

STATE OF THE BANGLADESH ECONOMY 2002-2003

by

Debapriya Bhattacharya

I. INTRODUCTION

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

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

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

National Budget for FY03: In June 2003, CPD further observed that, it was open to speculation whether the National Budget for FY03 would be able to catalyse investment growth. It was pointed out in the CPD's review that, in spite of all the positive measures envisaged under the Budget FY03, investment will still remain constrained due to lack of reforms, particularly in improving performance in the trade-supportive infrastructure, financial sector, public administration, and last but not the least, because of the deteriorating law and order situation.

Interim IRBD FY03: In its Interim Report on FY03, CPD pointed out that, the government has resorted to rather non-conventional measures to improve the law and order situation. A number of government committees are trying to give shape to reform measures in different areas of economic management. Now with the results of the first three quarter of the FY03 behind us, we may seek to identify and interpret the initial signals of the developments in the current fiscal year.

It is in this context that the present paper reviews a set of major variables defining the state of the Bangladesh economy in FY03. The analysis, based on official data, is divided into five broad parts. It sequentially addresses the developments in the *fiscal, credit and monetary sector, real economy, and external sector*. The review concludes by highlighting some issues which in the coming months will serve to influence the performance of the economy.

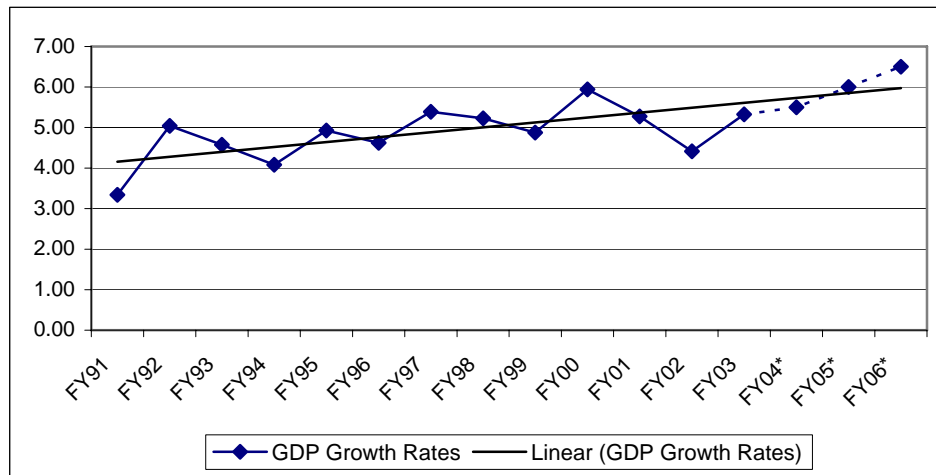
II. GROWTH, SAVINGS AND INVESTMENT

II.1 Improved Growth, Not Good Enough

According to the BBS, the Bangladesh economy posted a growth of 5.3 percent during FY03 as against 4.4 percent in FY02. It may be recalled that economic growth experienced acceleration during 1990s (linear growth rate 4.8 percent) in comparison to 1980s (linear growth rate 3.6 percent). In 1990s, the growth momentum was higher during the second half of the decade in comparison to the first half: average growth rate 4.4 percent (FY91-95) and 5.2 percent (FY96-00).

The provisional growth figure for FY03 is marginally above the I-PRSP target rate (5.2 percent). The improved growth rate still remains below the recent record figure of 5.9 percent achieved in FY00. According to the I-PRSP, Bangladesh economy is programmed to grow at 5.5 percent in FY04 and 6.0 percent in FY05, reaching 6.5 percent in FY06 (fig: I).

Figure I: Trend in GDP Growth



Notes: * indicates I-PRSP projections

The acceleration of the economic growth momentum which took place during the 1990s, seems to have planned at 5 percent plus level in the early 2000s, resulting in annual per capita income growth of little above 3 percent. Admittedly, such “mediocre” level of per capita income growth has failed to make a perceptible dent on the poverty situation. Currently about 40 percent of the total population in Bangladesh, live below the poverty line.

II.2 Sectoral Contribution to Incremental Growth

The contribution of the real economic sectors¹ to incremental growth has jumped from 19.7 percent during FY02 to 34.2 percent during FY03. This is largely due to the 12.1 percent recovery growth of the agriculture and forestry sector, which recorded negative (-) 2.6 percent growth in FY02.

However, it can be noted that the incremental contribution of the “tradable sectors” remains lower than its respective sectoral share (36.8 percent in FY03) implying that the service sector has played the decisive role in the incremental economic growth. On the other hand, the incremental contribution from service sector has decreased from 77.8 percent in FY02 to 63.2 percent in FY03.

¹Include crop + livestock + forestry + fisheries + mining & quarrying + manufacturing

II.3 Skewed Structural Transformation

The on-going structural transformation of the Bangladesh economy is characterised by falling share of the agriculture sector with marginal increase of the manufacturing in the backdrop of increasing contribution of the service sector. In FY03, the real economic sector accounted for 40.5 percent of the GDP; the said proportion was 43 percent a decade back. This suggests that in spite of improved growth, the evolution of the Bangladesh economy remains biased against modern, industrial transformation having concomitant implications for sustained growth and equitable income distribution.

II.4 Deteriorating Income Distribution

Notwithstanding improved growth, income distribution deteriorated during 1990s coupled with slow pace of poverty alleviation. Population below absolute poverty line (by HCR-DCI method) declined from 47.52 percent in 1991-92 to 44.33 percent in 2000. More importantly, the incremental growth had an anti-poor bias, which resulted in deterioration in income distribution. For example, between 1995-96 and 2000, national income attributable to the poorest 10 percent of the population declined further from a miniscule proportion of 2.24 percent to 1.84 percent. Conversely, the control on the national income by the richest 10 percent of the population increased from 34.68 percent to 40.72 percent. In other words, the income differential between the poorest and the richest increased from 35.7 times to 53.4 times during the second half of 1990s. There is no evidence, which suggests that this trend has been reversed during the last couple of years.

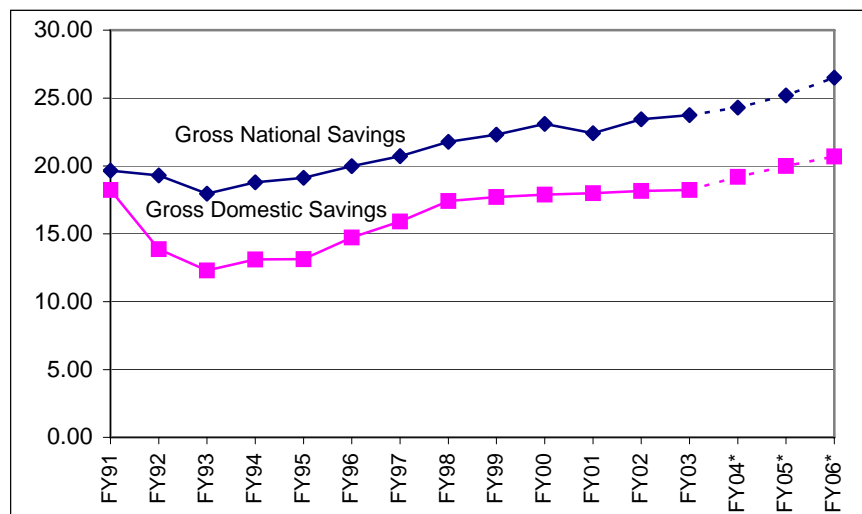
The bottom line is, incremental growth does not automatically benefit the poor. It is not clear how the budget for FY04, apart from adopting more of the same traditional measures, is going to change the situation. While the I-PRSP do outline a strategy for poverty alleviation, the elements of pro-poor economic growth is not quite obvious from the document.

II.5 Stagnated Savings Scenario

Domestic savings rate continues to stagnate at 18.2 percent of GDP, whereas the national savings rate increased marginally from 23.4 percent in FY02 to 23.7 percent in FY03 (fig: II). The marginal increase of the latter is underpinned by increasing flow of foreign remittances from

expatriate Bangladeshi workers. The prolonged stagnation of the domestic savings may be largely explained by the deteriorating income distribution scenario in the Bangladesh economy as the poor who demonstrate higher propensity to save are being deprived of their proportionate share in incremental national income.

Figure II: Trends in Savings Rate
(as percent of GDP)



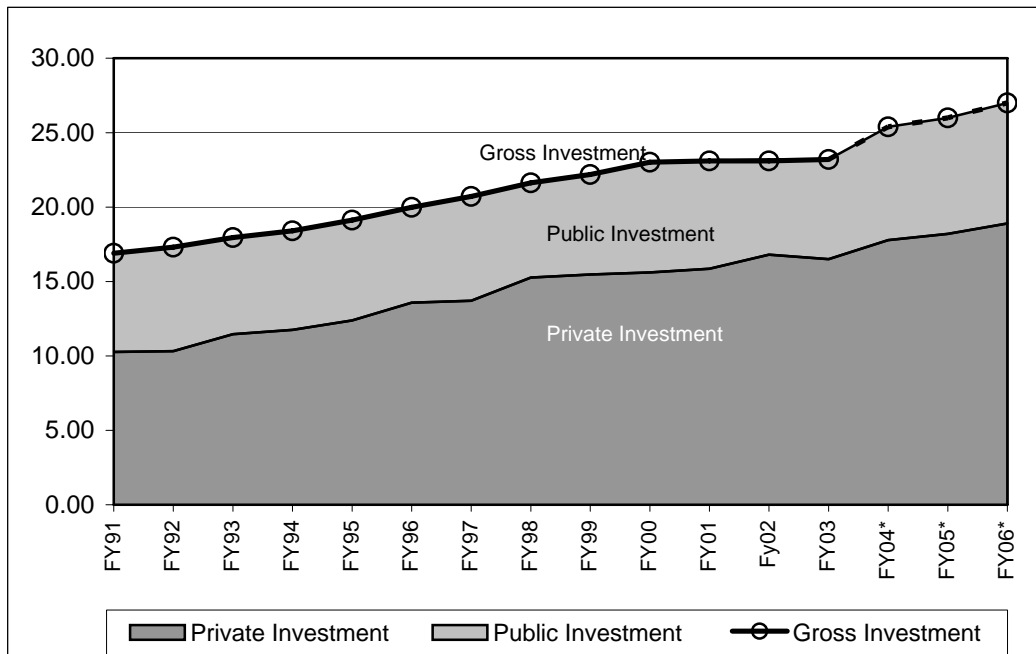
Notes: * indicates I-PRSP projections

One will have to wait in anticipation to see whether the domestic and national savings rates, projected by the I-PRSP for the FY04 at 18.7 percent and 23.4 percent respectively – are achieved or not. Moreover, even though national savings rate was 23.7 percent during FY03 and is set to be 23.4 percent in FY04, it is still uncertain if the target will be met or not.

