

A high reward high risk budget

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The new Bangladesh fiscal year (FY) 2012 National Budget, the second budget under the Sixth Five Year Plan, is on the whole a bold budget.

It is ambitious in nature but achievable, provided the underlying policy actions are taken. The budget has to be bold in order to align it with the growth targets of the Sixth Plan that requires substantial increases in public investment, especially in the area of infrastructure. Much of this additional investment has to be financed from additional domestic revenues that require tax collections to go up substantially. Public revenue mobilization target in the budget, while higher than last year, is quite feasible in view of Bangladesh's still low tax effort.

At issue, however, is whether all possible tax instruments are being harnessed. The tax structure has significant gaps in terms of tax efficiency and equity. On the expenditure side, the development budget, while large in relation to the past, is still low in relation to the development needs of the country. The weak implementation argument, while valid, is not insurmountable with right policies.

There is, however, a question about the size of the current spending. There is a risk that the projected subsidy spending may actually underestimate the likely spending unless corrective actions are taken to contain the energy subsidies. The pressure from growing subsidies could also undermine the overall budget deficit target. On the financing side, the main question is whether the government is able to mobilize the projected optimistic increase in foreign financing. If this is not realized, as is likely, this will challenge the consistency of monetary and fiscal policy targets.

Indeed, there is a serious risk that the recent policy actions to curb the growth of money supply in order to reduce inflationary pressures might get compromised by the increasing budgetary demand for bank financing. In the past two years monetary growth much exceeded prudent limits even with limited pressure from the fiscal front. With pressure now being built up from the fiscal side, the ability to keep monetary expansion within prudent limits to prevent inflation and contain the balance of payments pressure will again become a substantial macroeconomic policy challenge in FY2012.

Key Fiscal Developments: The trend in major fiscal developments is shown in Table 1. Overall fiscal deficit is projected to increase to 5.0 per cent of gross domestic product (GDP). This is higher than in recent years, but does not pose any threat to debt sustainability provided additional pressures from the growing subsidy bill is contained. As shown in Figure 1, the debt to GDP ratio and interest cost remain manageable and the primary balance, while growing, is still within prudent limits. More detailed debt sustainability analysis confirms this conclusion.

Table 1: Summary & Fiscal Operations (In billions of Taka)

	FY09	FY10	FY11(RB)	FY12(Budget)
Total Revenue	641	757	949	1184
Tax	529	625	788	958
Non Tax	112	132	161	226
Total Expenditures	881	1014	1192	1435
Current Expenditures	585	666	774	879
ADP (PPP + Public entities)	196	257	345	460
Non ADP Capital	22	87	87	146
Others Expenditures	78	4	86	150
Overall balance	-219	-217	-501	-483
Primary balance	-90	-108	-193	-272
Financing (net)	249	257	343	452
External	47	99	95	180
Domestic	193	158	248	272
<i>As % of GDP</i>				
Total Revenue	10.4	10.9	12.0	13.2
Tax	8.6	9.0	10.0	10.6
Non Tax	1.8	1.9	2.0	2.5
Total Expenditures	14.3	14.6	16.4	18.2
Current Expenditures	9.4	9.6	9.8	9.8
ADP	3.2	3.7	4.4	5.1
Non ADP Capital	0.4	1.3	1.1	1.6
Others Expenditures	1.3	0.0	1.1	1.7
Overall balance	-3.9	-3.7	-4.4	-5.0
Primary balance	-1.5	-1.6	-2.5	-3.0
Financing (net)	3.9	3.7	4.4	5.0
External	0.8	1.5	1.2	2.0
Domestic	3.1	2.2	3.2	3.0

Source: Ministry of Finance



Revenue Targets: The budget targets total revenues to go up from 12% of GDP in FY2011 to 13.2 % (Table 2). Some 50% of the increase is expected from higher tax effort, which is projected to go up by 0.6 percentage point of GDP, from 10% of GDP in FY2011 to 10.6%. The other 50% of the increase (0.6% of GDP) will come from non-tax revenues. This enhanced tax effort is consistent with the performance in FY2011. The 10.6% of GDP tax rate is a welcome development in view of Bangladesh’s historically low tax effort (Figure 2). Over the past two years the National Board of Revenue has been making a systematic effort to broaden tax coverage and strengthen tax administration. This is commendable and deserves strong support.

Table 2: Government Revenues (In billions of Taka)

	FY09	FY10	FY11	FY12
	Actual		Revised Budget	Budget
Total revenue	641	757	949	1184
Tax revenue	529	625	788	938
NBR taxes	502	597	756	919
Non-tax revenue	112	132	161	256
	(As % of GDP)			
Total revenue	10.4	10.9	12.0	13.2
Tax revenue	8.6	9.0	10.0	10.6
NBR taxes	8.2	8.6	9.6	10.2
Non-tax revenue	1.8	1.9	2.0	2.5

Source: Ministry of Finance



Nevertheless, the tax structure needs further reforms. The reliance on trade taxes, particularly supplementary duties, remains high and raises questions of consistency with export diversification efforts. New supplementary duties imposed in the budget will likely raise nominal rate of protection by another 2.0-3.0 percentage point, which goes in the wrong direction. Reliance on production taxes for revenues is known to distort incentives and reduces the efficiency of resource allocation. The budget’s equity aspects are compromised by the continued inadequate coverage of income and wealth taxes. The budget’s initiative to bring in salaries of senior public officials including parliament members into the tax net is a welcome move.

Similarly, the effort to broaden the wealth tax is also a positive development. Even so, the

evasion of a large number of potential income tax payers from the tax net, the lack of a broad-based property taxation and the needlessly highly favourable treatment of capital gains from stocks and property ownership continue to raise concerns about the equity and efficiency of the tax structure. The latter two aspects of the tax structure also distort incentives in favour of real estate holdings and stock options at the expense of investment in real activities. These fiscal policy weaknesses could compromise the Sixth Plan's targets for improving the composition and efficiency of private investment. (This is the first of a two-part write-up. The second part will appear tomorrow. The writer is Vice Chairman of the Policy Research Institute of Bangladesh.

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