A path to economic resilience: Insights from the PRI-CDRM paper “Bangladesh’s domestic resource mobilisation – imperatives and a roadmap”

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- Bangladesh currently has one of the lowest ratios of government revenues to GDP in the world.
- It is imperative that Bangladesh takes steps to increase revenues significantly to ensure fiscal stability, fund much-needed investment that supports economic growth, and increase the provision of public education, healthcare, and social protection.
- The PRI Study Centre on Domestic Resource Mobilisation has recently published a paper titled “Bangladesh’s Domestic Resource Mobilisation: Imperatives and A Roadmap”. Based on that study, this policy brief highlights a strategic roadmap that the government might follow to increase revenues.

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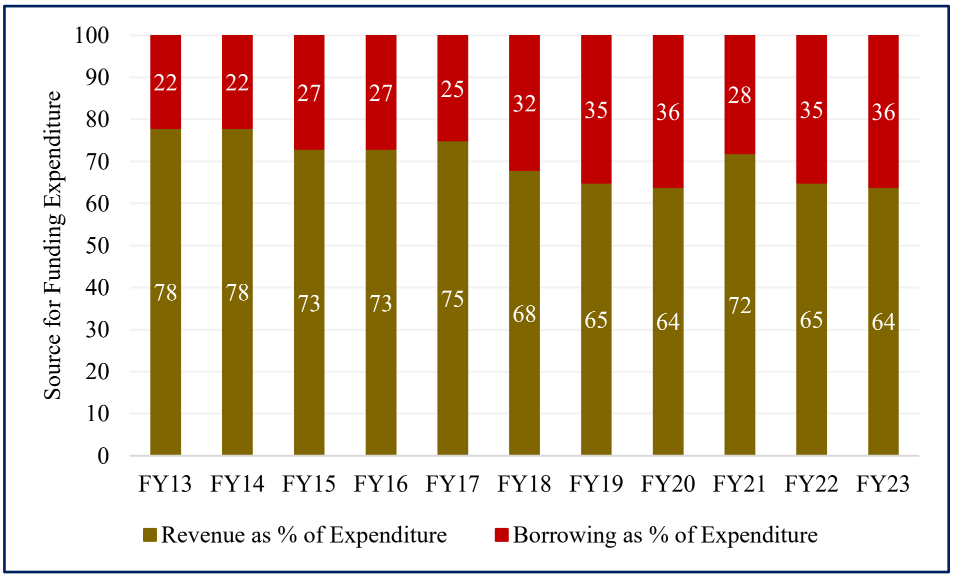
Policy context

Bangladesh enjoyed robust economic growth, macroeconomic stability, and low levels of debt from 2010 to 2019. However, the last four years have seen significant challenges due to two major external factors: the COVID-19 pandemic and the economic fallout from Russia's invasion of Ukraine. The economy of Bangladesh has been negatively impacted by these events, especially concerning the ability to preserve fiscal stability.

Bangladesh's economic credibility is currently at risk due to a combination of disturbing trends including declining tax revenue as a percentage of expenditure, a rising debt burden, and challenges to financing the growing fiscal deficit. Addressing these challenges will require increased revenue, as reducing spending is not a viable option given increasing pressures from interest payments, rising wage bills, subsidy and pension payments, and growing demand for social spending on health, education, and social protection.

FIGURE 1: Sources of funding for budget expenditure



Source: Ministry of Finance (2023)

These fiscal challenges highlight the urgent need for Bangladesh to increase domestic revenue to stabilise the economy and maintain essential public services.

In the short-term increasing revenues will prevent the rise in government debt and improve the government's capacity to service it. Moreover, it will reduce the government's need to borrow from the central bank, thus lowering the risk of a large and sustained increase in inflation. This will consequently allow the government to ease some of the pressures on discretionary spending.

In the longer term, to achieve its goals of becoming an upper middle-income economy by 2031 and a developed nation by 2041, Bangladesh needs to increase its spending on education, skills development, and infrastructure. This includes improving energy supply, roads, ports, and water systems to attract investment and support a more educated workforce. As living standards rise, better public services in education, healthcare, and social protection will be essential. However, there will be a decline in overseas development funds to support the rising government spending as the country graduates from LDC. Therefore, Bangladesh needs to boost its capacity to raise domestic revenues to ensure sustainable economic growth.

