The Daily Star
FOUNDER EDITOR: LATE S. M. ALI

Gas crisis requires urgent govt intervention

Businesses and households cannot continue on like this

We are alarmed by the acute gas crisis that is causing havoc for the industrial sector and immense suffering for households. According to data from Petrobangla, the gas supply in the country is now at its lowest since April 2020, at about 2,500 million standard cubic feet per day (mmcfd) against a demand of 3,800 mmcfd.

Despite the power sector's demand for gas dropping due to the onset of winter, other sectors are still struggling to get adequate gas due to a drop in local production and lower imports. The supply is only expected to increase in the latter half of February, at which time the demand is also likely to rise. Because of the ongoing scarcity, businesses across different sectors are struggling. Ready-made garment manufacturers, for instance, are having to decrease their production. Businesses in other industries are either incurring higher production costs, losses in terms of their raw materials, or are having to sacrifice the quality of their products. Bangladeshi businesses that participated in the World Economic Forum's Global Risks Report 2023-2024, cited energy supply shortage as the number one threat to the economy and their business. And it seems that their worst fear is now coming true.

Meanwhile, households in numerous areas of Dhaka are also facing a severe gas crisis, with many homes only getting enough gas in the middle of the night. As a result, households too are counting additional expenses, as people are being forced to eat out or wait till the middle of the night to cook their meals. Gas production will increase slightly once operation resumes in one of the two floating storage and regasification units (FSRU) on January 14, according to one Petrobangla official. However, this will not be enough to make up for the current deficiency. One of the major concerns here is the declining local production. And even though officials are working to increase production, it seems their efforts have come in too little, too late. For years, experts have been urging the government to focus on increasing local production. But the government's delay in paying heed to their warnings has now come home to roost.

While the government should, nevertheless, continue to work on increasing local production, at the moment, it seems there is no alternative but to ramp up LNG imports to address the crisis. Given the parallelly running reserve crisis, that could prove difficult. The government should, therefore, look to cut back on unnecessary costs elsewhere that are draining the country's reserves, and focus on making favourable deals with other countries to increase LNG imports.

Bracing for colder days ahead

Treat the cold wave as a crisis

It is concerning that the ongoing cold spell is likely to get worse in the coming days, as predicted by meteorologists. According to news reports, meteorologists predict heavy rainfall in January with some districts being affected more severely. This will mean even lower temperatures, as low as eight or 10 degrees in the morning in some districts. The cold, coupled with dense fog, will create bigger challenges for the people of this country. We must therefore take urgent measures to reduce the impacts of this cold spell.

Already, we are witnessing how people in lower income brackets are struggling to fend off the cold. The front-page images of newspapers of people huddling together in the streets completely exposed to the elements, is enough evidence of the dire situation. The government and private sector must immediately initiate drives to distribute warm clothes and blankets to the underprivileged, especially to the homeless poor living on the streets.

Such low temperatures will also affect agriculture. Farmers cultivating potatoes, watermelon and other seasonal produce must be given proper advice regarding irrigation and drainage management. The government should also provide support for farmers whose crops will be adversely affected to tide them over this period.

Dense fog creates a dangerous situation on the roads, with the possibility of crashes increasing. Traffic patrol must be increased, signboards to caution drivers must be installed, adequate lighting on the roads must be ensured and if necessary, traffic during hours when the fog is denser must be limited or even stopped. Schools and other institutions should plan ahead regarding possible closure during the period.

Public hospitals and healthcare complexes must be prepared to tackle the increase in patients, especially from among children and the elderly, with cold-related ailments. Unforeseen challenges may crop up during these cold spells, but many adverse situations can be avoided with early planning and efficient execution. We expect the government and private sector to start taking steps to mitigate the suffering of people struggling to stave off the cold.

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The real challenge is taming inflation fast

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Inflation is now a problem to be reckoned with. And the poor are bearing the brunt of it. Such inflation could be political dynamite if left untamed. Already, the latest assessment of the Household Income and Expenditure Survey (HIES 2022) showed a significant rise in income inequality, with the Gini coefficient rising to 0.49 in 2022, against 0.45 in 2010, and 0.35 in 1990. Inflation, which is the equivalent of a regressive tax on the poor, accentuates income inequality to make the situation worse.

To be fair, against this dismal backdrop, we must also juxtapose the notable progress in poverty reduction, as the proportion of moderate poor came down to 18.7 percent in 2022—against 60 percent in 1990—while the extreme poor decreased to only 5.6 percent. This means our economic progress has avoided double jeopardy, that is, high inequality plus high and rising poverty.

