

# State of the Bangladesh Economy 2002-2003

## *An Interim Report*<sup>1</sup>

### (Second Reading)

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## I. INTRODUCTION

***Benchmark conditions during FY02.*** At the beginning of the fiscal year 2001-2002 (FY02), the *Centre for Policy Dialogue* (CPD), in its annual *Independent Review of Bangladesh's Development* (IRBD), benchmarking the initial conditions of the economy observed that “the economy is facing possibly the most severe exigency since the macro-economic crisis of the late 1980s. The twin shocks emanating from the yawning fiscal deficit and deteriorating balance of payment has exposed the entrenched vulnerabilities of the Bangladesh economy. Both the successes of the macro-economy, achieved during 1990s, *viz.* stability and growth are in peril”.

CPD-IRBD 2002 raised the question “whether the emerging negative trends in the macro-economy will lead to an extensive loss of employment and income for a protracted period, or whether the present predicament is a short-term phenomenon to be overcome through prudent policy management and institutional reforms”.

***Year closing assessment of FY02.*** At the end of the FY02, as part of its reaction to the National Budget for FY03, the CPD undertook a year-ending assessment of the economy. Three major observations were recorded in this assessment on FY02. *First*, deterioration in the fiscal balance has been harnessed. *Second*, pressure on balance of payments has been partly contained. *Third*, recessionary trends continue to afflict the economy. CPD's review emphasised scored that the inability to address the prevailing stagnation in the investment scenario may jeopardise the recent gains.

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<sup>1</sup> The paper has been prepared under the Centre for Policy Dialogue's (CPD's) programme *Independent Review of Bangladesh's Development* (IRBD). This is the second interim version of the IRBD FY03 which focuses on the state of the national economy during the first three quarter of the fiscal year 2002-2003. The first interim version (dated December 29, 2002) covered the first half of the current fiscal year.

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***National Budget for FY03.*** It was open to speculation whether the Budget for FY03 would be able to catalyse investment growth. However, it was further pointed out in CPD's review that, in spite of all the positive measures taken under the Budget FY03, investment will still remain constrained due to lack of reforms, particularly in improving performance in the trade-supportive infrastructure, financial sector, public administration, and last but not the least, because of the deteriorating law and order situation.

***Interim IRBD FY03.*** More than ten months have elapsed since the foregoing observations were made. During this period, the government has resorted to rather non-conventional measures to improve the law and order situation with indifferent consequences. A number of government committees are trying to give shape to reform measures in different areas of economic management. Now with the results of the first three quarters of the FY03 behind us, we may seek to identify and interpret the initial signals of the developments in the current fiscal year.

It is in this context that the present paper reviews a set of major variables defining the state of the Bangladesh economy. The analysis, based on official data, is divided into five broad parts. It sequentially addresses the developments in the *fiscal, credit and monetary sector, real economy, and external sector*. The review concludes by highlighting some issues which in the coming months will serve to influence the performance of the economy.

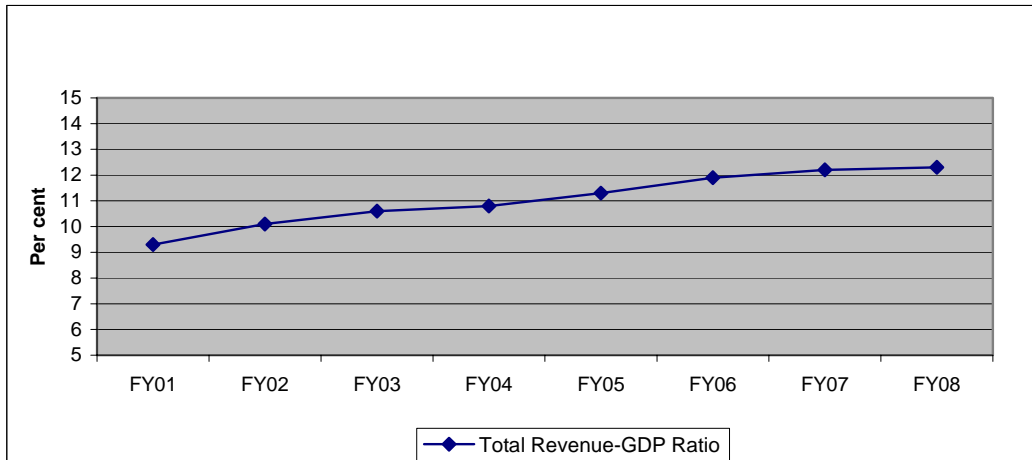
## **II. TRENDS IN FISCAL SECTOR**

***Revenue.*** In FY02, a total amount Tk. 276.70 billion was collected as revenue, of which the tax component attributable to the National Board of Revenue (NBR) accounted for about 75 per cent, non-NBR tax – a little above 4 per cent, and non-tax revenue – around 21 per cent. The total collection, in spite of being about 14.5 per cent higher over the earlier year's receipts, was about 2.8 per cent short of the target.

The National Budget for FY03, with a projection of about 19.6 per cent growth, fixed a target of Tk. 330.84 billion to be collected as revenue in FY03. The largest contribution to this growth is expected to originate from non-NBR tax revenue (45.8 per cent), followed by non-tax revenue (32.1 per cent). Full implementation of the target for FY03 is expected to push up

the share of revenue in GDP to a little above 11 per cent which still leaves Bangladesh with one of the lowest Revenue-GDP ratios, even amongst the low income countries.

**FIGURE 1**  
**TOTAL REVENUE-GDP RATIO**



Data for the first three quarters (July-March) of FY03 indicate that the fiscal year enjoyed a kick-start in terms of revenue collection. After a modest growth in the month of July, the collection geared up in the subsequent months. Revenue receipts under the NBR were about 20.3 per cent above collection achieved during the matching period of FY02. This was about 0.9 per cent higher than the corresponding target and accounted for 70.1 per cent of the annual target of the NBR (See Table 1).

**TABLE 1**  
**REVENUE COLLECTION FY03 (JULY-MARCH)**

No	Source of revenue	July-March FY03				July- March FY02			% change of collection (FY03 over FY02)	Original Target FY03	Collection as % of original target
		Target	Achieved	Difference	Collection as % of target	Target	Achieved	Collection as % of target			
1	Import Duty	4317.42	4863.62	546.20	112.65	3891.57	3780.99	97.16	28.63	5890.00	82.57
2	Value Added Tax (Import)	3180.30	2984.81	-195.49	93.85	2836.70	2683.17	94.59	11.24	4375.00	68.22
3	Supplementary Duty (Import)	1124.09	952.56	-171.53	84.74	1006.10	967.72	96.19	-1.57	1550.00	61.46
	<i>Total Import Related Revenue</i>	<i>8621.81</i>	<i>8800.99</i>	<i>179.18</i>	<i>102.08</i>	<i>7734.37</i>	<i>7431.88</i>	<i>96.09</i>	<i>18.42</i>	<i>11815.00</i>	<i>74.49</i>
4	Excise Tax	229.13	246.90	17.77	107.76	219.53	215.61	98.21	14.51	310.00	79.65
5	Value Added Tax (Local)	2498.26	2474.34	-23.92	99.04	1991.15	2144.81	107.72	15.36	3696.00	66.95
6	Supplementary Duty (Local)	2033.47	2257.36	223.89	111.01	1709.39	1604.59	93.87	40.68	2825.00	79.91
	<i>Total Internal Trade Related Revenue</i>	<i>4760.86</i>	<i>4978.60</i>	<i>217.74</i>	<i>104.57</i>	<i>3920.07</i>	<i>3965.01</i>	<i>101.15</i>	<i>25.56</i>	<i>6831.00</i>	<i>72.88</i>
7	Income Tax	2888.80	2687.13	-201.67	93.02	2367.85	2321.92	98.06	15.73	4788.00	56.12
8	Other Taxes	227.00	178.95	-48.05	78.83	126.60	118.00	93.21	51.65	316.00	56.63
	<i>Total Revenue Earnings</i>	<i>16498.47</i>	<i>16645.67</i>	<i>147.20</i>	<i>100.89</i>	<i>14148.89</i>	<i>13836.81</i>	<i>97.79</i>	<i>20.30</i>	<i>23750.00</i>	<i>70.09</i>

During the aforementioned period (July-March FY03), both *import related* and *internal trade related revenue* collections exceeded their respective target, with the gains more pronounced in case of the latter. Internal trade related revenue collection was 4.6 per cent above the target – thanks to high collection of Excise Tax and Supplementary Duty (SD). In contrast, collection of import related VAT and SD remained below the target possibly due to sluggish import growth. (However, import duties were collected 12.6 per cent above the target).

