

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

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## Second Interim Report (July 2003 – April 2004)

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*Independent Review of Bangladesh's Development (IRBD)*  
implemented by the *Centre for Policy Dialogue (CPD)*

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However, the author alone is responsible for the views expressed in this paper.

**Dialogue on**  
***Bangladesh Economy in FY04***  
**Date: Saturday, 27 December 2003**  
**Venue: CPD Dialogue Room**

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**(in alphabetical order)**

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**Follow-up Dialogue on  
Bangladesh Economy in FY04  
Date : Sunday, 30 May 2004  
Venue: CPD Dialogue Room**

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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 the fiscal deficit and balance of payments (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.<sup>1</sup>

In this context, CPD in its review of the National Budget for FY04 pointed out in June, 2003 that the performance of the economy in the current fiscal year would depend on the following four critical factors:<sup>2</sup>

- (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

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<sup>1</sup> See for details in *Bhattacharya, D. 2003. "State of Bangladesh Economy FY03" in the Independent Review of Bangladesh's Development 2003. Dhaka: CPD & UPL. [forthcoming]*

<sup>2</sup> See for details in *Bhattacharya, D. 2003. "State of Bangladesh Economy FY03 and Budget Responses FY04". Paper presented at the dialogue on June 19, 2003. Dhaka: CPD.*

- (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 review of the National Budget for FY04 in conclusion pointed out, "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".

The present government has since then 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 ten months of the current fiscal year (July 2003-April 2004), one can identify a number of issues which distinguish the period. These issues include energetic measures in the financial sector, 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 the price of essential consumer goods, seasonal employment and income deprivation (*Monga*) in the Northern districts and the emerging paralysis in the privatisation process. "High" rate of interest charged by the banks, slack implementation of the ADP, low utilisation of foreign aid and the state of trade union rights in the Export Processing Zones (EPZs) are some of the issues which dominated the public policy debate during FY04.

In this context, in order to generate a proper understanding of the state of economic affairs during the elapsing fiscal year, 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.

The information used in the analysis are primarily derived from official sources: Bangladesh Bureau of Statistics (BBS), Bangladesh Bank, National Board of Revenue (NBR), Export Promotion Bureau (EPB), Bangladesh Export Processing Zone Authority (BEPZA), Board of Investment (BOI) etc. These were supplemented by primary data generated by CPD through focussed field investigation (e.g. Rapid Appraisal of *Monga* and Perception Survey on Investment Situation).

## **2. Public Finance**

In the area of public finance it will be important to analyse the current trends in revenue generation, public expenditure including the Annual Development Programme (ADP) and financing of the budget deficit. Development expenditure of the government – both its size and quality- was the major issue on part of public finance which attracted maximum attention in FY04.

### ***2.1 Revenue Earning***

The National Board of Revenue (NBR) commands about three-fourths of total revenue generation in Bangladesh. The non-NBR taxes account for another 4 percent of the total revenue, while the remainder (20 percent) comes from non-tax revenues. In recent years, the NBR has been more or less fulfilling its budgetary targets, whereas the non-NBR revenue and non-tax collection have systematically lagged 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.<sup>3</sup>

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<sup>3</sup> In India and Pakistan, central government revenues as percentage of GDP (2002) are 20 percent and 17 percent respectively.

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-April of FY04 reveals that total revenue growth was 9.45 percent resulting in almost the full realisation (96.06 percent) of the “periodic target”. It needs to be pointed out in this context that there is a lack of transparency regarding monthly targets of revenue collection. Admittedly, the NBR’s targets are reported to be back-loaded resulting in a mismatch between the annual growth target and monthly targets. What will be most interesting to observe is whether the NBR succeeds in collecting about 27 percent of its annual yield in the remaining two months of the fiscal year.

A disaggregated analysis of the revenue collection by the NBR for the period July-April FY04 reveals that the growth of total *internal trade-related revenue* was higher (12.57 percent) than that of total *import-related revenue* (8.61 percent). In the backdrop of high import growth in the recent months (discussed later), non-fulfilment of target (around 9.0 percent shortfall) for collection of Customs Duty comes as a surprise. It is further contradictory that the Supplementary Duty (Import) collection recorded the highest growth (35.62 percent) which is tagged with core duty collection. A decomposition of imports and the tariff structure analysis may put some light on the matter and confusion may be removed. On the other hand, the revenue collection growth for VAT (Local) – has been 16.92 percent, and Supplementary Duty (Local) – 14.21 percent.

As a whole, collection by the NBR depicts a business as usual scenario, since a 10 percent annual growth usually comes from 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 (4.98 percent) in income tax collections, in spite of various potential payee identification initiatives suggests that efforts to increase the role of mean-tested direct taxes in total revenue is yet to show any sign of improvement. Rather, the incremental revenues are coming from indirect taxes which are borne by the consumers irrespective of their paying capacity. These emerging trends in revenue composition indicate that Bangladesh’s tax structure is increasingly becoming anti-equity.

### **Box 1: Failure to Raise Revenue Through Income Tax**

Bangladesh has one of the lowest Revenue-GDP ratios among the low income countries. In its effort to raise revenue earnings, the government in the recent past has sought to move away from its dependence on import-related taxes and increasingly expand the base of VAT (local) and income tax. It is well recognised that VAT, as an indirect tax, is borne by all consumers irrespective of their level of earnings; thus it tends to be anti-equity. A modern and progressive tax structure is supposed to increasingly base itself on direct taxes, particularly on income tax.

Records reveal that the annual targets of income tax have remained systematically underachieved. Consequently the contribution of income tax in the total in-take of the NBR has stagnated at 20 percent between FY93 and FY03. In fact, quite often the share has dipped to less than 15 percent (e.g. in FY98).

The *Taxpayer Identification Number* (TIN) system was launched on June 30, 1994. As of March 31, 2004, the TIN had a total cumulative number of 15,41,269 subscribers, registering a trend growth of 10.92 percent over almost a ten years period (FY94-FY04). About 95.5 percent of the subscribers belong to the individual person category, whereas the 2.6 percent are in the company category (the rest fall in the “others” category). However, it is suspected that a large portion of these subscribers are “dead”.

The total number tax returns submitted in FY03 was 9,37,483. This number has experienced a growth of about 9 percent between FY92 and FY04. About 97.3 percent of those who submitted tax returns in FY03 belonged to the individual person category. But it is important to note that about 40 percent of those who have a registered TIN did not submit a tax return. Incidentally, it seems that the composition of the tax returnees closely proximates the TIN subscribers’ break up.

The number of effective tax payees was 10,47,680 in FY03. This number was also achieved due to a trend growth of about 9 percent per annum since FY92. The split between the individual and company category once again by and large reflects the composition of the TIN subscribers. The number of effective tax payees is more than the number of tax returnees as the former group includes those from whom income tax was withheld at source of payment, but they preferred not to seek adjustment through filing of tax returns. In this sense, this number is also partly flawed by double counting on the one hand and evasion on the other.

It is really curious that the cumulative number of TIN issued is less than 3 percent of the labour force of the country, while the number of tax returnees is less than 2 percent of the same.

Whatsoever, the NBR faces a daunting challenge of collecting more than a quarter (27 percent) of its target within the last two months of FY04. More importantly, as the targets of the non-NBR and non-tax components of the revenue baskets remain regularly underachieved, the NBR has to collect much more than its allocated share to fulfil the aggregate target of revenue collection. Thus, the aggregate revenue target looks vulnerable as the fiscal year enters its last quarter.

Initial assessment suggests that the Revenue-GDP ratio will not be able to cross the 11 percent mark in FY04. Understandably, the evolving revenue mobilisation scenario will have concomitant implications for financing of the Annual Development Programme (ADP) and, consequently, financing the fiscal deficit - particularly in the face of low off-take of foreign aid (discussed later).

It has been reported that the government is likely to set a revenue collection target of Tk 32,200 crores for the National Board of Revenue (NBR) for the next fiscal year (FY05). This implies a target growth of 16 percent over the original target of the preceding year which is marginally less than the comparable growth rate for FY04..

## ***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 about 15.9 percent – without significantly changing the split between the 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.<sup>4</sup>

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<sup>4</sup> In India and Pakistan, central government expenditures as a share of GDP (2002) are 30 percent and 22 percent respectively.

### ***2.3 Revenue Expenditure***

The budgeted amount for revenue expenditure is about Tk. 29,000 crores. Regretably, real time data is usually not accessible for revenue expenditure till the end of the fiscal year. This should be seen as a commentary on the outcome of the public expenditure reforms which have been ongoing for over a decade with assistance from the Department for International Development (DFID) of the UK.

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 “interest payments” (more than 22 percent). For all practical purposes, allocation and spending practices 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 percent in FY98 to 13.5 percent in FY03. In FY04, the allocation for defence services amounts to 12.2 percent of the total revenue expenditure.

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, the 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. The recent decision of the government to transfer a number of projects to the revenue budget may also be underwritten by these unallocated resources.

## Box 2: Income Erosion of the Government Employees

Salary and allowances of the government employees account for about 28 percent of the Revenue Budget of the Government of Bangladesh (GOB). There exists a view that the public expenditure on this account needs to be controlled, particularly to avoid over-staffing. However, the existing government's pay scales does not allow for any cost of living adjustment (COLA) by way of taking note of the consumers' price index (CPI).

The last pay scale for the government employees was announced in 1997. Over the last seven years, due to an absence of any COLA, the government employees experienced an income erosion of about 39.4 percent. Thus, a person who joined the civil service as a first class Gazetted Officer in 1997 with a gross salary of Tk 6525 should have been receiving a gross salary of Tk 9100 in 2004 in order to protect the real value of his/her emolument in terms of 1997 prices. In other words, anybody joining the civil service in 2004 will be getting Tk 2573 less in current prices in comparison to his/her colleagues who started off in 1997.

CPD first raised this issue of income erosion of the government employees in May 2003. The government announced a 10 percent Dearness Allowance (DA) in the National Budget for FY04. Even when one accounts for this *ad hoc* benefit, the said income level remains 30.8 percent lower in real terms in 2004.

Once we take note of the Tk 185 annual increment allowed to government employees (as per the entry point scale of the officer category), it emerges that a government officer with seven years of experience is actually getting Tk. 850 less in current price or about 13 percent less in constant prices of 1997.

It may be mentioned that in US Dollar term, an entry point officer in Bangladesh gets about 45 percent less than what is paid to a comparable Indian Administrative Service (IAS) officer.

