Promises and challenges of fiscal 2013 national budget

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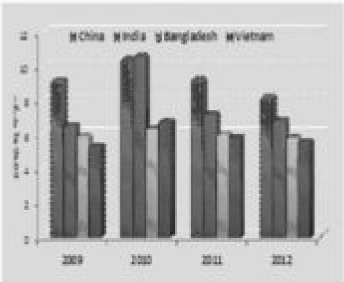
By *Dr. Ahsan H. Mansur*

The budget fiscal year (FY) 2012-13 has now come into effect. It was announced by the Honorable Finance Minister on June 7, 2012, against the backdrop of mixed performance in the preceding year in terms of macroeconomic and fiscal management. Global economic outlook and Bangladesh's export prospects have also deteriorated markedly because of further deepening of the Euro-Zone Debt Crisis. The budget would be last full-year budget for the current government before facing elections and it has been unveiled in an environment of intensifying political uncertainty. The budget targets an acceleration of real gross domestic product (GDP) growth to 7.2 per cent and a sharp deceleration of inflation to 7.5 per cent, while consolidating Government's efforts towards improved macroeconomic stability and further alleviation of poverty.

This policy note analyzes the emerging challenges in implementing the budget taking into account issues that emerged in implementing the FY12 budget. More specifically, following a brief review of the background against which the budget has been unveiled, it focuses on: whether the growth target will be achievable and its implications for fiscal management. This note is also an exercise in pointing out the major issues/factors that must be handled with vigilance in order to achieve the goals that have been set out in the new budget.

Overview of the World Economic Outlook Projections

	2009	2010	2011	2012	2013 e
IMF					
GDP at constant prices (% change)					
World Output	-0.6	5.2	3.9	3.5	4.1
Advanced Economics	-3.6	3.2	1.6	1.4	2.0
Euro Zone	-4.3	1.9	1.4	-0.32	0.9
Emerging and Developing Economics	2.8	7.5	6.2	5.7	6.1
Developing Asia	7.1	9.7	7.8	7.3	7.9
World Trade Volume (goods and services)	-10.5	12.9	5.8	4.0	5.6
Commodity Prices (USD) (% change)					
Oil	-36.3	27.9	31.6	10.3	-4.11
Nonfuel (Commodity Non-Fuel Price Index)	-15.7	26.3	17.8	-10.3	-2.1



Global economic outlook: Bangladesh has been somewhat sheltered from the full brunt of the global economic recession of 2008-09 due to its limited international financial integration. The Euro Zone Debt Crisis however is growing grimmer and its shockwaves are already being felt across the world through various channels. The Industrial World-the destination of Bangladeshi exports–has entered into an extended phase of slow growth or recession induced by the Euro Zone debt crisis.

Real GDP growth in most major regions of the world is expected to be lower in 2012 in comparison to 2011, with the Euro Zone expected to grow negatively. The slowdown in GDP growth in Asia and the developing world is being partly caused by mellowing of the growth spurt of large economies like China and India.

A review of Bangladesh's macroeconomic performance in FY12 shows that the estimated real GDP growth rate of 6.3 per cent, although lower than the 7.0 per cent target set earlier, is respectable. The moderate slowdown in growth-which is broadly in line with the predictions of professional bodies-is attributable to the slowdown in exports and the dampening of general investors' sentiment which led to a deceleration in the performance of the manufacturing and services sectors as well as private investment. However, the effect was cushioned to a certain extent due to domestic demand, supported by continued strong inflow of remittances which helped sustain domestic economic activity and revenue performance. There has also been a decline in agriculture performance which is a bit surprising, but perhaps owing to the decline in agricultural products prices in the global market.

Even though Bangladesh did not perform as well as it had set out to in terms of GDP growth, its performance has been better than its Asian counterparts like India, China etc., who have experienced a more pronounced decline in growth this year in comparison to the last. While Bangladesh has been affected primarily through the export channel, the comparator countries have been affected through trade as well as financial channels like FDI and portfolio investment.

