The new FY17 budget and implementation challenges

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An objective evaluation of the macroeconomic performance of the Bangladesh economy, in the context of its both global and domestic settings against which the national budget for the fiscal year (FY), 2016-17, has been formulated and finalised, is critically important for assessing its likely outcomes. The new national budget comes into effect tomorrow (July 01).

Against the global background, the growth performance of the Bangladesh economy in fiscal '16 has been commendable. The global economic expansion remains sluggish due to continued weakness in the industrial economies and the recent slowing of the Chinese economy. The decline in oil and non-oil commodity prices in FY16 indicates sizable terms-of-trade gains for oil-importing countries, including Bangladesh, in the form of lower subsidies and import bill. Despite improvement in the world trade volume, its growth rate at 3.1 per cent is quite low, indicating continued economic weakness in the health of major economies and lack of consumer confidence.

In Bangladesh, the real gross domestic product (GDP) growth rate in FY16 is officially estimated to be 7.0 per cent, in line with the Seventh Five Year Plan. There are reservations from many quarters over the estimates of this growth rate.

Sustainability of growth is certainly an issue because: 1) 0.4 per cent of the FY16 growth is attributable to public sector wage increase; and, 2) business confidence remains relatively low, as reflected particularly in the decline in private sector investment in relation to GDP.

Inflation is steadily coming down owing to prudent monetary measures, favourable domestic supply situation, and decline in commodity prices globally. Weak private sector credit demand during most of FY16 and the growing loan-loss provisioning, have, however,

undermined banking sector performance in terms of profitability and outlook. Private sector credit demand has picked up in most recent months (approaching 16 per cent), supported by lower lending rates offered by banks.

These macroeconomic signals indicate a clear growth momentum of the Bangladesh economy. The country's economic growth has been not only satisfactory but also commendably stable, in terms of the degree of volatility, when compared with high performing comparator ones like Vietnam, India and China, notwithstanding its some serious internal challenges.

Bangladesh's GDP growth has been hovering around 6.0-6.5 per cent throughout the Sixth Five Year Plan period. However, it has remained below the projected targets for its whole period, primarily due to sluggish private sector investment. And in the first year of the Seventh Five Year Plan, excluding the impact of the massive public sector salary increase (about 0.4 per cent of GDP), the growth rate would be about 6.65%, instead of the 7.0 per cent.

Private sector investment so far has been disappointing. The decline in private investment/GDP ratio in FY16 gives rise to the concern about sustainability of the 7.0 per cent plus growth rate in the coming years. Private investment has remained virtually stagnant at 22 per cent of GDP, with foreign direct investment (FDI) accounting for about 1.0 per cent of GDP, both being well short of their Seventh Five Year Plan (FYP) and Sixth FYP targets.

Breaking out of the 6.0 per cent plus growth range in a sustainable manner, will require massive efforts in attracting private investment of foreign and domestic origins. In FY17, Bangladesh, based on the goals, objectives and targets of the seventh FYP, will require private investment to reach 23.9 per cent of GDP including 1.8 per cent of GDP from FDI. This will be a challenging task, given its past performance.

In this context, the emphasis given in the FY17 budget on boosting private investment by addressing the infrastructure gap is, therefore, most appropriate. Higher allocations for the

transport and power sectors in the Annual Development Programme (ADP), with emphasis on mega-projects like Dhaka Metro Rail, Deep Sea Port, Strategic Transport Plan and upgrading of railways, are encouraging moves.

However, speedy implementation of such projects will remain to be the main challenge, particularly in view of the country's weak administrative capacity. To cite an example, more than six years have passed since the enactment of the Special Economic Zone (SEZ) Act but yet no Economic Zone (EZ) is in operation until now. Hence, it will be more effective to pour resources and complete the 30 EZs envisaged in the FY16 budget, rather than expanding the number of EZs to 46 in FY17.

FY16 Budget Implementation : On the fiscal front in FY16, a significant shortfall in revenue collection was witnessed, notwithstanding a marked improvement in revenue performance from FY15. The performance in the first 10 months of the year indicates that National Board of Revenue (NBR) revenue increased by 16 per cent to Tk. 1193 billion up to April 2016. Reaching the substantially lower revised target of Tk. 1500 billion will require collection of Tk. 300 billion in the final two months of the year, which appears realistic. The budget deficit would most likely remain at or less than 5.0 per cent of GDP in fiscal 2016, given that the government's Annual Development Programme (ADP) implementation would be about 90 per cent of the revised ADP.

While the budget deficit remains stable, the dependence on high cost domestic borrowing still continues. For financing the deficit, the government thus leaned heavily on domestic sources (71 per cent). This is inefficient, given that commitments of concessional foreign aid are much higher and there is an aid pipeline of US$23 billion. At 3.6 per cent of GDP in FY16, domestic financing would be the highest in recent years. It did not create any pressure on the banking system because most of it came from non-banking sources and demand for bank credit by the private sector was sluggish.

