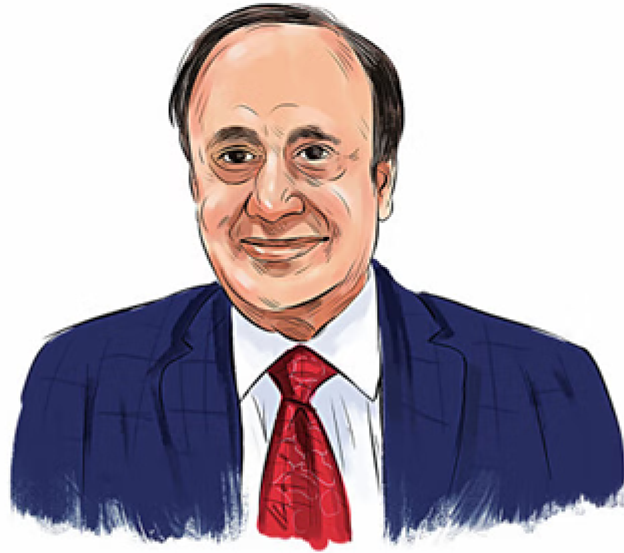

# BANGLADESH NATIONAL BUDGET FY2024-25: It’s time to correct fiscal stance

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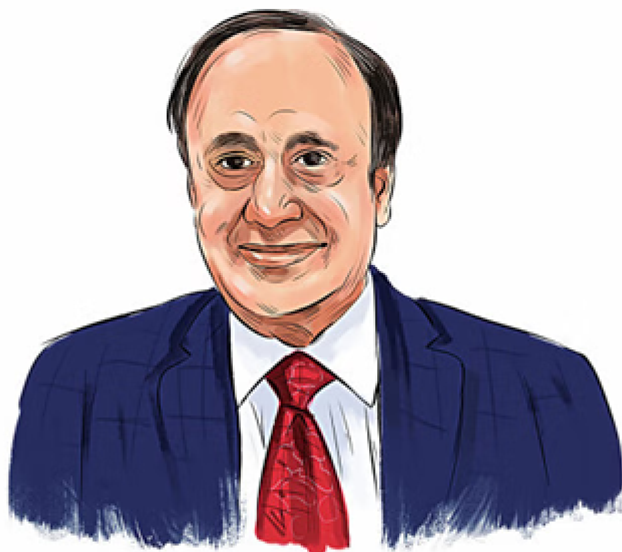
INTERVIEW

It’s time to correct fiscal stance



Sadiq Ahmed, vice-chairman of PRI

The government has not addressed the stability issue through its fiscal policy for two years in a row although the economy is in turmoil owing to both external and internal pressures. A noted economist, however, thinks it can bring the situation under better control through the budget in the next fiscal year beginning on July 1.

Sadiq Ahmed, vice-chairman of the Policy Research Institute of Bangladesh (PRI), a Dhaka-based think-tank, said he does not think the government can compromise on stabilisation at this stage.

“In the last two to three years, they did not use the budget for that. And that was a mistake. The government has done the monetary correction and the exchange rate correction, and now it will have to correct the fiscal stance.”

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For the past two years, Bangladesh has been facing serious macroeconomic instability reflected in higher inflation, depletion of foreign currency reserves, strain on the exchange rate, a decline in capital inflows, and pressure on the budget.

In response, the government has devalued the currency, imposed import controls, tightened public spending, and very recently allowed interest rates to go up.

But Ahmed thinks the full range of demand management policies necessary to reduce demand and stabilise the economy has not been made yet. "Consequently, macroeconomic imbalances continue to persist."

While the flexibility of the interest rate has already reduced the demand for credits and lowered the demand pressure on foreign exchange, the impact on the reduction in the inflation rate has been less visible.

This is partly because of the time lag, but also because the demand pressure, emanating from fiscal deficits, has not been addressed, the former senior official of the World Bank said.

Despite significant cutbacks in annual development spending, the budget deficit remains stubbornly high at around 5 percent of gross domestic product (GDP) owing to subsidies and shortfalls in revenue mobilisation.