It may be noted that *income tax* collection has suffered a shortfall to the extent of 21.2 per cent during the period July-March FY03. Recent initiatives of the NBR to identify potential tax payers are yet to translate into actual yield.

In this connection, one has to take note of the fact that, in the backdrop of less than expected import growth, there may be an attempt to achieve the aggregate target of revenue receipts through enhanced collection of internal trade related taxes (i.e. local VAT and SD). Reliance on such devices may exert recessionary pressure on the domestic investment situation.

It needs to be further pointed out that information for the period under review was not readily available for *non-NBR tax revenue* (Stamp Duty, Land Revenue, Taxes on Vehicles etc.) and *non-tax revenue* (Administrative Fees and Charges, Dividend and Profit, Interest etc.) receipts which together constitute about a quarter of the total target. Informal discussions suggest that collections on account of non-NBR tax revenue and non-tax revenue are remaining behind their respective targets. It is held that performance in the two areas will, at the margin, define the success of aggregate revenue collection at the end of the fiscal year.

**TABLE 2**  
**NON-NBR REVENUE**

	FY01	FY02	FY03 (p)
Share of Non-NBR in Total Revenue	4.9	4.3	5.3
Growth of non-NBR Total Revenue	8.6	0.8	45.8

p: projected

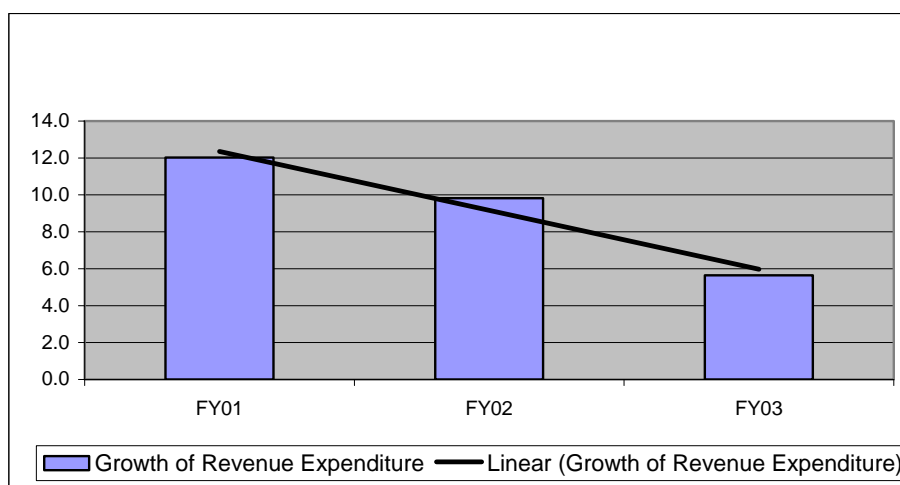
**TABLE 3**  
**NON-TAX REVENUE**

	FY01	FY02	FY03 (p)
Share of Non-Tax Revenue in Total Revenue	19.4	20.7	22.9
Growth of Non-Tax Revenue	10.2	22.6	32.1

p: projected

**Public Expenditure.** Public expenditure happens to be one of the major areas of government finance in Bangladesh for which real time data is almost totally absent. Revenue expenditure data becomes provisionally available only at the end of the fiscal year along with the budget documents. Information on implementation of the *Annual Development Programme (ADP)* is actually available with three to four months time lag, only when the *Executive Committee of the National Economic Council (ECNEC)* endorses the report of the *Implementation, Monitoring and Evaluation Division (IMED)*.

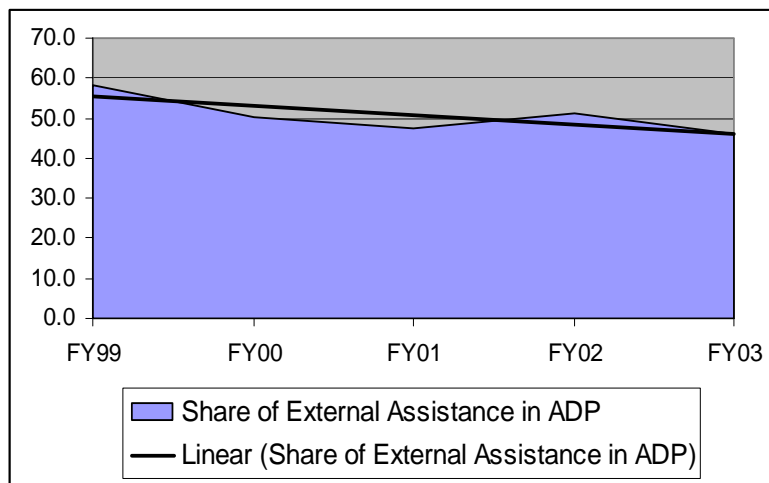
**FIGURE 2**  
**GROWTH OF REVENUE EXPENDITURE**



Thus, in the context of the absence of any up-to-date information, one may recall that the budget for FY03 provides for a conservative revenue expenditure growth of 5.64 percent supplemented by an ambitious target of ADP expansion in the order of 23.3 per cent. The programmed ADP constitutes about 43 per cent of the total public expenditure outlay for FY03.

The total public expenditure in Bangladesh as a share of GDP is still low in comparison to other low-income countries – programmed to be approximately 15.0 per cent in FY03. Thus, it is not the overall size of the public expenditure, but its composition and quality which remain a matter of greater concern. *First*, the ADP is routinely under-achieved. The government slashed down the ADP for FY02 by Tk. 30 billion, and yet could not fully implement the scaled down figure. Thus, a development expenditure target of Tk. 192 billion for FY03 was a daunting figure to chase. The mid-term review of the budget revised the original ADP target downward (in two phases) to Tk 171 million. *Second*, whatever may be the size of the ADP, it is the prioritisation and selection of the included projects as well as the quality of their envisaged expenditure lines which have always remained suspect. *Third*, in the backdrop of weak implementation of the ADP whilst the revenue expenditures have systematically crossed the budget limit, the composition of public expenditures is assuming an unhealthy structural rigidity. The revenue expenditure-basket is assuming an immutable character where three-quarter of the revenue budget remains committed to salaries and allowances, subsidies and transfers, and interest payments.

**FIGURE 3**  
**SHARE OF EXTERNAL ASSISTANCE IN ADP**



In FY03 a total of 1289 projects are included in ADP of which 188 are new. In July-January FY03, ADP has been implemented, in terms of spending the allocated money, to the tune of 38.6 per cent of the revised target.

**TABLE 4**  
**IMPLEMENTATION OF ADP**

(Billion Taka)

	Original target	Revised target	Implementation	Implementation as per cent of original target	Implementation as per cent of revised target
FY01	175	182	161.51	92.3	88.7
FY02	190	160	140.80	74.1	88.0
FY03	192	171	65.98 <sup>a</sup>	34.4 <sup>a</sup>	38.6 <sup>a</sup>

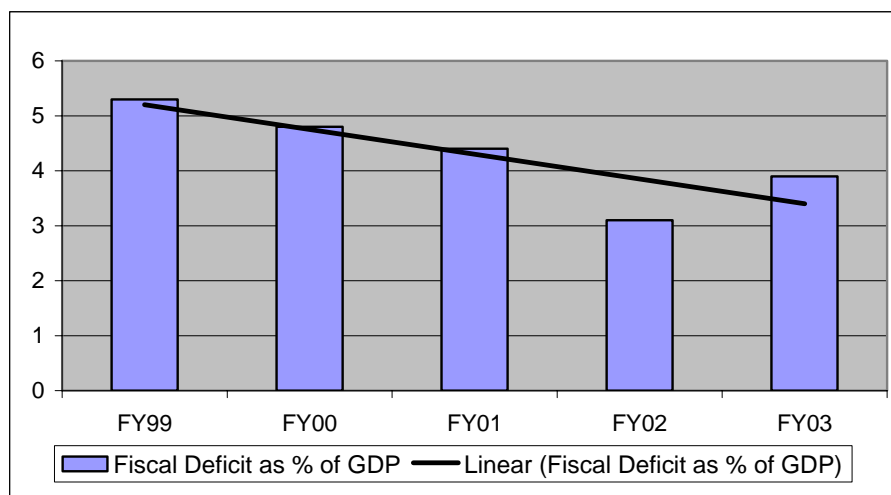
<sup>a</sup>July-January

Furthermore, indirect evidence, such as the trend in government borrowing (as discussed later) suggests that the government has been following a tight expenditure policy during the first eight months of FY03. In spite of the comfortable revenue collection situation, it is quite prudent on the part of the government to pursue such a conservative approach to budgetary management, given the softness in the foreign exchange reserve. In case of any exigency, this will also allow the government to cutback on expenditures (possibly ADP) to maintain the fiscal balance. However, this implies that a substantial part of the programmed expenditure will be back-loaded, taking away the smoothness in the expenditure trend.

