

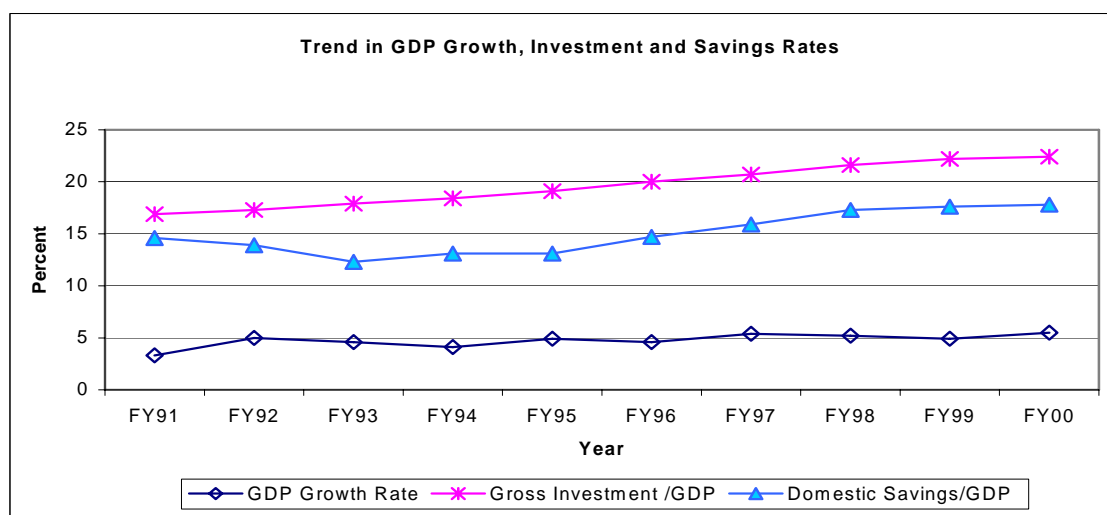
State of the Bangladesh Economy in FY2000-01: A Review of Some Early Signals

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The Setting

It is a matter of record (according to the old estimates of the national income accounts) that the Bangladesh economy experienced a higher average growth rate (4.88%) in 1990s in comparison to that of the 1980s (3.84%). Concurrently, it is observed (as per the new estimates) that, the economy registered accelerated growth rate during the second half of the 1990s (5.11%) vis-à-vis the first half of the decade (4.31%). However, the momentum of economic growth, underpinned by the prevailing macro-economic stability, did not get adequately translated into a rise in the aggregate investment and savings rates.

The 5.5% GDP growth rate, estimated for 1999-2000 (FY00), was largely driven by the performance of the agriculture (including fisheries) and the construction sectors. In the backdrop of declining share of industry, particularly manufacturing, in the GDP, the growth prospect was underwritten by three volatile variables, viz. crop production, apparels exports and migrant workers' remittances.



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It may be recalled that the macro-economic balances in FY00 was put under considerable pressure by trends in public finance. The stress was brought about by non-fulfillment of an extraordinarily high revenue target coupled with a rigid revenue expenditure structure and the compulsion of having an enlarged Annual Development Programme (ADP) in the face of depressed investment demand. The consequent government borrowing contributed to additional debt serving liabilities and squeezing of the share of the private sector in domestic credit expenditure. This in its own turn kept the interest rate at a high level and adversely affected cost of capital. As a consequence, import faltered, leading to low collection of revenue.

The annual *Independent Review of Bangladesh's Development* (IRBD) for FY00, conducted by the *Centre for Policy Dialogue* (CPD), concluded that, “currently, restoration of fiscal discipline, infusing investment in the manufacturing and other modern sectors, consolidation of achievements in the agriculture sector, and sustaining export growth remain the major challenges confronting the Bangladesh economy”. It was further noted that, “the fragile balance of payment situation may come under stress if imports pick up in response to various investment stimuli”.

How is the Bangladesh economy poised to perform during the opening year of the new millennium which coincides with the final year of the tenure of the present government?

Initial information suggests that the Bangladesh economy has made a good start during the current fiscal year, specially in comparison to the corresponding period of FY00. The emerging positive trends regarding some select indicators of economic performance may, however, potentially precipitate a different order of strains on the macro-economic balances, particularly on the balance of payment situation.

In this context, the present review seeks to interpret the early data on FY01 from the point of view of fiscal and monetary scenario as well as growth prospects in the real and external sectors.

Revenue Earnings

Declining share of revenue in GDP (to less than 9%) had been one of the fundamental structural weaknesses of the Bangladesh economy during the recent past. Actual revenue receipt in FY00 was only 1.8% above the benchmark of FY99. In this backdrop, the target for total revenue collection for FY01 was fixed at Tk. 192.78 billion, indicating a projected growth of 19.3%. The *National Board of Revenue* (NBR) component, which usually accounts for more than 93% of the total revenue receipts, is programmed to grow by 19.5% during the current fiscal year.