The International Monetary Fund (IMF) has just come up with its inflation diagnostics. As part of its assessment prior to release of the second tranche of the IMF 42-month programme (which includes Extended Credit Facility and Extended Fund Facility, with about $1.4 billion under the Resilience and Sustainability Facility) of $4.7 billion, IMF researchers gave us a hefty dose of inflation analytics. In my view, most important is the identification of the source and nature of the problem: the exchange rate pass-through effect on inflation, the standard instruments for curbing it, and the possible timeline for reaching the target level. While shedding enough light on the real cause of the ongoing inflation, the IMF country report on Bangladesh left us with an uncomfortable feeling in saying: "Given the lags in monetary transmission, the orderly disinflation process should take several quarters to two years to bring inflation to the target range, unless aided by favorable unexpected shocks." The target is apparently 5.5 to 6 percent inflation, which prevailed prior to the Russia-Ukraine war. The long wait unfortunately is not going to be costless. What about delivering a favourable, unexpected shock?

Inflation in Bangladesh was triggered by two simultaneous events in 2022: the supply chain disruption of the Russia-Ukraine war, which caused a spike in commodity prices (particularly for food, fuel, and fertiliser); and the sharp depreciation of the taka against the US dollar (which approximated to 30 percent as of September 2023). Though international commodity prices abated somewhat, the second-round effects of the two triggers are incurring their impacts. The 50-percent hike in fuel prices by the government in August 2022 did not help, either. General inflation is running at a tad below 10 percent, with food inflation at over 12 percent.

It is time we started rationalising our tariff structure, not just to make them comparable to those of our peers, but to make our exports more competitive and eliminate the anti-export bias of protection that has currently become a binding constraint for our national imperative of export diversification.

It is now clear that inflation in Bangladesh was induced primarily by cost-push factors. The impact of supply chain disruption and exchange rate depreciation was a supply shock that triggered inflation, which was reinforced by monetary expansion. The latter has now been reversed by Bangladesh Bank through the standard prescription of monetary contraction and interest rate hikes. Also, the tendency to finance the budget deficit by borrowing from BB (which is pure inflationary money creation) has been suspended since July 2023. A neutral fiscal policy is expected to limit the monetisation of the fiscal deficit to keep inflation at bay.

VISUAL: SALMAN SAKIB SHAHRYAR

In Bangladesh's context, the preceding standard prescription may only restrict demand but does not do anything to counter the supply shock emanating from import price hike and taka depreciation. Indeed, the severe import compression imposed on the economy by BB is likely to raise import costs (driven by scarcity), thus becoming an additional cost-push factor of inflation over time.

One particular trigger of inflation which needs to be seriously examined is the massive exchange rate depreciation. This has upset the cart of macroeconomic stability like no other event in my memory. Understanding the mechanism of exchange rate pass-through to inflation is critical for addressing the challenge at hand. The extent and periodicity of such pass-through depend on the economic environment that prevails, such as the degrees of (a) exchange rate flexibility, (b) import penetration and share of imports in the domestic market, (c) competition or monopolistic structure in the domestic economy, (d) prevailing trade openness, and (e) public intervention in markets. As was evident, the speed of transmission or pass-through was almost contemporaneous and significant. The substantial triggering of inflation, prompted by the massive depreciation, sustains inflation as no compensating countermeasures are in sight or discussed.

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So, how much of Bangladesh's inflation is caused by the pass-through? From May 2022 to September 2023, the depreciation of the taka against the US dollar was approximately 30 percent. Given that Bangladesh is a small economy when it comes to its import share on the world market, it is a pure price taker facing a horizontal import supply curve. Domestic prices reflect import prices, converted to taka using the exchange rate plus any trade taxes. This results in a one-to-one rise in domestic prices corresponding to any rise in import prices, including any spike caused by exchange rate depreciation. However, the impact on overall price level (inflation) will depend on the degree of import penetration (share in GDP), import share in the domestic market, and share of imported inputs in domestic production. Using an applicable model, the IMF did a rigorous exercise to determine the precise degree of exchange rate pass-through and found that, of Bangladesh's nearly 10 percent inflation, as much as five percent could be accounted for, directly or indirectly, by the exchange rate depreciation.