Reform measures to boost domestic revenue

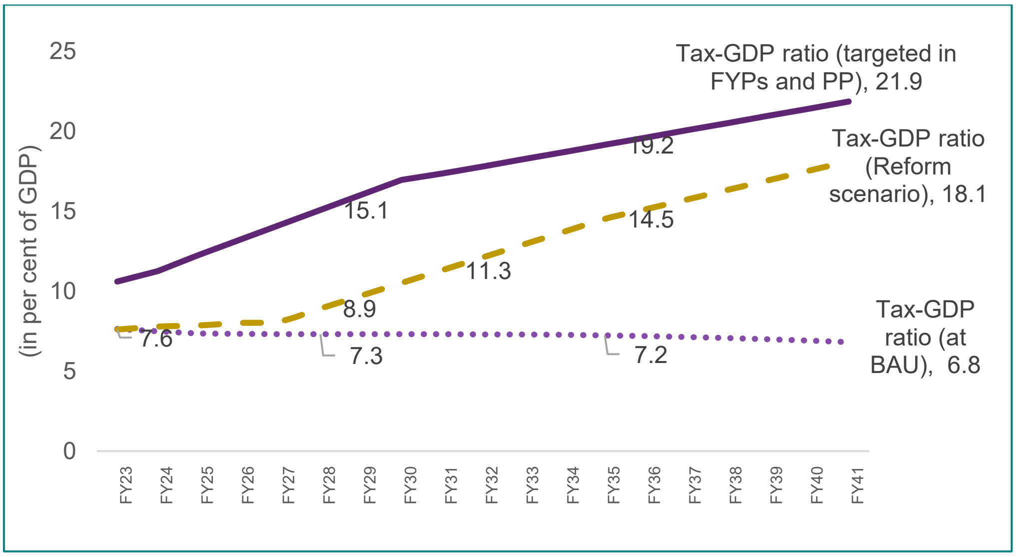
> **According to PRI-CDRM estimate, in the short term, BDT 600 billion could be raised over three to four years by gradually removing certain tax exemptions. This could be implemented immediately, while other reform measures will take more time to design and implement.**

The core medium-term and long-term fiscal reforms include:

- Increasing the share of direct tax revenue in total revenues. Usually, countries tend to increase their reliance on direct taxes as their average income levels increase
- The establishment of a separate tax policy division in the Ministry of Finance. Experts in tax planning should oversee this necessary revamp of the tax system.
- Reforming the VAT system by moving to a simpler VAT system, like those found in most other countries.
- Ensuring the reform and automation of tax administration.
- Reducing dependency on trade taxes through tariff rationalisation.
- Implementation and enhancement of the effectiveness of capital gains, property, and other wealth taxes by improving their design and collection mechanism.
- Improving the monitoring of the withholding of advance income tax from wages and salaries of employees.

According to PRI-CDRM projections, reforms along these lines could lift the tax/GDP ratio to 11.3 per cent in FY31 and to more than 18 per cent in FY41. As a result, by FY35, spending on education and social protection could double and spending on healthcare could triple and there would still be money left for an increase in the resources devoted to supporting growth equivalent to 2.3 per cent of GDP.

FIGURE 2: Projected revenue paths under three alternate scenarios



Source: Mansur (2024)

Conclusion

There will be resistance from within and outside the government to tax reforms and revenue-raising measures along these lines. However, this resistance must be overcome. The government secured a strong mandate in the recent election, including for increased tax revenues. Now is the ideal time to educate the public about the need for tax reform if their living standards are to continue to grow at the pace enjoyed in recent decades and if public services are to be improved. Effective action on several fronts is needed to deliver higher tax revenues.

According to the projection as shown above, a failure to implement more widespread reforms could incur a revenue loss worth around BDT 50 trillion by the end of the 2041 fiscal year. The reforms proposed in this policy brief, and other policy decisions to increase revenues, are necessary to ensure that Bangladesh remains one of the world's economic success stories in the next two decades.

References

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