Hopefully, necessary inputs from the *Public Expenditure Commission* (PEC) will be forthcoming in time to bring about the necessary adjustments in the revision of the governments' outlay for the rest of the current fiscal year. Currently, the government is considering the recommendations of the interim report of the PEC.

***Fiscal Deficit.*** The crawling increase of the overall budget deficit as a share of GDP was harnessed in FY02 by bringing it down to around 4.4 per cent from about 7.0 per cent in FY01. This was largely done by slashing down public expenditure.

**FIGURE 4**  
**FISCAL DEFICIT AS % OF GDP**



The budget for FY03 plans to bring down the share further to less than 4 per cent of which about 48 per cent will be financed from domestic sources and the rest through foreign financing. As we shall see later, the government has been able to avoid, to date, borrowing from the banking sector to finance its fiscal deficit. It will be, however, very important to observe to what extent the government will be successful in drawing down on its foreign aid pipeline to underwrite the deficit.

As of date, it seems the fiscal deficit target for FY03 has high possibility of being achieved – although possibly through trimming of development expenditures.

The foregoing review of the trends in the fiscal sector reveals that the process of consolidation, which set in FY02, has progressed further during the first nine months of the FY03. One may, however, raise the question whether such a tight public (development) expenditure policy is going to encourage any depressive effect on the investment situation. It is by now largely accepted that quality investment from the government source “crowds in”, rather than “crowds out” private investment in developing economies.

Scrutiny of the trends in the monetary sector presented in the following section would give us some clues about the obtaining situation in this regard.

### III. DEVELOPMENTS IN THE MONETARY SECTOR

**Domestic Credit Expansion.** Following expansion of domestic credit at the high rate of more than 17.7 per cent in FY01, domestic credit growth was brought down to below 13 per cent in FY02 as part of the overall strategy of fiscal consolidation. The most disturbing feature of the credit growth in FY01 had been greater increase in borrowings by the government and quasi-government sector in comparison to the private sector. In contrast, both the aggregate and inter-sectoral balance of domestic credit expansion was largely restored in FY02.

**TABLE 5**  
**DOMESTIC CREDIT EXPANSION**

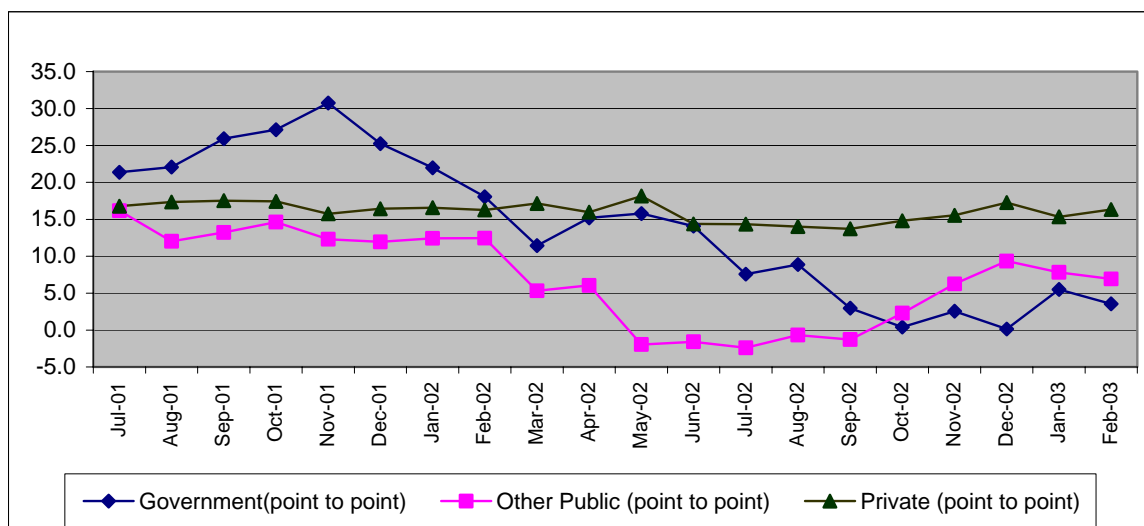
(Billion Taka)

	Government		Other Public		Private Sector		Total		Share of Private Sector in Total Credit
	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	
FY01	176.8	19.7	73.6	19.2	590.7	16.9	841.1	17.7	70.2
FY02	201.6	14.1	72.4	-1.6	675.7	14.4	949.8	12.9	71.1
FY03 (Feb)	203.5	3.5 <sup>a</sup>	77.3	6.9 <sup>a</sup>	745.5	16.3 <sup>a</sup>	1026.3	12.8 <sup>a</sup>	72.6

<sup>a</sup> Point to Point

Figures for July-February FY03 reveal that the domestic credit flow has further slowed down recording an aggregate growth of 12.8 per cent, which happens to be the lowest since FY94. Imposition of “hard budget constraint” on state-owned enterprises has resulted in a growth of 6.9 per cent for “other public bodies”, whereas credit growth was only 3.5 per cent in the government sector. In contrast, credit growth in the private sector has been about 16.3 per cent in FY03 (July-February).

**FIGURE 5**  
**GROWTH OF DOMESTIC CREDIT**



The low offtake of credit by the government during July-February FY03 is indicative of the low level of government expenditure in this period. However, a close look at the monthly data suggests that the secular slowdown in the rate of credit growth in the private sector since May 2002 was reversed in September 2003, although the flow started to show fluctuating trend in January-February 2003. Our subsequent analysis of the latest available figures on term loan disbursement will show that, this is a reflection of a slowdown in private sector investment.

**Government Borrowing and Public Debt.** High levels of government borrowing from the Bangladesh Bank as well as from the scheduled bank dominated the macro-economic concerns since FY00. Total domestic outstanding debt as a share of GDP secularly rose from 13.0 per cent in FY00 to 16.6 per cent in FY02. During this period one observes a change in the fiscal stance of the government as it moved away, partly, from borrowing from the banking system to raising of funds through sale of savings certificates to the public and treasury bonds to non-bank financial institutions. The latest figures (as of February 28, 2003) show that there had been a net flow from the banking system (including both Bangladesh Bank and scheduled banks) to the government to the tune of Taka 1918 million, though net borrowing from Bangladesh Bank experienced a negative flow of Tk 2.6 billion.

**TABLE 6**  
**GOVERNMENT BORROWING (NET) FROM THE BANKING SECTOR**

(Million Taka)

	Bangladesh Bank	Growth	Scheduled Bank	Growth	Total	Growth
FY01	20093	15.6	8951	(-)49.9	29044	(-)17.6
FY02	18827	(-)6.3	5576	(-)37.7	24403	(-)16.0
FY03 (Feb28,03)	(-)26132		28050		1918	

Notwithstanding such positive trends in government borrowing from the banking sector, total domestic outstanding debt has increased, as of December 2002, by about Tk. 43 billion on a point to point basis. This has happened due to incremental borrowing by the government through sale of National Savings Directorates (NSD) Certificates.

