Zahid Hussain

Be realistic, AVERT RISKS

Big budgets create unnecessary expectations, says former World Bank economist Zahid Hussain

REJAUL KARIM BYRON

In a country weighed down by high inflation, dwindling fiscal space and weak investments, now is not the time for illusions.

The interim government, free from electoral compulsions, has a rare chance to reset the national budget on a rational footing. The coming fiscal year demands a departure from grand narratives and exaggerated promises. Instead, the focus must shift to what is financially feasible, credibly fundable, and economically responsible.

That is the central message from Zahid Hussain, former lead economist at the World Bank Dhaka office, who in an interview with The Daily Star urged the government to pursue a prudent and realistic national budget grounded in hard fiscal truths.

The total budget size, he contends, should avoid the excesses of political grandstanding. "The total size of the budget should not be overly ambitious," Hussain said. "Given the current financing constraints, a budget of around Tk 720,000 crore would be reasonable."

He cautioned against a recurring pattern in budget cycles.

"Every year, right after the budget is announced, you hear the same familiar comment: the budget is overly ambitious." Political governments, he said, have traditionally used budget figures as a propaganda tool, aimed at showcasing artificial economic strength and justifying expanded spending.

"The interim government doesn't have to worry about those things. It doesn't have to create excessive expectations in the minds of the public," he said.

In determining the budget size, financing availability, and a manageable deficit must be the guiding principles. "It should be considered mainly in terms of financing. There are two components -- the size of the deficit and total revenue that can realistically be expected," said Hussain.

While Bangladesh has historically relied on domestic borrowing, this strategy has clear limits. "I don't think you can expect more than Tk 120,000 crore of domestic borrowing without creating pressure on interest rates and on the exchange rate," he cautioned. This pressure on the banking system would inevitably crowd out private sector credit.

Hussain emphasised the need for external financing to play a greater role, but warned against counting mere commitments. "The most important thing is a commitment of foreign financing, a commitment that is in the pipeline and disbursed," he said.

The economist estimated that with proper management, Tk 100,000 crore in external financing could be realised in fiscal 2026.

Even with strong external support, he warned that achieving Tk 500,000 crore in domestic revenue would be difficult, making deficit control even more urgent.

Hussain was adamant that monetising the deficit -- borrowing from the central bank -- must be avoided at all costs. "We are ruling out the option of borrowing from the Bangladesh Bank," he said. "The budget cannot be financed by printing money."

Drawing from experiences, he said devolving treasury bills to the central bank only "fed inflationary pressures. We did this in the past and paid for it."

Instead, deposit growth must be the backbone of sustainable domestic financing. "To get domestic financing without crowding out private credit, without creating pressure on interest rates and the exchange rate, deposits have to grow," he said. "Otherwise, the math won't add up, and you would need to cut the deficit."

NO ALTERNATIVE TO TAX REFORM

The broader fiscal situation, Hussain argued, highlights the urgent need for structural tax reform. Bangladesh's tax-to-GDP ratio remains far too low to sustain rising public spending. "We need to move towards greater reliance on direct taxes such as personal income tax, corporate income tax, and wealth taxes," he said. "Reliance on indirect taxes, particularly taxes based on import values, has to decline, given global situations and forthcoming LDC graduation."

> **"The total size of the budget should not be overly ambitious. Given the current financing constraints, a budget of around Tk 720,000 crore would be reasonable."**

He highlighted a deeply flawed tax structure riddled with exemptions and multiple rates, which facilitate evasion and abuse. "Multiple rates and exemptions create discretion, and discretion invites misclassification, evasion, and rent-seeking," he said.

Citing estimates from the local think tank Centre for Policy Dialogue (CPD), he said tax evasion cost Bangladesh Tk 226,236 crore in FY2023, with half stemming from corporate tax evasion. "If tax evasion exceeds half of actual tax collections, you have to ask yourself: how is this happening?" he said.

Among key reforms, simplifying the value-added tax (VAT) regime should be a priority. "I think the beginning point is to move towards a single VAT rate. Not necessarily 15 percent -- by international standards, it is on the high side," Hussain said, suggesting a 12.5 percent rate as more appropriate.

He called for eliminating special rates like turnover tax, truncated VAT, and package VAT. "These need to be rationalised, meaning they must eventually be eliminated," he said, noting that the reform cannot be done overnight but must steadily be attained to curb evasion.