Remittance inflows provided the much needed support from the demand side: Inflow ofworkers' remittances has been a saving grace for Bangladesh in FY12 with the country possibly recoding the highest growth in remittance inflows in the world. Initial worries that there could be a massive reflow of Bangladeshis from abroad due to the 'Arab Spring' as well as global economic slowdown did not materialize at all. It is expected that so long the crude oil prices remain around $70-$80 per barrel, much of the investment programmes in the Gulf Cooperation Council (GCC) region will continue to be implemented along with strong demand for expatriate workers. The number of workers going abroad has rebounded strongly in FY12 and the outlook remains favourable therefore providing a safety net for the external current account and foreign exchange balances in the upcoming fiscal year.While Bangladesh Bank has averted a balance of payments crisis in FY11 by allowing the domestic lending rates and the exchange rate freely determined by market forces, the balance of payments situation continued to remain fragile in FY12. The external trade account deficit grew by 13 per cent between July-March FY12 in comparison to the corresponding period in the previous fiscal year.

Despite the buoyant inflow of remittances (by 13 per cent), the current account balance declined by 22 per cent to US$ 456 million during the first nine months of FY12. The level of foreign exchange reserves declined further by US$ 0.5 billion to below the psychologically important $10 billion level at the moment.

Fiscal management got complicated by a surge in subsidy payments and a shortfall in aid utilization. The subsidy budget was exceeded by a substantial margin owing to increased funds required for the agriculture, fuel Bangladesh Petroleum Corporation (BPC) and electricity Power Development Board or PDB sectors which accounted for the over 70 per cent of the total subsidy in the revised budget. The rising price of fuel in the international market and a markedly higher volume of imports associated with the liquid fuel based, together with delays in adjusting domestic administered prices of fuel and electricity, led to a surge in budgetary subsidies in FY12. The resulting increase in government borrowing from the banking system exceeded the annual target by December 2011, created a liquidity crunch in the money market by crowding out the private sector.

While the government faced problems in its expenditure management, its revenue performance exceeded expectations and helped fiscal management. The revenue surplus of National Board of Revenue (NBR) is expected to be about Bangladesh Taka (BDT) 8.4 billion in FY12, despite a marked slowdown in non-oil imports and associated import stage taxes. As is the case every year, actual Annual Development Programme (ADP) implementation is expected to fall shy of its target in FY12 by about 10.87 per cent of the original budget. This development together with better than budgeted revenue performance, helped contain the overall fiscal deficit including grants to about 4.0 per cent of GDP, below the original budget target. Some corrective measures to contain subsidy through several rounds of petroleum and electricity prices adjustments played a crucial role in improving fiscal management in the second half of FY12. As a result, government borrowing from the banking system which surged to BDT [180] billion at end-November, remained stable at similar levels by end-April 2012. This level of fiscal deficit and debt is consistent with fiscal sustainability. However, the distribution of financing still remains a problem, as external financing (net) has been stagnant or declined in dollar terms in recent years due to government’s inability to implement foreign funded ADP projects.

The New Budget: Budget FY13 is the fourth budget of present government and the penultimate one before it goes for re-election. This budget therefore not only has economic ramifications for the country, the government also has a lot riding on it to meet their political aspirations. This budget is by far the biggest budget in the country’s history in both absolute and relative terms, respectively, at BDT 1.9 trillion or 18.4 per cent of GDP.

While many analysts have characterized the size of the budget as politically driven, we believe that an 18 per cent increase in spending may not be considered expansionary given that the nominal GDP growth rate would be more than 15 per cent. The deficit level of 4.5 per cent of GDP (including grants) is very much in line with past budgets and consistent with debt sustainability. At this crossroad with election ahead, the government had two basic options: (i) to go for an election oriented populist budget with much higher spending and overall deficit; or (ii) strive for maintaining macroeconomic stability through a prudent fiscal stance with fiscal deficit limited to 5.0 per cent of GDP. We believe that the authorities have opted for the second option in order to restore macroeconomic stability by containing inflation, easing money market tensions by avoiding crowding out of the private sector, and achieving a respectable growth rate even if it may not reach the ambitious target of 7.2 per cent.

