

State of the Bangladesh Economy in the Fiscal Year 2003-2004

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1. Introduction

Towards the end of 1990s, the macro-economic balances of the Bangladesh economy were confronting the twin pressures emanating from fiscal deficit and balance of payment (BOP). At a structural level, the economy had plateaued in terms of the upward movement in the domestic savings rate and gross private investment rate (as percent of GDP). In spite of robust growth of the agriculture sector, private investment, particularly in the manufacturing sector was decelerating. However the price level continued to remain low and stable.

The new incumbent government which took office in October 2001, during the first two years (2001-02 and 2002-03) of its tenure was thus engaged, on a priority basis, in strengthening the macro-economic coordinates of the economy through fiscal consolidation and strengthening of the BOP. The government also appreciated the need to stimulate investment. The *Independent Review of Bangladesh's Development* (IRBD) prepared by the *Centre for Policy Dialogue* (CPD) in its latest edition noted that in FY03 the fiscal balance experienced some consolidation and the country's balance of payment improved further; however, the signs of investment stagnation still remain manifest.

In this context, CPD in its review of National Budget for FY04 pointed out in June, 2004 that the performance of the economy in the current fiscal year will depend on the following four critical factors:

- (i) Full and faithful implementation of the ADP – promoting emphasis on the quality of the projects;
- (ii) Resurgence of exports and gradual diversification of the commodity basket;
- (iii) Higher inflow of private investment in manufacturing activities, particularly in import-competing sectors; and
- (iv) Ability to provide supportive credit and monetary policy to fiscal measures by maintaining stability of the exchange rate and price index as well as reducing the cost of capital.

CPD's budget review for FY04 in conclusion pointed out that "without significant alleviation of the micro-level impediments to investment, ranging from enhancing the efficiency of public utilities and the financial system, measures to improve the security for life and property, addressing the dysfunctional judicial process and tackling pervasive corruption, the anticipated supply-side response will be hardly forthcoming".

Recently the present government has entered into the third and, possibly, the defining year of its tenure. Common wisdom about the political cycle of Bangladesh tells us that successive governments are prone to undertake a series of energetic reform measures during the first couple of years of the regime which invariably run out of steam as the next national election approaches. From this perspective, FY04 has to be "the year of the big push" for the government in order to avert the setting in of the *mid-term inertia*.

As one looks back to the first six months of the current fiscal year, one can identify a number of issues which distinguish the period. These issues include energetic measures in the financial sector, and intensive bilateral, regional and multilateral trade negotiations, and fresh movements (bubbles!) in the capital market. But these positive movements were paralleled by such developments as the rise in price of essential consumer goods, seasonal employment and income deprivation (*Monga*) in the Northern districts and the emerging paralysis in the privatisation process.

In order to generate for a proper understanding of the current state of economic affairs, this paper puts under scrutiny some recent trends in the Bangladesh economy, particularly in the areas of public finance, monetary policy, real economy and the external sector.

2. Public Finance

In the area of public finance it will be useful to analyse the current trends in revenue generation, public expenditure including the Annual Development Programme (ADP) and financing of the budget deficit.

2.1 Revenue Earning

The National Board of Revenue (NBR) commands about three-quarter of total revenue generation in Bangladesh. Non-NBR taxes account for another 4 percent of the total revenue, while the remainder (20 percent) comes from non-tax revenues. In the recent years, NBR has been more or less fulfilling its budgetary targets, whereas non-NBR revenue and non-tax collection were systematically lagging behind.

Total revenue collection in FY03 was equivalent to about 10.4 percent of the GDP. Achievement of the target for FY04 may take this parameter to about 11 percent of GDP, which is still quite low by all cross-country standards.

The NBR target for FY04 is Tk. 27,750 crores implying a 16.8 percent annual growth. Analysis of information on revenue collection under NBR during the period July-November, 2003 reveals that total revenue growth was 9.74 percent resulting in almost the full realisation of the temporal target. However, a disaggregated analysis reveals that growth of total *internal trade-related revenue* was higher (12.1 percent) than that of total *import-related revenue* (8.1 percent). In the backdrop high import growth in the recent months (discussed later) non-fulfilment of target (around 4 percent shortfall) for collection of import duty comes as a surprise. It is further contradictory that the Supplementary Duty (Import) collection recorded the highest growth (39.6 percent) which is tagged with core duty collection. The revenue collection growth for VAT (Local) – 16.6 percent, and Supplementary Duty (Local) – 14.2 percent. A decomposition of imports and the tariff structure analysis may put some light on the matter and confusion may be removed.

As a whole, collection by NBR depicts a business as usual scenario, since a 10 percent annual growth usually comes for the normal expansion of economic activities. Reorientation of the tax base, from preponderance of foreign trade related taxes to higher expansion of VAT (Local) is a welcome trend. However, the relatively modest growth (9 percent) in income tax collections, in spite of various potential payee identification

initiatives suggests that efforts to increase the role of direct taxes in total revenue is yet to show any sign of improvement.

2.2 Public Expenditure

Total public expenditure in FY03 accounted for about 14.6 percent of GDP, of which ADP commanded about 39 percent, whilst revenue and other expenditures accounted for about 61 percent.

If the target volume of public expenditure is realised in FY04, its share in GDP will increase to 15.9 percent – without significantly changing the split between ADP and non-ADP heads. What is important to note is that public expenditure in FY04 is targeted to grow at a faster rate than revenue earning – particularly through ADP expansion underwritten by a higher inflow of foreign aid. Notwithstanding such gains, the public expenditure ratio in Bangladesh remains quite low when in comparable countries the said share is around 20 percent of GDP.

2.3 Revenue Expenditure

The budgeted amount for revenue expenditure is about Tk. 29 thousand crores. Regretably, real time data is usually not accessible for revenue expenditure till the end of the fiscal year.

However, the structural rigidities of the revenue expenditure portfolio are well known. Economic analysis of the composition of revenue expenditure indicates that only three heads account for more than 75 percent of the total.

These three heads include: Salary and allowances (about 26 percent), subsidies and transfers (27 percent), and debt servicing liability (more than 22 percent). For all practical purposes, allocation and spending practice in FY04 will not be significantly different from this trend.

In this connection, it may be noted that expenditure on account of defense services as a share of total revenue spending has secularly come down from its peak 18.2% in FY98 to 13.5% in FY03. In FY04, the allocation for defence services amounts to 12.2% of the total revenue expenditure.

