Policy Note: PN 2002

COVID-19 Crisis and Fiscal Space for Bangladesh Economy: A Comparative Analysis with South Asian Countries

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Chief Economist's Unit
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COVID-19 Crisis and Fiscal Space for Bangladesh Economy: A Comparative Analysis with South Asian Countries[1]

COVID-19 pandemic continued to spread and impacted Bangladesh economy since March 2020, reflecting in a sharp decline in growth rate of real gross domestic product (GDP) to 5.24 percent in FY20 as compared to a record high of 8.15 percent growth in FY19[2]. Likewise, other South Asian countries are not exception as being affected by COVID-19, slowing down their economic growth as well. In response to combat against the possible economic disruptions because of the pandemic, South Asian countries including Bangladesh have been taking extensive fiscal measures depending on their own capacities. This note attempts to assess the fiscal space of Bangladesh economy, comparing with that of peer countries from South Asian context and tries to understand whether Bangladesh economy has enough fiscal space to sustain in an adverse situation if uncertain future, like COVID-19, prolongs.

I. Growth outlook of South Asian countries

Despite economic slowdown, growth rate of Bangladesh in 2020 was projected to be the highest among all South Asian countries as estimated by the International Monetary Fund (IMF), World Bank (WB) and Asian Development Bank (ADB) (Table 1). Table 1 shows that only Bangladesh, Bhutan and Nepal will manage positive growth rates in 2020, where Bangladesh's performance would be much better than others. Growth rates of other South Asian countries including Afghanistan, India, Pakistan, Maldives and Sri Lanka were projected to decline in 2020. However, the economies of Bangladesh, India, and Maldives, would rebound in 2021 as forecasted by the IMF, WB and ADB (Table 1). Similar to other parts of the world, South Asian countries have announced comprehensive stimulus packages to be implemented by unconventional monetary and expansionary fiscal measures in order to protect or minimize the impact of the pandemic in their economies. Discussion of this note is limited to understand the absorbability of this unusual fiscal burden needed for Bangladesh's economic recovery from the effects of COVID-19 pandemic, while comparing with some peer countries of South Asian countries, as they have commonality in strategies for rapid growth and poverty reduction.

Table 1: Growth outlook for South Asian countries

	IMF			World Bank			ADB		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
Afghanistan	3.9	-5.0	4.0	3.9	-5.5	2.5	3.0	-5.0	1.5
Bangladesh	8.2	3.8	4.4	8.1	2.0	1.6	8.2	5.2	6.8
Bhutan	3.8	0.6	-0.5	3.8	1.5	1.8	4.4	2.4	1.7
India	4.2	-10.3	8.8	4.2	-9.6	5.4	4.2	-9.0	8.0
Maldives	5.7	-18.6	12.7	5.9	-19.5	9.5	5.9	-20.5	10.5
Nepal	7.1	0.0	2.5	7.0	0.2	0.6	7.0	2.3	1.5
Pakistan	1.9	-0.4	1.0	1.9	-1.5	0.5	1.9	-0.4	2.0
Sri Lanka	2.3	-4.6	5.3	2.3	-6.7	3.3	2.3	-5.5	4.1

Sources: World Economic Outlook, October 2020; World Bank, October 2020; Asian Development Bank Outlook, September 2020.

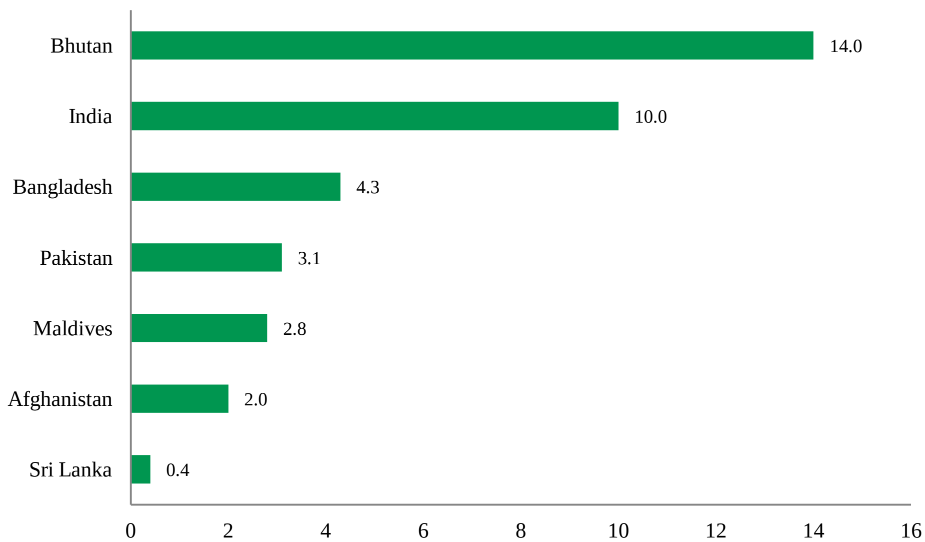
[1] The note is prepared by a team of Chief Economist's Unit comprising of Raju Ahmed, Deputy Director, Dr. Md. Salim Al Mamun, Deputy General Manager, and Dr. Md. Ezazul Islam, General Manager. The views expressed in the note are the authors' own and do not reflect that those of Bangladesh Bank.

