


Contingency plan needs to be in place

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The national budget fiscal year (FY) 2016-17 is going through parliamentary review and will be adopted by tomorrow (Thursday). Importantly, there have been considerable discussions on the budget outside Parliament for well over a month starting early May. This is a welcome practice that provides the opportunity for public participation in this major policy debate. 

Budget making is an ongoing process because many of the underlying issues are generic to all annual budgets. Many of the fiscal policy issues are long-term in nature and would not go away with this budget or the next. So, the budget ought to be looked at from its development perspective. There are two aspects.

First, the budget is a reflection of the government's fiscal policy stance. Therefore, in evaluating the budget, it should be noted that this is only one policy instrument. There are many other policy instruments including monetary policy, exchange rate management, trade policy, financial sector policy, infrastructure policy, industrial policy, agricultural policy, education policy, health policy and the like that together constitute the government's overall policy framework for the economy.

Looking at the budget alone to give all the answers is going to be futile. Second, the budget should be linked to the government's development plan (the 7th Five Year Plan).

As with any other policy document, the budget has its strength and challenges.

On the policy front, the budget has several positive factors including the focus on equity;

signal about the reduction of trade protection; emphasis on macroeconomic stability.

The budget being at 17.4 per cent of the Gross Domestic Product (GDP) is broadly consistent with the 7th Plan. The 7th Plan fiscal framework projected total expenditure to grow to 21% of GDP in FY2020.

Revenue and deficit targets are also broadly consistent with fiscal stability and private investment targets. Bangladesh has one of the lowest tax to GDP ratio in the world and there is no reason why it should not aim to get 10-11% of GDP in FY2016-17 as budgeted.

On the revenue side, the correction of tobacco taxation anomaly is a good move and will yield significant additional revenue. Emphasis on value-added tax, income taxes and tax administration improvements are also welcome.

On the expenditure side, a major positive factor is the focus on the timely completion of mega transformational projects. This initiative of the government deserves appreciation.

Another very positive expenditure allocation decision is the increase in spending on education and the implementation focus on social protection programmes. These are very much needed and we commend the finance minister for these policy measures.

The recognition to reduce the reliance on high-cost domestic financing to low-cost foreign financing of the budget deficit through better use of the growing aid pipeline is welcome.

There are, however, several areas of concern.

Implementation of the revenue strategy is a serious challenge, especially in view of the deferment of the implementation of the VAT 2012 law. In FY 2016 budget the tax revenue target was set at taka 1822 billion (10.6% of GDP). The revised budget target is only taka 1554 billion (9.1% of GDP). This is a huge shortfall. It is a combination of over-ambitious tax target and inadequate policy support and capacity of NBR. In the face of this reality, the target to achieve Taka 2104 billion tax revenue in FY2016-17 (10.8% of GDP) is a massive task. An increase of 35% in tax collections, which amounts to an additional 1.7% of GDP will be needed. For the new budget the stronger tax collection efforts were earlier pinned on the

introduction of new VAT law. This has now been deferred. How can NBR collect additional 35% tax revenues? This is a huge policy challenge that needs considerable substantial attention.

The emphasis on income tax is good but policy and administrative supports are not well developed. Instead of tinkering at the margin, the income tax regime needs a serious overhaul for both corporate and personal income. Tax administration has to be simplified and computerised with arms-length relationship between taxpayer and tax collector. Audits have to become meaningful, very selective and highly productive based on well defined criteria and real time database. Taxpayer service has to improve and all kinds of harassment stopped.

Non-tax revenue targets are very modest. The government has invested a substantial volume of resources in a range of state-owned enterprises (SOEs) including public banks. Instead of getting a solid rate of return, most enterprises are running in deficits and depend on the budget for investments and debt servicing. Public banks need cash injections from the Treasury to stay afloat. As of FY2015, the outstanding debt and debt service obligations of non-financial SOEs was Taka 1920 billion (12.7% of GDP). Non-performing loans of public banks was Taka 308 billion (2% of GDP). These are staggering sums of money and constitute a huge burden on the Treasury. The budget missed out in taking a strong approach to resolving the long-standing SoE problem.

Much of the growth in spending is on the revenue budget. These are mainly in wages, interest costs and subsidies. This causes considerable inflexibility in the budget, especially when revenue targets are not realised. The increase in wages is understandable but the increase in interest cost and subsidies is worrisome. On the interest cost, the government must find a way to substantially reduce its dependence on high-cost savings certificates. It should make more use of concessional foreign borrowing and use more low-cost Treasury-bills rather than high-cost savings certificates.

There is a category in the budget called other expenditures amounting to taka 346 billion. (1.8% of GDP). This was taka 183 billion (1.1% of GDP) in the FY2015-16 revised budget. The distribution of this huge amount of money is not discussed openly and adequately in the budget. The possible interpretation is that these are transfer payments to the state-owned

enterprises (SOEs), public banks and the like. This huge unexplained expenditure category should be scrutinized carefully. The continued Treasury funding of public bank and SOE deficits must be stopped and resources reallocated to the development budget.

As far as the FY2016-17 budget is concerned, since the government almost certainly will miss the revenue target, it should develop a contingency plan by which it will protect the main expenditure items in the development budget. It should re-examine the rationale for the large other expenditures category noted above and use that as the main source of expenditure cutbacks to adjust to the inevitable revenue shortages. The government may also want to revisit the need for such large reliance on high-cost national savings certificates and find ways to reduce the interest cost of deficit financing.

For the medium term, four major policy actions are needed. First, the government should introduce the 2012 VAT law with no further delay in July 2017. This should be declared, sealed and signed now leading no scope for any new debate in 2017. Second, the government must overhaul its direct taxation system. There is substantial scope for tax rationalisation, modernisation and increase in tax collection coverage. Third, the entire SOE policy should be rethought based on a careful review of the current situation, future prospects and reform options. The amount of public resources invested in SOEs is huge and some combination of corporatisation, privatisation and hard-budget constraint will bring about substantial improvement in the medium-term fiscal policy situation of Bangladesh.

Finally, the government must adopt a modern system of property taxation. This will be an important source of revenue, contribute to equity aspect of the budget and help support the growth of urban local governments.