II.6 Idle Investment Situation

The gross investment rate also stagnated during FY03 at 23.2 percent. More importantly, the role of the private sector, depicted by its share in the GDP, in fact declined from 16.8 percent in FY02 to 16.5 percent in FY03. The marginal increment in public investment from 6.4 percent (FY02) to 6.7 percent (FY03) sustained the gross investment figure at its preceding year's benchmark (Fig III).

Figure III: Investment Trend
(as percent of GDP)



Notes: * indicates I-PRSP projections

The revealed decline in share of private investment in gross capital formation vindicates CPD's express concern about the continuing investment recession in the economy. Our subsequent analysis of the state of the economy corroborates the above view. One wonders whether the announced fiscal measures are going to ensure the increase of gross investment rate to 24.3 percent in FY04.

III. FISCAL CONSOLIDATION

III.1 Enhancing Revenue Collection

The total revenue collection target for FY03 was 19.57 percent higher than the actual benchmark of FY02. The collection in FY03 was actually 12.47 percent more, i.e. about 94 percent of the target. Such a feat was possible thanks to spectacular success in meeting the revenue collection target by the NBR. In contrast, the achievement rate in case of non-NBR taxes was less than 70 percent and in case of non-tax revenues – a little above 80 percent (table 1).

The total collection was 12.5 percent higher over the earlier year's receipts and it pushed the revenue-GDP share to 10.36 percent which still leaves Bangladesh with one of the lowest Revenue-GDP ratios, even amongst the low income countries.

TABLE 1
Trends in Total Revenue Receipts

(In Billion Taka)

Year	Tax Revenue			Non-tax Revenue			Total Revenue			Total Revenue as percent of GDP
	Target	Realised	Difference as percent of target	Target	Realised	Difference as percent of target	Target	Realised	Difference as percent of target	
1997/98	161.53 (15.17)	150.01 (6.59)	-7.13	34.71 (12.15)	37.76 (22.96)	8.79	196.24 (14.63)	187.77 (9.52)	-4.32	9.38
1998/99	166.17 (2.87)	158.55 (5.69)	-4.59	41.59 (19.82)	38.45 (1.83)	-7.55	207.77 (5.88)	197.00 (4.92)	-5.18	8.97
1999/00	186.35 (12.14)	170.96 (7.83)	-8.26	55.16 (32.63)	42.49 (10.51)	-22.97	241.51 (16.24)	213.45 (8.35)	-11.62	9.00
2000/01	192.78 (3.45)	194.90 (14.00)	1.10	49.20 (-10.80)	46.83 (10.21)	-4.82	241.98 (0.19)	241.73 (13.25)	-0.10	9.53
2001/02	220.23 (14.24)	219.30 (12.52)	-0.42	64.33 (30.75)	57.40 (22.57)	-10.77	284.56 (17.60)	276.70 (14.47)	-2.76	10.13
2002/03	255.00 (15.79)	249.5 (13.77)	-2.15	75.84 (17.89)	61.70 (7.49)	-18.64	330.84 (16.26)	311.20 (12.47)	-5.94	10.36
2003/04	290.71 (14.00)	n.a.	n.a.	71.00 (-6.38)	n.a.	n.a.	361.71 (9.33)	n.a.	n.a.	10.94

Notes: Figures in the parentheses depict annual growth rates.

GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 percent inflation.

n.a.: not available/not applicable

Source: Computed from CPD-IRBD Database and Budget Summary data.

The National Budget for FY04, with a projection of about 16.2 percent growth, fixed a target of Tk. 361.71 billion to be collected as revenue in FY04. The largest contribution to this growth is expected to originate from NBR tax revenue (16.52 percent), followed by non-NBR tax revenue (15.07 percent).

III.1.1 NBR Component

The impressive overall trend in revenue receipt by the NBR however is underwritten by higher collection rate of total internal trade-related revenue in comparison to total import related revenue. Whatsoever, the underbelly of the NBR's tax portfolio remains to be the income tax.

The revenue collection from NBR sources during FY03, 17.53 percent more than the matching period of FY02. This was Tk 0.20 billion (0.09 percent) more than the revised target. In this connection, what is important to note is that the total *internal trade-related revenue* collection has grown 22.39 percent as against the 15.14 percent of total *import-related revenue*. One observes that total import related revenue has been realised more than 100 percent over target but *supplementary Duty (Import)* non-fulfilment of target (about 18 percent). As a result in FY03 the supplementary Duty (Import) has been decreased by 4.5 percent compare to the previous year (table 2).

TABLE 2
Composition of Tax Revenue Receipts
(NBR Component: FY02-FY03)

(In Billion Taka)

No.	Source of Revenue	FY 03			FY 02			Percent change of collection (FY03 over FY02)		
		Revised Target	Achieved	Difference	Collection as Percent of target	Revised Target	Achieved		Difference	Collection as Percent of target
1	Import Duty	58.90	66.87	7.97	113.53	53.50	53.95	0.45	100.84	23.95
2	Value Added Tax (Import)	43.75	41.14	-2.61	94.02	39.60	37.58	-2.02	94.89	9.47
3	Supplementary Duty (Import)	15.50	12.72	-2.78	82.06	14.00	13.32	-0.68	95.13	-4.50
	<i>Total Import Related Revenue</i>	<i>118.15</i>	<i>120.73</i>	<i>2.57</i>	<i>102.18</i>	<i>107.10</i>	<i>104.85</i>	<i>-2.25</i>	<i>97.90</i>	<i>15.14</i>
4	Excise Tax	3.10	3.18	0.08	102.62	3.00	2.93	-0.08	97.50	8.76
5	Value Added Tax (Local)	36.96	36.41	-0.55	98.50	30.00	32.29	2.29	107.65	12.73
6	Supplementary Duty (Local)	28.25	31.37	3.12	111.05	24.50	22.76	-1.74	92.89	37.84
	<i>Total Internal Trade Related Revenue</i>	<i>68.31</i>	<i>70.96</i>	<i>2.65</i>	<i>103.88</i>	<i>57.50</i>	<i>57.98</i>	<i>0.48</i>	<i>100.83</i>	<i>22.39</i>
7	Income Tax	47.88	43.72	-4.16	91.31	41.00	37.89	-3.11	92.42	15.38
8	Other Taxes	3.16	2.30	-0.86	72.78	1.70	1.53	-0.17	89.89	50.51
	<i>Total Revenue Earnings</i>	<i>237.50</i>	<i>237.70</i>	<i>0.20</i>	<i>100.09</i>	<i>207.30</i>	<i>202.24</i>	<i>-5.06</i>	<i>97.56</i>	<i>17.53</i>

Source: Computed from CPD-IRBD Database and NBR data

It may be noted that *income tax* collection has suffered a short fall to the extent tune of 9.13 percent during the period FY03. Recent initiatives of the NBR to identify potential taxpayers are yet to translate in to actual yield.

III.1.2 Non-NBR Component

The outlandish 45.83 percent growth target in FY03 for non-NBR taxes remained miserably unachieved recording less than 1 percent growth. The modest target growth of 10.08 percent for FY04 seems realistic. Shortfall in land revenue and stamp duty collection is the major reason behind non-fulfilment of the non-NBR targets in FY03; the budget does not spell out any special measure in this regard.

III.1.3 Non-Tax Revenue

Collection of non-tax revenue in FY03 was in fact less than the target by 18.64 percent but more than the same in FY02 by 7.87 percent. The major contributing factors in this regard had been low collection in Dividend and Profit, Administrative Fees and Charges, Rent, Leases and Recovery, and Capital Revenue. Thus, the Ministry of Finance has given a much humbler target growth of 15.07 percent for FY04.

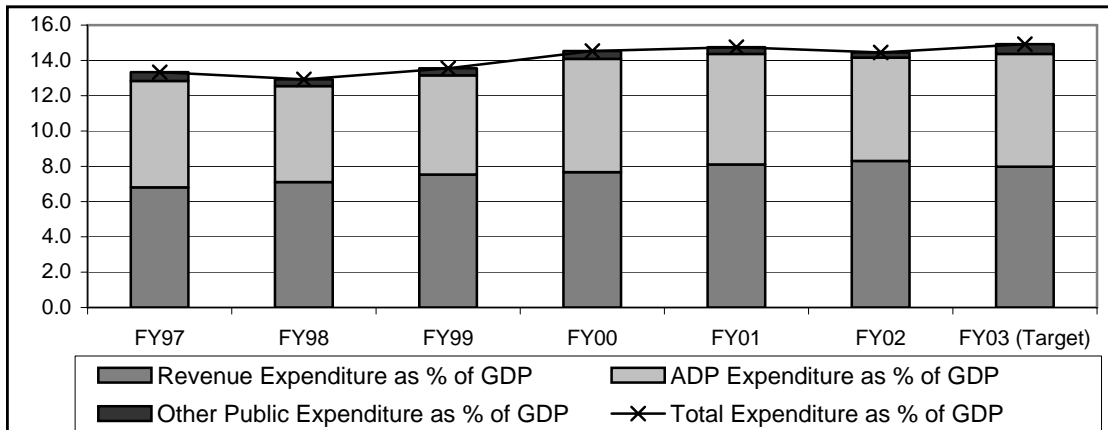
To sum up, the budget for FY04 has not spelt out any special initiative to augment revenue collection in the area of non-NBR taxes and non-tax revenues which currently together account for about 23 percent of the total revenue receipt.

