A Budget for Middle-Income Aspirations

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CURRENT EVENT ANALYSIS

Tomorrow, June 2, the Honorable Finance Minister, Mr. Abul Maal Abdul Muhith will present the National Budget for the eight consecutive time (and 10th, overall). We already know that the budget size will exceed BDT 3.40 trillion. The size is put into context by the fact that Bangladesh's GDP has almost doubled in the last five years, from ~US$ 100 billion to ~US$ 200 billion.

Noteworthy is the widespread media attention the budget has generated via pre-budget debates and commentaries. This is heartening, given the importance of the National Budget and regulatory policies to the aspirations of a market economy in which 90% of activities stem from the private sector.

A. External Sector – Remittance

While the resilience of the Bangladesh economy is now world famous, as is its growth potential, it is important that the budget considers challenges that may arise in the future. A potential challenge may lie in the remittance sector. In the first 10 months of the current fiscal, remittance received has fallen 2.4% year-on-year (increases year-on-year are the norm). A drop in remittance means a drop in consumption. Consequently, between FY15 and FY16, overall consumption as a ratio of GDP has fallen from 77.84% to 76.11%. The decline in remittance also reduces consumption in the rural economy. Therefore, tomorrow, we look forward to initiatives in the budget intended to stimulate remittance growth, such as guidance and allocation for vocational and technical training.

B. External Sector - RMG

To continue with the external sector, during a recent televised discussion organized by FBCCI, BGMEA President Mr. Siddiqur Rahman insisted on a 10% special corporate tax rate and reduced tax at source. While such requests from industry associations are expected before a budget, there should be no mistaking the real challenges to RMG sector growth, such as infrastructure bottlenecks, e.g., shortage of power, gas, land, and not to mention, a paucity of skilled workers and managers. In 2014, BGMEA set a target of US$ 50 billion in RMG Exports that it hopes to achieve by 2021. In order to achieve this target, the RMG sector is estimated to require fresh investments of around US$ 100 billion in the next 5 years.

This brings us to the crucial topic of investments, which have been stagnant in the current fiscal. According to provisional BBS data, the private investment-GDP ratio at current prices has declined to 21.78% in FY16 from 22.07% in FY15. Investments are essential for higher rates of growth, and Bangladesh's macroeconomic fundamentals certainly merit higher investment growth. So what does it take to encourage investments?

C. Investment Growth

On the topic of investment growth, the discussion tends to get hijacked by proponents of lower bank interest rates. Bank interest rates have fallen, and while it's true that Bangladeshi banks have among the highest interest rate spreads regionally, the cause is not only inefficiency, as is often said, but also the high price of real estate.

Investments are also encouraged by building of roads, flyovers, power and gas expansion, and political stability. Moreover, investments are also affected by the global economy, and there is little doubt that sluggishness in EU and the US have also contributed to slower investment growth in Bangladesh.

However, three things are worth highlighting if we are serious about creating investment growth: First, land prices; Second, deepening financial markets and financial innovation; and third, our "Mega Projects".

A binding constraint to investment growth is high land prices. Digitizing land records will be important, and it will be crucial to expedite this process, because that will allow market forces to streamline and if the case may be, lower land prices. Streamlining land prices also allows more revenue for the government through land taxes.

Second, deepening our financial markets may involve building new securities markets such as bond markets; strengthening our mutual funds sector and insurance sector; and providing more tangible stimulus to our capital markets through fresh issuance of new shares; and encouraging financial and investor literacy. Such steps augment the circulation of money in our economy, so the same quantity of printed money can generate greater economic growth.

Third, crucial to investment growth are the so-called "Mega Projects". As of now, there are talks that there may even be a separate budget for our Mega Projects. The government is already particular emphasis on priority projects such as the Padma Bridge, Rampal thermal power plant, LNG terminal, Matarbarhi power plant, and the metro rail. Whether the special budget for Mega Projects materializes or not, the focus on infrastructure projects is another heartening development.

D. Implementation Challenges

However, there is a tendency to over-program infrastructure projects in Bangladesh. According to a recent PRI analysis, the roads division at present has over 150 projects under implementation. Managing more projects than a public agency can handle naturally compromises its implementation capacity.

Therefore, the new budget should emphasize full and timely implementation of projects and a close monitoring thereof, especially for projects that have been in the pipeline for long periods without significant progress. Generally speaking, the implementation capacity at the relevant government offices ought to be carefully considered and measured before budget allocation.

E. Taxes, Environment, and Social Protection

The issues of VAT and SD have already received widespread pre-budget attention. Our general opinion, in a nutshell, is that there has to be an understanding of “voluntary compliance” in paying VAT, and rates as high as 15% VAT may compromise on voluntary compliance. Moreover, if the new VAT law is implemented, small business will be the hardest hit, notwithstanding the fact that VAT on small business is difficult to collect since very few maintain proper accounting records. However, given the ambitious revenue target associated with a large budget, the VAT law is expected to materialize, in some form or the other.

The likely deficits are expected to be met through a combination of bank borrowing, saving instrument sales, and external financing.

And last but not least, it is hoped that the budget will have a renewed and focused orientation towards the environment, since it is, quite simply, worse for the wear when the eighth-most populous country in an area the size of Michigan achieve middle-income status. Education, health and social safety are also areas in which the budget may provide increased allocation.