The budget deficit (including grants) for FY13 at 4.5 per cent indicates that the fiscal stance will remain more or less the same as in most other years. Nevertheless, we believe that the government will face enormous challenges in implementing the budget and achieving the macroeconomic objectives in several areas including achieving growth and inflation objectives, containing the surging subsidy bill; implementing the donor-funded projects included in the ADP, achieving the ambitious revenue target; and alleviating poverty through better management and targeting of social spending.

We consider the growth target as overly optimistic under the current global economic environment and stagnant level of domestic investment. The budget envisages a strong rebound in econom
ic growth to 7.2 per cent despite significant downside risks and a sharp reduction in inflation to 7.5 per cent through better co-ordination in fiscal and monetary policy. It also aims to bring forth more equitable distribution in income and thus reduce poverty level through more equitable growth and higher social sector spending. The authorities will face a number of challenges in achieving the growth target and in implementing the budget during the course of the year.

Double-digit manufacturing sector expansion is a pre-requisite for higher growth. The analysis presented in the Sixth Five Year Plan (SFYP) indicates that even with a sharp rebound in agriculture output, achieving 7.2 per cent real GDP growth will require the manufacturing sector to grow by more than 10 per cent. Given that the manufacturing sector is heavily dependent on the export sector which is facing a slowdown due to the European Union (EU) debt crisis, such a strong performance in the manufacturing sector is unlikely to materialize. Furthermore, the investment level (both public and private sector) required for achieving or sustaining growth rates in excess of 7.0 per cent is unlikely to materialize in FY13, given the shortfall in investment experience in recent years.

Despite resilience, Bangladesh cannot avoid a fall in exports to the industrial countries. The export sector of the country has performed quite resiliently even in the face of the global recession of recent years. While the global trade in value terms declined by more than 30 per cent at its bottom, Bangladesh's export decline was limited to 11.7 per cent at its worst. In line with the previous episode (FY 08-09), currently there are signs of a significant slowdown in global and Bangladesh exports. This situation will probably deteriorate further in next few months. Unlike the past episode (global economic crisis) this time the economic slump in the Euro Zone is likely to be much more protracted. The recovery process this time will probably be more prolonged taking the form of 'U', instead of the 'V' shape as it was in 2008-09. As the Euro Zone receives the largest amount of Bangladesh's exports, slowdowns in that region could have quite an adverse effect on our exports.

Both public and private sector investment are running well below their desired/required levels. Investment- public and private- is usually supposed to be the growth trigger for most economies and Bangladesh is no exception. Increasing the

Investment/GDP ratio to much higher levels was always considered to be critically important for achieving growth rates ranging from 7.0 per cent to 8.0 per cent under the SFYP. After completion of two years under the SFYP, the investment level still remains at about 25 per cent, where it has been hovering for many years, compared with the target of 29 per cent of GDP by FY13 under the SFYP.

The implicit target for investment set out in the FY13 budget seems even more unattainable for several reasons like the current unstable political environment, labour unrests and shutdowns in the RMG export sector, inadequate energy and infrastructural support, to name a few. All these factors tend to act as a disincentive for investors and thereby will most probably lead to decline in investment flows. In FY12, actual public investment fell short of the SFYP target for public investment. The targeted increase in public investment in FY13 also falls short of the SFYP target. The situation is much worse with private sector investment. The shortfall in private investment in FY12 was about 2.0 per cent of GDP.

Private sector investment would need to reach 23 per cent of GDP in FY13 from about 18 per cent level in FY12. A formidable task indeed!

Dr Ahsan Mansur is Executive Director, Policy Research Institute (PRI), Bangladesh. This write-up on Fiscal Year (FY) 2012-13 Budget and Its Challenges is a policy note that was presented at a recent policy dialogue in Dhaka, organised by PRI, Bangladesh.pri.bangladesh@gmail.com

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