In formal discussions suggest that collections on account of non-NBR tax revenue and non-tax revenue are remaining behind their respective targets. It is held that performance in the two areas will, at the margin, define the success of aggregate revenue collection at the end of fiscal year.

III.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.

Figure IV: Composition of Public Expenditure
(as percent of GDP)



If the target volume of public expenditure is realised in FY04, its share in GDP will increase to 15.7 percent – without significantly changing the split between ADP and non-ADP heads (Fig IV). 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.

III.2.1 Revenue Expenditure

Revenue expenditure overshoot the target from FY03 and recorded a rise of more than 11.5 percent (table 3). The revenue expenditure is to grow by about 14.5 percent in FY04. In the period FY03 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 28 percent), subsidies and transfers (more than 27 percent), and debt servicing liability (22 percent).

In this connection, it may be noted that expenditure on account of defence 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.

TABLE 3:
Trend in Revenue Expenditure

(In Billion. Taka)

Year	Expenditure			Annual Growth of Expenditure		Revenue Earning-Expenditure Ratio	Revenue Expenditure as percent of GDP
	Target	Actual	Difference as percent of target	Target	Actual		
FY98	145.44	145.00	-0.30	20.17	15.68	1.29	7.24
FY99	159.37	167.65	5.20	9.58	15.62	1.18	7.63
FY00	178.00	184.44	3.62	11.69	10.01	1.16	7.78
FY01	196.33	206.62	5.24	10.30	12.03	1.17	8.01
FY02	220.38	226.92	2.97	12.25	9.82	1.21	8.31
FY03	239.72	253.07	5.57	8.78	11.52	1.23	8.42
FY04	289.69	n.a.	n.a.	20.85	n.a.	1.25 ^b	8.76 ^b

Notes: ^a Based on target figure.

^b Based on total target revenue and estimated current GDP for FY04. GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 percent inflation.

Economic analysis of the projected revenue expenditure in FY04 reveals that it will continue to be dominated by Pay and Allowances (26.1 percent), Interest Payment (22.3 percent) and subsidies and current transfers (27.0 percent) – together for more than 75 percent. However, two major features of the revenue expenditure portfolio of the coming year relate to a lump sum Block Allocations of Tk. 1967 crores (6.8 percent) for *inter alia*, the declared 10 percent Dearness Allowance for government employees and significantly enhanced allocation for Repairs and Maintenance (table 4).

TABLE 4
Economic Analysis of Revenue Expenditures in FY03

(In Billion Taka)

Item	FY03			FY04 (Target)	Annual Growth	
	Target	Actual	Actual as percent of Target		Actual FY03 over Actual FY02	Target FY03 over Actual FY02
Pay of Officer and Establishment; and Allowance	73.19 (30.53)	72.82 (28.77)	99.49	75.02 (25.90)	7.07	7.62
Goods and Services	36.12 (15.07)	42.65 (16.85)	118.08	44.69 (15.43)	23.55	4.63
Interest Payment	46.14 (19.25)	55.74 (22.03)	120.81	64.37 (22.22)	23.32	2.08
Domestic	35.89 (14.97)	46.17 (18.24)	128.64	54.61 (18.85)	28.79	0.11
Foreign	10.25 (4.28)	9.57 (3.78)	93.37	9.76 (3.37)	2.35	9.63
Subsidies and Current Transfer	65.73 (27.42)	70.84 (27.99)	107.77	78.08 (26.95)	19.76	11.12
Block Allocation	14.39 (6.00)	5.66 (2.24)	39.33	19.67 (6.79)	-54.02	16.90
Acquisition of Asset and Workers	10.16 (4.24)	10.53 (4.16)	103.64	12.43 (4.29)	-4.79	-8.14
Recoveries(-)	6.01 (2.51)	5.17 (2.04)	86.02	4.57 (1.58)	55.26	80.48
Total	239.72 (100.00)	253.07 (100.00)	105.57	289.69 (100.00)	11.52	5.64

Notes: Figures in the parentheses give the percent of total revenue expenditure.

III.2.2 Annual Development Programme (ADP)

The ADP for FY03 has to be reduced to Tk. 17,100 by slashing it by more than 10 percent. In reality, the realised (actual) size of the ADP was to the last year tune of Tk. 15,434 crores, i.e. about 80 percent of the original target. The actual (implemented) ADP constitutes an only about 61 percent of the revenue expenditure (table 5).

In FY03 the implementation of ADP as percent of original and revised targets are 80.38 percent and 90.26 percent respectively. Because of the low implementation of ADP, the share of ADP came down to only 61 percent of revenue expenditure in FY03, while the matching figure in FY00 and FY01 was 83.9 and 78.2 percent, respectively. In FY03 a total of 1289 projects are included in ADP of which 188 are new.

The total public expenditure in Bangladesh as a share of GDP is still low in comparison to other low-income countries – it was only 14.6 percent in FY03. Thus, it is not the overall size of the public expenditure, but its composition and quality which remain a matter of greater concern. *First*, the ADP is routinely under-achieved. The government slashed down the ADP for FY03 by Tk. 21 billion, and yet could not fully implement the scaled down figure. Thus, a development expenditure target of Tk. 203 billion for FY04 was a daunting figure to chase. *Second*, whatever may be the size of the ADP; it is the prioritisation and selection of the included projects as well as the quality of their envisaged expenditure lines which have always remained suspect. *Third*, in the backdrop of weak implementation of the ADP whilst the revenue expenditures have systematically crossed the budget limit, the composition of public expenditures is assuming an unhealthy structural rigidity. The revenue expenditure-basket is assuming an immutable character where three-quarter of the revenue budget remains committed to salaries and allowances, subsidies and transfers, and interest payments.

TABLE 5
Annual Development Programme

Year	Annual Development Programme			Actual as percent of original	Actual as percent of Revised	Annual Growth of Actual ADP	(In Billion Taka)	
	Original	Revised	Actual				Actual ADP as percent of Revenue Expenditure	Actual ADP as percent GDP
FY98	128.0 (2.4)	122.0 (4.3)	110.4 (0.0)	86.2	90.5	0.0	76.1	5.5
FY99	136.0 (6.3)	140.0 (14.8)	125.1 (13.3)	92.0	89.4	13.3	74.6	5.7
FY00	155.0 (14.0)	165.0 (17.9)	154.7 (23.7)	99.8	93.8	23.7	83.9	6.5
FY01	175.0 (12.9)	182.0 (10.3)	161.5 (4.4)	92.3	88.7	4.4	78.2	6.4
FY02	190.0 (8.6)	160.0 (-12.1)	140.9 (-12.8)	74.1	88.0	-12.8	62.0	5.2
FY03	192.0 (1.1)	171.00 (6.87)	154.34 (9.54)	80.38	90.26	9.54	61.0	5.1
FY04	203.0 (5.73)	n.a.	n.a.	n.a.	n.a.	32.71 ^a	70..07 ^a	6.1 ^a

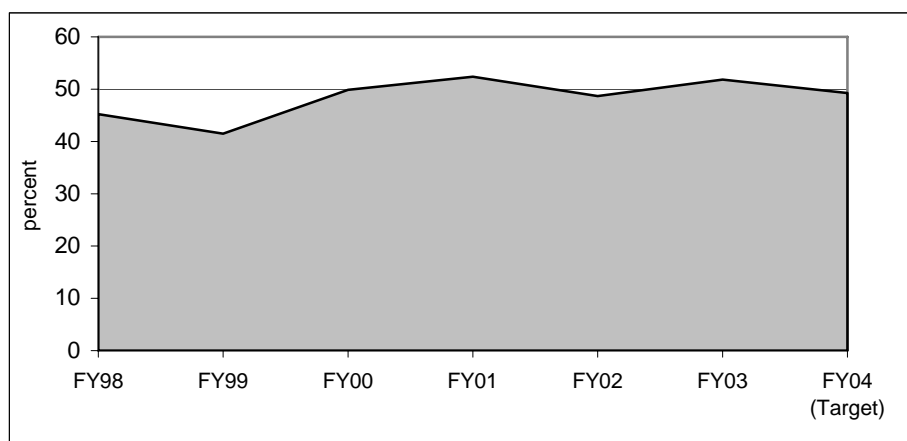
Notes: Figures in parentheses depict annual growth rates over preceding year.

^a Based on Target ADP of FY04.

Source: Computed from CPD-IRBD Database and Budget Summery Data

The share of internal resources in ADP financing in FY03 was 51.81 percent according to the revised budget while the said share in FY02 was 48.66 percent. In FY00 and FY01 the same figure was 49.85 and 52.36 percent, respectively. The share of internal resources in ADP financing in FY04 is supposed to increase to 49.26 percent (Fig V).

Figure V: Share of Internal Resources in ADP (Revised)
(FY98-FY03)



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

The size of the ADP for FY04 has been fixed at Tk. 20,300. Taking note of the development need of the country and public expenditure-GDP ratio in comparable countries, the said size does not seem to be inappropriate. However, question is whether the government is capable of effectively implementing such a portfolio.

The other issue regarding the ADP is the quality of the projects included. The ADP from FY04 includes 174 unapproved investment projects against which sectoral block allocation has been provided. Whilst this approach provides flexibility to the policymakers, it may not encourage allocative discipline.

The ADP has given relative priority to physical infrastructure – 17.4 percent to transport and 15.9 percent to electricity (in comparison to 13.3 percent to education). This seems justified to bring about inter-sectoral balance for economic growth.

It is not clear how the implementation of the projects scheduled for completion in FY04 and the priority projects will be expedited. Discontinuation of projects after significant incurred expenditures also raises concern.

