Budget 2013: Can it deliver macro stability and growth that it courts?

Friday, Jun 15, 2012

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Bangladesh economy continues to show a lot of promise and resilience despite heavy odds.

Growth is averaging 6.0-6.5% and poverty is declining by roughly two percentage points every year. But this is no ground for complacency when poverty can be brought down even faster if Bangladesh's private sector driven and employment intensive growth could reach its potential of 7.0-8.0% per annum. If Bangladesh could grow at that rate for a decade, it would become a middle income country no doubt.

We expect annual Budgets to facilitate that process without raising the costs of doing business. Against a background of challenging macroeconomic developments, Budget 2013 makes that commitment. But can it deliver? Rather than engage in cheap populist budget bashing, as an important stakeholder group, it is our professional responsibility as development economists to carefully analyze its contents, check for consistencies in the formulation of strategies for spending and resource mobilization, and, if there are constructive suggestions to offer, inform the public and the government, while the budget is being discussed in Parliament for finalization.

As a first step, we believe the budget statement should be made much more concise so that it saves a few hours of the time of Parliamentarians, reduces the energy and stress required of an aged Finance Minister in presenting it before Parliament, and cuts public time in watching the event unfold in the electronic media or read in newspapers. In this regard, the increased use of power point presentations is a welcome development, a medium that could be effectively used to save time and yet make a greater impact on the target audience.

The target gross domestic product (GDP) growth rate of 7.2% in the budget was not pulled out of a hat. It is the rate envisaged in the Sixth Five Year Plan (2011-15), for the fiscal year (FY), 2013, which happens to be the third year of the Plan – the first two years having seen 6.7% (FY11) and 6.3% (FY12). The growth rate is expected to move incrementally over the next two years and reach 8.0% by FY2015, resulting in an estimated average growth rate of 7.3% over the Five Year Plan period. Having fallen short of the target growth of 7.0% in FY2012, and having realized a lower but still respectable growth rate of 6.3%, justifiably raise questions regarding the plausibility of the 7.2% target for the coming year. The Sixth Plan target was set on the basis of a few inter-linked assumptions: (a) the energy constraint will ease, (b) investment rate will rise to 28-29% of GDP, (c) trade policy will be supportive of high growth, and (d) global economic trends will be stable. As we all know, gas and power shortages still remain significant impediments to rapid growth, and new investment is stymied by poor investment climate further jolted by the recent policies of monetary and credit restraint, with the result that the economy managed only a modest uptick in investment rate of barely 1.0% of GDP in the last three years – from 24.4% to 25.4%.

Going by the incremental capital output ratio (ICOR) of about 4.0, the country needs an additional investment rate of 4.0% to raise the growth rate by 1.0% on a sustainable basis. If the investment rate is not rising, because domestic and foreign investment are both constrained, it is time to accept reality and reconcile with a lower rate of GDP growth until the logjam of 24-25% investment rate is broken.

The budget comes in the wake of macroeconomic challenges stemming from rising pressures on internal and external balances in the past year. Years of generally prudent macroeconomic management have laid a solid foundation for macroeconomic stability that is a vital pre-condition for rapid growth. It is not a house of cards to crumble with the first onslaught of policy anomaly. But it is also important to safeguard the strong macroeconomic fundamentals that have been built, brick by brick over so many years, by not deviating from sound macroeconomic principles.

Therefore, the greatest challenge in budget implementation lies in making sure that there is optimal degree of fiscal and monetary policy coordination to keep inflation under control, exchange rate stable, ease pressures on the balance of payments, and yet leave enough space for private sector to invest and fuel growth. For this to happen, the subsidy bill on account of fuel, power, and agriculture, will have to be restrained within budgetary limits, and stipulated official development assistance (ODA) will have to materialize, to keep bank borrowing of the government within limits set by the budget. That is a tall order no doubt. Make no mistake, several unknowns threaten to upset the cart of macroeconomic stability, some of which – like global economic scenario – are beyond our control, but many others are.

There is one more variable in the equation that cannot be ignored: a trade regime that is a handmaiden of high growth. That trade regime has to be open, with a minimum of tariff and non-tariff restrictions; outward looking, and, if not neutral between import substitute and export production, with a modest policy bias in favor of export orientation. Do we have that trade regime which would support 7.0-8.0% growth? Are we moving in that direction, as articulated in the Sixth Plan? Upon reviewing the proposals on trade taxes, the answer to these questions, appears to be a NO. We find average tariffs and tariff escalation both on the rise. Average nominal tariff, which was 23.5% in FY09, has risen to 26.7% in FY12, and, our preliminary estimate based on proposed tariff adjustments, indicate a further rise to about 28%. For the first time, the share of para-tariffs (e.g. regulatory duty, supplementary duty) in average nominal protection rate (NPR) is higher than that of custom duty (CD). Simultaneously, tariff escalation at the last stage of processing – from intermediate goods to final goods – increases further as (a) customs duties on several intermediate inputs and basic raw materials have been reduced, and (b) supplementary duties on several final goods have been raised over the top rate of 30% (25%CD+5% regulatory duty or RD). This trend goes counter to the understanding with IMF for the $1.0 billion Extended Credit Facility (ECF) for reducing anti-export bias.

This may be the outcome of pre-budget consultations with several producer groups, but the ultimate tax burden lies with domestic consumers. Paradoxically, there has never been any consultation with this stakeholder group – the largest – and the ultimate payer of the protection tax. It is for this reason that trade policy seems biased in favour of producers of import substitutes and against the interest of exporters and consumers. And this trend has continued in Budget 2013.

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