[2] Bangladesh Bureau of Statistics (2019-20), Gross domestic Product of Bangladesh, Dhaka: BBS, p.4.

II. Stimulus packages announced by South Asian countries

To recover the economy from the disruptions caused by the coronavirus, most of the South Asian countries' governments and central banks have provided emergency lifeline through monetary and fiscal intervention. Though the interventions varied from country to country, the emergency supports were given to household and firms through cash transfer, wage support, food voucher, credit guarantee scheme, interest payment subsidy, different tax concession etc., among others. Government of Bangladesh announced a comprehensive stimulus package of Tk. 1.20 trillion (roughly 4.30 percent of GDP covering both fiscal and monetary measures) to help different segments of people including formal and informal sector workers, migrant and vulnerable workers, small vendors and farmers. [3] Government increased credit flow in priority sectors including small and medium enterprises (SME) and micro, small and medium enterprises (MSME). It is evident form Chart 1 that India and Bhutan provided largest amount of stimulus packages (roughly 14.0 and 10.0 percent of GDP) while Sri Lanka had minor share in terms of GDP. The concern is that most of the countries may need to scale up their stimulus packages in coming periods, if the effects of COVID-19 worsen further.

Chart 1: Comparison of stimulus package size across South Asian countries (in percent of GDP)



Source: COVID-19 response tracker from various sources of IMF, World Bank, and ADB.

III. Available fiscal space for implementing stimulus packages

The most widely used definition provided by Heller (2005) describes "the fiscal space is the room in a government's budget that allows it to provide resources for a desired purpose without jeopardizing the stability of the economy". Therefore, fiscal position in an economy would be sustainable if raising government's spending or experiencing lower tax collection would not create any disturbance on debt sustainability. If a country has enough fiscal space to be used for any adverse situation which will, in turn, help to recover the economic activities in future and, subsequently, increase government revenue collections through taxes. The fiscal space of Bangladesh is more spacious than other South Asian countries except Afghanistan and Nepal according to the public debt to GDP ratio as shown in Chart 5 in Section VII. Chart 5 also shows that Pakistan, Sri Lanka, India, Bhutan, and Maldives have high levels of

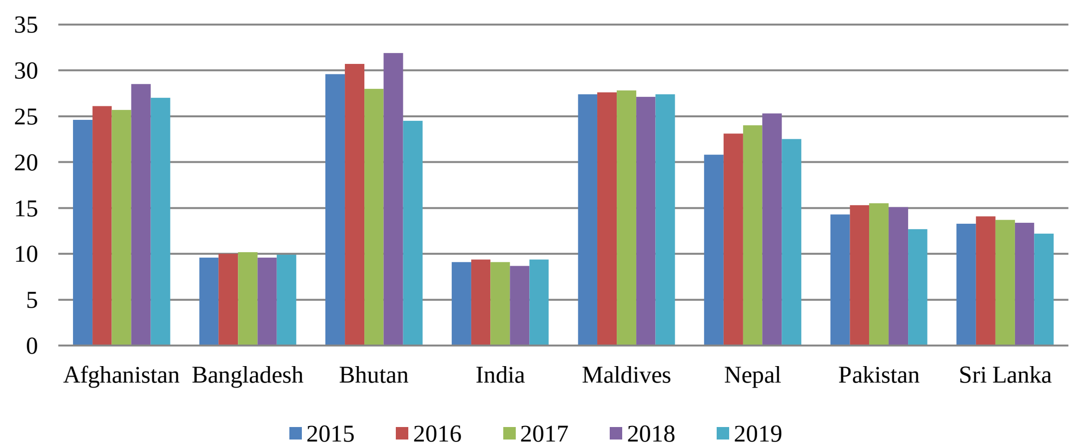
[3] Ministry of Finance, Bangladesh (2020). Bangladesh Economic Review. Dhaka. MOF, p.59

public debt to GDP ratios, margining their room for fiscal maneuver as well as limiting the space to recover from any crisis, like COVID-19 (Chart 5). This report, therefore, discusses five considerations to examine the fiscal space of South Asian countries in the wake of COVID-19 pandemic; they are: (i) central government revenue (ii) central government expenditure (iii) central government fiscal balance (iv) public debt situation and (v) public debt sustainability.