III.3 Fiscal Deficit and Financing

The budget deficit has been brought down sequentially during the last two years. In FY03, the actual budget deficit accounted for 4.3 percent of the GDP, which was same in the previous matching period. During the FY03 the foreign financing accounted for 55 percent and the rest (35percent) was from domestic sources.

The total public expenditure is to grow in FY04 by 18.4 percent in comparison to 16.4 percent growth in total revenue recipient during the same period. This has led to a programmed increase of the overall budget deficit (without grants) from 4.25 percent in FY03 to 4.81 percent in FY04. Once foreign grants are accounted for, the budget deficit figure comes down to a sustainable level of 3.4 percent.

The overall budget deficit in FY04 will be 59 percent financed by external sources. However, the share of grant will be only 16.4 percent in comparison to 19.1 percent in FY03, whereas foreign loans will account for 42.5 percent as against 35.5 percent in FY03 (table 6).

On the other hand, contribution of term-debt will increase in domestic sources. More importantly, in spite of significant increase in foreign aid prospect and satisfactory revenue collection, the financing need has to be balanced by borrowing from the banking system to the tune of Tk. 2603 crores (which is 42 percent more than that of in FY03).

TABLE 6
Budget Deficit and Financing

(In Billion Taka)

Year	Budget Deficit			Actual Budget Deficit as percent of GDP	Financing Deficit (as % of GDP)	
	Target	Actual	Difference as percent of Target		Domestic Financing	Foreign Financing
FY98	81.6	82.9	1.6	4.1	1.5	2.6
FY99	108.0	135.1	25.1	6.1	2.1	4.0
FY00	120.3	166.1	38.1	7.0	3.3	3.7
FY01	168.6	178.2	5.7	7.0	3.5	3.5
FY02	149.1	118.3	-20.7	4.3	2.1	2.3
FY03	117.7	127.8	8.6	4.3	1.9	2.1
FY04	158.1	n.a.	n.a.	4.8 ^a	2.0 ^a	2.8 ^a

Notes: GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 percent inflation.

^aBased on Target figures.

Source: Computed from CPD-IRBD Database and Budget Summary Data.

IV. DEVELOPMENTS IN THE MONETARY SECTOR

IV.1 Domestic Credit Expansion

Following expansion of domestic credit at the high rate of more than 17.6 percent in FY01, domestic credit growth was brought down to below 13 percent in FY02 as part of the overall strategy of fiscal consolidation. The most disturbing feature of the credit growth in FY01 had been greater increase in borrowings by the government and quasi-government sector in comparison to the private sector. In contrast, both the aggregate and inter-sectoral balance was largely restored in FY02.

TABLE 7
Domestic Credit Expansion

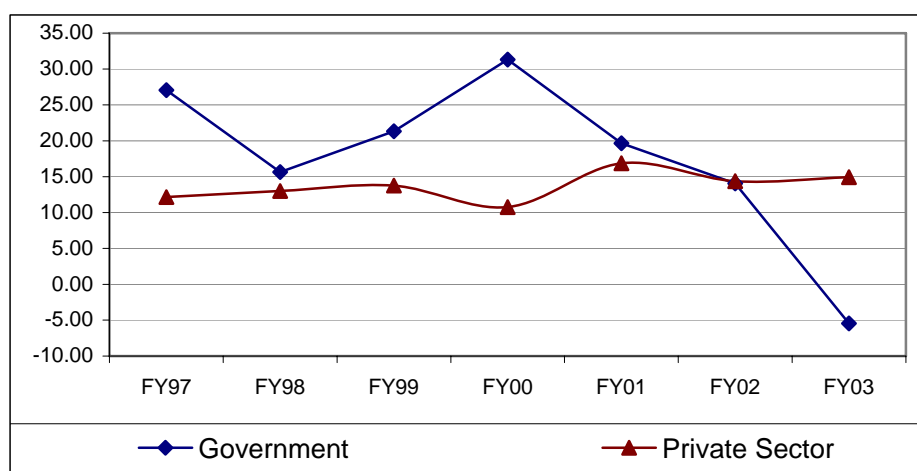
(In Billion Taka)

Year	Government		Other Public		Private Sector		Total		Share of Private Sector in Total Credit
	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	
FY98	92.7	15.7	62.5	6.4	401.2	13	556.4	12.6	72.1
FY99	112.5	21.3	60.2	-3.7	456.4	13.8	629.1	13.1	72.5
FY00	147.7	31.3	61.7	2.5	505.4	10.7	714.9	13.6	70.7
FY01	176.8	19.7	73.6	19.2	590.7	16.9	841.1	17.7	70.2
FY02	201.6	14.1	72.4	-1.6	675.7	14.4	949.8	12.9	71.1
FY03	190.6	-5.5	72.6	0.2	776.6	14.9	1039.8	9.5	74.7

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

Figures for FY03 reveal that the domestic credit flow has further slowed down recording and aggregate growth of 12.9 percent in FY02 to 9.5 percent in FY03 because of credit to the Government sector in FY03 decreased by 5.5 percent. The growth of credit to the private sector has increased from 14.4 percent in FY02 to 14.9 percent in FY03 and the share of private sector has also increased from 71.1 percent in FY02 to 74.7 percent in FY03 (table7).

Figure VI: Trends in Domestic Credit



The low off take of credit by the government during the period of FY03 is indicative of the low level of government expenditure in this period.

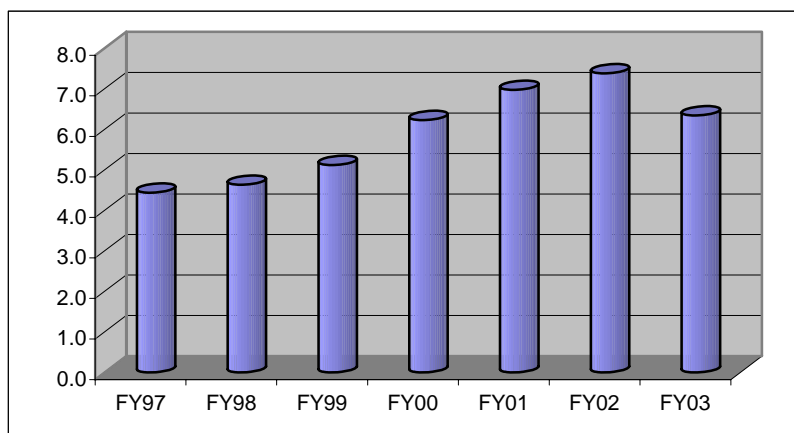
IV.2 Government Borrowing and Public Debt

High levels of government borrowing from the Bangladesh Bank as well as from the scheduled bank dominated the macro-economic concerns since FY00. Total domestic outstanding debt as a share of GDP secularly rose from 13.0 percent in FY00 to 16.6 percent in FY02. During this period one observes a change in the fiscal stance of the government as it moved away, partly, from borrowing from the banking system to raising of funds through sale of savings certificates to the public and treasury bonds to non-bank financial institutions.

At the end of FY03, there had been a net flow from the banking system (including both Bangladesh Bank and scheduled banks) to the government to the tune of Taka 190.6 billion. In FY03, the net decrease in government borrowing from the banking system amounted to about Tk.11 billion, which was 144.35 percent less than the comparable figure in FY02. The

outstanding government borrowing from the banking sector as share of GDP decreased to 6.3 percent in FY03, while the comparable figure in FY02 was 7.4 percent (Fig VII).

Figure VII: Outstanding Government Borrowing from Banking Sector
(as share of GDP)



The government borrowing through National Savings Department (NSD) during FY03 was Tk. 94.19 billion and repayment of principal amounted Tk to 51.13 billion. So the net sale amounted to Tk. 43.06 billion which is 9.08 percent lower than FY02 (table 8). The government has lowered the interest rate in FY03 for savings certificates with the dual purpose of lowering cost of borrowing and channelling funds to the capital market. This also implies that the government's desire to push the small savers towards the capital market through decreasing the rate of assured return on public savings instruments has not as yet yielded its results.

TABLE 8
Net Government Borrowing

Sources	<i>(In Billion Taka)</i>		
	FY 02	FY03	Growth Rate (FY03 over FY02)
Net Government Borrowing from the Banking Sector	24.87	- 11.03	- 144.35
Net Non-bank Borrowing of the Government from the Public	47.36	43.06	-9.08
Total	72.23	32.03	- 55.66

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

IV.3 Agricultural Credit

The agricultural credit delivery system since the post-1998 flood programmes had been low on disbursement and high on recovery. This resulted in net outflow of resources from the rural areas through the institutional credit system. During the period of FY03, against 10.96 percent growth in agricultural credit disbursement, recovery grew by 7.85 percent. This implies that, an amount of Tk. 2.37 billion was withdrawn from the rural economy (table 9).

TABLE 9
Agricultural Credit Expansion

Year	Disbursement		Actual Recovery	Net Flow
	Target	Actual		
FY98	23.53	18.15	17.79	0.36
FY99	32.69	30.19	19.16	11.03
FY00	33.31	28.51	29.96	-1.45
FY01	32.66	30.2	28.78	1.42
FY02	33.27	29.55	32.6	-3.05
FY03	35.61	32.79	35.16	-2.37

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

IV.4 Industrial Credit

Term Loan

During the period FY03 against a disbursement of Tk.39.62 billion, recovery was Tk. 38.35 billion. In FY03 disbursement grew by 13.0 percent while recovery grew by 19.5 percent. In FY02, the comparable figure was 14.7 percent and 15.1 percent and in FY01, the comparable figure was 87.87 percent and 69.06 percent, respectively (table 10).

TABLE 10
Disbursement and Recovery of Term Loan

Year	Disbursement	Growth of Disbursement	Recovery	(In Billion Taka)
				Growth of Recovery
FY98	11.2	-6.7	8.6	-3.4
FY99	13.3	18.8	10.9	26.7
FY00	16.3	22.3	16.5	51.4
FY01	30.6	87.9	27.9	69.1
FY02	35.1	14.7	32.1	15.1
FY03	39.6	13.0	38.4	19.5

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

The flow of industrial credit (both sanctioned and disbursement) registered significant raise during the FY03. During FY02 the amount of sanctioned and disbursed industrial credit accounted Tk 39.24 bln and Tk 35.05 bln respectively. During the FY03, the flow of sanctioned and disbursed industrial credit grew up to Tk 54.07 bln and 39.62 bln accounting a 37.8 percent and 13.0 percent annual growth respectively over the previous year (table 11).