**TABLE 7**  
**SALE AND REPAYMENT OF NSD CERTIFICATE**

(Billion Taka)

Year	Sale	Repayment (Principal)	Net Sale	Total outstanding at the end of the year	Growth of Net Sale	Growth of total outstanding
FY01	68.713	26.341	42.373	205.402	30.7	26.0
FY02	87.169	40.502	46.667	252.069	10.1	22.7
FY03 (July-Feb)	61.829	33.189	28.640	280.710	-9.4 <sup>a</sup>	18.4 <sup>a</sup>

<sup>a</sup> Point to Point

Outstanding liabilities of government through sale of NSD Certificates, at end February 2003, stood at about Tk. 281 billion, recording an increase of Tk. 43.7 billion over the same month of the preceding year. This implies that the reduction of the rate of interest of the NSD Certificates in June 2002 had a transitory effect on their sale, which has started to pick up since August 2002. Such a trend, once again, is expressive of the limited viable investment opportunities in the Bangladesh economy. This also implies that the government's desire to push the small savers towards the capital market through decreasing the rate of assured return on public savings instruments has not as yet yielded its results.

Since there is no effective ceiling on the sale of NSD Certificates, the government is ending up acquiring debt, even when it does not need it. Consequently, the government is using high cost borrowing to underwrite its domestic financing needs. Some would, however, maintain

that this is better than mopping up liquidity in the banking sector by the government to the detriment of private sector investment.

***Agricultural Credit.*** The agricultural credit delivery system, since the post-1998 flood programmes, had been low on disbursement and high on recovery. This resulted in net outflow of resources from the rural areas through the institutional credit system.

During the period of July-February FY03, against an approximate 3 per cent growth in agricultural credit disbursement, recovery grew by almost 12 per cent. This implies that, an amount of Tk. 2.5 billion was withdrawn from the rural economy. On the other hand, the rate of default with respect to agricultural loans reached more than 58 per cent at the end of February FY03.

**TABLE 8**  
**AGRICULTURAL CREDIT EXPANSION**

(Billion Taka)

Year	Disbursement	Recovery	Net Flow
FY01	30.2	28.8	1.4
FY02	29.5	32.5	-3.0
FY03 (July-Feb)	18.7	21.2	-2.5

***Industrial Term Loan.*** Curiously, in contrast to the agricultural credit, industrial term loan disbursement had been usually positive in net terms. For instance, in FY02, against a disbursement of Tk. 35.1 billion, recovery was Tk. 32.1 billion. However, this trend was reversed during the first two quarter of FY03 with a net outflow of Tk 1.32 billion.

**TABLE 9**  
**INDUSTRIAL TERM LOAN**

(Billion Taka)

Year	Disbursement	Recovery	Net Flow
FY01	30.6	27.9	2.7
FY02	35.1	32.1	3.0
FY03 (July-Dec)	17.1	18.4	-1.3

In comparison to a 43 per cent increase during July-December FY02, term loan disbursement increased by only 1.6 per cent in the first two quarters of FY03. The recovery has also slowed down in July-December FY03 (to 14.5%), although at a lesser degree (from 41.8%). Thus,

one observes two emerging trends in industrial credit at the beginning of FY03 – first, the inter-temporal growth in disbursement rate has increased marginally; and, second, the reduced volume of disbursement is lower than the amount recovered during this period.

One could have drawn solace from the obtaining situation attributing it to higher collection of outstanding loans, if only the flow of fresh industrial loan had not fallen so drastically. However, such a decline can be largely explained by the deepening of stagnation in the manufacturing sector. The trend in credit expansion in the private sector, mentioned earlier, corroborates the foregoing observation. Our subsequent analysis of recent trends in imports will also validate such a claim.

In the meantime, overdue as a percentage of the outstanding industrial term loans have decreased from about 36.6 per cent (July-December FY02) to 33.4 per cent (July-December FY03). One waits to see to what extent the recommendations of the *Committee set up to deal with defaulted loans* will be able to contribute to removing this structural impediment from the country's banking sector.

***Inflation.*** The recent trend of creeping growth in the inflation rate comes as a surprise in the backdrop of the contractionary monetary policy pursued by the government in the past months.

The general inflation rate based on *Consumer Price Index* (CPI), on point to point basis, increased from less than 3.0 per cent in June, 2002 to about 5.9 per cent in February 2003. However, two disturbing features of the recent rise in the price level may be noted. First, the inflation rate during July-February FY03 period had been higher in the rural area in comparison to its urban counterpart. Second, curiously, increase in food price during the abovementioned period had been again higher in the rural area along with the non-food price.

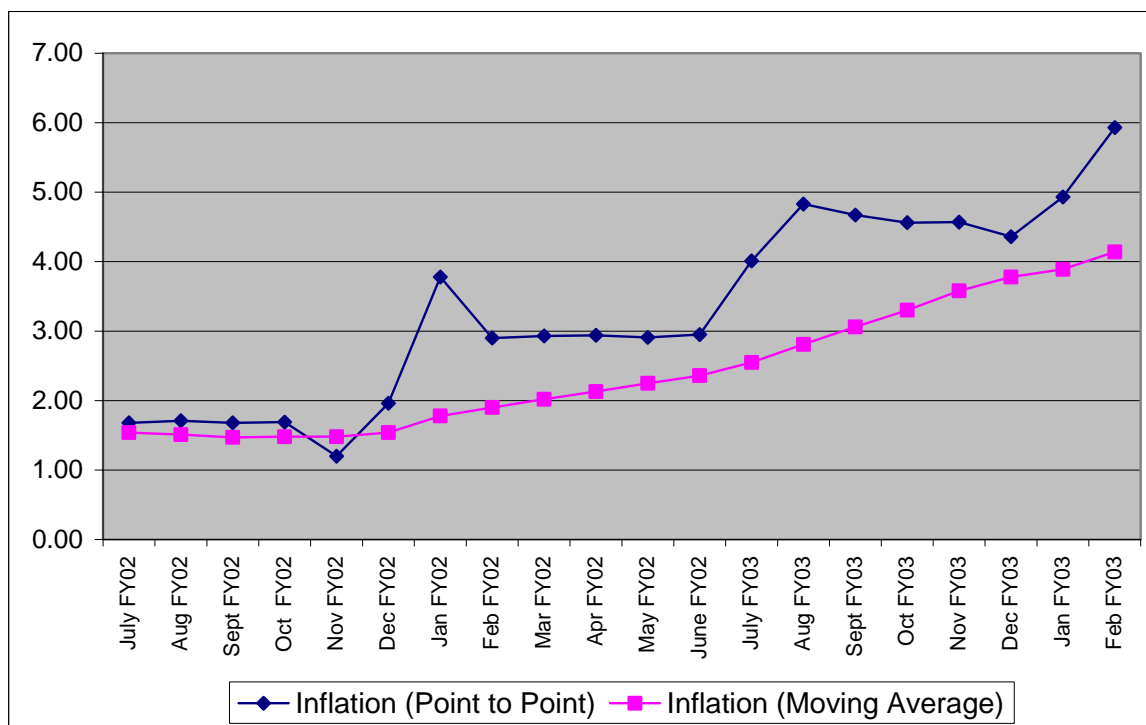
**TABLE 10**  
**INFLATION RATE**

	National		Rural		Urban	
	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)
FY01	1.58	1.66	1.53	1.49	1.75	2.16
FY02	2.36	2.95	2.23	2.88	2.72	3.18
FY03(Feb)	4.14	5.93	4.21	6.04	3.92	5.62

(%)

The trend in inflation rate – expressed through a moving average of 12 months observations – demonstrates an increasing trend. The inflation rate (moving average) has more than doubled from about 1.6 per cent in July 2001 to 4.1 per cent in February 2003 – the highest in the last 32 months, almost three times in just 20 months.

