience of 2010-12 shows, there is often a tendency to push the Bangladesh Bank to loosen its monetary policy to cover the shortage in fiscal policy or to compensate for policy failings in the stockmarket or public banks. This must be resisted. A particular risk is that the budget adopts a very ambitious development spending target and an attempt to implement this without adequate revenues or foreign loans could put pressure on monetary policy and compromise the inflation target. As chair of economic policy making, the finance minister will have to watch both the implementation of the budget and its consistency with inflation target and monetary policy.

The strategy for PPP financing of infrastructure has been on the cards for a while. But implementation record is poor. This is not a reflection on the Bangladesh economy. While political uncertainties are a problem, Bangladesh remains an attractive destination for private investment. What is lacking is a well-thought-out implementation strategy for PPP. International experience shows that securing PPP financing for large infrastructure projects requires a managing entity that is equipped with seasoned and competent technical staff who have knowledge and experience in developing, negotiating and supervising these projects. A proper legal framework providing internationally attractive guidelines and incentive policies is also required. Bangladesh is lacking on both counts. PPP cannot be managed as a part of the day-to-day bureaucracy. Without these essential reforms the ambitious $11 billion plus PPP projects identified in the budget will not materialise.

The emphasis on manufacturing exports is appropriate. This is an essential element of a strategy to secure higher growth and employment. However, while the budget is strong on intentions it is weak on policies except in the garment sector. A major problem is the continued policy bias against exports provided by trade tariffs and supplementary duties. It is high time that the National Board of Revenue and the commerce ministry should get together to develop a trade tariff policy that reconciles revenue mobilisation with investor incentives.

In the search for revenues, the fiscal policy is completely oblivious of implications of the tariffs and supplementary duties for investment decisions. Research shows that the underlying incentive regime favours inefficient domestic production that may not even be consistent with manufacturing growth and employment targets. This has been a serious shortcoming of all the previous budgets and this budget is no exception.

The focus on infrastructure continues from the first budget of this government in FY2009. This is appropriate as the infrastructure deficit remains serious. Good progress has been made in the power sector.

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Bangladesh can build global brands

Travyn Rhall of Millward Brown discusses potential in branding

MD FAZLUR RAHMAN

BANGLADESH should think long-term and focus on building brands that can bring huge benefits to the economy, said a top market research expert.

"There are already brands in Bangladeshi market. The challenge for them is to make sure building a brand for a long-term," said Travyn Rhall, global chief executive officer of Millward Brown, one of the largest market research organisations in the world.

"Sometimes you can fixate on prices. Prices can only go to some point. I think there is a trade-off. "

Launched in July 2013, Millward Brown Bangladesh currently offers globally-accepted research solutions on brand, media and communications.

Rhall's company is working with some major multinational clients, helping them build their brands, exposing them to the different channels the consumers are getting information from.

A former president of the Association of Market and Social Research Organisations in Australia, Rhall said brands—small or big—can be huge for an economy.

"Studies around the world have showed strong brands produce strong financial results. The motivation for companies to invest in branding to be a strong brand is imperative from business point of view," he told The Daily Star in an interview in Dhaka recently.

He cited the example of Samsung which is 10 percent of the Korean economy. Similarly, Nokia is a large chunk of Finnish economy.

On the role of branding, he said companies try to create a strong association between the brands and the customers with branding.

"Branding also gives you more market share. You can then give premium which is important when it comes to the question of finances. You can also create potential for growth in future."

Rhall, who has a more than 30 years of experience of working in market and social research industries, said Bangladesh can create brands and export those brands into other markets.

"If you want to export a brand then you will have to invest outside, which involves a large amount of money. That is the challenge all companies face. It takes time to build a brand."

"Entrepreneurs will have to make strong brands for western markets or other emerging markets. After that they will be out through that brand in that market."

In the last 20 years, China has been supplier of products to the rest of the world, he said, adding that now entrepreneurs of China are building products.

"Chinese smartphone maker Xiomi, which started with nothing in China, is now selling more than Samsung and Apple. It sells its brands completely through e-commerce. So,

Travyn Rhall

you can only buy it on the web."

Bangladesh's garment sector, which has already made the country the second largest exporter of apparel, can build global brand, he said.

"The basic expertise is very high in the country. The success in the garment industry is building profile of Bangladesh to show that the country is emerging."

According to Rhall, a number of factors are working in favour of Bangladesh: the country is grouped among the Next-11 and this group of countries are on the profile of major multinationals.

"They are saying that these countries will emerge in the next 20 to 30 years. Bangladesh has a lot of dynamics that can make the country successful in the future."

He said the government policy is important in building brands in the domestic market and outside of the country.

"The government of China formulated policies so companies can create brand outside of China. That government policy is enabling the company to expand outside of the country."