IV. Government revenue

The revenue to GDP ratio is one of the prominent measures to explain country's fiscal capacity or space to combat against economic crisis. Enhancing the mobilization of tax revenue would increase country's fiscal space. IMF mentions that the average tax to GDP ratio is lower in low- income developing countries than that of emerging and middle income countries[4]. In case of South Asian countries, the revenue to GDP ratio remained stable at around 20 percent over 2015-2019 (Chart 2). During that period, revenue-GDP ratio of Bangladesh is lower as compared with other south Asian countries, maintaining at around 10 percent. On the other hand, Afghanistan, Bhutan, Maldives and Nepal maintained more than 20 percent level of tax to GDP ratio. India experienced low level, similar trend of Bangladesh, while Pakistan and Sri Lanka maintained the ratio between 10 and 15 percent (Chart 2). The COVID-19 pandemic is likely to squeeze government revenues due mainly to a contraction in economic activity and depressed business sentiments in 2020 and beyond. Most South Asian countries provided tax rebates on emergency medicine, medical equipments to combating against COVID-19 in addition to relaxing the tax structure, which will affect revenue-GDP ratio in the respective countries. This lower revenue to GDP ratio, thus, creates a burden to execute country's recovery and development plan. However, in crisis time, the quick implementation of stimulus packages is critical in order to revive of the economic activities.

Chart 2: Central government revenue in percent of GDP



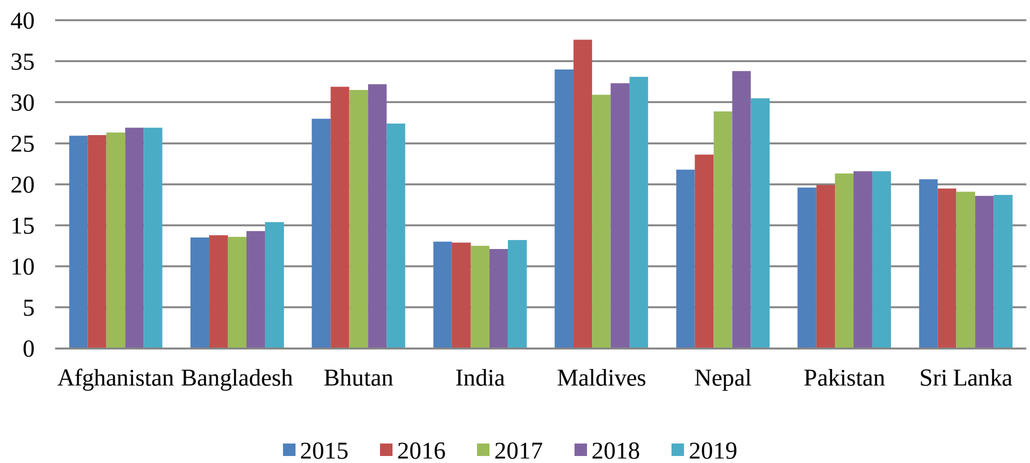
Source: Asian Development Bank data library, June 2020.

[4] International Monetary Fund (April, 2020). Fiscal Monitor..P.21.Washington D.C.: IMF

V. Government expenditure

Comparative study on government expenditure depicts that Bangladesh and India were the lowest spending countries over 2015-2019 compared with other south Asian countries (Chart 3). Similarly, the ratios of spending of Afghanistan, Bhutan, Maldives and Nepal were quite high, reaching more than 25 percent of GDP in 2019, while the ratios were at around 20 percent of GDP for Pakistan and Sri Lanka during the same period (Chart 3). The ADB estimated that the fiscal expenditure of Bangladesh will slightly increase from 15.4 percent of GDP in 2019 to 15.5 percent in 2020 due to the expenditure related to COVID-19 Pandemic[5]. Similarly, most of the South Asian countries have raised their expenditure in 2020 support their economy, fighting against the pandemic.

Chart 3: Central government expenditure in percent of GDP



Source: Asian Development Bank data library, June 2020.