**FIGURE 6**  
**INFLATION RATE**



Of course, there is no reason yet for panic because of the current level of inflation. Indeed some would say that a “little inflation” is good for stimulating investment. However, there is

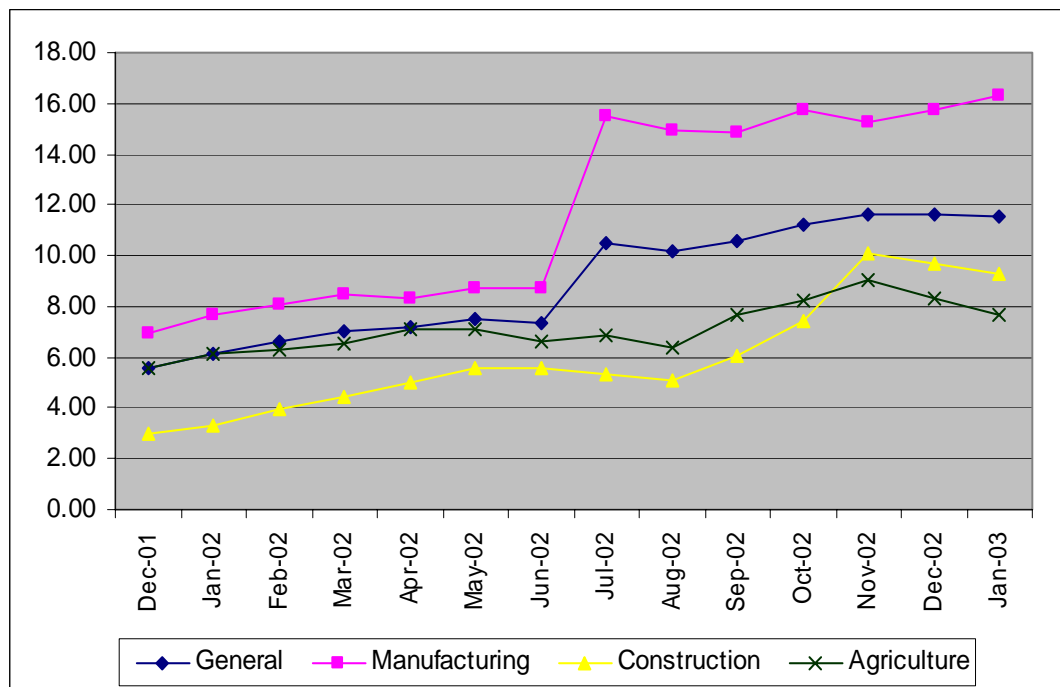
an urgent need to look into the factors contributing to such growth in CPI and its implications for the manufacturing sector.

However, the recent moderate rise in price level is largely a “cost push”, rather than a “demand pull” phenomenon. Increase in price of fuel, public utility rates and exchange rate adjustment may have been responsible for this. Temporary disruption in the domestic supply chain due to limited floods may have contributed to it as well.

In sum, it may be emphasised that in the backdrop of an overall conservative monetary policy, one observes low off take of private sector credit, particularly industrial term loans. Whilst inflationary pressure remains moderate, one should not end up with the worst of the two worlds epitomised by “stagflation” – stagnation coupled with inflation.

**Wage Inflation.** Such apprehensions are strengthened by the recent trends in wage rate index (See Figure 7). The point-to-point increase in general wage index in January 2003 was as high and 11.6%, while the increase in case of manufacturing sector was 16.3%. Even if we account for the increase in cost of living, the real increase appears to be quite high. One wonders whether this an indication that our inflation figures are underestimated.

**FIGURE 7  
WAGE INFLATION BY SECTORS**



#### IV. PERFORMANCE OF THE REAL ECONOMY

**Foodgrain Production.** Since the spectacular post-flood growth to the tune of 17 per cent in FY00, the foodgrain production growth rate came down in the subsequent years. As per final estimate of the Bangladesh Bureau of Statistics (BBS), actual food grain production for FY02 was 25.92 million metric tons (Aus - 1.81 million metric tons, Aman - 10.73 million metric tons, Boro - 11.77 million metric tons, and wheat - 1.61 million metric tons) which was 7.75 per cent lower than the operational target of 27.92 million tons. More importantly, the total foodgrain production in FY02 was 3.14 per cent lower than that of FY01, while the rice production was 3.11 per cent less.

**TABLE 11  
FOODGRAIN PRODUCTION**

Year	Rice				Annual Growth of Rice Production (%)	Wheat	Total Foodgrain	Annual Growth of Foodgrain Production (%)
	Aus	Aman	Boro	Total				
FY01	1.92	11.25	11.92	25.09	8.80	1.67	26.76	7.47
FY02	1.81	10.73	11.77	24.31	-3.11	1.61	25.92	-3.14
FY03 (Target figures)	1.84	11.46	13.03	26.33	8.31	1.75	28.08	8.33

In this backdrop, foodgrain production target for FY03 has been set at 28.08 million metric tons comprising 1.84 million tons of Aus rice, 11.46 million tons of Aman rice, 13.03 million tons of Boro rice and 1.75 million ton of wheat. Foodgrain production target for FY03 is marginally higher (0.57 per cent) than the preceding year's target, and 8.36 percent above the actual food grain production (25.92 million ton) in FY02.

The recently harvested Aus yielded a production of 1.94 million metric ton which is about 7.2 per cent more than that of the last year and 5.4 per cent above the relevant target. However, it is the production of Aman and Boro which defines the food situation of the country as they accounts for more than 93 per cent of total annual rice production.

The production target for Aman rice in FY03 has been fixed at 6.8 per cent higher than that of actual production in the preceding year. Early forecast says that Aman production had been good, but whether it has achieved the target is yet to be ascertained.

Cultivation of Boro was delayed in some areas due to cold and Boro seedlings faced cold injury in the seedbed. There was also serious crisis of HYV Boro seed in many areas of the country. Furthermore, government has increased the price of diesel from Tk17 to Tk 20 in January, 2003.

In these circumstances, question can be raised on whether the target is attainable or not.

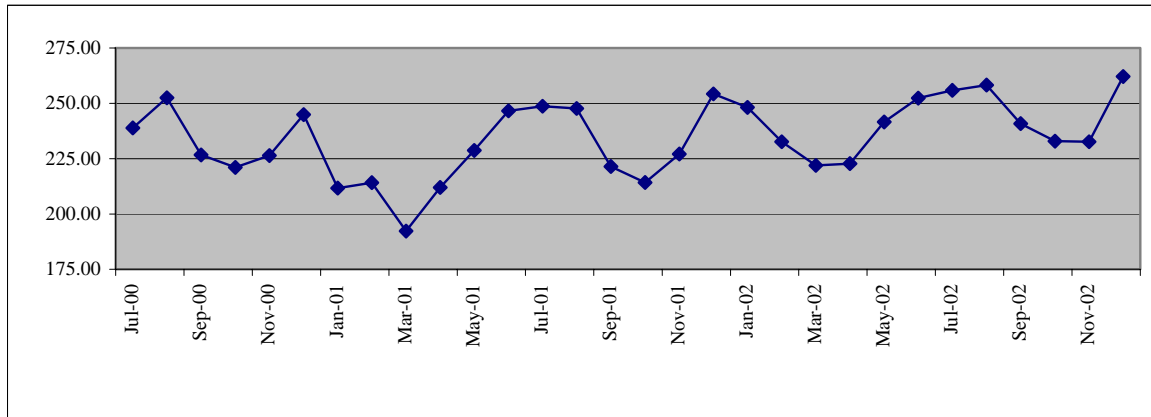
It may be pointed out that foodgrain import has increased significantly during the recent months. In FY03 (July-January), import of foodgrains amounted to 1.25 million metric ton, the matching figure for FY02 was 0.86 million metric ton, recording about 45.3 per cent increase. Information on opening of new letters of credit (L/C) indicates that import of foodgrains is going to increase further in the coming months. During the period July-February FY03, value of new L/Cs opened for importing foodgrains amounted to about \$335.2 million, recording a 185 per cent growth over the comparable figure for FY02.

**Manufacturing Production.** Since the floods of 1998, the manufacturing sector has slowly recovered recording 4.8 per cent, 6.3 per cent and 5.0 per cent growth in FY00, FY01 and FY02 respectively. In all these years, the growth of the large and medium scale industries was relatively subdued in comparison to the small and cottage sector.

The manufacturing sector during FY02 was greatly affected by the severe deceleration of the export-oriented apparels sector. The export sector marginally recovered in December 2001, with the ending of the RMG quota year; but the flicker did not translate into a trend. The *Quantum Index of Production (QIP)* of the medium and large scale units for FY02 was 3.35 per cent more than that of the previous year.