TABLE 11
Sanction and Disbursement of Term Loan

(In Billion Taka)

Year	NCB		DFI		PCB(D)		PCB(F)		NBFI		Total	
	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed
FY98	3.90	2.53	0.86	1.54	2.54	2.33	6.35	2.39	2.44	2.41	16.08	11.20
FY99	5.93	3.48	0.35	0.65	2.98	2.99	3.69	2.69	4.46	3.49	17.40	13.30
FY00	5.61	3.33	0.61	0.79	9.28	5.28	4.41	2.60	5.34	4.27	25.25	16.27
FY01	7.83	5.26	1.42	1.21	16.65	12.55	3.36	4.51	8.44	7.02	37.71	30.57
FY02	9.46	4.99	0.89	0.48	16.05	16.59	4.43	5.38	8.40	7.60	39.24	35.05
FY03	13.95	6.69	2.42	1.36	20.57	16.01	5.64	6.09	11.49	9.47	54.07	39.62

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

Working Capital

The flow of working capital also showed a significant increase in FY03-both in terms of sanction and disbursement. In FY02 the sanctioned amount increased by 9.34 percent while the disbursement grew by 2.86 percent. On the other hand, in FY03 sanction and disbursement of working capital stood at Tk 137.66 bln and Tk 156.72 bln accounting annual growth of 19.57 percent and 13.85 percent respectively (table 12).

TABLE 12
Sanction and Disbursement of Working Capital

(In Billion Taka)

Year	NCB		DFI		PCB (D)		PCB (F)		NBFI		Total	
	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed	Sanc- tioned	Dis- bursed
FY98	39.64	35.42	0.73	1.00	11.33	16.35	27.32	13.03	0.12	0.12	79.14	65.91
FY99	40.58	37.52	1.35	1.30	15.98	22.85	27.73	17.14	0.26	0.25	85.89	79.06
FY00	43.77	43.43	1.51	1.45	24.56	32.22	28.14	28.55	0.86	1.17	98.84	106.82
FY01	39.79	39.82	2.75	3.61	35.42	51.26	25.25	33.52	2.09	5.62	105.30	133.82
FY02	40.45	39.20	2.90	4.00	49.17	68.23	21.80	23.45	0.81	2.76	115.13	137.65
FY03	37.67	34.30	2.18	2.74	67.85	87.33	29.31	29.71	0.64	2.64	137.66	156.72

Source: Computed from CPD-IRBD Database and Bangladesh Bank data

IV.5 Loan Default Scenario

The total amount of classified loans decreased to Tk. 219.7 billion in FY03 (as of June 30, 2003) from Tk. 244.6 billion (as of June 30, 2002) in FY02, registering a negative growth of about (-) 10.2 percent. The share of classified loans in total outstanding loans decreased to 25.26 percent in FY03 from 31.08 percent in the preceding year (table 13).

TABLE 13
Classified Loan

(In Billion Taka)

Type of Bank	As of 30-06-2003			As of 30-06-2002			Annual growth of total classified
	Total Outstanding	Total Classified	Classified as % of Total	Total Outstanding	Total Classified	Classified as % of Total	
NCBs	359.20	117.89	32.82	339.58	130.70	38.49	-9.80
DFIs	100.03	48.24	48.23	108.44	61.68	56.88	-21.79
PCB(D)	351.34	52.31	14.89	293.32	50.98	17.38	2.61
PCB(F)	59.27	1.28	2.16	45.56	1.24	2.72	3.23
All Banks	869.84	219.72	25.26	786.90	244.60	31.08	-10.17

Source: Computed from CPD-IRBD Database and Bangladesh Bank Data

Both the NCBs and DFIs made significant progress in FY03 in reducing the total classified loan by recording negative growth rates of (-) 9.8 percent and (-) 21.8 percent respectively over the preceding year (FY02). For NCBs and DFIs, the share of classified loans in total outstanding loans also decreased from 38.5 percent and 56.9 percent in FY02 to 32.8 percent and 48.2 percent in FY03. However, for both the domestic and foreign PCBs, the total classified loan have

increased in FY03 registering annual growth of 2.6 percent and 3.2 percent respectively over the previous year (table 13).

IV.6 Inflation

Up to FY02 the Bangladesh Bureau of Statistics (BBS) reported consumer price inflation data with reference to the consumption weights and prices of FY86 as the base year. From the FY03 the BBS has commenced reporting inflation data with reference to FY96 as the new base year. The principle changes arising from the rebasing are: (i) the consumption baskets for both rural and urban CPI have higher numbers of items, with weights based on the FY96 Household Expenditure Survey (HES), (ii) the food component in both rural and urban CPI baskets now has lower weight than before, although it still remains dominant in the rural CPI basket, and (iii) in aggregation for national level CPI, the rural CPI has a lower weight than before in the new base, reflecting the increased urbanization of the country side.

At the national level, the inflation rate based on *Consumer Price Index (CPI)*, on a point to point basis (FY96=100), increased from 3.58 percent in end June of FY02 to 5.03 percent in end June of FY03. However, two disturbing features of the recent rise in the price level may be noted. *First*, the inflation rate during the period FY03 had been higher in the rural area in comparison to its urban counter part. *Second*, curiously, increase in food price during above mentioned period had been again higher in the rural area along with non-food price.

Table 14
Inflation Rate
(Base: FY96=100)

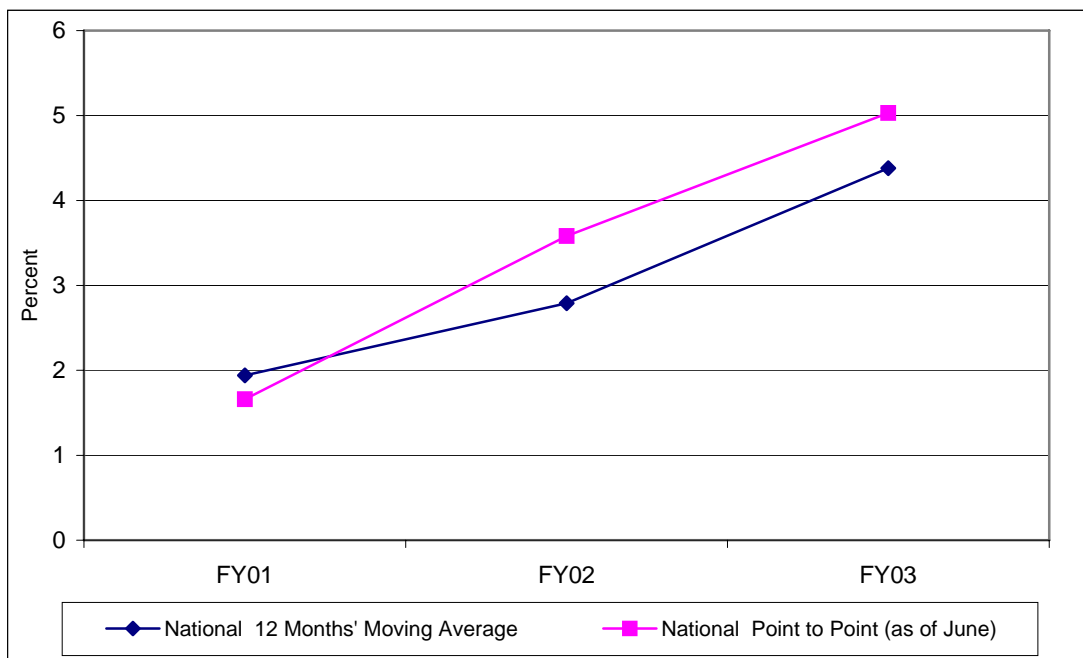
Year	National		Rural		Urban	
	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)
FY01	1.94	1.66	2.11	1.52	1.52	1.99
FY02	2.79	3.58	2.57	3.40	3.35	4.03
FY03	4.38	5.03	4.73	5.34	3.52	4.27

Source: CPD-IRBD Database and BBS data.

The trend in inflation rate - expressed through a moving average of 12 months observations - demonstrates an increasing trend. The inflation rate (moving average) has increased from 2.79 percent in the end June of FY02 to 4.38 percent in the end June of FY03 (table 14).

The food inflation, on point to point was higher than the non-food inflation but the non-food inflation on moving average was higher than food inflation. For instance, non-food inflation in FY03 on point-to-point basis and moving average were 4.68 and 5.66 percent, respectively. The matching figure for food inflation is 5.22 and 3.46 percent, respectively.

Figure VIII: National Inflation FY01-FY03



Of course, there is no reason yet for panic because of the current level of inflation. Indeed some would say that a "little inflation" is good for stimulating investment. However, the recent moderate rise in price level is largely a "cost push", rather than a "demand pull" phenomenon. Increase in price of fuel, public utility rates and exchange rate adjustment may have been responsible for this. Temporary disruption in the domestic supply chain due to limited floods may have contributed to it as well.