Advisably, in FY04, revenue expenditure growth (14.5 percent) has been kept below the revenue earning growth (16.2 percent). But experience suggests that while revenue expenditure routinely exceeds the budgetary limit, target for total revenue earning is often missed.

One of the positive aspects of the revenue expenditure portfolio for FY04 has been the higher allocation (more than 28 percent increase) for Operation and Maintenance – an usually neglected area. On the other hand, in FY04 about 6.8 percent of the revenue budget was kept as a “Block Allocation” (an increase of Tk. 100 crores to Tk. 1700 crores) – possibly for meeting an anticipated pay rise for government employees. Recent decision of the government to transfer a number of projects to revenue budget may also be underwritten by these unallocated resources.

Although the volume of domestic debt (currently 16% of the GDP) remains moderate trends in revenue expenditure composition reveal continuous rise in debt servicing liability (DSL) on account of domestic debt, whilst DSL for foreign loans may be expected to rise in the coming years given the nature of the recent aid inflow.

It may be recalled that interest payment on account of domestic debt has steadily increased from about 11% of revenue expenditure in FY98 to more than 18.2% in FY03. The target figure for the same in FY04 is about 18.85%. The recent increase in domestic DSL may be explained by the government’s attempt to finance deficit through borrowing from non-banking sources – which is costlier than the money from banking source, but is non-inflationary. On the other hand, debt servicing liability on account of foreign debt decreased from 5% of revenue expenditure in FY98 to about 3.8% in FY03. The projected figure for this in FY04 is about 3.37%.

2.4 Annual Development Programme

The ADP for FY03 was Tk. 19,200 crores which was later slashed down to Tk. 17,100 crores. In reality, the realised size of the ADP was to the last year tune of Tk. 15,297 crores, i.e. about 80 percent of the original target. The realised ADP figure for FY03 was only about 66.5 percent of the revenue expenditure.

The ADP target for FY04 has been fixed at Tk. 20,300 crores, i.e. an additional Tk. 5,000 crores has to be spent during the current fiscal year over its preceding benchmark. From experience of earlier periods, it is anticipated that the overall size of ADP will be reduced by around Tk. 4000 crore. In the discussions in wake of the National Budget FY04, some questions have been raised on the viability of this “ambitious target”. In FY03, private investment as share of GDP actually decline from 16.78% to 16.49%, whereas the corresponding share of public investment increased from 6.37% to 6.72%.

However, it needs to be pointed out that in the recent past the gross investment rate remained stable inspite of the deceleration of private investment thanks to moderate ADP growth. However in a recent speech before the Economic Cadre officers the Finance Minister pointed to the proliferation or useless projects and the padding of many projects with wasteful expenditure. It is thus not the overall size, but the quality of the projects included in the ADP which matters most. Furthermore, the capacity of the line ministries to absorb such incremental allocation of resources is open to doubt. Thus the operative issue which needs to be investigated is whether this increase in ADP expenditure actually constitutes growth generating investment.

The National Budget FY04 stated that a total number of 1176 projects will be included in the ADP, including 174 unapproved projects. Upto November, 2003, 24 projects have been approved and approximately Tk. 1100 crores has been allocated already to this end. It may be recalled that Tk. 2346 crores (about 12 percent of ADP) was allocated under the different ministries as “Block Allocation” in the budget for the current fiscal year. It was not immediately clear whether such flexibility in allocative decision will breed

allocative indiscipline in course of time or that these projects will be purposefully designed and resources used more efficiently.

Foreign resources are expected to underwrite about 51 percent of the ADP outlay in FY04, while the balance is to come from domestic sources – revenues surplus (36 percent) and bank borrowing (13 percent). Such a contribution of bank borrowing may be compared with the 20.7 percent contributed by bank borrowing in 2000-2001 when the issue of rising dependence on bank financing was exposed to intense public debate.

Early information on ADP implementation suggests that a total amount of Tk. 2141 crores, i.e. about 10.6 percent of the total budget was spent during the first quarter of FY04 (July – September). The overall utilization of ADP upto October, 2003 was 15%, in comparison with the utilization rate of FY02 (upto October, 2002) 16.5%. The first quarter of any fiscal year is usually a dull period from public expenditure point of view. This ratio compares almost equally with the same share for other years (with respect to actual ADP size). Financing through project aid (about 52 percent) during the first quarter was however relatively higher in pro-rata term. However, it needs to be pointed out that such a business-as-usual approach will not be helpful in realising the full annual target of the ADP in the current fiscal year.

In the ADP of FY04, a number of projects have been identified as “poverty alleviation projects”, although the doubt remains about the content of those projects and how they are related to poverty alleviation. Out of Tk. 1175 crore, earmarked for “poverty alleviation projects”, already Tk. 600 crore has been utilized.

In the past years one of primary criticisms of ADP budget management related to the tardy use of ADP allocations in the first nine months of the fiscal year and the subsequent rush by the line ministries to spend their budget allocations in the last quarter. This approach to project management directly contributes to the process of waste and corruption in the public expenditure process. There is a concern that the ADP management quality has been further deteriorated, which might increase the incidence of

wastage of resources. Thus, acceleration of ADP implementation from the second rather than the fourth quarter of the fiscal year remains one of the major tasks for FY04 – particularly for crowding-in private investment and improving quality of public utilities and social services.

2.5 Budget Deficit and Financing

The budget deficit has been brought down sequentially during the last three years. In FY03, according to the latest estimate, the net budget deficit accounted for 3.4 percent of the GDP of which foreign financing accounted for 64 percent and the rest (36 percent) was from domestic sources.

The target for the net budget deficit has been fixed at a higher level in FY04 – about 4.0 percent. It is expected that the incremental deficit will be largely financed by the enhanced flow of foreign aid, a larger part of which is loan.

Figures for the period July-September 2003 indicates that the government has to mobilise about Tk. 1908 crores to finance the fiscal deficit which is about 5.5 percent lower than the comparable figure for the preceding year. Domestic resources accounted for more than 81 percent of this amount – the exclusive source being net borrowing through non-bank instruments. During this period the government held a negative balance in its favour in case of borrowing from the banking sector.