VI. Government fiscal balance

The higher fiscal deficit creates debt burden and constrains country's fiscal space to combat against pandemic situation. The fiscal deficit of all South Asian countries except for Bhutan increased in 2019 (Chart 4). The data also show that the Maldives and Sri Lanka have high fiscal deficit, while fiscal deficits of India, Bangladesh, and Pakistan have increased gradually in recent years. In 2020, the pandemic and the associated great lockdown led to increase in deficit in most of the South Asian countries (Chart 4). World Bank estimated that the fiscal deficits for Bangladesh, India and Pakistan are 8.2, 7.6 and 8.1 percent in 2020 in terms of GDP. Meanwhile, the average overall fiscal deficit for South Asian countries is projected to soar to 9.13 percent of GDP in 2020-2021 fiscal years (World Bank, 2020)[6]. Bangladesh and other South Asian countries have been trying to meet up their fiscal deficits through different modes of borrowing from domestic and international sources, which will, in turn, make pressure on public debt to GDP ratio in the respective countries.

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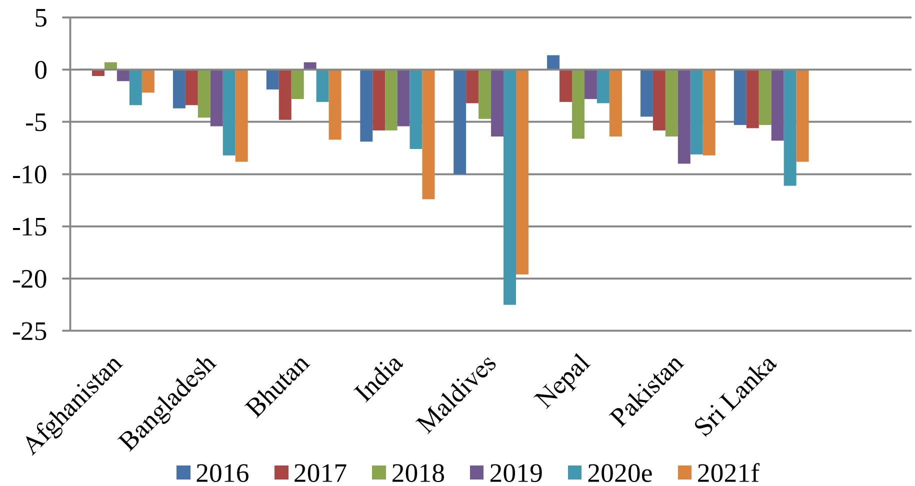
[5] Asian Development Bank (September 2020). Asian Development Outlook. p.171 Manila: ADB.
[6] World Bank (2020), Beaten or Broken? Informality and COVID 19. South Asia Country briefs. Washington D.C. WB.

Chart 4: Central government fiscal balance



Source: South Asia Country Briefs, World Bank, 2020.