He said multinationals invest more money and have programmes on market research compared to local companies.

"However, if local companies see there is good return on their investment in market research they will do more."

Rhall said Bangladesh being named as one of the next-11 emerging markets brings it to the focus of many companies outside the country to look at what is going on here, he said.

"They are asking: should I be investing here? This led Millward Brown to open its office in Bangladesh."

"The market will grow quite strongly. That is why we are here."

The market research will grow twice the GDP if the economy continues to demonstrate strong growth for the next 20 years, he said.

Rhall said the growth of market research would be 10 to 15 percent annually. The size of global research market is $30 billion to $40 billion.

He said Bangladeshi companies have not invested a lot in market research and development.

"It is still very new industry relative to other markets. That changes with the time. That is changing in Bangladesh too. The same thing you would have said in China 20 years ago. Now the industry is skyrocketing."

"There is a lot of opportunity for the people to get into that industry. It will grow quickly because the economy will grow quickly."

He said the market and advertising have changed over the years thanks to fast digitalisation.

"The biggest change now is what is happening digitally, and what is happening with mobile phones. It is evolving with people spending more time with their brands of different media and newspapers."

"In the last five years, there has been a lot more activity on the digital stuff such as websites and Facebook. More fragmentation in the digital space will continue to happen, as new sites are coming up all the time, people going to them and there is advertising on them."

"In the past, people did not have much access to online. Now it is growing and creates a medium for the people to advertise their brands."

He said brands talk on their social media, and whenever global brands like Apples or Samsung launch a new mobile phone, there is a lot of discussion on the internet across many countries.

"It is quite important. It is helping us to understand what consumers are thinking."

How people are consuming media to get exposure for brands is changing, said Rhall. "This will probably be the biggest single thing that will impact everybody in the next five to 10 years."

"The amount of time people spend using their mobiles in many countries is more than the time they spend watching TV."

Rhall said the government has to be behind any effort aimed at promoting any brands.

"The government would have to take policy decision if it wants to promote a brand because the brands will require setting up offices and launching campaigns."

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AFP

A Roma family rides a tricycle in Tirana, Albania yesterday. The World Bank says most of the pick-up in growth this year will come from high-income countries.

World Bank sees 'flat' growth for developing countries

AFP, *Washington*

The World Bank lowered its 2014 growth forecasts for the global economy Tuesday, but said advanced economies' rebound from a rough start would help offset stagnation in developing countries.

Most of the pick-up in growth this year will come from high-income countries, particularly the United States and the 18-nation eurozone, the World Bank said in its twice-yearly Global Economic Prospects report.

But a rough start to the year -- bad weather in the United States, financial market turmoil and the Ukraine crisis -- dragged down global growth for the year as a whole, the Bank said.

It marked down its 2014 forecast to a 2.8 percent pace from its January forecast of 3.2 percent. The global economy grew 2.4 percent growth in 2013.

High-income countries would see stronger growth this year of 1.9 percent from 1.3 percent in the previous year, the World Bank said.

But developing countries can expect mixed challenges from the accelerating growth in the rich countries.

As high-income economies expand, their import demand should grow, boosting developing-country exports.

But developing countries will be hard-pressed to find the capacity to meet that demand, because most of them already are fully recovered from the 2008 financial crisis and growing close to potential, the Washington-based development lender said.

Developing countries were projected to grow 4.8 percent this year, substantially below the 5.3 percent estimate in January.

"The outlook for developing countries is for flat growth in 2014. This marks the third year in a row of sub-five percent growth and reflects a more challenging post-crisis global economic environment," it said.

The World Bank's latest outlook marked a deterioration from the January report, when it had raised its growth forecasts, saying both rich and developing countries appeared to be "finally turning the corner" after the global financial crisis.

Much of the slowdown this year reflected weakness in China, the world's second-largest economy.

First-quarter growth in Chinese gross domestic product was only a 5.8 percent annualized rate, with a sharp deceleration in industrial output and Beijing taking steps to tighten credit.

The Washington-based lender forecast growth of 7.6 percent this year, lower than China's 7.7-percent growth rate in 2013. Beijing's own target for this year is 7.5 percent.

GDP growth accelerated slightly in the first quarter in India, Mexico and the Philippines. But the pace of growth slowed in Indonesia, Mongolia, Malaysia and Brazil and turned negative in South Africa and Peru.

Sharp annualized contractions of between eight and 12 percent occurred in Ukraine, Thailand and Morocco.

The weakness in developing countries reflected a slew of factors, including knock-on effects from the severe winter in the US; political tensions in Thailand, Ukraine and Turkey; labor unrest in South Africa; and monetary policy tightening following financial market turmoil a year ago, the Bank said.