The relatively low level of the fiscal deficit during the first quarter of the fiscal year reinforces the revealed trend in ADP implementation. This is of course not immediately evident from what the government is doing with the large volume of budgetary support it has received from the international financial institutions (IFI) in the recent months. It seems that these resources are currently underwriting the increasing gap in the trade balance.

It should here be kept in mind that the concept of the fiscal deficit in aid dependent countries such as Bangladesh is a synthetic issue. The aggregate deficit in public

expenditure is a structural aspect of aid dependence which accommodates the volume of foreign aid disbursed in a given year. The rise and fall in the fiscal deficit in any year reflects the efficacy and timing of aid disbursements rather than some significant improvement in macroeconomic management. Thus it is important to keep in mind whether inefficient aid utilisation is being falsely interpreted as improvement in fiscal deficit situation.

3. Monetary Aggregates, Credit Expansion and Inflation

In response to recessionary business conditions and the deceleration of private investment, the government is currently pursuing an accommodative monetary policy through a number of measures: reduction in bank rate, reduction in interest rates on government bonds, and reduction of Statutory Liquidity Requirement (SLR).

Financial sector reforms is also being pursued through strengthening of the oversight functions of the central bank, improving the corporate governance of the private commercial banks through higher transparency and accountability, contracting out of management of a number of nationalised commercial banks (NCBs), amending legal framework for loan recovery, improving prudential guidelines and their enforcement.

It is well recognised that currently an inefficient financial sector in Bangladesh is imposing a heavy structural constraint on the investment situation in Bangladesh. How far these financial sector reform measures may actually stimulate investment without addressing the other structural constraints to investment (e.g. underdeveloped infrastructure) remains to be seen.

3.1 Domestic Credit Expansion

As of October 2003, overall domestic credit expansion rate (on point to point basis) was 10.13 percent. In October 2002, the comparable figure was 10.49 percent. Relatively moderate aggregate growth in the domestic credit flow during the first four government months of the FY04 is due to the negative balance (-7.03 percent) in case of government borrowing and relatively low growth (3.93 percent) in case of “other public bodies”.

What needs to be noted is that domestic credit recorded a net increase of 3.54 percent (Taka 3681.90 crores) during July-October 2003 compared to 2.93 percent (Taka 2780.70 crores) during the matching period in the earlier year. This increase is largely attributable to higher inflow to the private sector (Taka 3499.60 crores or 4.51 percent increase). On a point to point basis, credit growth in the private sector, as of October 2003, was 15.76 percent. These positive developments in monetary expansion resulted in the growth of the private sector's share in total domestic credit flow to 75.35 percent, which is the highest share recorded in recent years.

It needs to be pointed out that the central bank's measures relating to reduction of Bank Rate and SLR came in November, 2003, and thus, could not be responsible for the relatively higher disbursement of term loans during July-September 2003. Moreover, whatever decline in interest rate has taken place, it did not take place in the second half of FY03 and this was the period when most of the investment decisions took place resulting in disbursement in the first quarter of FY04. Whatsoever, it is now to be seen to what extent the declining trend of interest rate accelerates the investment flow in the coming months.

It seems that after an early pick-up till September 2003, some restraint was imposed on monetary growth in October 2003. It is not immediately apparent whether this is the result of a conscious constraint imposed by the central bank in the face of the rising price level or it is a reflection of poor response from effective investment demand. This may well reflect the monthly trend projected under the Bangladesh Bank's monetary programme.

It may be pointed out that excess liquidity of the scheduled banks, as of end November 2003, stood at Tk. 7204 crores. Out of the total amount Tk. 7204 crores, Tk. 2118 crores (29.4 per cent) are in foreign currency clearing account which is readily not available for local lending. In addition, excess liquidity in the Islamic Banks is about Tk. 1,000 crores (13.9 per cent). If these two amounts are excluded, effective excess liquidity is about Tk.

4,086 crores which is less than 4 per cent of an average daily balance of Tk. 110,520 crores. However, it will be enlightening to take a closer look at the composition of this amount to assess the extent of effective liquidity

It is to be seen whether the commercial banks will be able to avoid “moral hazard” and avoid financing bad projects.

3.2 Government Borrowing

Following the reduction of the interest rates on the National Saving Deposit (NSD) certificates, the growth of their sales gradually declined from the peak of 15.08 percent in July 2003 to (-) 5.23 percent in October 2003. The average growth in this period was 2.8 percent – the total amount purchased being more than Tk. 3520 crores. The total outstanding to the government on account of borrowing from the public at the end of October 2003 amounted to Tk. 31312 crores (16.6 percent growth over the four month period).

It is evident that the fall in yield rate has partly dampened the demand for NSD, although every month, till date, on average Tk. 800 crores worth of NSD continue to be purchased by the public. In sum that net government borrowing during July-October 2003 declined by 5.8 percent, notwithstanding a 9.8 percent net increase in non-bank borrowing. The debate on the implications of the so-called high interest rates paid by NSD certificates for lowering interest rates in the commercial banks is worth pursuing, but possibly on a different occasion.

3.3 Agricultural Credit

Between July and October 2003, a total amount of Tk. 729.53 crores were disbursed as agriculture credit, recording an increase in disbursement by 5.7 percent. However, due to higher recovery (Tk. 850.60 crores), the sector experienced a net outflow of Tk. 121.1 crores during these four months. The only comforting fact seems to be that there had been a larger outflow in FY03 during the comparable period. More importantly, it seems that the agriculture sector is yet to benefit from the current moderately expansionary policy.

Currently (October 2003), the share of overdue loans as a percentage of total outstanding loans stood at more than 63 percent. Collection of overdue loans should be seen as a healthy initiative, leading to better loan disciplines. However, if the recovery rate increases in the backdrop of such a modest growth in fresh loans, the agricultural credit delivery system will emerge as the main conduit of transfer of resources from the rural to the urban areas. Although, refinance facility from the Bangladesh Bank is available to the scheduled and specialised delivery of agriculture credit, it appears that the banks are not so enthusiastic about giving credit to the farmers. It therefore needs to be explained to what extent the financial sector reforms have failed to address the importance of channelling credit to the poorer sections of society and may even be responsible for slowing down credit flows to the rural areas.

AGRICULTURAL CREDIT EXPANSION

In crore TK.