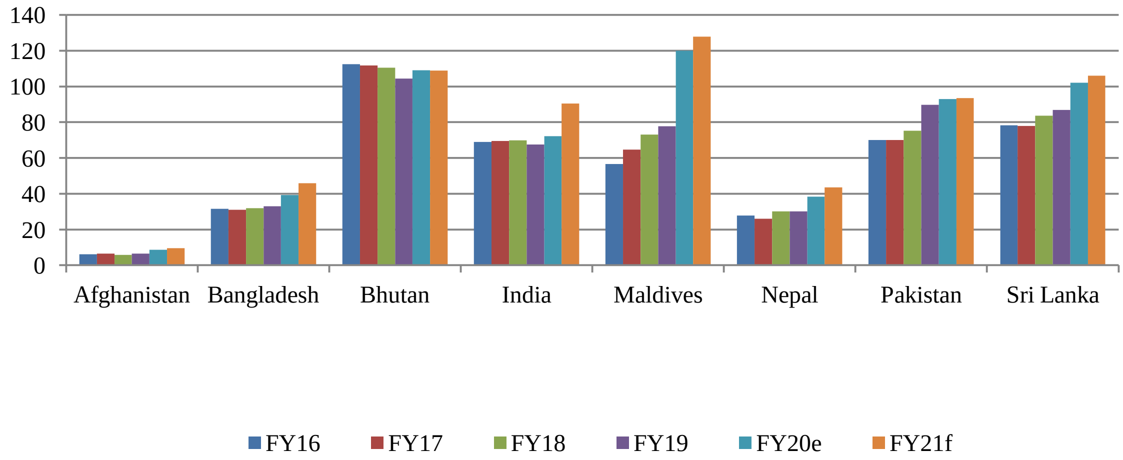
VII. Public debt situation

The public debt to GDP ratio indicates a country's ability to borrow from the market and capacity to act countercyclically in a crisis period. Any country with high debt to GDP ratio can take less countercyclical fiscal measures in prior to crisis or during crisis time.[7] The data of public debt to GDP ratio during pre COVID-19 indicate that Bangladesh has managed conservatively the public finance to address the economic fallout of the COVID-19 crisis. Bangladesh has experienced low debt-GDP ratio of around 34 percent of GDP since last few years, on an average, as compared with other South Asian countries except Afghanistan and Nepal, reflecting Bangladesh's managing capacity of public finance in addressing the economic fallout from the COVID-19 (Chart 5). According to the analysis conducted by the International Monetary Fund (IMF), Bangladesh was classified as 'strong' in terms of debt carrying capacity.[8] Other some South Asian country has experiences much more Public debt even some countries have close to full of their GDP equivalent to public debt (Chart 5). Countries like India, Pakistan, Sri Lanka, Bhutan and Maldives have high debt to GDP ratios which are close to or higher than their GDP.

[7] Jorda, O, Schularick, M., and Taylor, A. M. (2016). Sovereign versus Banks: Credit, Crises, and Consequences. *Journal of the European Economic Association* 14 (1): 45–79.

[8] IMF Country Report No. 19/199, September 2019.

Chart 5: Public debt to GDP ratio



Source: South Asia Country Briefs 2020, World Bank.

VIII. Public debt sustainability

The public debt sustainability is another important factor of fiscal space for a country. As part of policy response to counter COVID-19 crisis, a number of South Asian countries implemented significant fiscal stimulus in the early stage of the crisis. But such efforts may soon confront public debt sustainability problem where public debt was already high and run up with the global financial crisis. Some of the South Asian countries entered into this COVID-19 pandemic with high public debt levels and high risk of debt distress (Table 2). These high public debt and debt distress may limit the room for further fiscal support for economic recovery. Among South Asian countries, Bangladesh and Nepal is at low risk in terms of vulnerable debt sustainability. The joint World Bank-IMF Debt Sustainability Framework confirmed that Bangladesh can afford significant amount of borrowing from internal and external sources. The data on debt sustainability depict that Afghanistan and Maldives are at high risk of debt distress among South Asian countries (Table 2).

Table 2: Indicators of public debt sustainability in South Asian Countries

Country	Public debt as % of GDP(2019)	External debt as % of GDP (2018)	Short term external debt in % of GDP (2018)	Risk of debt distress	Debt sustainability analysis year
Bangladesh	34.6	18.1	17.3	low	2019
India	69.0	19.2	20.0	-	2019
Pakistan	76.7	28.9	9.1	-	2020
Sri Lanka	83.0	59.5	15.5	-	2020
Nepal	32.6	18.9	4.6	low	2020
Maldives	70.1	43.8	11.3	High	2020
Bhutan	108.6	101.4	0.2	Moderate	2018
Afghanistan	7.6	13.1	14.0	High	2020

Note: '-' indicates not available.

Source: The United Nations Economic and Social Commission for Asia and Pacific (UNESCAP) report titled "COVID-19 and South Asia: National strategies and subregional cooperation for accelerating inclusive, sustainable and resilient recovery". The UNSCAP report used the data based on various debt sustainability analysis reports, IMF Fiscal Monitor (April 2020), World Development Indicators and Fiscal Space Dataset (April 2020).

IX. Conclusion

This report discusses the structure of fiscal policy, providing information for fiscal spaces for the South Asian countries. Bangladesh maintained at around 10 percent of tax to GDP ratio which is lower than all other south Asian countries, except India. This report also finds that Bangladesh was the lowest spending country among South Asian countries. The fiscal deficit as percent of GDP for Bangladesh is below 5 percent in the last decade. Bangladesh managed public debt to GDP ratio in a conservative way so that the country now can afford more borrowing to address the economic fallout from COVID-19 pandemic. Bangladesh has experienced low debt to GDP ratio of around 34 percent of GDP since last few years. Debt statistics report also shows that Bangladesh is at low risk in terms of vulnerable debt sustainability. Therefore, Bangladesh can increase their expenditure, if needed, at significant level through domestic borrowing and foreign loans to support affected sectors of the economy. The report also recommends that the government may improve tax compliance with proper implementation of tax reform policies for improving tax-GDP ratio in the near and medium term.