It goes without saying that one cannot expect the government officers to service the new demands of managing a market economy without being paid an adequate compensation which ensures standard living conditions as well as provides for higher incentives in comparison to other jobs including those in the private sector. In place of *ad hoc* and arbitrary benefits, pay adjustment needs to be implemented through the awards of a Permanent Pay Commission for government employees. In fact, the present government did promise setting up such a Commission in its Election Manifesto of 2001.

However, the issue of compensation adjustment of the government employees needs to be considered within the broader context of Public Administration Reform. This needs to address such issues as workforce rationalisation, skill development, predictability of career path.

Although the volume of domestic debt (currently 16 percent of the GDP) remains moderate, trends in revenue expenditure composition reveal a 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 composition of the recent aid inflow.

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

The latest available figures show that Tk 24000 crores has been spent as public expenditure (including ADP) during the first eight months (July-February) of the current fiscal year (FY04). Including ADP, the current expenditure till February is Tk 14307crores. During this period, 32 percent of the total revenue expenditure has been used up for Salaries and Allowances, whilst interest payments on foreign and domestic debts accounted for about 20 percent to 25 percent of the total revenue expenditure. Early figures show that the expenditures under the Block Allocation in FY04 would be lower than that of the last fiscal year.

#### ***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, last year the realised size of the ADP was 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 was originally fixed at Tk. 20,300 crores, i.e. an additional amount of Tk. 5,000 crores was to be spent during the current fiscal year over its preceding benchmark. In the wake of the National Budget FY04, in various discussions questions have been raised on the viability of this “ambitious target”. Others have

maintained that Bangladesh remains an underinvested economy and as such a large ADP target is worth chasing.

It needs to be pointed out that in the recent past the gross investment rate remained stable in spite of the deceleration of private investment thanks to moderate ADP growth. In FY03, private investment as a share of GDP actually declined from 16.78 percent to 16.49 percent, whereas the corresponding share of public investment increased from 6.37 percent to 6.72 percent. However, in a recent speech before the Economic Cadre officers the Finance Minister pointed to the proliferation of useless projects and the padding of many projects with wasteful expenditure.<sup>5</sup> It is thus not the overall size, but the quality of the projects included in the ADP which matters. 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 1163 projects will be included in the ADP, including 174 unapproved projects. Upto April, 2004, 75 projects have been approved. It may be recalled that Tk. 2346 crores (about 12 percent of ADP) was allocated under different ministries as “Block Allocation” in the budget for the current fiscal year. It was not immediately clear whether such flexibility in allocative decisions will breed indiscipline in course of time or whether 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 – revenue 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.

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<sup>5</sup> “There are many projects, which seek funds double or even triple the actual cost. During the revision of a project, the cost multiplies progressively.” – Finance and Planning Minister M. Saiful Rahman, *The Daily Star*, 21 December 2003.

Most recent information on ADP implementation suggests that a total amount of Tk. 9189 crores, i.e. about 45 percent of the total allocation was spent during the first three quarters (July–March) of FY04. Out of this, Tk 5852 crores is government expenditure and Tk 3337 crores is project aid expenditure which indicates that 50 percent and 39 percent of their respective allocations have been implemented.

This aggregate ratio of ADP implementation compares almost equally with the same for the last year (with respect to actual ADP size). During the July-March period, the rate of ADP implementation for FY01, FY02 and FY03 was 54 percent, 42 percent and 45 percent respectively. 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. It is now becoming increasingly obvious that one of the prime reasons for underachievement of the ADP relates to low utilisation of foreign project aid available in the pipeline.

During the period July 2003 – March 2004, Tk. 7128.57 crores, i.e. 60 percent of the total government allocation was released for government expenditure. Among the line ministries, the Ministry of Religious Affairs has utilised most of its allocation (70 percent) followed by the Ministry of Home Affairs (69 percent), Local Government Division (65 percent) and the Ministry of Health & Family Welfare (57 percent). On the other hand, the Ministry of Liberation War Affairs, the Ministry of Information and the Planning Division are among the low weaker ADP implementing ministries/divisions utilising 5 percent, 10 percent and 13 percent of their corresponding ADP allocation during the first three quarters of FY04.

In the ADP of FY04, a number of projects were identified as “poverty alleviation projects”, although there remains a doubt about the content of those projects and their relationship with poverty alleviation. Out of Tk. 1175 crore, earmarked for “poverty alleviation projects”, Tk. 600 crores (51 percent) has been utilized till March 2004. It was not immediately evident, how these projects fit into the sectoral strategy enunciated by

the I-PRSP. As the list of these projects was not available, it was not possible to take a close look at their profile.

In the past years, one of the primary criticisms of the ADP budget management was 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 further deteriorated, which might increase the incidence of wastage of resources. Thus, acceleration of the ADP implementation from the second rather than the fourth quarter of the fiscal year had been one of the major tasks for FY04 – particularly for crowding-in of private investment and improving quality of public utilities and social services. It seems that the ADP implementation process in FY04 has failed in this task. According to its original target, the government will have to spend about 55 percent of the total allocation within the last three months (April-June) of the current fiscal year.

In the first interim report of the IRBD 2004 (covering the period July-December 2003), it was mentioned, “from the experience of earlier periods, it is anticipated that the overall size of the ADP will be reduced by around Tk. 4000 crore”. Interestingly, it has been reported that the Planning Ministry has proposed to reduce the ADP by Tk. 1366 crores, refixing the revised size at Tk. 18,934 crores.<sup>6</sup> It is fully conceivable that the final figures of the ADP will be less than Tk. 17,000 crores resulting in a shortfall of more than Tk. 4000 crores from the original budget.

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<sup>6</sup> It has been reported that the National Economic Council (NEC) at its meeting held on May 19, 2004 has revised ADP at TK. 19000 crores which is about 6 percent less than the original target (TK. 20,300 crores). About 51 percent of the total revised amount is to be financed from internal resources, while the rest 49 percent is to be underwritten by foreign aid.

### **Box 3: Annual Development Programme Stagnates**

In the face of the increasing development needs of the country, Bangladesh remains an under-invested economy. Gross investment – GDP ratio has been stagnating around 23 percent for the last four/five years. In this context public investment is expected to play a greater role in creating the enabling physical and social infrastructure for promoting private investment.

However, the realised size of the Annual Development Programme (ADP) has stagnated in real term and has hovered between \$3000 million and \$2500 million during the last five/six years. The largest ever ADP was implemented in FY00 (\$3033.5 million), followed by FY01 (\$2850.0 million). From all indications it seems that FY04 will not be able to break these records.

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One can identify at least four factors which have contributed to the poor implementation of the ADP. First, introduction of the new public procurement policy limited the scope for indulging in corruption while implementing foreign aided projects created some disincentive to spend. Second, inability to undertake “prior actions” as agreed with the development partners under the project documents seriously constrained the country’s access to foreign aid in the pipeline. Third, over-centralisation of the project planning and approval process coupled with the confusion relating to the state of the sector-wide programme approach made the utilisation of resources more time consuming. Finally, the state of uncertainty pervading the public administration in the backdrop of growing political confrontation encouraged many of the key persons in various government

agencies to be indecisive or free sitters. It is also getting abundantly clear that without effective devolution of power and decentralisation of development administration through setting up of a strong upzilla system, Bangladesh will not be able to effectively handle a larger ADP.

#### **Box 4: Declining Public Expenditure in Agriculture**

Total public expenditure (revenue + development) for agriculture (including fisheries and livestock) has been declining both in absolute and relative terms. Total expenditure for agriculture (as per revised budget) was Tk 3053 crore (7.75% of total budget) in FY01 which has decreased to Tk 2596 crore (6.04% of total budget) in FY03. Budgeted allocation in FY2004 is Tk. 2838 crore (5.70% of total budget). In terms of development expenditure, amount was Tk. 2205 crore in FY01, Tk. 1629 crore in FY03 and Tk 1855 crore in FY2004. In agriculture, 46.1% of total allocation comes from project aid. Bangladesh must have to increase total public expenditure for agriculture. Though the total public expenditure has declined, subsidy for agriculture has increased. This year (FY04) budgetary allocation for agricultural subsidy is Tk 300 crore against Tk 100 crore as agricultural subsidy in FY02. In addition, there is allocation of Tk 50 crore in FY04 for development of agro-based industries. Subsidy is mostly used for financing the deficit of imported urea fertilizer. In Barind areas (Rajshahi, Chapainawabganj and adjacent districts), electricity for irrigation is provided at 20% lower tariff rate.

The government must increase total public expenditure for agriculture as well as subsidy for agriculture. Subsidy may be provided for following activities:

- Provision of quality rice seed can increase rice production by 2.2 million tons. For this, special projects for breeder's seed production and strengthening of infrastructure (modern processing and storage) and additional manpower for breeder seed production at BIRRI and BINA is needed to meet the growing demand of breeder's seed by NGOs and private companies who are producing seed for farmers. Subsidies for production of seeds of potato, oilseeds, vegetables, pulses and maize would also be helpful.
- Subsidies for diesel used for irrigation is required. However, considering multiple use of diesel government must ensure its proper use. It may be noted that 83% of the total irrigated area in Bangladesh is under diesel operated engines. Two districts (Munshiganj and Borguna) are irrigated only through diesel operated engines and in 18 other districts, more than 95% percent of the irrigated area is irrigated by diesel engines.
- Poultry farmers are facing problem of quality chicks, feed, vaccines and financing. Subsidy for "parent stock", poultry vaccines and feed production would be helpful for further growth in this sector. Budgetary allocation for monitoring these and timely actions are also needed for proper functioning of private sector in these areas. Number of veterinary doctors in poultry growing zones such as Daudkandi, Gazipur, Narsingdi has to be increased to ensure professional support.

Fish farmers are facing the problem of quality fingerlings, feed and professional advice of fisheries specialists. To overcome the problem of quality fingerlings, subsidies for development and maintenance of "broodstock" of *rohu*, *catla*, shrimp and tilapia is needed. Present staffing strength is inadequate to cater the professional advice need of fish farmers in intensive fish growing areas such as Mymensingh and Comilla. Number of fisheries extension service personnel in these areas need to be increased and special projects to ensure quality service delivery, cold storage facility to minimize risks of price fall is essential.