Month	FY04			FY03			% Growth	
	Disbursement	Recovery	Net Flow	Disbursement	Recovery	Net Flow	Disbursement	Recovery
July	132.13	177.98	-45.85	109.01	200.07	-91.06	21.21	-11.04
August	114.12	142.86	-28.74	149.91	181.50	-31.59	-23.87	-21.29
September	242.00	276.51	-34.51	176.68	218.07	-41.39	36.97	26.80
October	241.28	253.25	-11.97	254.72	256.02	-1.30	-5.28	-1.08
November	247.55	230.91	16.64	246.79	273.30	-26.51	0.31	-15.51
December	427.90	437.28	-9.38	367.68	493.96	-126.28	16.38	-11.47
January	332.52	285.22	47.30	316.67	282.93	33.74	5.01	
July-January	1737.50	1804.01	-66.51	1621.46	1905.85	-284.39	7.16	-5.34

3.4 Industrial Loan

In the backdrop of the slowdown in growth of industrial term loans in the recent years (since FY01), the disbursement record for July-September 2003 is quite impressive – Tk. 1423 crores, i.e. more than 106 percent growth. The net flow to the sector is Tk. 482.5 crores which compares favourably with the outflow of (-)Tk. 206.1 crores during the comparable period in FY03. The sharp growth can be partially explained by the growth of import of capital machinery. However, the question remains whether the settlement of L/C for capital machinery imports took place after the disbursement of the loan.

INDUSTRIAL TERM LOAN

In Crore Tk.

Quarter	FY04			FY03			% Growth	
	Disbursement	Recovery	Net Flow	Disbursement	Recovery	Net Flow	Disbursement	Recovery
July-Sep.	1369.7	964.73	404.97	689.77	895.87	-206.1	98.57	7.69
Oct.-Dec.	1756.95	1148.03	608.92	1087.59	994.95	92.64	61.55	15.39
July-Dec.	3126.65	2112.76	1013.89	1777.36	1890.82	-113.46	75.92	11.74

Source: Bangladesh Bank

It needs to be recalled that the share of overdue as a share of outstanding industrial term loans declined from 32.8 percent in September 2002 to 28.7 percent in September 2003. This decline took place largely due to write-off decisions by the commercial banks. NCBs have written-off Tk. 1984 crores, which is 2.73 per cent of NCBs classified loans. Five specialized bank have written off Tk. 779 crore of bad loans, reducing their default loans by 8 percent; private commercial banks and foreign banks have written-off Tk. 1079 crore and Tk. 125 crore respectively.

As a whole, the reduction of classified loans occurred as a result of window-dressing, which is a normal practice, but not due to improvement in recovery. It should be kept in mind that the policy of debt rescheduling, practised by successive regimes in Bangladesh, has contributed to a serious moral hazard problem in the banking system which may actually have contributed to the perpetuation of the default culture in Bangladesh.

3.5 Price and Wage Inflation

The latest available figures from the BBS show that the national inflation rate (base year 1995/96, in September 2003) was 4.71 percent moving average. On a point to point basis the rate was about 5.58 percent. It may be recalled that the inflation rate (moving average) was 2.79 percent and 4.38 percent in June 2002 and June 2003 respectively.

Although we do not have official statistics on the consumer price index (CPI) for more recent months, market information on prices of essential commodities suggests that the inflation rate has further increased during October and November 2003 (Ramadan months). The inflation rate (moving average) for non-food prices has been higher (5.1

percent) than for food prices (4.4 percent). However, very surprisingly one finds that both food and non-food price increase had been higher in the rural areas than in the urban areas. Thus, it is evident that the recent price hike will hit the poor more (those who spend relatively more on food), particularly those living in the rural areas. The higher inflation in rural area also indicate the emergence of structural shift of rural economy with increasing monetization and growth of non-farm sectors.

It needs to be seen how the food price index behaves once *Aman* crop is harvested. But the need to monitor the inflation closely in the coming months, particularly when the government is pursuing a moderately expansionary policy. A larger portion of rural population is dependent on agricultural labour.

This concern for price inflation becomes quite serious when we consider the recent trend in wage inflation. The wage index grew by more than 11 percent throughout FY03, and during the period July-September 2003 this has remained above 8 percent. It goes without saying that such wage inflation is often driven by the wage goods price inflation, which in turn erodes export competitiveness of the economy. On the other hand, increase in real wage (around 5.3 per cent) may be an expression higher of labour demand and growth in productivity. Thus, it needs further examination to explain a growth in real wage during a period in a country with one-third of its workforce unemployed or underemployed when it has experienced a large retrenchment of manufacturing labour (more than 51,000) through closing of the SOEs.

In assessing inflationary trends in the economy we need to recognise that very little research evidence is at hand to explain the dynamics of price inflation in Bangladesh to enable us to differentiate between the contribution of monetary and structural factors. The sudden escalation of price levels during Ramadan which appeared to be at variance with supply and demand trends for certain key items of consumption suggests that the structural components of price and wage inflation and their institutional foundations merits investigation if appropriate policy responses are to be designed to cope with the problem.

4. Real Economy

4.1 Agricultural Production

Foodgrain production has increased in FY03 after a decline in FY02. According to per the final estimate of the Bangladesh Bureau of Statistics (BBS), actual foodgrain production for FY03 was 26.69 million metric tons (*Aus* - 1.85 million metric tons, *Aman* - 11.11 million metric tons, *Boro* - 12.22 million metric tons, and wheat - 1.51 million metric tons) which was 2.97 percent higher than that of FY02. Total rice production in FY03 was 4.35 percent more than that of FY02. It may be mentioned here that though the production of foodgrain has increased in FY03, it is still below the production level of FY01 (26.76 million metric tons).

The foodgrain production target for FY04 has been set at 28.12 million metric tons which is 5.36 percent higher than actual production in FY2003. The area under *Aus* production has declined (1.15 million hectare in FY2004 against 1.24 million hectare in FY2003), but the area under HYV *Aus* rice has increased by about 28 percent over the last year. Therefore, preliminary estimates show that the production of *Aus* rice would be able to meet the target level (1.85 million metric tons). BBS is yet to finalise the production estimates of *Aus* rice. The production prospect of the current *Aman* crop seems to be good. According to the Directorate of Agricultural Extension (DAE) sources, the area under transplanted *Aman* rice is at the level of last year, but the yield prospect is better. Harvesting of *Aman* paddy is almost over, and hopefully we will soon get the estimates on the actual production during *Aman* season.