The clear winners of FY02, in terms of physical production growth, included *cement* (29 per cent), *pharmaceuticals* (16 per cent), *cotton fabric* (11 per cent), *jute sacking* (10 per cent). In contrast, *fertilizer* (-16 per cent), *jute hessian* (-12 per cent) and *paper* (-6.5 per cent) pulled the manufacturing sector down in FY02.

**FIGURE 8**  
**QUANTUM INDEX OF PRODUCTION (QIP) OF LARGE AND MEDIUM INDUSTRIES**  
**(1988/89=100)**



The QIP during July-December FY03 grew by 4.9 per cent over the matching period of the previous year. Although the QIP of December 2002 is 12.6 per cent higher than that of the preceding month, it is only 3.1 per cent higher on point-to-point basis.

Production data for the period July-December FY03 suggest that the frontrunners in terms of production growth had been, once again, *pharmaceuticals* (24.5 per cent), *petroleum products* (8.1 per cent), *cotton fabric* (5.5 per cent) and *cement* (3.0 per cent). Fertiliser sector, with 26.0 per cent production growth, seems to have recovered. The *paper* industry continues to be in a state of doldrums as its production fell by another 16.9 per cent during July-December FY03. Curiously, in spite of the improved performance of the export sector during the first two quarter of FY03, RMG production decreased by 1.5 per cent. (As we shall see later, while knit RMG demonstrated growth, woven RMG suffered decline.)

**TABLE 12**  
**TREND IN PRODUCTION OF MAJOR INDUSTRIES**

Industry	Unit	Weight	July-Dec FY03	July-Dec FY02	% change Point to Point	% change x Weight
1. Jute Textile	mt	14.07	164665	171722	-4.11	-57.82
Hessian	mt		35756	36300	-1.50	-21.09
Sacking	mt		95290	99939	-4.65	-65.45
Carpet backing cloth	mt		18080	18375	-1.61	-22.59
Others	mt		15539	17108	-9.17	-129.04
2. Cotton Textiles		7.83				
Yarn	mt		29899	30021	-0.41	-3.18
Cloth	000' metre		8216	7789	5.48	42.92
3. Garments	million Tk.	9.13	88885	90269	-1.53	-14.00
4. Paper	mt	2.26	16480	19825	-16.87	-38.13
5. Fertilizer	mt	11.34	1120275	889054	26.01	294.93
6. M.S. Rod	mt	1.91	81577	83048	-1.77	-3.38
7. Cement	mt	1.17	804349	781159	2.97	3.47
8. Petroleum products	mt	0.66	743975	688175	8.11	5.35
9. Cigarettes	million sticks	2.10	10191	10221	-0.29	-0.62
10. Matches	000' box	0.35	6083	6012	1.18	0.41
11. Drugs & Pharmaceuticals	000" Tk.	7.01	9492920	7623643	24.52	171.88
12. Tea	mt	7.87	39704	41561	-4.47	-35.16
13. Salt	mt	0.30	19221	20085	-4.30	-1.29
14. Edible oil	mt	0.44	15545	15496	0.32	0.14
15. Soap & detergent	mt	1.74	23969	23871	0.41	0.71
Sum		68.18				185.89
Weighted Growth Rate						2.73

Slowdown offtake of term loan coupled with fall in import of capital goods (discussed subsequently) do not make one very optimistic about the prospect of manufacturing growth in the near future.

**Foreign Investment.** According to CPD's estimate, in FY02, Bangladesh received a net amount of \$114.8 million as foreign investment, of which about \$65 million came as foreign direct investment (FDI) in the domestic tariff area and another \$55.7 million in the EPZ. Reinforcing the earlier trend, portfolio investment recorded a net outflow of \$6 million.

**TABLE 13**  
**FOREIGN INVESTMENT**

(Mln. US\$)

Year	FDI			Portfolio Investment			Foreign Investment in EPZ (Net Inflow) <sup>a</sup>	Total Net Inflow of Foreign Investment
	Inflow	Outflow	Net Inflow	Inflow	Outflow	Net Inflow		
FY01	166.10	0.10	166.00	5.90	6.30	-0.40	48.41	214.01
FY02	65.24	0.56	64.68	0.50	6.09	-5.59	55.71	114.80
FY03 (July-Dec)	na	na	16.00	na	na	1.00	79.14 <sup>b</sup>	na

Notes: <sup>a</sup>Includes investments in joint-venture enterprises with local entrepreneurs.

<sup>b</sup>For July- February

Net flow of FDI experienced a fall of about 61 per cent in FY02. In contrast, foreign investment in the EPZ recorded a more than 15 per cent increase in FY02, continuing the recovery since the drop in FY00, consequent to the controversy surrounding the trade union rights issues in the country's EPZs.

Available figures indicate that a meagre \$16 million was received by Bangladesh as net FDI inflow during the months of July-December FY03, which is 55.6 per cent less than the comparable figure for FY02 (which itself was disappointingly low). However, incremental growth in foreign investment is marginally visible in the EPZs which have already surpassed the previous year's benchmark during the first eight months of FY03 recording about \$80 mln receipt. (This figure however includes local investment in the EPZs as well.)

Thus, in spite of all the pro-active policy procurements and expensive road-shows, foreign investment continues to shy away from Bangladesh. It is to be seen how much the recent reinvigorated efforts of the Board of Investment (BOI) yield result during the rest of the year.

**Foreign Aid.** Foreign aid commitment and disbursement in FY02 were \$879 million and \$1250 million respectively. The commitment was 57.2 per cent lower than the previous year, whereas the disbursement was 8.7 per cent less.

Higher level of disbursement, in comparison to commitment, may suggest that Bangladesh has been finally successful in drawing down from its burgeoning foreign aid pipeline – the opening balance for FY03 being \$5.7 billion. Regrettably, further queries show, that the

higher disbursement figure was, at the margin, underwritten by flow of costly suppliers credits.

**TABLE 14**  
**FOREIGN AID AND DEBT SERVICES**

(Million US\$)

Fiscal Year	Foreign Aid			Debt Services		Outstanding External Debt as on June	Total Foreign Currency Earnings	Outstanding External Debt as % of GDP	Debt Servicing as % of Foreign Currency Earnings
	Commitment	Disbursement	Pipeline	Principal	Interest				
FY01	2053	1369	5713	438	159	16239	9117	34.6	6.5
FY02	879	1250	5864	407 <sup>a</sup>	148 <sup>a</sup>	16648	8487 <sup>b</sup>	35.2	6.5

Notes: a. Excluding repurchase against drawing from the IMF

b. Provisional Figure

Total foreign aid commitment for FY03 (July-March) is \$616 million of which project aid accounts for 92.5 per cent. Conversely, total disbursement during July-February FY03 amounted to \$547 million with project aid constituting about 80 per cent. To date, in FY03, there had been only \$8 million commitment and \$24 million disbursement of food aid. It is quite apparent that the conservative approach demonstrated in FY02 by the development partners by way of holding back of fresh foreign aid commitments continued to remain largely valid during the first half of FY03. It is to be seen how the PRSP process plays out in Bangladesh and whether it leads to significant improvement in the foreign aid disbursement scenario.

The total outstanding external debt of Bangladesh as of June 2002 was \$16.65 billion (a little above 35 per cent of GDP), which was 2.5 per cent higher than the previous year. The repayment of external debt in FY02 amounted to \$555 million with 26.7 per cent of the amount accounting for debt servicing. The debt serving liability (DSL) for FY02 was 9.33 per cent of merchandise exports and 6.5 per cent of total foreign exchange earnings, i.e. including foreign remittances. The external debt management situation remains quite satisfactory due to low off-take of foreign coupled with growth in foreign exchange earning.

**Capital Market.** The recovery of the capital market remains painfully slow since the boom and bust episode of the 1996. During the period January-December, 2002, the weighted average share price index of the Dhaka Stock Exchange (DSE) increased by only 0.56 per cent. During this period, enlisted issues increased by 11 in number and market capitalisation increased by 11.75 per cent in Taka terms. In January-February 2003 there is no new enlisted

issues and market capitalization decreased by 3.4 per cent in February 2003 in comparison with December 2002.

The capital market in Bangladesh remains shallow, and is yet to emerge as a major source of equity financing in the industrialisation process. The discrete benefits offered in the budget for FY03 along with cuts in the interest rates of the NSD certificates have yet failed to bring back the small investors to the secondary market of shares and securities.