Notwithstanding the continuous failure to implement the full amount of the development budget, it seems that the government is planning to target an ambitious ADP to the extent of Tk 22800 crores for the next fiscal year (FY05). In the context of the growing demand for reforming the power sector, early projections show that in the upcoming ADP, the power sector is likely to receive the highest allocation of Tk. 3243.38 crore (14.74 percent of total development outlay). Education and Religion (14.28 percent) and Local Government (10.61 percent) would be the second and third largest recipients from the ADP, followed by Road Transport (10.33 percent and if Air, Rail and Water Transport are included with Road Transport, Transport sector will receive the second highest allocation by the amount of Tk. 3189.79 crores or 14.50 percent of the development outlay) and Health, Population and family Welfare (9.80 percent). Despite the government promises to allocate more resources to agriculture, this sector is likely to receive a development allocation of Tk. 880.73 crore (4.00 percent) which is around Tk. 50 crore less than that of the previous year.

### ***2.5 Budget Deficit and Financing***

The budget deficit has been brought down sequentially during the last three years (FY00-FY03). In FY03, according to the latest estimate, the net budget deficit accounted for 3.4 percent of the GDP of which foreign financing contributed 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 in the form of loans.

Figures for the period July 2003 – January 2004 indicate that the government has to mobilise about Tk. 4114.58 crores to finance the fiscal deficit which is about 11.37 percent lower than the comparable figure for the preceding year. Domestic resources accounted for about 99 percent of this amount – the exclusive source being net borrowing through non-bank instruments (Tk. 3331.62 crores). During this period the government

held a negative balance (– Tk. 28.70 crores) in its favour in case of borrowing from the banking sector.

The relatively low level of the fiscal deficit during the first seven months of the current fiscal year reinforces the revealed slow trend in ADP implementation. During this period the government has utilised less than US\$ 140 million worth of foreign resources to finance the budget deficit. It seems that in FY04, the government will end up with a lower budget deficit because of the below target level of ADP spending. Nonetheless, given the subdued disbursement rate of foreign aid the share of domestic sources in financing the deficit may end up above the target.

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 (IFIs) in recent months. It seems that these resources are currently underwriting the increasing gap in the trade balance.

It should 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 how far inefficient aid utilisation is being falsely interpreted as an improvement in the fiscal deficit situation.

### **3. Monetary Aggregates, Credit Expansion and Inflation**

In response to recessionary business conditions and the deceleration of private investment, the government was currently pursuing an accommodative monetary policy in the recent past 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 are 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 the 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 March 2004, overall domestic credit expansion rate (on point to point basis) was 9.51 percent. In March 2003, the comparable figure was 12.32 percent. Relatively moderate aggregate growth in the domestic credit flow during the first nine government months of the FY04 is due to the negative balance (-7.45 percent) in case of government borrowing and relatively low growth (3.95 percent) in case of “other public bodies”.

On a point to point basis, credit growth in the private sector, as of March 2004, was 14.66 percent. In comparison with the 15.14 percent growth in February 2003, the March 2004 figure shows a slower growth of credit to the private sector. However, this moderation positive in monetary expansion of public sector credit resulted in the growth of the private sector’s share in total domestic credit flow to 75.69 percent, which is the one of the highest shares recorded in recent years.

It seems that after an early pick-up till September 2003, some restraint was again 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 also well reflect the monthly trend projected under the Bangladesh Bank's monetary programme.

Total liquid assets of Scheduled Banks stood at Tk 26916.77 crores as on 26 February 2004, compared to Tk 26656.25 crores at the end of June, 2003 indicating an increase of only 1 percent. Excess liquidity of Scheduled Banks increased by Tk 2414.21 crores (more than 30 percent) during the same period and stood at Tk 10385.43 crores as on 26 February 2004.

#### **Box 5: Did Interest Rate Spread Decline?**

In the absence of real time data from the Bangladesh Bank on interest rate spreads, CPD collected data from seven local commercial banks (LCD) and two foreign commercial banks (FCB) to generate average weighted interest rates for both deposits and advances.

The sample data revealed that during 2003, the local private banks reduced their spread from 7.05 percent to 6.21 percent. In case of foreign banks, the spread increased to 7.68 percent from 7.40 percent.

The sample local private banks during 2003 decreased their lending rate by (-)12.6 percent (i.e. from 14.12 percent to 12.34 percent), while the deposit rate declined by (-)13.4 per cent. (i.e. from 7.07 percent to 6.12 percent). This implies that the lending rate has been reduced at the cost of the depositors, while the efficiency level remained more or less unchanged.

Thus, there is hardly an conclusive evidence to show that the recent initiative of the government to decrease interest rate have had any fundamental effect on the interest rate behaviour of the private banks – both local and foreign<sup>7</sup>.

However, it will be enlightening to take a closer look at the composition of this amount to assess the extent of effective liquidity. As mentioned in the First Interim IRBD, the excess liquidity of the scheduled banks, as of end November 2003, stood at Tk. 7204 crores in which Tk. 2118 crores (29.4 per cent) remains in the foreign currency clearing account which is not readily available for local lending. In addition, excess liquidity in the Islamic Banks was about Tk. 1,000 crores (13.9 per cent). If these two amounts are

<sup>7</sup> For more details on interest rates and Bangladesh's financial sector, please see Raihan, A. 2004. *Second Generation Financial Sector Reform: How Far We Are from A Sound Financial System?* in Independent Review of Bangladesh's Development 2003. Dhaka: Centre for Policy Dialogue. [forthcoming]

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.

Burdened with such excess liquidity, it is to be seen whether the commercial banks will be able to escape “moral hazard” and avoid financing bad projects. The Bangladesh Bank needs to make its prudential guidelines for corporate governance more effective in this respect.

Curiously, one finds that the banking system is flushed with excess liquidity on the lookout for viable business opportunities – a baseline estimate would put the figure at least 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? Our survey reveals that overseas investment by the entrepreneur of this investment-starved country is increasingly becoming a reality, while NRBs are not investing in Bangladesh as much as we want them to.

### ***3.2 Government Borrowing***

Following the reduction of the interest rates on the National Saving Deposit (NSD) certificates, the growth (on point-to-point basis) of their sales gradually declined from 15.08 percent in July 2003 to (-) 10.16 percent in March 2004. However, prior to the implementation of the much anticipated lower interest rate in 01 January 2004, very high rates in the sale of NSD certificates were observed during the previous two months. Monthly NSD sale during November and December 2003 recorded as high a growth as 46.62 percent and 70.43 percent (point-to-point basis) respectively. This has pushed the average NSD sale growth for July-March period of FY04 to 14.69 percent with a total amount purchased being more than Tk. 7458.50 crores. The total outstanding loan to the government on account of borrowing from the public at the end of March 2004 amounted to Tk. 32,805 crores (14.98 percent growth over the eight month period).

It is evident that the fall in yield rate has partly dampened the demand for NSD, although every month, to date, on average more than Tk. 800 crores worth of NSDs continue to be purchased by the public. However, as the monthly sale figures of NSD certificates are declining since January 2004 in the face of maturity of a larger amount of the certificates, the net sales figures per month have come down to less than one-quarter between July 2003 and February 2004. 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. But it needs to be pointed out that one of the major reasons which have depressed the demand for NSD certificates relate to discontinuation of the practice of accepting these certificates by the commercial banks as second collateral for the purpose of granting loans.

### ***3.3 Agricultural Credit***

Between July-February FY04, a total amount of Tk. 2053.23 crores were disbursed as agriculture credit, recording an increase in disbursement by 9.89 percent. Due to lower recovery (Tk. 1966.33 crores), the sector experienced a net gain of Tk. 121.1 crores during these eight months against a net outflow of Tk 255.62 crores from the rural economy during the matching period of FY03.

Available figure shows that the position of overdue agricultural loans as a percentage of total outstanding loans improved significantly, decreasing from 60.29 at the end of January, 2003 to 57.64 at the end of January, 2004. Collection of overdue loans should be seen as a healthy initiative, leading to better loan discipline. Although some improvement of the classification rate may have occurred due to writing off of the “bad loans”.

However, if the recovery rate increases in the backdrop of such a modest growth in fresh loans, the agricultural credit delivery system will remain as the main conduit of transfer of resources from the rural to the urban areas. Although, a refinance facility from the Bangladesh Bank is available to the scheduled banks 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.

Recently (on March 29, 2004), the government has decided to waive all interest and penal interest on agricultural loans upto Tk. 5000. This decision is supposed to help about 15 lakh marginal farmers and the government would have to reimburse an amount of about Tk. 500 crores to different public commercial and specialised banks to underwrite the losses in this connection. It was also decided earlier that the certificate cases against dues below Tk. 5.0 lakh would not be tried in the financial courts. These measures, if implemented effectively, are expected to directly benefit a significant section of the rural poor.

### ***3.4 Industrial Loans***

In the backdrop of the slowdown in growth of industrial term loans in the recent years (since FY01), the disbursement record for July-December 2003 is quite impressive – Tk. 3175.91 crores, i.e. almost 79 percent growth. The net flow to the sector is Tk. 1063.15 crores which compares favourably with the outflow of (-)Tk. 113.46 crores during the comparable period in FY03. The sharp growth in disbursement can be partially explained by the carry-over of sanctioned (but not disbursed) loans from FY03. But the incremental off-take of industrial loans may very well be due to an increase in investment demand.

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-December 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. It is now to be seen to what extent the declining trend of interest rate accelerates the investment flow in the coming months.

It needs to be recalled that the share of overdues as a share of outstanding industrial term loans declined from 32.76 percent in December 2002 to 27.69 percent in December 2003.

This decline took place largely due to write-off decisions by the commercial banks. The NCBs have written-off Tk. 1984 crores, which is 2.73 per cent of the NCBs classified loans. Five specialized bank have written off Tk 779 crores of bad loans, reducing their default loans by 8 percent. The private commercial banks and foreign banks have written-off Tk 1079 crores and Tk 125 crores respectively.

### Box 6: Effect of Declining Interest Rate

The government resorted to vigorous “moral suasion” in FY04 in order to bring down the lending rate of bank loans. CPD undertook a rapid perception survey regarding the realised benefits of the declining rate of interest (lending) in the banks in terms of production cost. This was implemented during April 22, 2004-May 17, 2004 among a group of more than 70 entrepreneurs with fixed assets ranging above Tk 10 crores.

Analysis of the responses revealed that 38 percent of the respondents acknowledged that during FY03 the reduction in the rate of interest (lending) has benefited their companies in terms of reduced production costs. This trend in responses sharply increase in FY04 (July 2003-March 2004) to 60.3 percent. This implies that in FY04 an overwhelming majority of the enterprises enjoyed the benefits of a fall in interest rates. However, it is also true, as suggested by the survey, that a large section of the entrepreneurs (about 40 percent) are yet to receive such benefits.