The government has already set the rice procurement target at 200 thousand metric tons for FY2004. The government would buy 150 thousand metric tons of rice and about 73 thousand metric tons of paddy (equivalent to 50 thousand metric tons of rice) directly from the farmers. Procurement of *Aman* paddy was scheduled to start from November 15 and to continue upto February 28, 2004. Procurement price of *Aman* paddy and rice has been set at Tk. 8.40 and Tk. 12.80 per kg respectively. It remains to be seen whether the Food Ministry will be anymore effective this year than in the past in actually procuring

its foodgrain targets directly from the farmers or whether the traders will continue to monopolise the supply chain. The procurement regime will need to ensure that the experience of last year when poor quality foodgrains imported from India ended up in the silos of the Food Directorate, are not repeated.

4.2 Monga Situation

The relatively good performance of the foodgrain production has been foreshadowed by the *monga* situation in FY04 prevailing in some Northern districts of Bangladesh. *Monga* is a local term used to indicate acute deprivation caused due to the erosion of purchasing power from lack of gainful employment opportunities. Although this happens every year during September-November (*Aswin* and *Kartik*) in the Northern districts, this year the situation was more severe than in the recent past. A CPD research team visited two upazillas of Rangpur and Gaibandha districts (one from an “affected” area and another from a “severely affected” area) to assess the reasons for the dire distress experienced this year. Stakeholder consultation and desk level research revealed the following factors responsible for the severity of the hardship this year.

- Reduced production of foodgrain in FY02 and FY03. According to the data obtained from the BBS, total foodgrain (rice and wheat) production in the greater Rangpur region in FY02 was 11.62 percent lower than that of FY01. On the other hand, total foodgrain production in FY03 was 5.87 percent lower than that of FY01.
- Reduced foodgrain production has resulted in reduction of employment opportunities for harvesting and processing of agricultural commodities.
- Loss of crops by flood in '03 has also aggravated the situation by delaying the transplanting time thereby reducing employment opportunities for land preparation, transplanting and weeding of *Aman* rice.
- The worst affected people were also victim of river bank erosion.
- There is a perception among people that the traditional instruments or disaster relief such as Test Relief (TR), Food for Work and Vulnerable Group Feeding

(VGF) programmes have been reduced this year resulting in lower entitlement opportunities in the lean period.

- Outflow of money from the rural area due to greater loan recovery compared to disbursement by both government banks and NGOs.
- Lack of participation by NGOs to help the vulnerable to cope with the hardship has aggravated the situation. Some NGO workers indicated that since the government was not acknowledging the prevalence of *monga*, they did not dare to initiate any targeted programme.

CPD field work further revealed that, for their survival, *monga* affected people tried to cope with the situation in the following ways:

- Foreward sale of their labour at reduced wages – Tk. 20-25 per day with food or Tk. 35-40 per day without food. This may be compared with the potential wage rate of Tk. 35-40 with food and Tk. 55-60 without food during the crop harvest and planting season.
- Selling of crops (paddy) in advance at a lower price – Tk. 150-200 per maund of paddy against a potential price of Tk. 300-350 per maund after harvesting.
- Informal loans obtained from money lenders. An amount of Tk. 100 obtained in *Aswin-Kartik* has to be paid with 50 percent interest after 2-3 months.
- Temporary migration in search of work in other districts such as Comilla, Kishoreganj (Bhairav), Chittagong.
- Eating of *banana thors*, *kachu-ghechu* which are not naturally eaten even by the poor people during the normal period.

At the end of the day the *Monga* situation of FY04, reflected weak monitoring on the part of the government and its slow response to the emerging situation. However, it would be a mistake to view this problem as a mere weakness in governance.

The more fundamental problem highlighted by the recent *Monga* crisis arises from the failure of successive governments to develop a long term solution to the problem which has been affecting certain Northern districts of Bangladesh, with varying degrees of

severity at least since the Liberation and possibly before this. The root causes of the problem, associated with entitlement deprivation, with its territorial location, are well known. Given the local dimensions of the crisis it should have been possible to provide structural as well as programmatic solutions to this problem in all these years. Failure to do so indicates that the problem will remain.

4.3 Industrial Production

The lowest growth rate (3.2 percent) in the manufacturing sector was recorded in the recent past during the 1990s in the year of severe floods, i.e. in FY99. Since then, the sector has gradually recovered. In FY03, the sector recorded 6.6 percent growth with its medium and large component expanding at a slightly lower than average rate (6.0 percent).

For an assessment of the performance of the manufacturing sector in FY04, one has to fall back on the series of Quantum Index of Production (QIP) which is available only upto the month of September. On a point to point basis, industrial production increased between September 2002 and 2003 by about 4 percent. However, what is to be noted is that the QIP in September 2003 fell in comparison to that of in the preceding month by 5 percent.

The faltering growth of the manufacturing sector is largely attributable to the visible withering away of the jute industry in Bangladesh. During the first quarter of FY04 production fell in all categories of jute products (i.e. hessian, sacking, carpet backing etc.) – both in public and private sector enterprises. This process has been accelerated by the liquidation of the Adamjee Jute Mill. The weight of the jute textiles in the QIP is still as high as 14.1 per cent. Along with the jute sector, among the major industries, the fall in productions of paper and petroleum products is also discernible.

The most encouraging feature of the manufacturing production during July-September 2003 had been the robust growth of yarn and fabric production which generates confidence about Bangladesh's growing capacity to meet the challenges in the post-

Multifibre Arrangement (MFA) period. Among the other major industries, fertilizer, pharmaceuticals and tea continued to grow, albeit at a modest rate.

A 4 percent manufacturing growth rate does not inspire excitement particularly when it rests on a very narrow base. Nor does the current weak manufacturing growth match up to the higher flow of term loan to the industrial sector mentioned earlier and the rise in capital machinery import discussed later.

The issue of industrial and export diversification has been part of the policy discourse for at least two decades. Unless a new generation of industries which can be either globally competitive or can provide efficient import substitution, the promise associated with Bangladesh's export gains and industrial change registered in the last decade may leave us with severe social as well as economic problems.

At the same time, it needs to be recognised that a structural transformation is going on in the country's manufacturing sector and there is great deficiency in enterprise level data, which are quite often not consistent with macroeconomic aggregates.