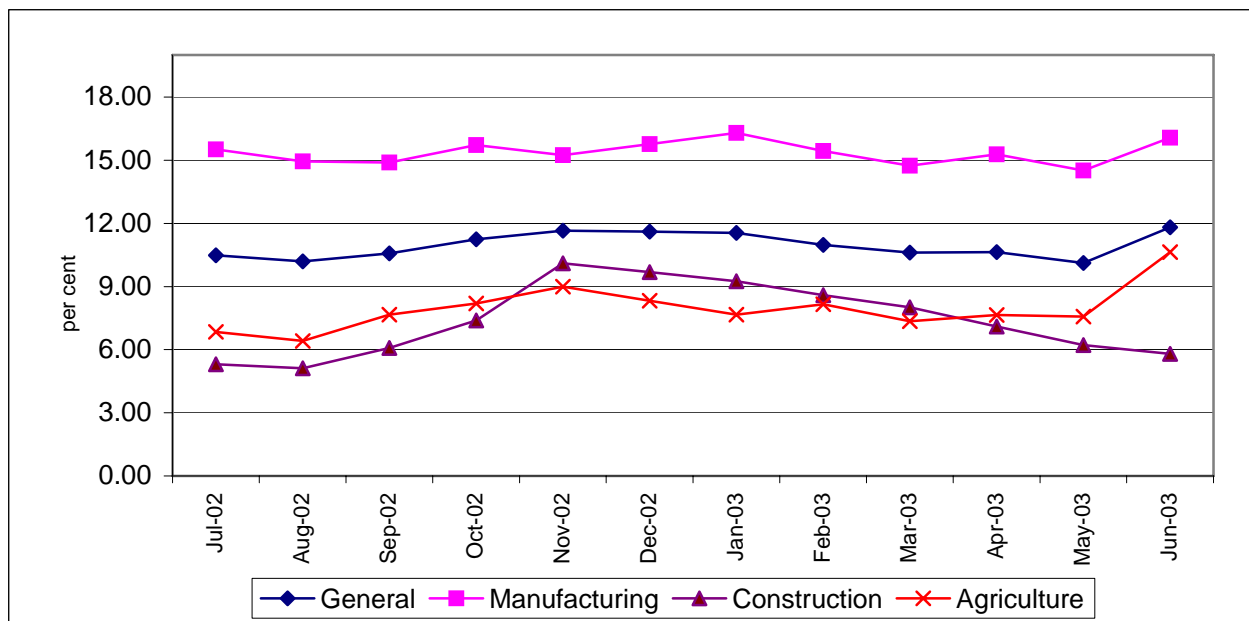
In sum, it may be emphasised that in the backdrop of an overall conservative monetary policy, one observes low off take of private sector credit, particularly industrial term loans. Whilst

inflationary pressure remains moderate, one should not end up with the worst of the two worlds epitomised by “stagflation” – stagnation coupled with inflation.

IV.7 Wage Inflation

This concern for price inflation becomes quite serious when we consider the recent trend in wage inflation. The general wage index grew by more than 10 percent throughout FY03; it was only 7.37 percent in FY02. The point-to-point increase in manufacturing wage index grew to 16.07 percent in FY03 compare to 8.68 percent in FY02. On the other hand, agricultural wage index grew to 10.64 percent in FY03 against 6.59 percent in FY02 and construction wage index grew slightly to 5.8 percent in FY03 from 5.55 percent in FY02 (fig IX).

Figure IX: Wage Inflation by Sectors



In an economy with strong unionised collective bargaining for wages this could have signified a pressure of wage push inflation. In Bangladesh collective wage bargaining is yet to gain strong ground, with only about a fifth of the total labour force in formal sector employment. The wage rate index increases therefore probably reflect actual increase in demand for the related skills in the economy, which gained momentum after the FY02 slowdown. Migration of workers to job markets abroad is also likely to have an impact in underpinning wage levels in the domestic labour market. That wage rate increases exceeded the consumer price inflation levels even for

the relatively lower skilled agriculture and fisheries sectors signifies the gradual decline of poverty in the lowest income brackets of the population.

V. PERFORMANCE OF THE REAL ECONOMY

V.1 Agriculture Sector

Growth in agriculture in FY03 is projected to be 3.6 percent. According to the Economic Survey of Bangladesh 2003, crop and horticulture sector has grown at 3.21 percent while livestock and forestry have grown at 4.51 percent and 4.96 percent, respectively. Growth in the fishery sector is estimated to be 2.33 percent. Performance of different sub-sectors of agriculture, underlying reasons for such performance and new measures proposed for promoting growth of the sector is discussed below (table 15).

TABLE 15
Annual Growth of Agricultural Output
(Base FY96=100)

Year	Agriculture	Crops and Horticulture	Forest	Livestock	Fisheries
FY98	1.64	1.07	4.49	2.65	8.98
FY99	3.24	3.12	5.19	2.69	9.95
FY00	6.92	8.10	4.93	2.74	8.87
FY01	5.53	6.18	4.84	2.80	-4.53
FY02	-0.62	-2.39	4.92	4.70	2.23
FY03	3.59	3.21	4.96	4.51	2.33

Source: Computed from CPD-IRBD Database and BBS data

Foodgrain Production

As per final estimate of the Bangladesh Bureau of Statistics (BBS), actual food grain production for FY03 25.96 million metric tons of which Aus rice is 1.85 million metric ton, Aman rice is 11.11 million metric ton, Boro is 11.60 metric tons and wheat is 1.4 million metric ton which was 7.55 percent lower the target of 28.08 million tons. Aus production is slightly more than the targeted production while Aman production is 3 percent less than the targeted production and Boro production was 10.97 percent less than the target. In other words, total rice production was 1.03 percent higher than that of FY02. On the other hand, wheat production in FY03 had been less by 20 percent than that of the targeted amount of 1.75 million metric ton. Total food grain production in FY03 increased by only 0.15 percent.

More importantly, the total food grain production in FY02 was 3.14 percent lower than that of FY01, while the rice production was 3.11 percent less.

TABLE 16
Foodgrain Production

Year	Rice				Annual Growth of Rice Production (%)	Wheat	Total Foodgrain	Annual Growth of Foodgrain Production (%)
	Aus	Aman	Boro	Total				
FY97	1.87	9.55	7.46	18.88	6.73	1.45	20.34	6.7
FY98	1.87	8.85	8.14	18.86	-0.11	1.80	20.66	1.62
FY99	1.62	7.73	10.05	19.40	2.86	1.91	21.31	3.15
FY00	1.73	10.30	11.03	23.06	18.87	1.84	24.90	16.85
FY01	1.92	11.25	11.92	25.09	8.80	1.67	26.76	7.47
FY02	1.81	10.73	11.77	24.31	-3.11	1.61	25.92	-3.14
FY03	1.85	11.11	11.60	24.56	1.03	1.40	25.96	0.15
FY04	1.85	11.74	13.03	26.62	9.50	1.5	28.12	8.32

(Target Figures)

Source: Computed from CPD-IRBD Database and BBS Data

Rising Import of Foodgrain

It may be pointed out that Foodgrain import has increased significantly during FY03, amounted to US\$ 412.7, the matching figure for FY02 was US\$ 186.0, recording more than 100 percent increase. During the period FY03, value of new L/Cs opened for importing food grains amounted to about US\$ 642.06 million recording a 199.99 percent growth over the comparable figure for FY02. Increase in import of food grain was encouraged by low import duty of rice (decreased to 7.5 percent from 34 percent in July 2002) and low production of wheat and also by subsidised export of food grain by India. Food Corporation of India (FCI) off loaded rice and wheat for export purpose at half of their economic cost.

V.2 Manufacturing Production

According to the estimates provided by the BBS, the industrial sector (including manufacturing, electricity, and mining and quarrying) has decreased at the rate of 4.6 percent in FY03, against the growth rate of 4.7 percent in FY02 (Base = 1988/89). Vision in industrialisation is to increase the share of the manufacturing sector to 25 percent of GDP having employment for 20 percent of work force. The *Quantum Index of Production* (QIP) during FY03 grew by 4.57 percent over the period of FY02. Production data of major industry group for the period FY03 suggest that the manufacturing growth recorded (- 4.58 percent). The frontrunners in terms of production growth, included fertilizer (28 percent), *pharmaceuticals* (11 percent), *cloth* (11 percent), *garments* (7 percent) and *soap & detergent* (6 percent). In contrast, negative growth of

production of M.S rod (-90 percent), *paper* (-19 percent), *jute Hessian* (11 percent) and *jute sacking* (-12 percent). The manufacturing sector in FY03 was greatly affected by the severe deceleration of the jute textile and M.S rod production.

The faltering growth of the manufacturing sector is largely attributable to the visible withering away of the jute industry in Bangladesh. During the period FY03 production fell in all categories of jute products (i.e. hessian, sacking, carpet backing etc.) – both in public and private sector enterprises. This process has been accelerated by the liquidation of the Adamjee Jute Mill. The weight of the jute textiles in the QIP is still as high as 14.1 percent. Along with the jute sector, among the major industries, the fall in productions of paper and petroleum products is also discernible.

TABLE 17
Growth of Industrial Production
 (Base = 1988/89)

Year	All Industry	Mining and Quarrying	Manufacturing		Electricity
			Large and Medium	Small (1995/96=100)	
FY 98	8.17	7.14	9.28	6.77	8.65
FY99	5.35	3.52	4.20	0.63	7.68
FY00	5.22	14.20	4.97	15.00	6.25
FY01	7.01	12.34	6.59	9.77	10.28
FY02	4.75	5.03	4.52	7.65	7.13
FY03	4.61	5.86	4.57	5.48	4.78