"While a fiscal deficit of 5 percent of GDP may not appear high in a normal year, in the present context of high inflation and pressure on the balance of payments, there is a need to contain it to 2-3 percent."

Ahmed said the main elements of the budget strategy should be to reduce fiscal deficit significantly to lower aggregate demand. This demand reduction should be achieved in a way that it does not compromise the future growth prospect or hurt equity.

For this to happen, the strategy will involve raising tax revenues through effective tax reforms, increasing the profitability of state-run enterprises (SoEs) through corporate governance and pricing reforms, reducing subsidies, and raising spending on human development and social protection.

The PRI has carried out considerable research on the tax reform agenda.  Hence, he said, the main elements of the tax reform are well-known and have been presented in public forums and shared with the government many times.

These include separating tax planning and tax policy from tax collection; strengthening both units with autonomy, professional management and quality staffing; digitalising tax assessment and collection thereby eliminating the interface between taxpayers and the tax collector; simplifying tax filing by eliminating the income, expenditure and wealth reconciliation; selective and productive audits done by professional auditors; implementing the 2012 VAT law; and introducing a modern property tax system.

"While the full implementation of the tax modernisation plan will take two to three years, an early start can be made in the FY25 national budget and these can have substantial positive revenue effects," Ahmed said.

He said there is no shortcut to digitalisation of the tax system and there is no reason this cannot be done within the next twelve to eighteen months.

"I am confident if the government implements the above measures and the VAT law, you will get revenue equal to 1.2 percent of GDP in nine months to one year."

The economist said the government has invested heavily in SoEs and most of them suffer from operating losses. As a result, as against a book value of total non-financial SoE assets of 17 percent of GDP in FY2021, profits were a mere 0.6 percent of GDP.

"A 10-12 percent financial rate of return should yield profits equivalent to 1.8-2 percent of GDP. It is conservatively assumed that the government can raise an additional surplus of 0.3 percent of GDP from SoEs in FY25."

He said the government can't afford to neglect the fiscal adjustment agenda anymore. "I know bringing about fiscal reforms is politically difficult. But all reforms are politically difficult."

To control inflation, the government has finally agreed that the interest rate will be market-

based. Ahmed said: "That's a very good policy and a forward-looking one. It's better late than never."

In recent months there were multiple exchange rates from as low as Tk 110 to as high as Tk 127 per USD, he said. Nevertheless, it was clear that very few transactions were happening at Tk 110.

Ahmed's recommendation is to go for full flexibility to manage the exchange rate and he called the crawling peg as not a meaningful concept. "The central bank can't keep the exchange rate at any fixed number or even a narrow band as it does not have the reserve cover to back it up. It can, however, influence the market rate by using monetary and fiscal policy instruments."

Cutting down the annual development programme (ADP) to a large extent will not be desirable as this will compromise the development agenda. The fiscal adjustment has to be addressed through some meaningful reforms, he said.

"Frankly speaking, there is not much scope to cut public expenditure. The only area where spending can be adjusted is to reduce subsidies on energy, exports and remittances," Ahmed said.

With a market based exchange rate, there is no need for export and remittance subsidies. Regarding energy subsidies, the government does not have the fiscal space to carry those subsidies. A subsidy on fossil fuel consumption is also inconsistent with the carbon reduction agenda. But, by and large, in order to meet the development objectives of growth acceleration and poverty reduction, the government will have to raise more resources.

The problem with Bangladesh is that it relies heavily on indirect taxes, especially import taxes. On the contrary, all developed countries raise 70 to 80 percent of the taxes through income taxes.

In Bangladesh, the capacity to pay has grown tremendously compared to the early 1990s when per capita income was $300 against $2,800 currently.

"Then why is the personal income tax to GDP ratio only 1.3 percent, one of the lowest in the world?" questioned Ahmed.

"This is because the rich don't pay taxes. The system functions in such a way that they can skip the taxes or reach negotiated setllements. The tax system has to be overhauled."

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