4.4 Privatisation

At present the total number of state owned enterprises (SOEs) approved by the Government for privatisation is 94. Around ten SOEs have been closed down during the last two years, while only three SOEs were privatised, i.e. handed over to the buyers. These were Nishat Jute Mills Ltd. at Tongi (November 6, 2003), Mymensingh Jute Mills Ltd. at Shambhugonj (November 2, 2003) and Deshbandhu Sugar Mills Ltd. at Narshingdi (February 20, 2003). Sale proceeds from these three enterprises amounted to around Tk. 68 crores.

Currently Letters of Intent (LOI) for privatisation have been issued for 16 enterprises and these units are yet to be handed over to the buyers. The expected receipt from these sales is around Tk. 112.6 crores. The Privatisation Commission is facing problems regarding handing over of a number of enterprises.

Incidentally, the Textile Ministry has recently taken back three of its big textile mills from the Privatisation Commission list and has planned to liquidate them on its own. The Ministry of Industries is trying to reopen four of its enterprises it sent to the Privatisation Commission years ago. A letter has been sent by the Ministry of Industries to the Privatisation Commission expressing its wish to reopen the North Bengal Paper Mills in Pakshey. It had already asked the Bangladesh Chemical Industries Corporation (BCIC) to initiate plans to run three other SOEs. A plan is afoot to start production of the Dhaka Leather Company, which was shut down way back in 1998 and, since then, all its employees have been transferred to other enterprises of the Corporation. Several ministries are also keen to take back their enterprises and liquidate them on their own in spite of the fact that no ministry has such cell. Nor do these ministries have any expertise to conduct the liquidation process on their own.

The Ministry of Civil Aviation and Tourism decided not to privatise the enterprises under the Bangladesh Tourism Corporation that had been approved by the government earlier for privatisation. It is apparent from the above evidence that the privatisation process remains paralysed due to lack of a coherent policy within the government. Nor is it clear how the sales proceeds from the privatisation of the SOEs will be reinvested, if at all. On the other hand, the Privatisation Commission is yet to come up with its annual report which is mandated under its Act. Little is known of the fate of the approximately 359 enterprises privatised over the last 30 years except for a few episodic studies. Nor is there any indication that the Privatisation Commission is taking any measures to keep the people of Bangladesh or even the Parliament informed of the fruits yield by the privatisation process. This lack of transparency relating both to the privatisation process and its outcomes may have contributed to the problems faced by the Privatisation Commission.

4.5 Foreign Investment

A new round of debate on estimates of foreign direct investment has once again reemerged following publication of foreign direct investment (FDI) inflow data for the first half of the calendar year 2003 by the Board of Investment (BOI). There is no scope for an

elaborate discussion here on whether internationally accepted accounting methods of FDI, in the context of practices in Bangladesh, have been used by the BOI. Although there is a high probability that FDI flow remains underreported in the BOP statement in Bangladesh as it often does not fully capture, capital machinery brought in, reinvested earning and inter-company loans under appropriate heads. Curiously, the current BOP accounts also do not include foreign investments the EPZs. However, the central bank still remains the final authority to confirm the FDI estimates.

CPD estimate based on BOP data on FDI and portfolio investment as well as foreign investments in EPZs indicates that a net total of \$63.50 million of foreign investment came to Bangladesh during July-September 2003. More than 63 percent of it was invested in the EPZs. No portfolio transaction was reported during this period.

The foreign investment figure for the first quarter of FY03 compares favourably with that for FY02 – a more than four fold increase. Net flow of FDI increased by almost 2.5 times – although on a very insignificant base of \$9 million. In case of EPZs, the growth was almost seven fold. However, one should not lose sight of the fact that all this is projected from an insignificant base.

FOREIGN INVESTMENT

(In Mln. US\$)

Year	FDI			Portfolio Investment			Foreign Investment in EPZ	Total Net Inflow of Foreign Investment
	Inflow	Outflow	Net Inflow	Inflow	Outflow	Net Inflow	(Net Inflow) ^a	
1996/97	17.00	1.00	16.00	16.00	148.00	-132.00	53.88	-62.12
1997/98	273.00	24.00	249.00	14.00	11.00	3.00	68.82	320.82
1998/99	200.00	2.00	198.00	3.00	9.00	-6.00	70.61	262.61
1999/00	194.40	0.80	193.60	10.70	10.60	0.10	34.98	228.68
2000/01	166.10	0.10	166.00	5.90	6.30	-0.40	48.41	214.01
2001/02	65.24	0.56	64.68	0.50	6.09	-5.59	55.71	114.80
2002/03	94.90	3.00	91.90	2.00	0.40	1.60	103.13	196.63
2002/03 (July-Dec.)	n.a.	n.a.	22.00	n.a.	n.a.	1.00	48.71	71.71
2003/04 (July-Dec.)	n.a.	n.a.	30.00	n.a.	n.a.	0.00	55.93	85.93
Growth (%) (July-Dec.)			36.36			-100.00	14.80	19.82

Notes: ^aIncludes investments in joint-venture enterprises with local entrepreneurs

After a secular fall from the peak in FY98 (the days of high FDI flow to the energy sector) till FY02, foreign investment for the first time recorded an increase in FY03 (\$197.13 million from \$114.80 million). It seems that the figure may rise further in FY04 – but largely in the EPZs. However, the resurgence of the controversy regarding trade union rights in the EPZs, reflecting the concerns of Bangladesh’s largest export market, the USA, vis-a-vis the concerns of some of Bangladesh’s largest sources is investment in the EPZ, drawn from Japan and the Republic of Korea needs to be reserved without prejudice either to Bangladesh’s export or investment prospects. This may be no easy task.

4.6 Capital Market

Between January 1, 2003 and November 30, 2003, DSE General Index, Weighted Average Index and DSE20 Index grew by 8.8 percent, 0.14 percent and 13.21 percent respectively. Turnover in terms of volume increased by 18 percent during this period. A bullish trend in the bourse may be observed from mid November which gathered momentum in the early part of December. Suspecting speculative trading, on December 2003, the Securities and Exchange Commission (SEC) suspended trading of 16 companies with weak fundamentals (Z Category Companies) following a surge in their share prices. Subsequently all prices of all shares in categories B and Z went down resulting in corrections in the prices in Category A.