Source: Computed from CPD-IRBD Database and BBS data

TABLE 18
Trend in Production of Major Industries in FY03

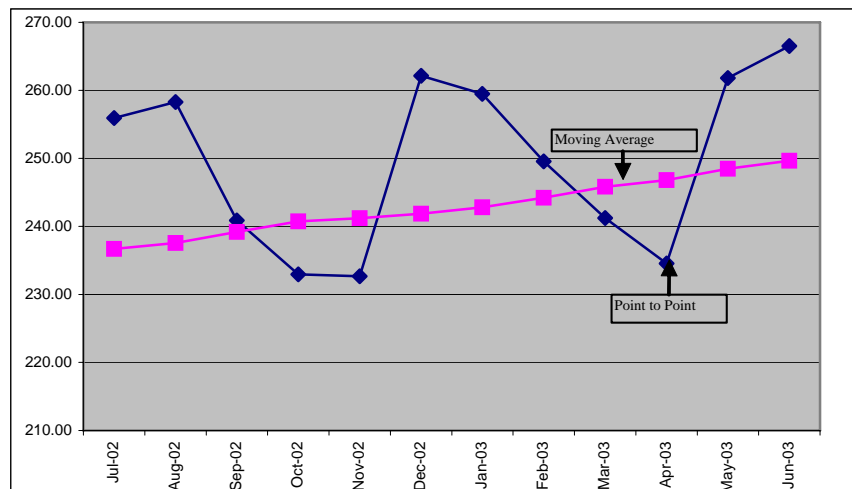
Industry	Unit	Weight	July-June FY03	July-June FY02	percent change Point to Point	percent change x Weight
1. Jute Textile	mt	14.07	312053	351864	-11.31	-159.19
Hessian	mt		66024	73948	-10.72	-150.77
Sacking	mt		181483	205580	-11.72	-164.92
Carpet backing cloth	mt		34416	37655	-8.60	-121.03
Others	mt		30130	34681	-13.12	-184.63
2. Cotton Textiles		7.83				
Yarn	mt		64401	65576	-1.79	-14.03
Cloth	000' metre		17834	16138	10.51	82.29
3. Garments	million Tk.	9.13	191471	179381	6.74	61.53
4. Paper	mt	2.26	30212	37387	-19.19	-43.37
5. Fertilizer	mt	11.34	2236518	1753530	27.54	312.35
6. M.S. Rod	mt	1.91	16946	162773	-89.59	-171.12
7. Cement	mt	1.17	1735759	1729406	0.37	0.43
8. Petroleum products	mt	0.66	1351080	1331113	1.50	0.99
9. Cigarettes	million sticks	2.10	20418	20384	0.17	0.35
10. Matches	000' gross box	0.35	12127	11875	2.12	0.74
11. Drugs & Pharmaceuticals	000" Tk.	7.01	18787861	16963040	10.76	75.41
12. Tea	mt	7.87	55455	55916	-0.82	-6.49
13. Salt	mt	0.30	39491	40575	-2.67	-0.80
14. Edible oil	mt	0.44	31833	31438	1.26	0.55
15. Soap & detergent	mt	1.74	44982	42436	6.00	10.44
Sum		68.18				-312.07
Weighted Growth Rate						-4.58

Source: Computed from CPD-IRBD Database and BBS Data

Notes: 1. mt means Metric Ton.

2. The growth of the cotton textiles reflects only the performance of yarn textiles.

Figure X: QIP of Large & Medium Manufacturing Industries



V.3 Foreign Investment

A new round of debate on estimates of foreign direct investment has once again reemerged following publication of foreign direct investment (FDI) inflow data for the first half of the calendar year 2003 by the Board of Investment (BOI). There is no scope for an elaborate discussion here on whether internationally accepted accounting methods of FDI, in the context of practices in Bangladesh, have been used by the BOI. Although there is a high probability that FDI flow remains underreported in the BOP statement in Bangladesh as it often does not fully capture, capital machinery brought in, reinvested earning and inter-company loans under appropriate heads. Curiously, the current BOP accounts also do not include foreign investments the EPZs. However, the central bank still remains the final authority to confirm the FDI estimates.

In FY03, Bangladesh received a net amount of \$196.63 as foreign investment, of which \$92 million came as foreign direct investment (FDI) in the domestic tariff area and another \$103.13 million in the EPZ. Net flow of FDI has increased 42.1 percent in FY03. In contrast, foreign investment in the EPZ recorded a more than 85 percent increase in FY03, continuing the recovery since the drop in FY00, consequent to the controversy surrounding the trade union rights issues in the country's EPZs.

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. However, the resurgence of the controversy regarding trade union rights in the EPZs, reflecting the concerns of Bangladesh's largest export market, the USA, vis-a-vis the concerns of some of Bangladesh's largest sources is investment in the EPZ, drawn from Japan and the Republic of Korea needs to be reserved without prejudice either to Bangladesh's export or investment prospects. This may be no easy task.

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

TABLE 19
Foreign Investment

(In Million. US\$)

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

Notes: ^a Includes investments in joint-venture enterprises with local entrepreneurs.

Source: CPD-IRBD Data Base, Bangladesh Bank and BEPZA.

V.4 Capital Market

The recovery of the capital market remains painfully slow since the boom and bust episode of the 1996. New investment through Initial Public Offer (IPO) in FY03 is Taka 311 million. The amount of total market capitalisation at the Dhaka Stock Exchange (DSE) at the end of FY03 (US\$ 1.26 billion) was 10.53 percent higher than in dollar terms compare to FY02. On the other hand, amount of total market capitalisation at the Chittagong Stock Exchange (CSE) has increased by 7.15 percent from Taka 56.19 billion in FY02 to Taka 60.21 billion in FY03.

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

At the end of FY03 the all share price index of DSE increased to 830.46 compare to 792.56 in FY02 that is 4.78 percent higher than previous period. Eight companies raised new equity through the primary market in FY03 compare to nine companies in FY02.

TABLE 20
Capital Market (DSE)

Year (End June)	All Share Price Index (As of End June)	Market Capitalisation (Billion US\$)	Listed Securities (Including Mutual Fund and Debenture)
FY98	676.47	1.30	224
FY99	546.79	1.06	230
FY00	561.00	1.07	239
FY01	716.06	1.34	244
FY02	792.56	1.14	257
FY03	830.46	1.26	260

Source: Computed from CPD-IRBD Database and DSE Data

TABLE 21
Initial Public Offerings (DSE)

Year	Number of Company	Sponsors Equity	Securities Offered	Amount Subscribed	(In Million Tk.)
					Rate of Over- subscription (percent)
FY97	18	2998	1384	17582	1170.4
FY98	10	1064	410	1166	184.1
FY99	7	946	406	669	65.0
FY00	11	2047	298	653	119.6
FY01	10	857	175	902	415.4
FY02	9	1138	183	640	249.9
FY03	8	48630	311	1921	517.7

Source: Computed from CPD-IRBD Database and DSE Data

TABLE 22
Capital Market (CSE)

Year (End June)	All Share Price Index (As of End June)	Market Capitalisation (In Billion Tk.)	Listed Securities (Including Mutual Fund and Debenture)
FY99	222.06	40.95	154
FY00	1173.89	44.84	161
FY01	1502.40	62.82	171
FY02	1315.68	56.19	184
FY03	1395.04	60.21	185

Source: Computed from CPD-IRBD Database and CSE Data

In case of CSE at the end of FY03 the all share price index increased to 1395.04 compare to 1315.68 in FY02 that is 6.03 percent higher than previous period.

VI. EXTERNAL SECTOR

VI.1 Exports

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

The external sector in FY 2002-03 performed comparatively better than in the previous fiscal, although the price of Bangladeshi exportable continued to fall in FY 03. With 9.4 percent of growth the export was back to a positive trend. According to the statistics for FY 2003 the tea, leather and handicrafts growth was still negative, which was registered at (-) 11.0 percent, (-) 7.8 percent and (-) 2.8 percent respectively. However, the chemical, raw jute, frozen food and knitwear recovered and had shown strong growth, 51.0 percent, 34.9 percent, 16.6 percent, and 13.3 percent respectively during the period FY03. The net fall in receipts from woven RMG exports is the major current concern regarding Bangladesh's exports. It seems the advent of the third phase of quota integration (which started in January 1, 2002) under the *WTO Agreement on Textiles* is foreshadowing the impact of full phase-out of the *Multi-Fibre Arrangement* (MFA) for Bangladesh. It may be pointed out that under the third phase of ATC two items of Bangladesh's export internal have been made quota-free and Bangladesh has lost out significant market shares to China and India in both these commodities. For example, in terms of exports of babies garments (category 239) and robes (category 350 and 650) Bangladesh's export (in volume terms) declined by 18 percent and 6 percent respectively, whilst China was the major gainer. Thus, there is an urgent to comprehensively review the textile and RMG related issues to undertake integrated and focused policy measures.

TABLE: 23
Growth of Export

Items	FY98	FY99	FY00	FY01	FY02	FY03
Raw Jute	-7.4	-33.4	0.3	-6.7	-9.0	34.9
Tea	24.5	-18.8	-53.3	19.9	-19.5	-11.0
Leather	-2.7	-11.6	15.9	30.2	-18.4	-7.8
Frozen Food	-8.4	-6.6	25.4	5.6	-24.0	16.6
Jute Goods	-11.5	7.3	-11.9	-13.4	5.7	5.6
Handicraft	5.8	27.0	5.1	-9.9	-15.1	-2.8
Ready-made Garments	27.1	5.0	3.3	9.1	-7.1	4.3
Knitwear	23.2	10.1	22.7	17.8	-2.5	13.3
Chemical	-31.6	6.8	18.0	3.9	-31.5	51.0
Others	19.8	19.3	-9.4	39.1	-7.4	26.3
Total	16.8	4.8	6.4	12.3	-7.4	9.4

Source: Computed from CPD-IRBD Database and EPB Data

It seems that the export performance of the primary goods sector had been better than its manufacturing counterpart in the recent months. The primary goods sector has experienced a

growth of 18.52 percent in FY03, while the growth in manufacturing sector was only 8.76 percent. Moreover, primary sector and also manufacturing has secured more than 100 percent of target.

The positive volume index (7.08 percent) contributed to a positive export growth and the price index also contributed to a positive export growth this fiscal (2.31percent).

VI.2 Imports

The slowdown of imports in FY02 was due to a combination of factors which included regulatory measures taken by the government to release pressure on the depleting foreign exchange reserve and decline in import of raw materials for the RMG sector due to drastic fall of exports. Thus import payments recorded a negative growth of 8.8 percent in the elapsed fiscal year (FY02).

The import growth arrested a positive tone during the FY 2003. The actual import growth was 13.0 percent for this period. The moderate growth of imports has been achieved due to robust growth of sugar, spices, food grain, coconut oil and edible oil etc. On the other hand the import of cement, oil seeds and yarn has been decreased by 63.3 percent, 11.7 percent and 4.7 percent respectively.