Hussain also urged caution in raising personal income tax exemption thresholds, arguing that "we do not have the luxury of providing large revenue giveaways through exemption increases." He said such increases also benefit high-income groups and have minimal impact on the poor. However, an inflation adjustment could bring some relief to the middle class. If such an adjustment is made, the government would need to find ways of offsetting the resulting revenue loss.

REVIEW DEVELOPMENT PROJECTS

On the expenditure side, Hussain said that structural constraints limit the government's flexibility. Salaries, pensions, debt servicing, and subsidies consume a significant share of the budget. "When you look at the expenditure side, the government's space for reform is limited," he said.

Still, some rationalisation is possible. "We have to ask ourselves: where are we spending the money, and how do we divide it between the operating and development budgets?" he said, calling for greater strategic planning in resource allocation.

He lauded recent efforts to scrutinise the Annual Development Programme (ADP) and reduce non-essential spending such as on buildings, vehicles, and foreign travels within projects. The focus has shifted not only to reducing the number of projects, but also to identifying savings within project components.

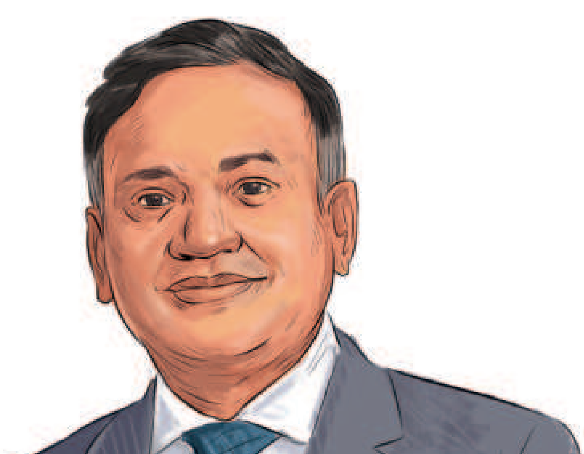
On the subsidy front, Hussain noted that fertiliser subsidies offer little flexibility, but mechanisation subsidies in agriculture might be reconsidered.

He welcomed recent steps to renegotiate contracts with independent power producers and reduce Power Development Board subsidies by reducing costs, adding that "the government is under heavy pressure from the IMF on this."

Timely disbursement of subsidies is also critical. "The release of subsidy funds must happen on time to prevent arrears from building up because of late payment penalties," he said.

Export and remittance subsidies should be re-evaluated. "Remittance subsidies have not achieved their intended effect," he said. "Recent remittance boom is attributable not to the subsidy but to a slump in illicit outflows."

Despite its limited tenure, the interim government has the opportunity to lay the groundwork for institutional reform, according to the economist.



Mohammad Abdur Razzaque

A unique chance to reset FISCAL PRIORITIES

Economist Mohammad Abdur Razzaque tells The Daily Star that upcoming budget must be realistic, prioritise smooth LDC graduation

REJAUL KARIM BYRON AND AHSAN HABIB

Bangladesh's upcoming national budget, set to be unveiled by the interim government in June, could mark a rare departure from past fiscal cycles. Free from electoral pressures, the interim government has an opportunity to frame a budget grounded in realism and focused on ensuring a smooth exit from the UN's group of least developed countries in 2026.

"This budget is going to be unique," Mohammad Abdur Razzaque, chairman of Research and Policy Integration for Development (RAPID), a think-tank, said in an interview with The Daily Star.

"There is no pressure on the government to go for populist measures. It's an opportunity to be realistic in terms of what the economy should try to achieve and what the most pragmatic policy goals are."

The interim administration, led by Nobel laureate Muhammad Yunus, is not bound by a political manifesto or a five-year development plan.

The Eighth Five-Year Plan has lapsed and the current regime has not proposed a new one.

"There is no prior commitment that needs to be fulfilled," Razzaque said. "That gives the government greater flexibility."

This, he argued, opens the door to an alternative approach: anchoring the budget in Bangladesh's LDC transition strategy.

The government recently adopted the UN-mandated "smooth transition strategy" as its post-LDC roadmap.

"This year's budget should be focused on how to start implementing this in an effective manner. It is also an excellent opportunity to think about this strategy considering a medium-term framework."

He said the interim government should identify a handful of clear actions for implementation now while outlining medium-term targets for the next administration.

"If they can set the direction, the elected government can also take this forward if they want to."

He added that restoring macroeconomic stability remains a top priority as the country grapples with persistent inflation.

"The inflation rate is quite high, close to 10 percent. Despite some of the macroeconomic stability that we have seen, inflation is not coming down at the rate that we anticipated.