Effect of declining Interest rate	Yes		No	
	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04
	(In per cent)		(In per cent)	
Declining rate on interest (lending) in the banks benefit you in terms of production cost	38.00 (R-73)	60.30 (R-75)	62.00 (R- 71)	39.70 (R- 78)

Note: Figures in the parentheses indicates the number of respondent

As a whole, the reduction of classified loans has largely occurred as a result of window-dressing through rescheduling and write off, 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 (moving average, base year 1995/96) in February 2004 was 5.59 percent. On a point to point basis the rate was about 5.77 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.

After the steady rise in the consumer price level during October-November (Ramadan months) and December 2003, the inflation rate has shown some slowdown on a point-to-point basis. However, when estimated as a moving average, the inflation rate seems to have risen further, due to its momentum, to 5.59 percent from 5.36 between December 2003 and February 2004. In fact, even on a point-to-point basis, the food prices have continued to rise throughout January – February 2004.

#### Box 7: Effect of Rising Inflation

With view to asses the perception of the enterprises regarding the effect of the rising trend of inflation on production cost, a questionnaire based survey was carried out by CPD among a group of entrepreneurs with fixed assets ranging above Tk. 10 crores. The survey was implemented during April 22, 2004 – May 17, 2004 with more than 70 valid respondents.

Analysis of the responses revealed that almost half of the respondents (49.3 percent) felt that the rising trend of inflation affected their companies' production cost during FY03. This trend in responses further increased in FY04 (July 2003-March 2004), as 56 percent of respondents maintained that the present rate of inflation is affecting their production costs. This increasing trend between the two periods of time coincides with the matching rise in the inflation rate. The respondents who reported that they are immune from the impact of the price rise largely belonged to the export oriented clothing sector.

Effect of Rising Inflation	Yes		No	
	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04
	(In per cent)		(In per cent)	
Did rising trend of inflation affect your production cost during the following periods?	49.30 (R-73)	56.00 (R-75)	51.70 (R- 71)	44.00 (R- 78)

The inflation rate (moving average) for food prices has been higher (6.33 percent) than for non-food prices (4.53 percent). However, very surprisingly one finds that both the food and non-food price increase had been higher in the rural areas than in the urban

areas. The inflation rate (moving average) as of February 2004 for food and non-food prices in the rural areas has been 9.47 percent and 4.60 percent respectively, in comparison with the corresponding inflation rates of 6.52 percent and 4.37 percent 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 the rural areas also indicates the evolving structural shift of the rural economy through increasing monetization and growth of the non-farm sectors.

### **Box 8: Price Trend of Some Imported Commodities**

Facing the rising price of rice and wheat, the government reduced tariffs and duties on rice and wheat imports in FY03 and continued these reduced rates in FY04. Government policies of lower tariff for rice and wheat imports in FY03 enabled gradual convergence of wholesale price of wheat in Bangladesh (Dhaka) and India (Delhi). It may be noted that India is the largest exporter of rice and wheat to the Bangladesh market. Indian government policy of exporting subsidised rice and wheat and transport subsidy for export also contributed to this convergence. In October 2003, Indian government increased the administered price of rice and wheat. Since January 2004, the rice price in Bangladesh as well as in India has been showing an upward trend. Increase in the rice price in recent months is mainly due to the increase in the international price. In the case of the increase of wheat price, a sharp upward trend in Bangladesh was observed since October 2003. The wheat price in Bangladesh (Dhaka) was slightly higher than that of India (Delhi) up to January '04. After that, the wheat price is consistently going up in Bangladesh (data is available up to 19 May '04) but is declining in India (Delhi; data is available up to 14 April '04).

Bangladesh imports crude soyabean oil and the refined oil is marketed by the domestic companies. Price of soyabean oil is consistently increasing. The wholesale price of refined soyabean oil in Bangladesh increased from Tk 39.90 per litre in July 2003 to Tk 47.10 per litre in May 2004. An analysis of differences between the crude oil price of soyabean in the international market and refined oil price of soyabean in the domestic market indicates that the gap is increasing. In other words, the price of soyabean oil in Bangladesh has been increasing at a faster rate than in the international market.

Price of sugar has increased from Tk 27.50 per kilo in July '03 to Tk 31.50 in May '04. Comparison of the wholesale price of sugar in India (Delhi) and Bangladesh (Dhaka) indicates that wholesale price of sugar in Bangladesh (Tk 35.64 per kg or US\$0.61) during September '03 was much higher than that of India (Rs. 14.30 per kg or US\$ 0.31). After that the sugar price in Bangladesh remained higher but stable while sugar prices in India were gradually increasing. It may be noted that the per kg wholesale price of sugar in Dhaka in April '04 was Tk 28.32 (US\$0.48) while it was Rs. 15.10 (US\$0.33) in Delhi.

The price of construction materials, particularly iron rods was high. According to Daily Star (February 28, 2004), "MS (mild steel) rod price has shot up by 50 to 80 percent during the last one year. Price of each ton of 60 grade MS rod was Tk 21,500 while 40 grade MS rod price was Tk 23,500 in January 2003. Now (February '04), the prices are Tk 35,500 and Tk 42,000 respectively".

It needs to be seen how the food price index behaves once the *Boro* crop is harvested. But it is imperative that, the inflation rate is closely monitored in the coming months, particularly when the government is pursuing a moderately expansionary policy.

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-February FY04 this has remained about 6 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 wages (around 5.3 per cent) may be an expression of higher labour demand and growth in productivity. Thus, it needs further examination to explain the growth in real wages during a period in a country where one-third of its workforce unemployed or underemployed and it has experienced a large retrenchment of manufacturing labour (more than 51,000) through closure of some 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 appeared to be at variance with supply and demand trends for certain key items of consumption. This 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.

Whatsoever, there is little doubt that the recent inflationary trend observed in the Bangladesh economy is a 'cost-push' one. The major factors which have contributed to this trend include upward adjustment of utility tariffs, rise in global prices of some consumer goods, and the downward adjustment exchange rate of the national currency. One should be also open to the possibility of a warming up of the economy expressed by the rise in CPI in the face of increased investment demand. Similarly, to what extent the present price hike relates to inefficient market intermediation underpinned by corrupt practices and extortion also needs to be investigated.

## 4. Real Economy

### 4.1 Agricultural Production<sup>8</sup>

Foodgrain production has increased in FY03 after a decline in FY02. According to the final estimate of the 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 foodgrains 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 FY03. Initial estimates show that areas under *Aus* and *Aman* marginally declined during FY04. While production of *Aus* experienced a marginal decline, *Aman* registered an increase.<sup>9</sup> Flash flood caused by onrush of hilly waters from upper reaches across the border and heavy rains during the third week of April has damaged *Boro* rice in Sylhet, Sunamganj, Moulvibazar, Kishoregonj and Netrakona districts. Total production of *Boro* rice in FY04 may be at par with that of last year. Harvesting of *Boro* paddy is yet to be completed, and hopefully we will soon get the estimates on the actual production during *Boro* season.

In FY04, the government fixed the rice procurement target at 200 thousand metric tons of *Aman* rice. About 150 thousand metric tons of rice and about 73 thousand metric tons of paddy (equivalent to 50 thousand metric tons of rice) are to be directly purchased from the farmers. Procurement of *Aman* paddy started from 15 November 2003 and continued upto 28 February 2004. Procurement price of *Aman* paddy and rice was set at Tk. 8.40

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<sup>8</sup> For more on Bangladesh's agricultural issues, please see Deb, U.K. 2004a. Performance of Bangladesh Agriculture in FY2004 [*under preparation*]; and Deb, U.K. 2004b. Agriculture Situation in FY2003 in Independent Review of Bangladesh's Development 2003. Dhaka: Centre for Policy Dialogue. [*forthcoming*].

<sup>9</sup> The area under *Aus* production has declined (1.20 million hectare in FY04 against 1.24 million hectare in FY03). Production of *Aus* rice has decreased from 1.85 million metric tons in FY03 to 1.83 million tons in FY04 (i.e. 1.02 percent decrease in production). The area under *Aman* production has marginally declined (5.677 million hectare in FY04 against 5.682 million hectare in FY03). Production of *Aman* production in FY04 has increased to 11.52 million metric tons, from 11.11 million metric tons in FY03 (i.e. 3.65 percent higher than that of FY03).

and Tk. 12.80 per kg respectively. During this period, more than 131 thousand tonnes of rice and 16 thousand tonnes of paddy were procured.<sup>10</sup> This indicated a shortfall of 12.7 percent and 78.1 percent in procurement for *Aman* rice and paddy respectively. This shortfall has happened because the farmers were getting better prices for their harvests in the open market and the procurement price operated as a market supportive lever.

In a recent meeting of the interministerial committee on Food Planning and Management (FPMC), held in April 2004, it was resolved to procure 600 thousand tonnes of rice and 154 thousand tonnes of paddy during the *Boro* season. The committee also set a procurement price of *boro* paddy and rice at Tk. 8.40 and Tk. 13.25 per kg.<sup>11</sup> The procurement is scheduled to begin from 25 April and end on 31 August 2004. The procurement regime will need to ensure that the experience of last year is not repeated when poor quality foodgrains imported from India ended up in the silos of the Food Directorate.

#### **4.2 Monga Situation**<sup>12</sup>

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

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<sup>10</sup> The Bangladesh Observer, March 1, 2004.

<sup>11</sup> The Bangladesh Observer, April 9, 2004.

<sup>12</sup> For more details on *Monga* read also Deb, U. K. 2004. *Nature and Causes of 'Monga' in Northern Districts of Bangladesh*. Dhaka: Centre for Policy Dialogue (CPD) [under preparation]

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 due to floods 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 victims of river bank erosion.
- The traditional instruments for 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 areas 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.

### **Box 9: Poverty Trends and Spatial Variation in Poverty**

Bangladesh made notable progress in income-poverty reduction during the 1990s. I-PRSP reported that the income-poverty at the national level has declined from 58.8 percent in 1991/92 to 49.8 percent in 2000. In other words, rate of poverty reduction in the nineties was 1 percentage point per year. The progress was faster during the nineties compared with the eighties. The faster pace of poverty reduction in the nineties is attributable to the accelerated growth in income. The pace of rural poverty reduction was slow in the eighties, but became faster in the nineties. The reverse was true for the urban areas. It is well known that poverty trends are influenced by the changes in inequality. Income inequality at the national level has increased from 25.9 percent in 1991/92 to 30.6 percent in 2000. During the same period, urban inequality was rising much more (from 30.7 to 36.8 percent) than rural inequality (from 24.3 to 27.1 percent). The sources of rising inequality are linked with the uneven spread of economic and social opportunities, unequal distribution of assets especially in respect of human capital and financial capital, growing disparity between urban and rural areas as well as between developed and underdeveloped areas (I-PRSP, 2003)<sup>13</sup>.