The balance of payment (BOP) performance remains strong, despite a decline in inflow of

remittances. The overall external balance would record a surplus of $3.8 billion and the level of foreign exchange reserve would reach $30 billion mark at the end of fiscal 2016. The external current account will remain in surplus mainly due to the higher export, while import growth has remained robust (10 per cent). A decline in the services account deficit, due to lower shipping costs, has also contributed to the current account surplus. The reserve buildup is attributable to the continued surplus positions in the current account and in the financial and capital accounts ($2.5 billion). This also reflects the impact of foreign currency borrowing by the private sector. In the coming months, managing the capital inflows and the exchange rate stability will continue to remain major problems for Bangladesh Bank.

A MACROECONOMIC ANALYSIS OF THE BUDGET 2016-17: The FY17 Budget envisages a strong rebound in economic growth to 7.2 per cent, despite significant downside risks. A number of other issues pertaining to the budget came up in various forums. Is the budget too big? What could be possible sources for achieving the ambitious revenue target set there? Is the allocation for social sector sufficient to help enhance welfare of the population as stipulated in the Finance Minister’s budget speech? Do we see a major increase in ADP and any shift in its composition?

The FY17 overall budget size is at 17.4 per cent of GDP. Certainly this cannot be considered too big for any country. Any respectable $230 billion economy like that of Bangladesh should have budget size of at least 25 per cent of GDP. The size of the FY17 budget is higher than FY16 revised budget (RB) by 2.1 per cent of GDP. This is slightly higher than the increase in total expenditure between FY15 and FY16 revised budget (RB) of 1.8 per cent of GDP. These considerations dispel the argument that the budget is too large or overambitious, since this kind of growth was not unprecedented and was considered necessary for the GDP growth target for the year, while ensuring the realisation of the revenue growth target on a sustainable basis.

Revenue target at 12.4 per cent of GDP in FY17 is otherwise high, in light of the poor revenue performance in recent years. Achieving the revenue target could be a steep task. While a mammoth target has been set for FY17, the NBR has taken numerous measures to provide the boost in revenue collection. The required growth in revenue, from the revised FY16

estimate will be more than 35 per cent, compared with 16 per cent growth rate recorded in the 10-month period of FY16. After accounting for the autonomous growth in revenue due to economic expansion and price developments, the total amount of discretionary measures is estimated to be more than Tk. 300 billion. Taking all factors into account a shortfall of about Tk. 200 billion is expected during FY17. This is somewhat similar to the level of shortfall experienced in FY16.

Social Infrastructure spending and allocation in FY17 in terms of total budget, as well as GDP, has rebounded after recent years of decline in FY16 budget (B). Out of total budgetary spending, social infrastructure spending will be 28.3 per cent in FY17, the same level recorded in FY11. The increase in allocation in social sector in FY17 is a welcome move.

Expenditure on all key social welfare and development sectors like education, health, food and social security had stagnated or declined in recent years relative to GDP and their share in total spending declined. Hence, the increase in allocation in social sector is considered welcome.

The FY17 budget projects an expanded size of the ADP, reflecting an increase of 50.9 per cent over that of the revised budget in FY16. This seems unprecedented at a glance. However, it is not likely to be so high because actual implementation is not expected to be more than 90 per cent of the revised budget. The ADP allocation for FY17 (B) seems very high in nominal terms since it has crossed the BDT 1.0 trillion mark. However, in terms of growth the budget for the ADP is not unprecedentedly very high. The increased ADP is expected to help the ambitious economic growth target for FY17.

But its implementation challenges will remain, and based on past experience, actual ADP utilization may be 15 per cent-20 per cent less than the budgeted amount. Sectoral allocation pattern of the ADP for FY17 indicates a further increase in allocation for the transport sector owing to the Padma bridge project, along with major railways and Dhaka Metro projects. The emphasis on transportation is appropriate and consistent with the government’s political commitment to complete Padma Bridge before the next election in 2019. There is a reduction in allocation for electricity, which is not a matter of concern since much of the new capacity expansion for electricity generation, will be done by the private sector under long-term power purchase agreements.

Meanwhile, the continued weaknesses in the financial sector due to major governance problems in public owned banks and the growing loan losses across the banking system, are issues of consequence. All these issues will need to be addressed forcefully with strong political backing in FY17.

On the while, the budget for FY 17 would need to be implemented carefully so that it does not crowd out private sector credit through the targeted high level of domestic bank borrowing by the public sector. As economic activity including investment picks up, credit demand from the private sector could easily expand by more than 20 per cent. This may then create new tensions in the money market, undermining economic growth.