No rational reason could be identified behind the upward surge observed in the market in November-December 2003. It may be recalled that 64 (29%) companies out of 221 did not pay any dividend in 2000 and 49 in 2001 (21%) out of 230 companies, whereas 76 (32%) companies out of 241 companies are yet to declare dividend for 2002. It is suspected that the lucrative initial public offerings of banks attracted a significant amount of undeclared money to the capital market. It is also reckoned that a number of blue-chip securities had been under-valued for a long time and their prices went up as they started declaring good dividends.

Notwithstanding the above facts there had been some movement in the stock market as 14 new companies were listed in FY03 putting up about Tk. 680 crores as sponsors' equity. These companies offered Tk. 135 crores worth of securities against which Tk. 1801.5 cores was deposited recording a staggering 13.5 fold oversubscription. Only one company could not raise the targeted amount for its IPO from the market.

However, it needs to be pointed out that, although, almost all the IPOs in varying degrees were oversubscribed, it is the IPOs relating to banks, insurance and investment activities which attracted most of the investors' interest.

Nonetheless the capital market remains both shallow and skewed in Bangladesh. Market capitalisation in DSE in October 2003 amounted to \$1290 million which is less than 2.5 percent of GDP. In June 2002 the comparable figure was 2.2 percent GDP. Three groups of listed companies, viz. Banks, Pharmaceuticals and Chemicals, and Food and Allied Products together controlled about 60 percent of the market capitalisation.

It will be interesting to observe how the SEC succeeds in weeding out the dead stocks and restores confidence in the capital. However, the recent movements in the capital markets have revealed that at least Tk. 2000 crores of liquidity is looking for opportunities for investment in dependable scripts.

5. External Sector

The behaviour of the external sector in the early months of FY04 is best revealed by the trends in import and export, remittances flow, foreign aid disbursement and the balance of payment situation.

5.1 Import

The latest evidence suggests that imports have picked up in the early months of FY04. Actual import payments during July-October 2003 were 21.2 percent higher than that of

FY03. During the comparable period in FY03, import payments in fact declined by (-)0.4 percent.

In the backdrop of only 4.5 percent growth in FY03, capital machinery import has exhibited a robust increase during the first quarter (July-October) of FY04. Fresh opening of letters of credit (LCs) for capital machinery increased by about 49 percent. This growth captures \$33.4 million worth of import for a PDB power plant in Tongi and \$12.9 million worth of import for a glass factory financed by Janata Bank. Machinery import for miscellaneous industries also recorded a growth as LCs opened on account of this increase by more than 8.5 percent. LCs opened for industrial raw materials increased by 27.0 percent.

However, it needs to be pointed out that imports of consumers' goods (other than foodgrains) also depict a high import trend as LC openings for those goods increased by 26.25 percent. With the relaxation of LC margin requirements, it may be safely assumed that the import of consumers' goods in the coming days will increase further.

On the other hand, during July-September 2003, import of foodgrains by the private sector was 996 thousand metric tons which was 71 percent higher than that of the preceding year. It may be mentioned that government for the first time since FY00, has undertaken commercial import of wheat amounting to 29 thousand metric tons during July-September 2003.

In fine, the import growth rate is currently more than twice that of export. Amount of L/Cs opened upto October of FY04 was worth \$3.71 billion compared to \$3.05 billion over the corresponding period of the preceding year, posting a robust growth of 21.8 percent. Interestingly, growth of L/Cs opened for production related imports such as industrial raw materials and capital machineries was 28.3 percent and 56.4 percent respectively. L/C settlement figures during this period also shows a 28.3 percent growth. If the trends in L/C openings are any clue, the current high growth of imports are likely to sustain in coming months (upto October 2003).

Whilst higher disbursement of foreign aid and remittances flows may provide some cushion for the time being, there is every possibility that this import surge may create fresh pressure on our foreign exchange reserves in the subsequent months of FY04. It is also expected that the exchange rate in a floating regime would absorb much of this pressure.

5.2 Exports

Exports grew at 9.4 percent in FY03. During the first quarter (July-September) of FY04 growth in exports has been sustained at 9.94 percent. One needs to be reminded of the fact that this growth was achieved through a more than 12.6 percent increase in export volume in the face of about 2.7 percent decline in the export price index.

If we consider that export prices declined by 14.8% in FY02, to rise by 2.3% in FY03 only to fall by 2.4% in the early months of FY04 as stated above, it will not be difficult to appreciate the level of erosion in the overall export prices in recent years. As a matter of fact, analysis carried out at CPD shows that average price levels for Bangladesh's exports is yet to reach the 1996 price level.

It goes without saying that such an extensive method of export expansion is not sustainable over the medium term. This is particularly true when one single group of commodities, namely clothing, accounts for more than 76 percent of the export receipts. As is well known, the export competitiveness of Bangladesh will be put to severe test once the RMG quota is phased out in another year's time, on January 1, 2005.

Other than jute goods and handicrafts, export receipts for all other categories of items increased during the first quarter of FY04. This remains particularly true for such non-traditional items such as pharmaceutical and chemical (121 percent) as well as for a less traditional item such as tea (93 percent). These are may be some of the initial signs of export diversification.

Notwithstanding such growth, the export target for July-September 2003, period was missed by about 19 percent. These figures suggest that the recent close to double digit export growth remains below expectation.

5.3 Remittance

In recent years importance of flow of remittance has been on the rise. In FY03 flow of remittance was equivalent to about 85% of net export earnings of the country. Remittance flows for the first time crossed the threshold level of \$3.0 billion in FY03, when it was \$3061.9 million or 22.4% higher than FY02. During the period July-November, 2003 Bangladesh received about \$1285 million as foreign remittances recording 4.33 percent point to point growth. However this growth performance looks very pale compared to what was achieved in FY03.

In fact the slowdown in the volume of foreign exchanges sent by migrant workers may appear as the first revealed signs of exhaustion of growth. The recent erratic remittance flow (when it registered a negative 6.9 percent growth in November 2003) will take sometime to settle down. It is reckoned that the post 9/11 global situation along with government's steps to improve the efficiency of the formal channel of transfer played an important role in accelerating remittance growth in Bangladesh.

Sustaining a buoyant flow of foreign remittances will be one of the most challenging tasks for the Bangladesh economy in the coming months. This will be a further challenge if the growth in the number of persons going abroad falls-it was only 3.7 percent in September 2003. Will Bangladesh be able to protect its saving grace or it has run out of its outstanding stock and now has to depend on current flow only?