Kam et al. (2004)<sup>14</sup> reported geographical concentration of rural poverty in Bangladesh for 425 upazilas in 2000-01<sup>15</sup>. The study measured and mapped incidence of poverty (using Head-count Index) and severity of poverty (using Squared Poverty Gap Index). The Head-count Index varied from 15.0% to 79.9% of the rural households across the 425 upazilas. According to the study, the areas with highest incidence of poverty (greater than 47%) are the depressed basins in Sunamganj, Habiganj and Netrokona districts; the northwestern districts of Kurigram, Nilphamari and Nawabganj; and Cox's Bazar and coastal islands of Bhola, Hatia and Sandeep. The areas with low levels of poverty are the greater Dhaka and Barisal regions, and Bogra, Pabna, and Jessore regions. The picture appears to be similar with regard to the severity of poverty. One implication of findings of the study is that safety-net programmes such as Food for work, food for education, vulnerable group feeding (VGF), vulnerable group development (VGD), etc., be targeted with greater intensity in the Upazilas with higher intensity of poverty. Another implication is that strengthening special and targeted employment programs for the vulnerable poor should get priority in the upazilas with high incidence of poverty.

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

<sup>13</sup> I-PRSP (2003). Bangladesh—A National Strategy for Economic Growth and Poverty Reduction. Dhaka: Government of Bangladesh, March 2003.

<sup>14</sup> Kam, S.P, M.L. Bose, Tahmina Latiff, Abeer H. Chowdhury, S.G. Hussain, Mahbub Ahmed and Mahabub Hossain (2004). Geographical Concentration of Rural Poverty in Bangladesh. Paper presented at the dialogue on “Mapping Poverty for Rural Bangladesh: Implications for Pro-poor Development” held at CIRDAP Auditorium on 26 May 2003; organised by the Centre for Policy Dialogue (CPD) in collaboration with International Rice Research Institute (IRRI).

<sup>15</sup> Most of the upazilas of the Chittagong Hill Tracts and the metropolitan thanas were not included in the study.

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 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 February. On a point to point basis, industrial production has declined between February 2003 and 2004 by about (-) 2.75 percent. Conversely, the first eight months' average QIP for FY04 is only 1.53 percent higher than the same in FY03.

### Box 10: Assessing the Investment, Employment, Production and Export Situation

In view of the conflicting signals emanating from the investment and employment scenario, CPD undertook a limited survey of large scale entrepreneurs to assess their production performance.

The findings of the survey reveals that the investment employment, production and export situation had been better in first three quarters of FY04, in comparison to FY03.

On investment, about half of the respondents (50.60 percent) mentioned that they have expanded their base in FY03, whilst this share increased to 53.70 percent in FY04. More importantly, a little over 20 percent of the respondents admitted to investing in new businesses during FY03 and FY04.

Investment Situation	Expanded Existing Business		No New Investment		Invested in New Business	
	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04
	(In per cent)		(In per cent)		(In per cent)	
Investment situation of your company	50.60 (R-79)	53.70 (R-82)	24.10 (R-79)	25.60 (R-82)	21.50 (R-79)	20.70 (R-82)

In case of employment about 56.30 percent of the respondents reported that they have hired more people in FY03. The matching share was, 63.00 percent in FY04. The share of enterprises experiencing labour retrenchment was less than 10 percent in both the years.

In the same view, 64 percent in FY03 and about 67.50 percent in FY04 of respondents mentioned that they have increased their volume of production.

Finally, about 56.3 percent of export-oriented respondent entrepreneurs in FY03 and FY04 respectively achieved higher export growth.

Volume of Production, Export Situation and Employee Situation	Increased		Decreased		Unchanged	
	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04	July' 02 - June' 03	July' 03 - March' 04
	(In per cent)		(In per cent)		(In per cent)	
State of volume of production of your company	64.10 (R- 78)	67.50 (R- 80)	5.10 (R- 78)	7.50 (R- 80)	30.80 (R- 78)	25.00 (R- 80)
Export situation of your company	65.10 (R- 43)	72.72 (R- 44)	16.27 (R- 43)	11.36 (R- 44)	18.60 (R- 43)	15.90 (R-44)
Total number of employees	56.30 (R-80)	63.00 (R-81)	6.30 (R-80)	8.60 (R-81)	37.50 (R- 80)	28.40 (R-81)

However, what is to be noted is that the QIP in February 2004 fell in comparison to that of the preceding month (January 2004) by more than 16 percent. In January 2004 the QIP stood at 282.94, the highest in the last two years, recording a surprising 8.65 percent growth (point to point). This was largely due to the incremental contribution of the garments and cotton textiles sector which accounts for about 17 percent weight in the total manufacturing industries.

The faltering growth of the manufacturing sector is largely attributable to the visible withering away of the jute industry in Bangladesh. During the first two quarters of FY04 production fell in all categories of jute products (i.e. Hessian -19.33 percent, sacking -7.91 percent, carpet backing -20.35 percent and others 36.16 percent) – both in the 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 production of paper and petroleum products is also discernible.

The most encouraging feature of the manufacturing production during July-December 2004 had been the robust growth of yarn (34.30 percent) and fabric (48.09 percent) production which generates confidence about Bangladesh's growing capacity to meet the challenges in the post-Multi-fibre Arrangement (MFA) period. During the first six months of the FY04, the major industries (among others which include jute, textile, fertilizer, pharmaceuticals and tea and carries 68.18 percent weight in the total manufacturing industry) recorded a 1.54 percent growth over the same period of the previous year.

An early estimate shows that the QIP in March 2004 has recorded a month to month growth of about 1.67 percent. This will however score a 1.13 percent average growth for the July to March FY04 period in comparison to the last fiscal year (FY03).

On the other hand, the QIP for the small scale manufacturing industries shows a 5.36 percent growth during July – December 2003 in comparison to the comparable period of the preceding year. The substantive sub-sectors (at 2 digit level) which demonstrated fastest growth are food, beverage and tobacco (8.65 percent), and textiles, leather and apparels (8.61 percent).

Such a low manufacturing growth rate does not inspire excitement particularly when it rests on a very narrow base. The issue of industrial and export diversification has been part of the policy discourse for at least two decades. This debate has acquired acute relevance with the advent of the total phase-out of the Multi-Fibre Arrangement (MFA) in 2005. 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. The current weak manufacturing growth does not match up to the higher flow of term loans to the industrial sector mentioned earlier or the rise in capital machinery import discussed later. There is a need to revisit the estimation procedure of the QIP. It is suspected that the current methodology of calculating QIP neither adequately covers the population of the manufacturing sector, nor does it incorporate a proper representative sample of the sector.

#### ***4.4 Privatisation***

At present the total number of state owned enterprises (SOEs) approved by the Government for privatisation is 97. Around ten SOEs have been closed down during the last two and a half years, while only fourteen SOEs were privatised, i.e. handed over to the buyers. These were: Nishat Jute Mills Ltd., Tongi; Mymensingh Jute Mills Ltd., at Shambhugonj; Deshbandhu Sugar Mills Ltd., Narshingdi; Corn Flour Mills Ltd., Narayanganj; Cabinet Manufacturing Plant, Mirerdanga, Daulatpur, Khulna, Wood

Treating Plant, Mirerdanga, Daulatpur, Khulna; Mangrove Tannin Plant, Mirerdanga, Daulatpur, Khulna; Bangladesh Oil Mills, Khulna; Kaliachapra Sugar Mills Ltd., Kishoreganj; Fish Export, Khulna; Bawa Jute Mills, Narayanganj; Lira Industrial Enterprise, Tongi; Bangladesh Monopol Paper Manufacturing Co. Ltd and Service Facilities Centre (SFC), Sirajganj. Sale proceeds from these fourteen enterprises amounted to around Tk. 110.50 crores.

Currently Letters of Intent (LOI) for privatisation have been issued for 7 enterprises and these units are yet to be handed over to the buyers. The expected receipt from these sales is around Tk. 71.57 crores. However, the Privatisation Commission is facing problems regarding handing over of a number of enterprises scheduled for privatisation.

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.<sup>16</sup> The Ministry of Industries is trying to reopen four of its enterprises it sent to the Privatisation Commission years ago. The Ministry of Industries has sent a letter 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 to 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. Citing ambiguous reasons, a Cabinet committee decided on December 27, 2003 that instead of the Privatisation Commission, ministries would liquidate the laid-off mills and factories.

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<sup>16</sup> The Ministry of Jute has also taken back three of its jute mills from the Privatisation Commission list recently and planned to run these enterprises by the ministry itself.

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 554 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 yielded 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 or inter-company loans under appropriate heads. Curiously, the current BOP accounts also do not include foreign investments in 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 \$105.93 million of foreign investment came to Bangladesh during July-January FY04. More than 53 percent of it was invested

in the EPZs. A net total of \$1 million in portfolio transactions was reported during this period.

The foreign investment figure for the first two quarters of FY04 compares favourably with that for FY03 with a 36.30 percent increase. Net flow of FDI increased by 81.48 percent, while EPZs recorded around 14.8 percent growth during the July-December FY04 period. However, one should not lose sight of the fact that all these growth trends are projected from an insignificant base.

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 (\$196.63 million from \$114.80 million). It seems that the figure may rise further in FY04 – but largely in the EPZs which during the first ten months (July – April) of FY04 has received \$78.84 million of foreign investment.

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 of investment in the EPZ, drawn from Japan and the Republic of Korea, needs to be resolved without prejudice either to Bangladesh's export or investment prospects. The recent agreement between the governments of the USA and Bangladesh to phase-in trade union rights in the EPZs and its slow operationalisation indicate that this may be no easy task.

#### ***4.6 Capital Market***

Between July 02, 2003 and May 24, 2004, DSE General Index and DSE20 Index grew by 39.01 percent and 35.91 percent respectively. Turnover in terms of volume decreased by (-)36.13 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 recording a 1015.97 general index for the first time after 1996. Suspecting speculative trading in 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. However, an upturn has again been observed at the end of April 2004 when the DSE index crossed the thousand-mark once again.