## **V. EXTERNAL SECTOR BEHAVIOUR**

**Imports.** The slowdown of imports in FY02 was due to a combination of factors which included regulatory measures taken by the government to release pressure on the depleting foreign exchange reserve and decline in import of raw materials for the RMG sector due to drastic fall of exports. Thus import payments recorded a negative growth of 8.9 per cent in the elapsed fiscal year (FY02).

Sluggishness in import trend seems to have continued during the first seven months of FY03. Import payments for July-January FY03 had been only 2.8 per cent higher in comparison to the depressed benchmark of the matching period in FY02. Data on settlement and opening of L/Cs for the period July-September FY03 indicated continuation of the depressing trend in imports. However, the recently released information on L/C operation during the period July-February FY03 has suggested some upward movement in import growth.

Analysis of information on L/C settlement for the period July-February FY03 reveals import growth of 12.8 per cent (in US Dollar term) over the matching period of FY02. However, this moderate growth in aggregate import has been achieved due to robust growth of consumer goods import (84.3 per cent) including high growth of foodgrain import (131.95 per cent). Conversely, imports of capital machinery and intermediate goods, as per the L/C settlement figures for July-February FY03, increased by 25.4 per cent and (-)8.8 per cent respectively. If one excludes foodgrain import, the increase in L/C settlement value comes down to 10.6 per cent.

Analysis of the figures relating to opening of new L/Cs (July-February FY03) suggests an increase by 18.6 per cent in comparison to the corresponding figure for FY02. It is to be

noted that this sign of import dynamism was largely underwritten by phenomenal growth of consumer goods (99.5 per cent) including a surge in foodgrains import (184.9 per cent). Some growth was also observed in cases of capital machinery (43.5 per cent), petroleum and petroleum products (30.4 per cent), machinery for miscellaneous industries (21.9 per cent) and industrial raw material (15.0 per cent), while new L/C opening for intermediate goods fell by 5.2 per cent.

Once again, the growth in value of freshly opened L/C is diminished to only 14.4 per cent, once foodgrain imports are accounted for. Moreover, if exclude the bulk capital machinery import (US\$ 158 million) under supplier's credit for the SOE Barapukuria Coal Field, then the growth of capital machineries falls to only 3.4%.

More importantly, the apparent import growth is an illusion as import trend suffered a serious set back in FY02 following the terrorists attack in the USA on September 9, 2001. Thus, the point-to-point growth by 18.1 per cent in opening of new L/C in July-February FY03 is largely due to use of a depressed benchmark. Only real time actual data for subsequent months will show whether we are dealing with a real import recovery.

In the backdrop of substantial recovery of the foreign exchange reserve and partial recovery of the RMG exports, one is tempted to attribute the continued sluggishness in imports to stagnation in investment, which is corroborated by evidence on decline in term loan disbursement. Interestingly, the slowdown in import has come in FY02 and in early FY03 without any substantial devaluation of the national currency.

**Exports.** In FY02 exports declined by 7.4 per cent – the first ever such decline in the last two decades. The fall in export earnings was experienced across the board, by almost all export items.

It is heartening to observe that exports during July-January FY03 have recorded a comeback, registering 5.5 per cent growth. This recovery was spearheaded particularly by growth of *raw jute* (58.5 per cent), *chemical* (26.1 per cent), *jute goods* (20.2 per cent), *frozen food* (17.2 per cent) and *knitwear* (14.4 per cent). The export of *tea*, *leather products* and *woven RMG* declined by 14.6 per cent, 13.4 per cent and 2.6 per cent, respectively.

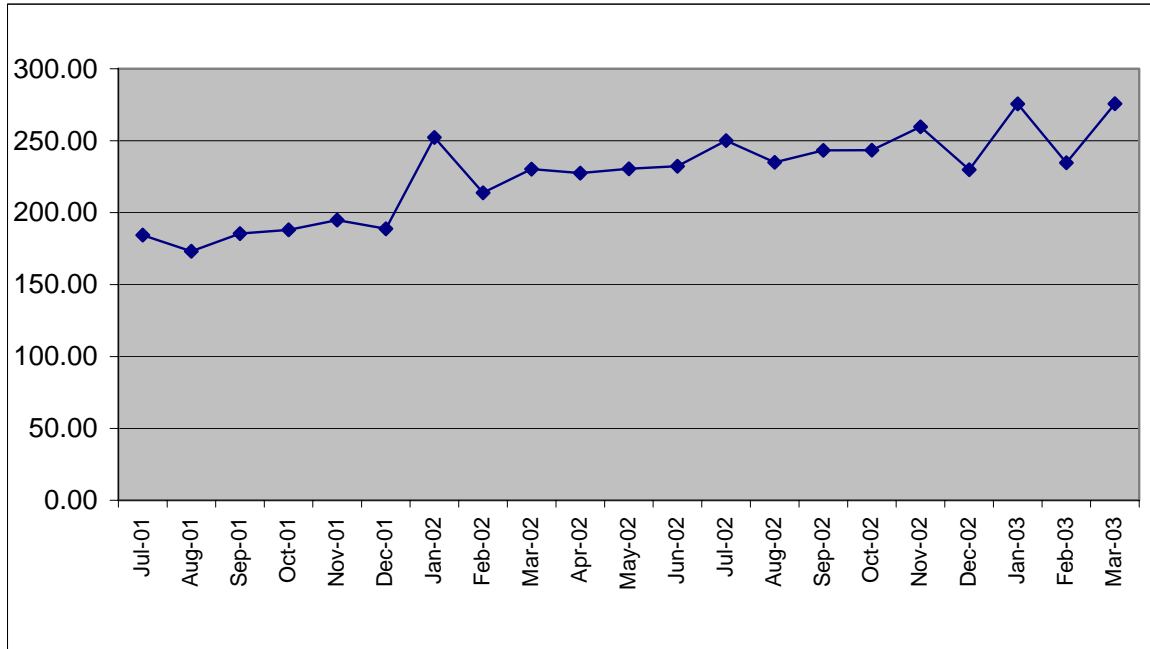
The net fall in receipts from woven RMG exports is the major current concern regarding Bangladesh's exports. It seems the advent of the third phase of quota integration (which started in January 1, 2002) under the WTO *Agreement on Textiles* is foreshadowing the impact of full phase-out of the *Multi-Fibre Arrangement* (MFA) for Bangladesh. It may be pointed out that under the third phase of ATC two items of Bangladesh's export internal have been made quota-free and Bangladesh has lost out significant market shares to China and India in both these commodities. Thus, there is a urgent to comprehensively review the textile and RMG related issues to undertake integrated and focussed policy measures.

It seems that the export performance of the primary goods sector had been better than its manufacturing counterpart in the recent months. The primary goods sector has experienced a growth of 22.2 percent in July-January FY03, while the growth in manufacturing sector was only 4.2 per cent. Moreover, primary sector has achieved 63.8 per cent of its overall target for FY03, whereas manufacturing has secured 54.6 per cent of target.

However, it is to be noted that the recent recovery of the export sectors is driven by increase in volume (about 14.8 per cent) and underwritten by fall in price index (more than 9.3 per cent) of the exportables. The international market is currently relatively comfortable for primary sector exports from Bangladesh as its price index has increased by 9.7 per cent in comparison to 11.2 per cent decline experienced by the manufacturing sector. In these circumstances, it will be a challenging task to attain significant export growth in the coming months with a continuing deceleration in the price level of manufacturers.

**Remittances.** Remittances, in the recent past, have emerged as the saving grace of Bangladesh economy. In FY02, the country received the record inflow of more than \$2.5 billion registering an annual growth of about 33 per cent. Fortuitously, the buoyant trend in remittance inflow has sustained during the period July-March FY03, when it recorded a growth of 24.1 per cent over the matching period of the previous year. In July-March FY03, the country received \$2.3 billion as foreign remittance which is almost 90 per cent of previous year's record remittance.