"Without macroeconomic stability, we cannot improve export competitiveness in the post-LDC era. It's impossible."

Additionally, the fiscal space remains tight.

Bangladesh, grappling with one of the lowest tax-to-GDP ratios in the world, has witnessed a growing share of the national budget being swallowed by interest payments.

"We are becoming more and more dependent on foreign resources to implement the national budget," Razzaque warned. "Our annual development programme is now, I think, close to 40 percent dependent on foreign financing."

The most immediate risk from LDC graduation, Razzaque explained, is the erosion of preferential trade terms.

However, the UK has already pledged to maintain Bangladesh's market access and Razzaque added that there was a good chance to engage with the European Union to secure a similar level of market access after graduation.

"The UK plus EU account for almost 60 percent of our total exports."

The EU's current GSP regime expires in December 2027, and its new trade rules will shape Bangladesh's market access beyond the LDC transition window.

"This negotiation with the European Union needs settling immediately," he said, calling the next 12-18 months "a critical opportunity".

Bangladesh is expected to qualify for GSP+ status, but even under GSP+, readymade garments, which dominate the country's export basket, may be excluded due to their large market share.

"We need to negotiate a waiver," he said.

"This can be the single most effective way of minimising the impact of any potential LDC graduation-related consequences."

SUBSIDIES AND REFORMS

As World Trade Organization rules prohibit export subsidies after LDC graduation, phasing them out is another looming challenge.

"We should continue with the current policy that we have until our LDC graduation timeline, which is November 2026," Razzaque said. "We need to start thinking about how export support measures can be implemented after LDC graduation."

He also called for deeper structural reforms to address long-standing anti-export bias in the economy.

"We have been trying to diversify exports for the past 30 years and almost nothing has happened. We failed to tackle core policy problems."

Bangladesh's high import duties, including customs, supplementary, and regulatory taxes, have made the domestic market more attractive than export markets.

"High duties cause prices in the domestic market to be very high, making production for the domestic market lucrative. Some kind of tariff rationalisation could help investors make the right decision."

The lack of quality enforcement in the domestic market also hinders export readiness. "If we can enforce quality standards, the products we are selling to our domestic consumers will be ready for the international market," he said.

He pointed to the leather industry as a case in point.

"One concrete example is the leather industry. Because of a lack of facilities and other problems, leather goods made in Savar may not be accepted in international markets. Yet, they continue to be produced and sold in the domestic market. There is no restriction."

Razzaque stressed the importance of attracting foreign direct investment (FDI) to offset export shocks.

"Attracting FDI is best supported by negotiations of FTAs," he said. "Securing the Bangladesh-Japan trade agreement should be given maximum priority."

He called for the establishment of a chief trade negotiator's office to centralise and coordinate trade policy.

"We need to have a facility where the government can pool the right kind of expertise. They also need to be trained properly.

"Through that office, resource people, maybe sitting in the Bangladesh Bank, Bangladesh Bureau of Statistics, Planning Commission, commerce ministry and foreign affairs ministry can be brought together. Then we can develop a coherent trade policy."

CHRONIC IMPLEMENTATION FAILURES

Bangladesh's credibility is often undermined by poor implementation. "Normally, countries are able to implement their national budgets. We always struggle," Razzaque said. "Some of the commitments we undertake in the budget become aspirational rather than binding."

Even well-conceived projects suffer from chronic delays.

"The main problem was the implementation time. Especially at the beginning of projects. Recruiting the project director and planning how the project is going to be implemented – that went on and on.

"More than $50 billion in aid money is sitting in the pipeline. That has happened because our absorptive capacity has been extremely low."

At the same time, accountability has been weak.

"Project audits have been very poor. No punitive action has been taken," he said, urging the government to engage think-tanks and civil society and support independent evaluations.

He also criticised the last regime's obsession with "visible" mega projects. "The most priority was given to projects that would be visible rather than those that would be most effective," he said.

"Cronyism and political favouritism skewed project selection."

With elections expected between December 2025 and June 2026, the interim government is expected to serve through a full implementation cycle, making this a chance to set a precedent, Razzaque said.

"This can be the time to set an example and show that the government should formulate a realistic budget and implement it in the most effective manner.

"There are no fundamental issues about which there are disagreements," he added.

"Macroeconomic stability, controlling inflation, generating jobs, preparing for LDC graduation -- these are the core areas. Whoever is elected in the next elections cannot disagree with that."