**Box 11 : Trend in Over Subscription of IPOs**

After the boom and bust in 1996, the capital market could not regain the faith of small and medium investors on the secondary and curb market shares. Moreover, the suspension of sixteen Z category companies by the SEC made it inevitable for the general investors to go for the primary shares of reputed companies which has been mirrored by the trend in over subscription of initial public offerings (IPOs).

According to the DSE statistics, the rate of over subscription of IPOs increased from 249.90 percent in FY02 to 517.68 percent in FY03. Latest available figure shows that Tk 25046 million was subscribed as against Tk 1135 million security offers during the first three quarter of FY04, accounting for a 2106 percent over-subscription rate during this period. Thus, an amount of Tk 2299.66 million was over-subscribed for offerings by four private commercialized banks (PCB), while the rest of the ten companies over-subscribed Tk 91.37 million. Four PCBs, namely Standard Bank Ltd, One Bank Ltd, Bank Asia and Mercantile Bank Ltd., accounted for a 2770.11 percent over subscription during the first nine months of the current fiscal year (FY04). It can be mentioned that since November 2003, no new IPO was offered on the market.

As part of a market correction, in order to ensure the supply of quality shares, and thereby broaden the depth of the stock market, the SEC agreed to specify the responsibilities of all parties - including issue managers, underwriters, and auditors - concerned with the initial public offering process. The regulatory body pointed out that it will take punitive action against those who fail to carry out their due responsibility while issuing an IPO.

One can relate the current trend of IPO oversubscription with the reaction of the previous experience with secondary shares and current market correction initiatives of SEC.

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 percent) companies out of 221 did not pay any dividend in 2000 and 49 in 2001 (21 percent) out of 230 companies, whereas 76 (32 percent) companies out of 241 companies are yet to declare dividends 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 March 2004 amounted to \$1643 million which is less than 3.2 percent of GDP. In June 2002 the comparable figure was 2.2 percent of GDP. Three groups of listed companies, viz.(i) Banks, (ii) Pharmaceuticals and Chemicals, and (iii) 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 market. However, the recent movements in the capital market have revealed that at least Tk. 2000 crores of liquidity is looking for opportunities for investment in dependable scripts.

## **5. External Sector<sup>17</sup>**

Fiscal Year 2003-04 is expected to be a defining year and an important threshold for Bangladesh's external sector. One major reason for this so is that FY04 is the last fiscal year before the final phase-out of the MFA quotas on January 1, 2005. With the phase-out of the MFA, the relatively secured market access in the USA under the quota regime will come to an end; just as in the European Union, the advantages emanating from a

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<sup>17</sup> For more details on the external sector of Bangladesh, please see Rahaman, M. 2004. *Crossing A Critical Watershed: Bangladesh's External Sector in FY2004*. Dhaka: Centre for Policy Dialogue. [under preparation] and Rahaman, M. 2004b. *Recovery and Beyond: Bangladesh's External Sector in FY2003* in Independent Review of Bangladesh's Development 2003. Dhaka: Centre for Policy Dialogue. [forthcoming]

quota-free market access (whilst quotas are imposed on major competitors) will no longer be available. The post-Cancun scenario has put completion of the Doha Development Round negotiations in disarray. This means that the decisions on important market access issues which are of interest to Bangladesh and other LDCs will get delayed. Bilateral and plurilateral trade initiatives between developed countries and some of Bangladesh's competitors will begin to be felt in a more pronounced way in FY04 as rival supply networks gradually get on with the task of regrouping and repositioning in order to take advantage of enhanced market access opportunities. The pace of the bilateral and regional trade initiatives in South Asia, in which Bangladesh is an active participant, is set to gain momentum in the current fiscal year. A welcome development of recent times is that the issues of the workers' right to organise trade unions in the EPZs appears to have been resolved for the time being.

The current year is expected to be a busy one in terms of trade negotiations. The SAFTA Framework Agreement signed at the 12<sup>th</sup> SAARC Summit in Islamabad held in January, 2004 requires Bangladesh to get on with the important task of preparing tariff liberalisation schedules, articulating preferred rules of origin and preparing proposals for dispute settlement and revenue compensation mechanisms. A committee of experts has already held two meetings. The next meeting is scheduled to be held in the first week of June, 2004. Negotiations have also progressed significantly towards establishment of a BIMSTEC Free Trade Area. Bangladesh is also exploring establishment of bilateral FTAs with India, Pakistan and Sri Lanka.

As a result of these initiatives, opportunities are expected to emerge which will need to be accessed. At the same time Bangladesh's external sector will also face many challenges which will have to be addressed with appropriate measures. All this will have important short, medium and long term implications for the performance of Bangladesh's external sector in particular and the Bangladesh economy in general. Negotiating the various bilateral and multilateral trade negotiations in a manner that best serves Bangladesh's economic interests will be a major challenge for Bangladesh in the coming months.

An analysis of the performance of the external sector during the first three quarters of the current fiscal year shows that, overall, in FY04 Bangladesh's external sector was able to consolidate the recovery which was experienced in FY03 following the deceleration of the export sector and deteriorating balance of payments situation experienced in FY02. The following sections detail out the growth and structure of the performance of the external sector and point out some of the emerging trends, as the fiscal year draws to its end.

### ***5.1 Imports***

The import situation in FY04 has reversed compared to FY03 when the sector registered a negative growth of (-) 2.7 percent compared to FY02. As actual imports for the first eight months indicate, imports during July-February FY04, at \$6596.9 million, posted an increase of 16.9 percent compared to the corresponding period of FY03. Although to some extent this growth was underwritten by a rise in imports of foodgrains (by 51.3 percent); imports without food grains also posted an impressive growth of 15.8 percent. Import of textile and related articles registered a high growth of 16.34 percent, whilst import of important industrial raw materials such as raw cotton (58.68 percent) and yarn (17.1 percent) have also registered high growth rates.

Import of capital goods over the first eight months of FY04 was \$1412.2 million, which was 14.6 percent higher than that of the corresponding period of the previous year, and substantially higher than the 3.6 percent registered in FY03. Interestingly, disaggregated import figures show that import of textile and garments machineries (HS 8445-8) exhibited a robust growth of 54.76 percent, rising from \$96.91 million during July-February FY03 to \$149.98 million during the corresponding period of FY04.

If fresh openings of import L/Cs is taken into consideration, it is found that L/Cs opened for import rose to \$8.71 billion during the first nine months of the current fiscal year (July-March) compared to the corresponding period of FY03 when it was \$7.41 billion – this indicates a growth of 17.4 percent. The amount of L/Cs opened for consumer goods during this period remained almost unchanged (a decrease of 0.45 percent); L/Cs opened

for consumer goods other than foodgrains registered a high growth rate of 25.5 percent, perhaps in response to the relaxations of L/C margin requirements. Import L/Cs for industrial raw materials posted a growth of 24.9 percent, although growth figures for intermediate goods at 6.8 percent were low by comparison. Growth of L/Cs opened for import of capital machineries was 13.2 percent. This growth also 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 the Janata Bank. Both textile and garments subsectors showed high import growth rates of 93.4 percent and 48.7 percent respectively. L/Cs opened for importing machineries for miscellaneous industries registered a growth rate of 6.2 percent. Import L/C settlements for this period also show a good performance, rising from \$6.61 billion during July-March, FY03 to \$7.90 billion during the corresponding period of FY04, a growth of 19.5 percent. However, L/C settlements for import of capital machineries posted a negative growth of (-) 10.2 percent, although the growth figures for L/C settlements of both textile machineries (83.7 percent) and garments (45.6 percent) were quite robust during this period.

#### **Box 12: Inconsistencies in the Information on Import of Capital Goods Machinery**

Import of capital machinery is critically important because of its implications and impact on investment. However, it appears that there is a need to streamline the relevant information for reliability and comparability. The information compiled by the BB on imports of capital machineries through opening and settlement of L/Cs is collated from various banks. There is no set proforma as regards definition and classification of the relevant data, nor are compilers of such information adequately trained for the job. Data on imports of capital machineries collected by NBR is classified under HS codes at disaggregated level, which is subsequently aggregated at two digit levels, 84 and 85.

Although most of the imports under 84 and 85 are capital goods, it is sometimes difficult to ascertain whether machineries listed here are for domestic or industrial purpose, leaving a margin for error when this data is used as proxy for investment in capital machineries. Moreover, it appears that some of the imported capital machineries do not fall under HS 84 and 85. This is also evident from the fact that data on imports of capital goods provided by BB is consistently higher compared to import data of NBR under HS 84 and 85. For example, import of capital goods during July – February 2004 was US \$ 1412.2 million according to BB data, whilst import of capital goods under HS 84 and 85 as per NBR data was US \$ 990.7 over the corresponding period.

There is thus a need to (a) design an appropriate methodology for information on imports of capital goods by BB, and (b) reconcile the NBR and BB data sets.

L/C openings during the first nine months of FY04 indicate that imports are likely to sustain over the remaining next few months of the current year, and there may be pressure on the balance of payments in the trade account. Thankfully, both export earnings and remittance flows have registered robust performance, and if growth trends of these two sectors sustain over the rest of the fiscal year, there should not be any significant pressure on foreign exchange reserves arising from the recent surge of imports. Higher disbursement of foreign aid is also likely to provide some cushion. The exchange rate in a floating regime may also be expected to absorb a significant part of this pressure.

On the other hand, during July-April 10, 2004, import of foodgrains by the private sector was 2100 thousand metric tons; to compare, total private sector import of foodgrains in FY03 was 2966 thousand tons. It may be mentioned here that the government, for the first time since FY00, has undertaken commercial import of wheat in FY04. Between July-September 2003 the government had imported 29 thousand metric tons of wheat.

## ***5.2 Exports***

Exports recovered somewhat in FY03 when earnings registered a growth of 9.4 percent following the negative growth of (-)7.4 percent in FY02. The export sector demonstrated remarkable resilience and the momentum generated in FY03 has been sustained in FY04. Export accruals rose from \$4722.2 million to \$5420.9 million registering a growth of 14.8 percent over the first nine months of the current fiscal year compared to the corresponding period of the previous year. This was slightly higher than what was targetted for the period (higher by 0.04 percent), and was a good performance by any measure. Export earnings from woven garments posted a growth of 9.8 percent during the first nine months; earnings from knit garments continued to register a robust growth and increased by 25.4 percent. Export of chemical products (18.8 percent), leather (7.8 percent), tea (11.3 percent) and frozen foods (13.1 percent) also experienced modest to high growth rates. Unfortunately, the deceleration experienced in case of export of both raw jute (-9.5 percent) and jute goods (-3.8 percent) has sustained in FY04. It is to be borne in mind that most of the export growth of 14.8 percent was accounted for by a rise

in volume (13.6 percent) and only to an insignificant extent by a rise in average prices (1.2 percent). Bangladesh's average export price fell by 10.7 percent over the last four years. As a matter of fact, CPD analysis shows that average export prices of Bangladeshi goods are yet to reach the 1996 level. It is also to be noted that most of the incremental exports in the first three quarters came from an increase in exports to the EU. In the US market, export during July-March, 2004 in fact came down to \$1400.6 million from \$1619.2 million earned over the corresponding period of FY03, a decline of 13.5 percent. Export of woven garments to the US market came down from \$1130.2 million to \$1012.8 million (-10.4 percent), whilst the corresponding figures for knit-RMG were \$273.6 and \$174.6 million (-36.2 percent).