5.4 Foreign Aid

In FY03 foreign aid committed to Bangladesh amounted to about \$2179 million, whilst actual disbursement was in the region of \$1577 million. After a secular decline in the

volume of foreign aid disbursement since FY99, a growth of more than 26 percent was recorded in FY03 compared to the preceding year.

The latest figures available for FY04 indicate a modest commitment level of \$136.6 million upto November 2003. Drawing on the pipeline, the disbursement till October 2003 amounted to \$209.2 million.

The recent increase in foreign aid inflows to Bangladesh largely owes to the *Development Support Credit* (DSC) contracted with the World Bank. Under the DSC \$300 million was disbursed in one go to Bangladesh as it promised to implement a time bound Structural Policy Reform Matrix.

On the other hand, the IMF also agreed to give Bangladesh SDR 347 million (about \$490) as a loan *Poverty Reduction and Growth Facility* (PRGF), of which SDR \$49.5 mln (\$70 million) has been disbursed as first tranche. The second tranche will be available once Bangladesh services a number of commitments in the area of budgetary and financial sector reforms.

In comparison to many other low income countries the foreign debt scenario of Bangladesh remains manageable. The country's DSL on account of foreign loans amounted to only 6.3 percent of its total foreign exchange earnings during FY03.

The major problem for Bangladesh originates in its weak capacity to utilise the already committed foreign aid. Thus, the aid pipeline amounts to more than \$6.2 billion (as of June 2003). At the same time, most of the foreign assistance disbursed in the recent past had been in the form of loans implying a growth in DSL in the near future.

5.5 Balance of Payment

With imports growing at a faster rate than that of exports, the trade balance recorded a larger deficit during July-September 2003. The current account balance registered a

smaller surplus due to lower level of current transfers including foreign remittances coupled with larger trade deficit. Consequently, the overall balance showed a smaller surplus of \$163 million as against \$229 million in the matching period of FY03.

The slight weakening of the BOP during the early months in FY04 may not raise immediate concern, however this will definitely be an issue to be monitored closely in the coming months. It is expected that, if the current trends of the relevant variables continue, the BOP may come under increased pressure, particularly in view of the robust growth of the amount of L/C opening.

5.6 Foreign Exchange Reserve

Foreign exchange reserve of Bangladesh stood at \$2438 million at the end November 2003. This amount was about 61.5 percent higher than that of in November 2002.

The current level of forex reserve, propped up by foreign loans provides a cushion for the growing import demand. However, if a draw-down on the forex reserve sets in, one may have to once again resort to monetary policy instruments to contain the import growth.

6. Concluding Remarks

It is evident from the foregoing review that most of the key variables influencing macro-economic performance that the project FY04 has started off in a relatively strong footing. Revenue collection is on target, export growth is stable and agricultural production is steady. Positive movements are taking place in case of import growth, industrial loan disbursement, and financial sector reform. However, these reassuring trends are somewhat depressed by marginal growth in the manufacturing sector, low level of FDI inflow, net outflow of agricultural credit, transitory bubbles in the capital market, paralysis in the privatisation process, slowdown in remittance flow, and, last but not the least, the perceptible price hike of essential commodities.

One observes that, the fiscal balance remains sound mainly by default (largely due to low ADP implementation), and the balance of payment situation is subjected to some pressure

because of the increasing trade gap and the expected pressure of input payments in the coming months.

The four critical factors for successful implementation of the National Budget FY04 mentioned in CPD's in June 2003 Budget Review may be recalled in this connection.

- (i) Implementation of ADP still remains the most vulnerable aspect of this year's economic programme – from the point of view of both quantity and quality. Particular attention will need to be given to the recommendations of the *Public Expenditure Review Committee*.
- (ii) Export recovery is getting stronger and there are signs of diversification in new non-traditional exports. In view of the impending phase-out of MFA this needs to be strengthened.
- (iii) Private investment in the manufacturing sector has gathered momentum, particularly in the backward linkage industries of the RMG (i.e. yarn and fabric production). Other import-competing and potential export-oriented industries such as pharmaceuticals is showing sustained growth.
- (iv) A successful supportive monetary and fiscal policy has generated enhanced inflow of investible surplus in the market. However, price index is showing crawling upward trend. With the emerging pressure on the BOP, the floating regime will have to effectively adjust the exchange rate, and some monetary control may become necessary.

Thus, it seems from our review that, other than the ADP and inflation, almost all other major target indicators of the *Mid-Term Macro-economic Framework* of the I-PRSP will be achieved. Accordingly, the economy is poised to record a 5.5 per cent or above growth in FY04. However, it is well known that a 5.5% growth will result in a little above 3.5% per capita income growth, which although being impressive in the global context, may not be good enough for alleviating the situation of more than 40 percent of the population living below the poverty line. This is important particularly in the context of aggravating income disparity in the economy.

Curiously, one finds that the system is flushed with excess liquidity on the lookout for viable business opportunities – a baseline estimate would put the figure at least to the tune of Tk. 10,000 crores (almost \$2 billion) at any point in time. These numbers of course do not include the savings of the lower income groups which remain underutilised due to lack of investment opportunities or appropriate financial instruments to productively use such savings. One wonders what would happen with this excess liquidity if investment does not pick up further – growth in conspicuous consumption or flight of capital?

As the government crosses the critical mid-point of its tenure it is expected that the accumulated momentum will provide a ‘big push’ in the second part of FY2004 averting the setting-in of the oft-seen mid-term inertia.

What is holding back the country from a big push? Is it a mid-term inertia? Successive surveys carried out by CPD (and other institutions such as the World Bank-BEI and Japanese Commerce and Industry Association in Dhaka) to assess the business environment have revealed that it is the non-economic factors relating to governance, viz. high corruption, and weak law and order situation, which are creating serious disincentives for investment. Entrepreneurs no longer complain so much about unpredictability of policy, but emphasise poor services of the public institutions. These are the factors which can largely explain the mismatch between the strong macroeconomic fundamentals of Bangladesh and inadequate confidence of the investors.

Admittedly, the trigger to alleviating such a situation lies more within the domain of politics, rather in economics. Will the underlying political economy of Bangladesh continue to arrest its development prospects and to perpetuate poverty and inequality? The final outcomes of Bangladesh’s economic performance in FY04 may partly provide answer to these questions.