If that is the case, then what is the panacea? The IMF's ECF-EFF-RSF programme is largely focused on enhancing domestic resource mobilisation. As such, it is silent on the matter of prevailing high trade taxes which account for some 29 percent of the National Board of Revenue's tax revenue. What is missing is any guidance regarding the changing composition of trade versus domestic taxes. The challenge of enhancing domestic resource mobilisation entails augmentation of direct domestic taxes, such as income and corporate taxes as well as the value added tax, while gradually reducing reliance on trade taxes. Furthermore, revenue augmentation has to be done by expanding the tax base rather than by raising any rates, as a matter of principle.

Trade taxes (that is, tariffs and para-tariffs), considered the most distortionary taxes in public finance literature, primarily have two objectives: 1) to raise revenue; and 2) to offer protection to domestic industries. Raising tariff rates yields higher revenue up to a point (called the optimum rate) beyond which revenue yield declines (as imports fall) but protection continues to rise.

Bangladesh's average tariffs, at 27.6 percent currently, is higher than the average of Low-income countries (9.79 percent), Lower middle-income countries (7.2 percent), High-income countries (2.02 percent), and the world average of six percent.

It is time we started rationalising our tariff structure, not just to make them comparable to those of our peers, but to make our exports more competitive and eliminate the anti-export bias of protection that has currently become a binding constraint for our national imperative of export diversification. The stubborn resistance to lowering or rationalising tariffs is based on the argument that revenue loss goes against the objective of enhancing revenue mobilisation, while domestic industries need protection to survive and prosper.

This is where our current tariff structure presents a uniquely Bangladeshi opportunity to counter the inflationary pass-through effect of depreciation, through an approach that can be described as "compensated depreciation." Rather than let the exchange rate pass-through have an unabated impact on inflation, it can be countered with a reduction in tariffs. A depreciation of the exchange will have the effect of raising tariffs across the board by exactly the percentage increase in the assessable value of imports. In this case, the 30 percent depreciation of taka may result in a 30 percent rise in the value of imports. Even if the tariff rate remains unchanged, the higher import value now yields 30 percent more revenue from the same ad valorem tariff rate.

That is a bonus for NBR. Why? Without actually raising rates, revenue yields rise due to an increase in import value post-depreciation.

Just as the exchange rate depreciation has a pass-through effect on domestic prices (in the form of inflation), so does any change in the tariff rate. As such, a negative pass-through trigger on inflation could be induced by a reduction in tariffs. If not the entire 30 percent depreciation, at least a partial remission in inflation could be induced by lowering some tariffs or para-tariffs—a case of compensated depreciation. This could be one of IMF's "favorable unexpected shocks" that could be delivered before or in the forthcoming national budget.

One low-hanging fruit is the three-percent regulatory duty (RD) imposed on nearly half of all imports. Depending on how deep and how fast the government would like to see inflation tamed, the removal of RD could be associated with removing or setting various caps on supplementary duty (SD). These adjustments would incur negative pass-through triggers on inflation, just as the exchange rate depreciation triggered higher inflation in the first place.

To conclude, a downward shock to inflation could be brought about by a downward tariff adjustment. Any downward tariff adjustment would partly neutralise the price or inflationary impact of depreciation, swiftly and sharply. This would be a radically and uniquely Bangladeshi approach to counter the inflationary impacts of depreciation—if the objective is to tame inflation swiftly and sharply—without us having to wait for two years.

The argument that tariff cuts will cause loss of revenue is not valid in this case as all tariffs have increased by 30 percent due to taka depreciation. Furthermore, using exchange rate depreciation as a strategy for revenue mobilisation cannot be a valid tax effort. Simultaneously, the basic principle of effective protection tells us that the depreciation has raised effective protection by 30 percent, since both input and output tariffs have risen in tandem. Thus, neither the revenue nor the protection arguments hold water. Besides, import compression applied for the past year will soon have to be lifted as that policy is slowing down production activities and causing more pain than is necessary. Rising imports should yield more revenue for the NBR over the next few months.

Tariff remission of 5 to 10 to 15 percent (from existing rates) will have an immediate effect on domestic prices of imports as well as import substitutes and costs of production. This is one great opportunity to remove RDs as an emergency measure to control inflation. More downward adjustments in tariffs and para-tariffs could and should be done in the national budgets for 2025 and 2026, as part of the tariff rationalisation initiatives stipulated in the National Tariff Policy 2023. These measures are consistent with the need to get our overall tariff structure to be World Trade Organization-compliant as we approach 2026, the year of our graduation from LDC status.

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