One has to admit that the intensive process of export expansion, experienced by Bangladesh till now, should be a matter of concern for Bangladesh's policy makers, and may not be sustainable over the medium term. This is particularly true when one single group of commodities, namely clothing, contributes the major share (three-fourths) in the export receipts. In recent years most of the attendant growth is coming through the export of increasingly larger volume of apparels to the global market. 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. Under the circumstances, renewed effort will need to be undertaken to broaden Bangladesh's export basket and also in terms of assisting the country's export-oriented apparels sector to enhance its competitive strength in the global market. Bangladesh should also start to strategise on how she can make the best use of the potential market access opportunities arising out of the various bilateral and multilateral trading arrangements being negotiated at present, particularly as part of the SAFTA. Greater access to regional markets thus need to be given a high priority in Bangladesh's trade strategy.

### ***5.3 Remittance***

In recent years remittance sent by expatriate Bangladeshi workers has become an increasingly important component of Bangladesh's forex earnings. At present remittance earnings is on average, equivalent to about four-fifths of *net* earnings from exports of goods.

Remittance flow first crossed the threshold of \$3.0 billion in FY03 when earnings posted a growth of 22.4 percent over the previous year. During the first ten months of FY04 (July-April) forex earnings from remittance flows amounted to \$2.8 billion which was \$250.65 million or 9.90 percent more than the corresponding period of FY03. 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 Bangladesh's remittance growth. The Middle-East continues to generate most of the remittance income (about 56.5 percent) with Saudi Arabia being the front-runner (39.8 percent).

**Box 13 : Are the NRBs Investing in Bangladesh? Are the Bangladesh is Investing Abroad?**

A CPD survey carried out among the big entrepreneurs reveals that about 57.9 percent of the respondents "fully agree" or "partially agree" that non-resident Bangladeshi are investing in Bangladesh. Conversely, 40.70 percent of the respondents either "fully agree" or "partially agree" that Bangladeshis are investing overseas. However, it needs to be pointed out that the share of respondents "fully agreeing" are greater (10.10 percent) in case of the proposition that more Bangladeshis are investing overseas than the NRBs are investing in Bangladesh.

It is important to point out that in both cases the share of dissenting view was around 20 percent.

However, it is important to note is that in response to the question whether Bangladeshis are investing abroad a larger share (39.2 percent) pleaded ignorance, whilst in case of investment by NRBs the comparable share was 24.40 percent. This pattern of response may on the one hand depict the varying state of knowledge regarding both the subjects or people still feel shy to talk about flight of capital from the country.

Whilst it is well known that some NRBs are investing in Bangladesh in various degrees, the recognition of the fact that Bangladeshis are also finding it opportune to invest abroad comes as a surprise.

The three major sectors where the Bangladeshis are inventing abroad are real estate and housing, RMG and textiles, restaurant, trade in stocks and shares.

Curiously, these are also the sectors where NRBs are investing in Bangladesh.

Investment Situation (NRB's and Bangladeshi)	Fully Agree	Partially Agree	Don't Agree	Don't Know
	(In Percent)	(In Percent)	(In Percent)	
Non Resident Bangladeshis (NRBs) are investing in Bangladesh	6.10 (R-82)	48.80 R-82)	20.70 (R-82)	24.40 (R-82)
Bangladeshis are investing abroad	10.10 (R-79)	31.60 (R-79)	19.00 (R-79)	39.20 (R-79)

It is well known that it is the ordinary (unskilled and semi-skilled) workers who send most of their earnings home, whilst in case of professionals the amount of retention abroad is significantly higher. A recent CPD-ICTSD study<sup>18</sup> shows, in view of the ongoing negotiations on GATS-Mode 4 (Movements of Natural Persons), an window of opportunity is likely to emerge for Bangladesh in terms of enhanced opportunity to participate in the labour market of developed countries. The aforementioned CPD study has mapped Bangladesh's supply side capacities with respect to *International Standard Classification of Occupation* (ISCO) which is followed by the WTO, and it is hoped that this exercise will help Bangladesh to prepare the *Request List* in terms of GATS-Mode 4 in the context of the upcoming negotiations in the WTO. A concerted effort will now need to be undertaken to address such crucial issues as skill upgradation, and also preparing new cadres of service providers capable of taking advantage of the emerging opportunities in the global labour market, particularly in information technology related sectors.

#### ***5.4 Foreign Aid***

It is to be noted that following 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. Bangladesh is experiencing a ballooning aid pipeline in recent years. Bangladesh had received US\$ 49.12 billion from the day of independence till date, of which more than US\$ 40.74 billion (83 percent) was disbursed. The trend of aid disbursement shows that the mismatch between the commitment and disbursement is increasing on a continuous basis. In FY03 foreign aid committed to Bangladesh amounted to about \$2179 million, whilst actual disbursement was in the region of \$1577 million. During FY03, only 73 percent of the total commitment had been disbursed. The total aid pipeline today stands at more than US\$ 6.2 billion; of this 96 percent is on account of project aid.

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<sup>18</sup> CPD-ICTSD study on *Risk and Opportunities of Liberalisation Trade in Services: Country Study Bangladesh*.

Aid disbursement during the first eight months of FY04, at \$412.3 million was 47.6 percent below the comparable figure for FY03. Even if commodity aid (of which there was no disbursement in FY04) is excluded, the disbursement during the current fiscal is still about 36.0 percent less than the previous year. Disbursement of project aid also came down by 34.1 percent during the matched period.

Conversely aid commitments during the first eight months, at \$902.9 million, is 3.4 percent higher compared to the corresponding period of FY03. The good part of it is that the grant component is higher by 84.9 percent, while the loan component is lower by 30.3 percent. It is to be noted that aid commitments during the first ten months of FY04 (July-April) stood at \$1193.1 million, compared to \$963.3 million for the corresponding period of the previous fiscal year, implying a growth of 23.9 percent.

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 has also agreed to give Bangladesh SDR 347 million (about \$517) as a loan under the *Poverty Reduction and Growth Facility* (PRGF), of which two tranches of SDR \$49.5 million (\$74 million) each has already been disbursed. The third tranche of the PRGF is expected to be discussed following the Consultation Mission of IMF with the GOB in early May 2004. The IMF also indicated that in case there is any shortfall in the BOP due to the negative impact of MFA phase-out it would provide support, if necessary.

In recent consultations, the World Bank has agreed to make available to Bangladesh about \$1 billion as aid under various projects subject to compliance with a host of conditionalities or “poor actions”, as they are currently called. Out of this amount \$600 million will be disbursed shortly as budget support under three programmes, namely the *Development Support Credit Phase II* (\$200 million), *Education Sector Adjustment*

*Credit* (\$150 million), and *Enterprise Growth and Bank Modernisation Credit* (\$250 million). Negotiations for the *Enterprise Growth and Bank Modernisation* project is scheduled to start soon. The Bank is also expected to approve another five projects in education, water, communications and power sectors involving an amount of more than \$400 million.

It needs to be noted with some satisfaction that in comparison to many other low income countries the foreign debt scenario of Bangladesh remains manageable. Debt outstanding, was \$16939.0 million in FY03, was equivalent to 32.6 percent of the GDP, which may be represent a decline from 41.0 percent of GDP in FY91. In turn, 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 \$6201.0 million (as of July 01, 2003). At the same time, most of the foreign assistance disbursed in the recent past had been in the form of loans implying the possibility of a growth in DSL in the near future.

### ***5.5 Balance of Payments***

With both export and remittance sectors demonstrating good performance in the face of rising imports, the current account balance registered some improvement during the first seven months of FY04. Although the deficit in the balance of trade in goods increased from (-) \$776.0 million to (-) \$906.0 million (an increase of \$130.0 million) in view of the rise in the import bill, net current transfers rose by \$198.0 million (from \$1939 million to \$2137.0) thanks mostly to the rising flow of remittance. The current account balance was \$680.0 million for the period of July-January FY04 as against \$638.0 million for the corresponding period of FY03 with the surplus registering a rise of about 6.6 percent. The overall balance during this period (July-January FY04) stood at \$187 million which is 28.08 percent higher than \$146 million for the corresponding period of the previous fiscal year.

As was mentioned, and this needs to be kept in view, L/C openings during the first nine months of FY04 was a high 17.4 percent, alluding to a possible pressure in terms of import payments in the coming months. Under the circumstances, a watchful eye will need to be kept on the behaviour of export earnings and remittance flows in the coming months as this will have important implications for sustaining the growth in the reserves observed in the recent past. This surveillance will be all the more necessary and judicious in view of the impending shock from the total phase out of the MFA.

### ***5.6 Foreign Exchange Reserves***

Foreign exchange reserves at the end of April 2004 stood at \$2747.0 million compared to the corresponding months of the previous year when it was \$1874.3 million. This was a rise of \$872.7 million or 46.6 percent. It is to be noted that as on May 22, 2004 foreign exchange reserves declined somewhat to reach the level of \$2556.36 million, which is equivalent to 97 days of exports. Although the current forex reserves are yet to reach the level of \$3.6 billion attained in 1995, it reflects the continuing rebound in the reserve situation experienced in recent years.

The current level of forex reserves, somewhat beefed up by foreign loans, provides a cushion for the growing demand for imports. However, in case there is a pressure on the forex reserve situation, the government may have to once again resort to monetary policy instruments to restrain the growth in imports.