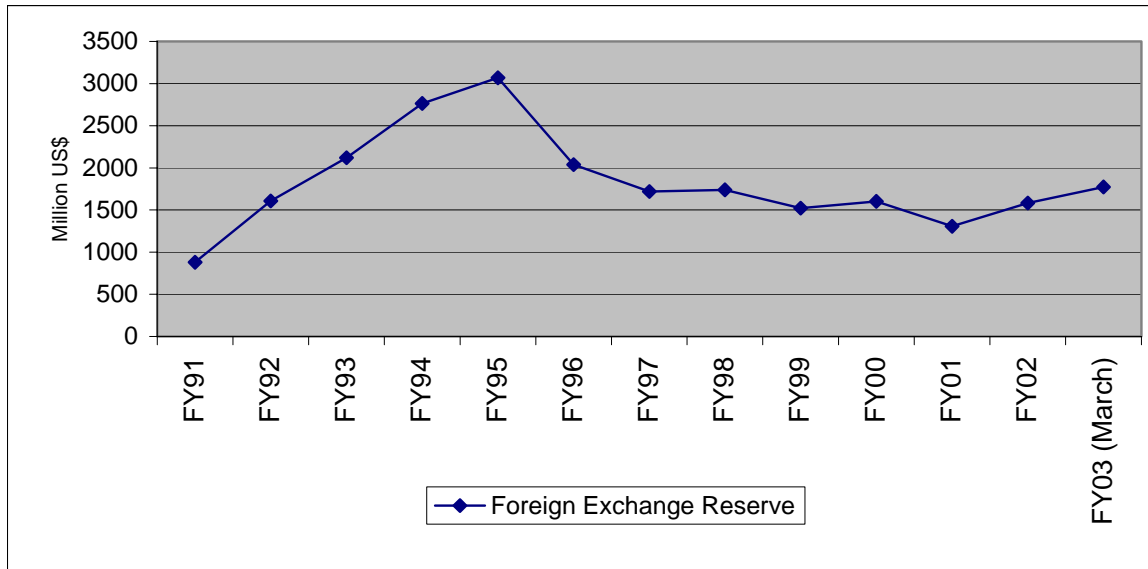
**FIGURE 9**  
**REMITTANCES**



Whilst some quarters attribute this recent surge in remittance inflow to the sequence of events which followed the 9/11 terrorist attacks on the USA, there are reasons to believe that this is largely due to the institutional and legislative measures taken in the country to redirect remittance flow to the official banking channel.

**Foreign Exchange Reserve.** The drawdown on the foreign exchange reserve which set in FY95 was reversed in FY02. The forex reserve bounced back to \$1.58 billion at the end of FY02 from \$1.11 billion in November 2001, registering a growth of 21.3 per cent.

**FIGURE 10**  
**FOREIGN EXCHANGE RESERVE**



The positive trend in the growth of foreign exchange reserve continued during July-March FY03 and reached \$1.77 billion at the end of the period. The point to point growth in March 2003 was as high as 32.6 per cent.

As it is evident from our foregoing analysis, further strengthening of the foreign exchange reserve has taken place in the early part of FY03 thanks to export resurgence, surge in workers' remittances and fall in imports. It needs to be appreciated that, given the obtaining situation, the country was able to avert serious balance of payment crisis, without any emergency foreign exchange support from the international financial institutions (IFIs).

***Balance of Payment.*** Given the movement of various external sector variables described earlier, Bangladesh's balance of payment situation, during July-December FY03 has also improved further. Trade balance recorded a smaller deficit of only \$624 million, and current account recorded a higher surplus (\$564 million) thanks mainly to workers' remittances. The overall balance of payment showed a surplus of \$177 million against the \$48 million in July-December FY02.

## VI. CONCLUDING OBSERVATIONS

A brief review of the early signals of the FY03 allows us to conclude that the three major macro-economic trends observed by the CPD at the close of FY02 have strengthened further. Concretely they are as follows.

*First, the fiscal balance has experienced further consolidation* during July-March FY03 due to collection of revenue (NBR component) in line with the target set by the budget. This process was complemented by high control exercised by the government on public expenditure, particularly with respect to ADP. This has contributed to restrained borrowing by the government, albeit temporarily, from the banking system. Although borrowing from the public through sale of NSD Certificates has increased in the said period. In this connection, ability to incrementally draw on foreign sources of financing for underwriting the fiscal deficit will provide necessary breathing space to the monetary policy.

*Second, the country's balance of payment has also improved further* due to continued high flow of foreign remittances, partial recovery in the export sector and depressed growth in import payments. Consequently, foreign exchange reserve, although still not above the safe limit, has also demonstrated incremental growth. However, there is no scope to ignore the vulnerability of the external balance given the fragility of export resurgence and the unpredictability which generally characterises the remittance flow. Low disbursement of foreign aid and deceleration of FDI have accentuated the vulnerability of the external balance.

*Third, signs of investment stagnation have become more manifest* during the first three quarters of FY03. Deepening of investment stagnation is borne out by the net fall in term industrial loan disbursement as well as stagnation in import of capital machinery by the private sector. Higher level of L/C opening in July-February FY03 (on point to point basis) does not foretell real growth in import as imports practically collapsed in the preceding year at this time subsequent to the terrorist attacks in the USA. High demand for NSD Certificates and increase in time deposits in the schedule banks, in spite of interest rate rationalisation,

suggest that investors' confidence level continues to be abysmally low. The moribund state of the stock market further reinforces this observation.

**Thus, strengthening of the macro-economic fundamentals and the fiscal stimuli provided in the budget for FY03 have had no discernible effect in dynamising the micro-economic behaviour in Bangladesh during the period July-March FY03.**

One of the new developments of the first two quarter of FY03 had been the creeping rise in the inflation rate with its rural bias. Whilst the current inflation rate continues to remain moderate, it might become an issue if the government changes its fiscal stance. The other disconcerting feature relates to perceptible increase in wage rate – possibly underwritten by rise in prices of wage goods, not by productivity growth.

***Need to Strengthen Domestic Demand.*** Under the circumstances, how will the government respond with policy and institutional measures in the coming months to achieve its GDP growth target set at 6 per cent for FY03? It is maintained that given the fragility of the export scenario as well as the obtaining depression in the manufacturing sector, the government may have to consider taking measures to prop up domestic demand. *However, attention to cultivate domestic demand does not have to come through the neglect of our export promotion drive.*

Three major vehicles of augmenting domestic demand would be fiscal stimuli, credit expansion and public expenditure. The government has already exercised, up to a point, the first option (fiscal stimuli) through the National Budget for FY03. Regarding the second, our review has shown that the trend in agricultural credit flow has remained quite lacklustre during the elapsed months. One possibly needs to recreate the successful experience of the rural credit delivery exercise undertaken following the devastating floods of 1998.

With respect to the use of public expenditure as a tool for rejuvenating domestic demand, it may be underscored that the government currently enjoys some elbow room for a moderate expansionary policy, thanks to the conservative approach pursued in the last year as well as during early part of FY03. However, if the economy responds to such trigger mechanisms, it will not only expose itself to the risk of losing its grip on the fiscal deficit situation, but also

*unleashing high pressure on the soft exchange reserves in response to an investment driven import resurgence-up.*

***PRSP Outcome and Alternative.*** Under the circumstances, one of the important factors defining the choice of the macro-economic policy stance during the second half of FY03 will be the outcome of the *Interim Poverty Reduction Strategy Paper (I-PRSP) preparation exercise.* If the government can negotiate some soft term foreign financing, at least by end FY03, then it will be in a relatively comfortable position regarding its development expenditures and the need for an accelerated private investment stimuli-up.

However, some of the pre-conditions set by the IFIs for accessing such funds are also fraught with high risk. The demand for a free float of the exchange rate is a case in point. *In this connection, the government will be well advised not to opt for a tight package of policy conditionalities; rather, it should retain its flexibility by committing itself to appropriate but autonomously derived reform measures.*

Alternatively, in anticipation of a possible absence of new and enhanced foreign aid flow, the government may like to urgently revisit its public expenditure package and priorities through the mid-term review of the ADP and redesign its approach to investment stimulation by assessing the impact of incentives offered in the National Budget for FY03. *The government may also like to consider more pro-active use of the levers available in the financial sector.*

**Whatever may be the case, the government will have to address the three standing objectives.**

- **Further fiscal consolidation,**
- **Strengthening the balance of payment, and**
- **Stimulating efficient investment.**