According to the statistics of L/C opening, the import of consumer items (food grains) had a robust growth (around 200 percent), while the import of intermediate goods was negative (-5.23 percent). The import of capital machinery experienced a positive growth (43.46 percent). Import of industrial raw materials, petroleum products and machinery for misc. industries also registered a positive growth during the period.

Analysis of information on L/C settlement for the period FY03 reveals import growth of 12.83 percent over the previous period FY02. However, this moderate growth in aggregate import has been achieved due to robust of consumer goods (food grains 131.95 percent).

VI.3 Foreign Remittances

Remittances, in the recent past, have emerged as the saving grace of Bangladesh economy. Remittances flows for the first time crossed the threshold level of \$3.0 billion in FY03, when it was \$3061.9 million or 22.4 percent higher than FY02.

TABLE 24
Foreign Remittance and Foreign Exchange Reserve

(In Million US\$)

Year	Remittance	Annual Growth Rate (percent)	No. of Workers Abroad (000)	Annual Growth Rate (percent)	Forex Reserve (As of 30 June)	Point to Point Growth (%)
FY98	1525.43	3.39	243	6.58	1739.24	1.18
FY99	1705.74	11.82	270	11.11	1523.26	-12.42
FY00	1949.32	14.28	248	-8.14	1602.08	5.17
FY01	1882.10	-3.45	213	-14.11	1306.74	-18.43
FY02	2501.13	32.89	186	-12.68	1582.90	21.13
FY03	3061.97	22.42	241	29.57	2469.57	56.02

Source: Computed from CPD-IRBD Database and Bangladesh Bank Data

VI.4 Foreign Aid Flow

In FY03 foreign aid committed to Bangladesh amounted to about \$2179 million, whilst actual disbursement was in the region of \$1553 million. The commitment was more than 100 percent higher than the previous year. After a secular decline in the volume of foreign aid disbursement since FY99, a growth of more than 7.77 percent was recorded in FY03 compared to the preceding year. Foreign aid commitment and disbursement in FY02 were \$879 million and \$1442 million respectively.

TABLE 25
Foreign Aid and Debt Services

(In Million US\$)

Year	Foreign Aid		Debt Services			Outstanding External Debt ^a	Total Foreign Currency Earnings ^b	Outstanding External Debt as percent of GDP	Debt Service as percent of Foreign Currency Earnings
	Commitment	Disbursement	Pipe line	Principal	Interest				
FY98	1791	1251	4697	307	137	13418	6687	30.5	6.6
FY99	2648	1536	4896	373	166	14354	7019	31.4	7.7
FY00	1475	1587	5980	447	172	15727	7702	33.4	8.0
FY01	2053	1369	5752	438	159	14677	8349	31.2	7.2
FY02	879	1442	5858	435	151	15885	8487	33.4	6.9
FY03	2179	1553	5450	452	156	16953	9610	33.3	6.3

Notes: ^a Excluding the IMF loan

^b Total Foreign Currency Earnings = Total Export income + Annual Remittances

Source: CPD-IRBD Data Base and *Flow of External Resources into Bangladesh 2003*, ERD.

The total outstanding external debt of Bangladesh as of June 2003 was \$16.95 billion (a little above 33 percent of GDP), which was 6.72 percent higher than the previous year. The repayment

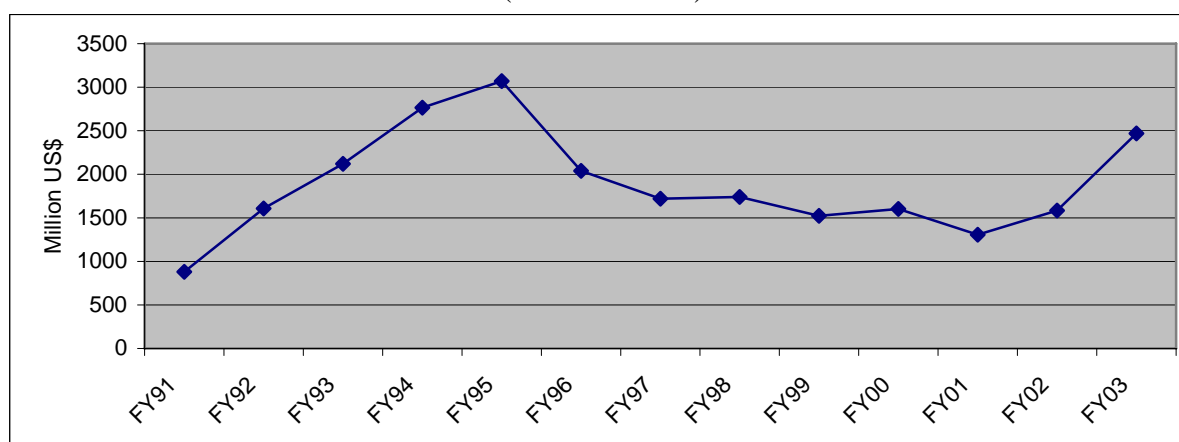
of external debt in FY03 amounted to \$608 million with 25.7 percent accounting for interest payment.

VI.5 Foreign Exchange Reserve

The draw down on the foreign exchange reserve, which set in FY95, was reversed in FY02. The foreign exchange reserve bounced back to \$1.58 billion at the end of FY02 from \$1.11 billion in November 2001, registering a growth of 21.3 percent.

The positive trend in the growth of foreign exchange reserve during the FY03 and it bounced to \$2.5 billion at the end of period. The end of period the point to point to growth was as high as 56.02 percent.

Figure XI: Foreign Exchange Reserve
(as of end June)



As it is evident from our foregoing analysis, further strengthening of foreign exchange reserve has taken place in the FY03 thanks to export resurgence, surge in workers' remittances.

VI.6 Strengthening Balance of Payments

Given the movement of various external sector variables described earlier, Bangladesh's balance of payment situation, during the period FY03 has improved further. The positive current account balance reached US\$ 328 million, which was more than 35 percent higher than the previous period. The positive current account balance owed to the robust growth of remittance during this period of the FY 03. The remittance flow was US\$ 3061.97 million for the period FY03, which

was 22.4 percent higher than it was in the previous period. However, the capital account was not in a good shape, with a pale US\$ 92 million direct investment. The direct investment during FY03 period was US\$ 27 million more than it was in previous period. The suppliers' credit weakened the composition of the capital account, where the outflow amounted US\$ 431 million. The foreign reserve situation improved strongly during FY03 period. The foreign reserve on end of June 2003 was US\$ 2469.57 million, which was equivalent to 94 days of import. For the same period in FY 02, the import equivalent was only for 68 days. As a whole, the balance of payments situation was under control.

TABLE-26

Bangladesh Balance of Payment (FY98-FY03)*(In Million US\$)*

Source	FY98	FY99	FY00	FY01	FY02	FY03
Trade Balance	-1669	-1934	-1865	-2011	-1768	-2207
Export, fob (including EPZ)	5103	5283	5701	6419	5929	6492
Imports, cif (including EPZ)	-6772	-7217	-7566	-8430	-7697	-8699
Services (net)	-570	-603	-645	-914	-499	-688
Receipts	707	707	849	759	865	887
Payments	-1277	-1310	-1494	-1673	-1364	-1575
Income (net)	-100	-135	-221	-264	-319	-195
Receipt	91	91	97	97	50	64
Payment	-191	-226	-318	-361	-369	-259
Current Transfers	1876	2195	2394	2171	2826	3418
Official	126	220	165	72	69	60
Private	1750	1975	2229	2099	2757	3358
of which worker's remittances	1525	1706	1949	1882	2501	3062
Current Account Balance	-463	-477	-337	-1018	240	328
Capital Account (net)	445	387	561	432	410	392
Capital Transfers	445	387	561	432	410	392
Financial account	237	-395	-185	407	71	302
Direct Investment	249	198	194	174	65	92
Portfolio Investment	3	-6	0	0	-6	2
Other Investment	-15	-587	-379	233	12	208
MLT Loans	706	821	806	790	733	937
MLT Amortization Payments	-308	-341	-396	-416	-421	-431
Other Long Term Loans (net)	-47	-41	127	-13	-42	-20
Other Short Term Loans (net)	168	-78	56	86	20	226
Other Assets	-41	-58	-55	-68	-52	-81
Trade Credit (net)	-522	-829	-641	-260	-253	-494
Commercial Bank	29	-61	-276	114	27	71
Assets	-19	-31	-161	147	-90	217
Liabilities	48	-30	-115	-33	117	-146
Error and Omissions	-88	267	125	-47	-356	-123
Overall Balance	131	-218	164	-226	365	899
Reserve Assets	-82	218	-164	226	-365	-899
Bangladesh Bank	-131	218	-164	226	-365	-899
Assets	-14	205	-79	302	-276	-887
Liabilities	-117	13	-85	-76	-89	-12

Source: Computed from CPD-IRBD Database and Bangladesh Bank Data

VII. CONCLUDING OBSERVATIONS

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

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

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

Third, signs of investment stagnation have become more manifest during the FY03. Deepening of investment stagnation is borne out by the fall in term industrial loan disbursement as well as import of capital machinery. Higher level of L/C opening in FY03 (on point to point basis) does not foretell real growth in import as imports practically collapsed in the preceding year at this time subsequent to the terrorist attacks in the USA. High demand for NSD Certificates and increase in time deposits in the schedule banks, in spite of interest rate rationalisation, suggest that investors' confidence level continues to be abysmally low. The moribund state of the stock market further reinforces this observation.

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

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

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

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

With respect to the use of public expenditure as a tool for rejuvenating domestic demand, it may be underscored that the government currently enjoys some elbowroom for a moderate expansionary policy, thanks to the conservative approach pursued in the last year. *However, if the economy responds to such trigger mechanisms, it will not only expose itself to the risk of losing its grip on the fiscal deficit situation, but also unleashing high pressure on the soft exchange reserves in response to an investment driven import resurgence-up.*

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

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

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

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

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