## **6. Concluding Remarks**

It is evident from the foregoing review that most of the key variables influencing macro-economic performance in FY04 did start off on a relatively strong footing. The variables were strengthened further during the second quarter of FY04 (October-December). However, some mixed signals are discernible as the economy enters into the third quarter of FY04 (January-March). Although real time data on the last quarter of FY04 (April-June) are not yet available, it is difficult to forecast how the fiscal year will fare in its

entirety, although it appears that the mixed signals transmitted so far in the economy will persist. Whatsoever, the initial promises in terms of the macroeconomic performance evidenced in the first half of the current fiscal year did become somewhat less robust in the second half.

Major distinguishing features of FY04 had been stability in export growth recovery, buoyancy in remittance flows and the steady state in agriculture production. Positive movements have also taken place in case of import growth, industrial loans and agricultural credit disbursement. However, these reassuring trends are somewhat moderated by the marginal growth in the manufacturing sector, low level of FDI inflow, transitory bubbles in the capital market, 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 payments situation may be subjected to some pressure because of the increasing trade gap and the expected pressure of import payments in the coming months.

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

- (i) Delivery of ADP still remains the most vulnerable aspect of this year's economic programme – from the point of view of both quantity and quality. Implementation of the ADP, underpinned by slow off-take of foreign aid, has now emerged as the major issue of macro-economic management. No systematic attempt was made to implement the recommendations of the *Public Expenditure Review Committee*. It is now obvious that the acceleration in economic growth to a higher level is largely contingent upon enhanced and improved public expenditure in physical and human development infrastructure. This will warrant not just the streamlining of development administration, but also strengthening of local government institutions. These issues need to be kept in focus in the upcoming national budget for FY04.

- (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 trend needs to be strengthened. In view of the possible shock on the BOP emanating from the apprehended export deceleration, the government will need to closely monitor both the inflow (including remittance and foreign aid) and outflow (particularly import growth) of foreign exchange. Whilst it will be prudent to negotiate some BOP support from the development partners on account of the MFA phase-out, one should not exclude the need for import control if the situation calls for such a step. The possibility of strong pressure on the national currency should also not be overruled altogether.
- (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 are showing sustained growth. However, one can observe from the BOI data that the rate of registration of FDI has slowed down since January 2004. BOP data also corroborates this trend. The expansion in investment which we observe relates largely to the existing enterprises coupled with “old” entrepreneurs investing in “new” business. Assessment as regards the state of small enterprises remains unclear because of paucity of reliable data.
- (iv) A successful supportive monetary and fiscal policy has generated an enhanced inflow of investible surplus into the market, although the real outcome of the campaign for interest rate reduction remains suspect. An upward trend in the price index which was visible in recent past has been temporarily halted. With the emerging pressure on the BOP, the floating exchange rate regime will have to effectively adjust the exchange rate of taka, and some intervention in the market may become necessary.

Thus, it appears from our updated 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 post a 5.5 percent or

above growth in FY04. However, it is well known that a 5.5 percent growth will result in a little above 3.5 percent per capita income growth, which although 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 the aggravating income disparity in the country.

**Box 14 : Increasing Disparity and Marginalisation of Middle Class**

Bangladesh has been experiencing a modest, but stable 5+ percent GDP growth rate in the recent past. However, the deteriorating distribution of income suggests that the some of the citizens are disproportionately benefiting from the incremental income generated in the economy.

The Household Income of Expenditure Survey 2000 (HIES 2000) reveals that income accruing to top 5 percent of the households is about 46 times larger than that of poorest 5 percent of the households. The comparable multiple in 1995-96 was 27 times.

On a broader scale, concentration of income in the hands of the top 20 percent of households increased from 50.1 percent in 1995-96 to 55.0 percent in 2002. Conversely, the share of income accruing to the bottom 20 percent of households during the same period decreased from 5.71 percent to 4.97 percent.

As a consequence of the above trends the Gini-coefficient deteriorated from 0.432 in 1995-96 to 0.472 in 2000.

Income disparity is more pronounced in rural areas compared to the urban areas.

The growing concentration of financial wealth in Bangladesh is also revealed by the fact that the top one percent of account holders in the banking sector control about three-quarters of the banking assets. On the other hand, only 13.5 percent of the assets in the banking sector accrues to the bottom 95 percent.

Curiously, in this process of income differentiation, the middle class (defined as the middle 20 percent of the households) is getting marginalised. In 1995-96, this group controlled about 14 percent of the national income; to compare, by 2000 this share has fallen to 12.5 percent.

### ***National Income Accounts FY04 (Provisional)***

BBS has recently drawn-up the provisional estimates as regards a number of key macro-economic variables. These estimates show that the five top contributors to *incremental GDP growth* in FY04 are the following sectors.

Manufacturing	208%
Wholesale trade	15.8%
Construction	12.5%
Transport and communication	11.3%
Agriculture	11.0%
Crop sub-sector	3.9%

As may be seen, the GDP growth in FY04 was spearhead by manufacturing industries and various service sectors; while share of agriculture was relatively low (i.e. below its sectoral share). Does this mean that we are observing a more urban biased growth? Will it deepen the disparity even further? One would need to do indepth focused investigation in order to seek answers to these important questions.

BBS has also reestimated the values for National and Domestic savings and Private and Public Investment for FY03. BBS has also estimated the provisional figures for the above mentioned indicators for FY04. The most notable change which has occurred as a result of this exercise is that for FY03 the final figures for private investment rate has been revised upward from 16.49% to 17.21% of GDP (i.e. a change of 4.37%). As a result, the difference between the final figure for FY03 and the provisional figure for FY04 with respect to private investment is as low as 0.17% of GDP. This implies that contrary to the official version, the magnitude of pick up in private investment during FY04 was rather modest.

Thus, the major economic challenges for FY05 relates to the following :

- Pushing GDP growth beyond 6%
- Ensuring a more equitable distribution of incremental GDP
- Lifting private investment share beyond 20% of GDP within a couple of years
- Improving domestic savings rate to 20%
- Keeping inflation under control
- Maintaining exchange rate stability

Regarding the macro-economic balances, one needs to also emphasise the relatively lacklustre performance in revenue mobilisation. It is not only that the non-tax and non-NBR tax components remain underachieved, but also there has been no significant improvement in the collection of income tax vis-à-vis VAT (local) expansion. Thus, an effective increase in income tax collection continues to remain a major challenge. On sectoral prioritisation of development expenditure, whilst the emphasis on education and health is necessary, there is also the emerging need to pay attention to power generation on an urgent basis. Lack of dependable power supply is emerging as the major impediment to investment, particularly for small enterprises. Among the indirect sources of revenue, the price of energy, particularly of petroleum products, will be a major issue in the backdrop of the global rise in oil prices. Given the political costs involved in pushing up prices, the government will be well advised to reduce the taxes on petroleum products. There is also an urgent need to monitor the rising trend in global price of rice, and in anticipation of this, the domestic food stock.

### **Box 15: Petroleum: Increasing Retail Price or Duty Adjustment?**

Bangladesh Petroleum Corporation (BPC) is the single largest source of government tax earnings as petroleum is also the single largest imported item in Bangladesh. Through multiple taxation that includes import tariffs, supplementary duty, VAT, development surcharges, advanced income tax etc, BPC is paying around 13 percent of the total budgetary tax revenues annually. This profit making institution began to incur huge losses since the mid 1990s due to an upward trend of petroleum prices in the international market. However, it continued to fuel the revenue budget with an average Tk 2500 crores tax payment each year. Even with a net loss of Tk 1162 crores in FY00 and Tk 1311 crores in FY01, it paid around Tk 2854 crores and Tk 3032 crores respectively to the national exchequer over these years.

Tax is charged on the imported price of petroleum on an incremental basis. According to the latest government gazette, a 30 percent customs duty is charged on imported petroleum. Additionally, a 15 percent (25 percent for jet oil) supplementary duty is charged on the customs duty added price and another 15 percent VAT is charged on the supplementary duty added price. A 4 percent infrastructure development surcharge and 3 percent advanced income tax is charged before the price is adjusted within the BPC handling and service charges. In FY03, the BPC contributed Tk 2766 crores tax of which customs duty, VAT, development surcharge and income tax accounted to 59 percent, 32 percent, 5 percent and 4 percent respectively.

The international price of petroleum has been going up steadily during the last couple of months. Under such circumstances, possible actions that could be taken to eliminate the losses that BPC is currently facing are:

- increasing the retail price of petroleum products,
- liberalising the sector to allow competitive private participation, and
- reconstructing the petroleum sector taxation structure (if possible through a duty cut)

Increasing retail prices would be irrational at this moment as it would affect the overall inflation rate which is already quite high. Besides, increasing the diesel price may have a severe affect on the agricultural production process. Liberalizing the sector would again involve various policy measures and reforms, which may be part of a long-term strategy.

Thus, adjusting the import duty would be a better option for the government at this moment. From 01 May 2004, the price of kerosene has been adjusted with the diesel price which would supplement some of the losses that the government might face if the duty structure is not fine tuned. The latest statistics show that the price of oil in the international market has stabilized which may encourage the government not to raise the petroleum price in the upcoming budget.

As the regime moves on to “last lap” when the budget for the next fiscal year is to be presented to the nation, the first signs of the oft-seen mid-term inertia is already visible. In all probability, nothing short of a *big-push* will enable the economy to attain the sort of growth rates that has the capacity to address the major challenges such as poverty alleviation and reduction of growth income inequality. What is holding back the country from a big push? Successive surveys carried out by CPD (and other institutions such as

the World Bank-BEI and the 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 the weak law and order situation, which are creating serious disincentives for investment. Entrepreneurs no longer complain so much about unpredictability of policy; rather they are putting increasing emphasis on the need to raise the efficacy of the public institutions. These are the factors which can largely explain the mismatch between the strong macroeconomic fundamentals of Bangladesh and lack of confidence on the part of the investors.

**Box 16: To Improve Understanding of Macroeconomy and Raise the Quality of Policy Making**

Set up an *Independent Commission on National Statistics* to undertake the following tasks:

- Make available Real Time Data
- Ensure better coordination among related government agencies
- Strengthen the methodology of data collection and relevant institutional capacity
- Reconcile various indicators and variables
- Enable users to have better access to information and data

Admittedly, the trigger to alleviating such a situation lies more within the domain of politics, rather than economics. Will the underlying political economy of Bangladesh continue to undermine its development potentials and arrest its development prospects, which will inevitably result in perpetuation of poverty and inequality? The final outcomes of Bangladesh's economic performance in FY04 may partly provide some answers to these questions. As the last quarter of the fiscal year tends to play an important role in ensuring economic growth in Bangladesh, it is now to be seen to what extent the emerging political scenario is going to influence that opportunity in FY04, with consequent impact for the period far beyond.