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Searching for fiscal space

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THE economics department of Jahangirnagar University has recently organised a seminar titled ‘Bangladesh at 50: aspirations, achievements and challenges’. Professor Rehman Sobhan in the keynote speech vented anguish by arguing that despite development over the years on many fronts, we have failed to establish a just society — an avowed goal of our liberation movement as well as a principle laid out in the constitution. He discussed the pervasive presence of inequality in its various forms in society. However, Bangladesh is now poised to reach a middle-income country status by 2030 and a developed one by 2041. This, perhaps, requires an unprecedented level of resource mobilisation, domestic and foreign.

Towfiqul Islam Khan, a senior research fellow at the Centre for Policy Dialogue, spoke on ‘how fiscal space can constrain attainment of development aspirations of Bangladesh.’ He began his presentation by shedding light on few vital issues.

First, the tax-GDP ratio in Bangladesh, with the GDP per capita at $2,122, hovers around a pitiable 7.66 per cent. Bangladesh stands in the 93th position in terms of the GDP per capita and in the 110th in terms of the tax-GDP ratio among 116 countries. Again, with revenue being 8.53 per cent of the gross domestic product, Bangladesh stands in the 93th position in terms of the GDP per capita and in the 113th in terms of the revenue-GDP ratio among 116 countries,

Second, possibly as fallouts, with expenditure on education hovering around 1.72 per cent of the gross domestic product, Bangladesh stands in the 75th position in terms of the GDP per capita and in the 109th position in terms of the education expenditure-GDP ratio among 111 countries.

Third, Bangladesh’s GDP per capita was $1,964 in 2018 when health expenditure was a meagre 0.64 per cent of the gross domestic product. Bangladesh stands in the 147th position in terms of the GDP per capita and in the 186th position in terms of the health expenditure-GDP ratio among 193 countries.

Fourth, the out-of-pocket expenditure on both education and health has increased on the heels of a lower public spending.

The moot question is whether development is possible without domestic resources. The following comparative picture can come up with some suggestions.

Nicaragua is a country in the 128th position in the Human Development Index ranking with the per capita GDP of $1,927. The tax-GDP ratio in the country stands at around 18 per cent. Bangladesh, on the other hand, stands in the 133th position in the Human Development Index with the per capita GDP of $2,122 but the tax-GDP ratio is a half of that of Nicaragua. The comparison with the neighbouring India is not consoling either, with Human Development Index ranking of the 131th, per capita GDP of $2,100 and the tax-GDP ratio of 12 per cent. By and large, out of comparable 11 countries, Bangladesh holds a median position in terms of the GDP per capita and the Human Development Index ranking but the lowest position in the light of the tax-GDP ratio. The pertinent point is how aspirations can be turned into achievements in the absence of required domestic resources.

Generally speaking, tax revenues are required to finance the government; public services and public investments serve as a strategic policy instrument to establish equity in society. But the emerging or ongoing crises and aspirations in Bangladesh warrant huge resources to face the Covid recovery, post 2021, LDC graduation, in 2026, SDG delivery, in 2030, high income status, in 2041, and so forth.

To be pointed on the aspirations, drawing on the Perspective Plan 2021–2041, it has been shown that public spending on health would increase from 0.7 per cent of the gross domestic product in the 2018 financial year to 2 per cent in the 2041 financial year and public spending on education would increase from 2 per cent of the gross domestic product to 4 per cent over the period.

The Perspective Plan postulates that the revenue-GDP ratio would increase from 14.5 per cent in 2025 to 24.2 per cent in 2041; the tax-GDP ratio from 12.3 to 21.9 per cent and the public expenditure from 19.1 to 29.2 per cent over the period. This asks for a high increase in revenues, failure of which might lead to falling short of aspirations, underdeveloped pockets, leaving the marginalised behind, trading quality over quantity etc, resulting in a highly unequal state — a contradiction to the core aspiration of Bangladesh's independence.

One of the reasons for the low tax-GDP ratio is allegedly the tax exemptions offered to different sectors as incentive to further production and productivity. 'According to the Economic and Social Survey of Asia and the Pacific 2018, tax gap in Bangladesh is estimated at 7.5 per cent of the country's GDP — one of the highest in Asia and the Pacific. In Bangladesh, corporate income tax rates are not lower, but revenue is diminished by numerous tax exemptions — estimated tax expenditure is 2.28 per cent of GDP'.

There is little doubt that tax exemptions are required to induce incentives. But equally important it is to see that the exemptions meet certain criteria such as relevance, cost effectiveness, impact and efficiency.

Tax exemption to agriculture appears to provide high payoffs in terms of relevance, low cost, impact and efficiency. In other words, in a regime where agriculture is operated by small and marginal farms, such tax exemptions could be conceived as equalising. But exemptions for fisheries, within agricultural sector though, seems to be unequal, scoring very low in terms of the criteria. Policymakers need to note that the exemptions made to fisheries, a favourite sector for candidates in national elections to show their sources of income, is just a wasteful venture to wane tax revenue. Exemptions to the apparel sector have relevance but such exemptions are fraught with high cost and not impactful or efficient. In fact, high cost-exemptions are fisheries, apparel, and economic zones and export procession zones. Thus tax exemption to different sectors on the basis of relevance, cost, impact and efficiency still remains a challenge in the augmentation of domestic resources for development purposes and hence requires a revision.

Researcher also reckons that not only exemptions but also other challenges such as lack of reform, illicit financial flows, a highly centralised tax system, a low level of institutional capacity, inertia in exploring new avenues and widespread corruption gripe the attempts to augment resources.

Where do resources come from? There are various ways of raising revenues or scope for fiscal space enhancement — printing new currency ie, seigniorage, external finances, grants and loans, domestic borrowings, additional domestic resource mobilisation, and re-prioritising public expenditure structure. Quite understandably, each of those has respective demerits. For example, printing notes is never a solution in the wake of invoking inflationary psychosis; domestic borrowing from banks could inject 'crowding out effect'. It seems that additional domestic resource mobilisation and prioritising public expenditure could provide some room for expansion of fiscal space — 'the room for additional resources in government's budget which allows the government to allocate the resources to the desired and required sector without risking the stability of the economy.'

Ipso facto, the way forward, as researcher reveals, lies in implementing legal and institutional reforms, curbing illicit financial flows, exploring the new avenues, making the best use of technology, using the public money more efficiently; ensuring good governance and addressing widespread corruption. Finally, a strong political commitment is a sine qua non for an expansion of fiscal space.

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