Information relating to first quarter (July-September) of FY01 indicates that the revenue yield has been about 1.4% above the target for the NBR. This modest success in target attainment is driven by an impressive 17.5% actual collection growth during July-September of FY01 over the corresponding period of the preceding year. While collection of import-related revenues increased by about 14.2% during the said period, growth of internal trade-related revenues and income tax had been more robust – 21.7% and 28.4% respectively. Early indications evince that these positive trends in revenue collection have also been sustained in the month of October 2000.

It is too early to say to what extent the improved revenue collection situation is spurred by an upturn in business environment. However, as we discuss later, there are some disparate signs of investment dynamism portrayed by import scenario and credit flow.

Whatsoever, the improvement in the revenue scenario may be partly explained by broadening and deepening of administrative efforts. These include enlargement of the tax coverage by activity-oriented perusal, enthusiastic use of spot-collection and self-assessment arrangements. Curiously, it is still not evident to what extent the *Pre-Shipment Inspection* (PSI) system is functioning smoothly as problems relating to import valuation allegedly continue.

Public Expenditure

During FY00, the country implemented a record level public expenditure programme which accounted for 14.3% of the GDP. Budget figures indicate that the said share is to fall back to 13.9% in FY01 with revenue expenditures accounting for 53% of the public expenditure basket.

Figures on initial trends relating to both revenue expenditures and ADP had not been readily available. However, concerns persist regarding the composition and quality of the public expenditure programme, particularly with respect to its recurrent component. It will be interesting to observe whether the share of “salaries and allowances” in revenue expenditures, now accounting for more than 40%, records any decline during the current fiscal year. The other feature demanding close monitoring relates to “interest payments on domestic and foreign debts” which presently accounts for almost 20% of the revenue expenditures.

Fiscal Deficit

The overall budget deficit for FY01 has been estimated to be Tk. 186.61 billion, which is about 7% and 6% of GDP in gross and net terms respectively. The government, in a courageous move, has pre-announced that, in FY01, it is going to finance the fiscal deficit through bank borrowing to the tune of Tk. 35.14 billion. Given the fact that domestic sources now shoulder almost an equal share in financing budget deficit, any shortfall in revenue earnings and/or public expenditures overrun is going to increase the budget deficit with concomitant implications for the monetary and real sectors.

Domestic Credit Expansion

The government has been following a moderately expansionary monetary policy during the last couple of years. The aggregate domestic credit expansion rate has been 13.6% in FY00. However, during this period the rate of growth of domestic credit in the government sector from the domestic sources had been consistently higher than that of in the private sector. For example, in FY00, as against 31.3% net growth in credit to the “central government”, the comparable growth in the private sector was only 10.7%. Such

differential rates of growth lead to decline in private sector's historical share in total credit flow – from an average of 72% to 70.7% in the last fiscal year.

Early figures for FY01 reflect a welcome shift towards convergence of the growth rates between public and private sectors in the backdrop of overall pickup in the domestic credit expansion. Thus, at the end of September 2000, the domestic credit flow recorded a growth of 15.2%, while the credit growth to the central government (net) and private sector had been 27.3% and 13.3% respectively.

In spite of the incipient positive trends in the monetary sector, the broad money growth has remained relatively high during the first quarter of FY01 – i.e. about 20%. In the coming months it will be definitely an issue to contain the monetary growth, if not to reduce it, without squeezing the credit flow to the private sector.

Furthermore, while the gradual growth in total domestic credit may be reflective of greater activism in the economy, the growth differential between private and public sectors is still quite high, being in favour of the latter. It also needs to be pointed out, on the basis of the monthly data on monetary survey, that credit growth to “other public sector” is also on the rise (about 4.9% in September, 2000) indicating the fiscal haemorrhage which the economy is subjected to due to the impasse prevailing in privatisation of the *state-owned enterprises* (SOEs).

Government Borrowing

An accelerated level of domestic credit expansion in the government sector in FY00 resulted from a rising level of government borrowing from both the banking system as well as from the public through savings instruments. The net government borrowing in last fiscal year stood at Tk. 180.16 billion, recording a massive growth of more than 38% over the preceding period.

Initial data for FY01 reveals that the level of government borrowing from the banking sector has come down appreciably. Government borrowing during July-October,

2000 was about Tk. 10.73 billion which is about 42.5% less than that for the comparable period of FY99.

Admittedly, it will be a major challenge for the government to cap its borrowing needs in the current fiscal year given the potential threat of a lagged inflationary response.

Inflation

The rising trend in inflation which was observed in FY99 was corrected during FY00 as the moving average came down to about 3.9% in June 2000. The fall in the inflation rate was largely underwritten by a record *amon* harvest as we notice that the (moving average) inflation rate for food component steadily came down from 11.8% to 4.1% between July-June of the last fiscal year.

Information on *Consumer Price Index* (CPI) for the first quarter of FY01 suggests that the inflation rate has fallen further during the recent months. The national inflation rate (on a point-to-point basis) had been as low as 2.21% in September 2000, while the corresponding rates for food and non-food items have been 1.77% and 3.08% respectively. Between urban and rural areas, the inflation (point-to-point in September 2000) was marginally higher in the latter (2.31% as against 1.92%).

Once again, the price stability has been largely ensured by successive good harvests. In fact, low inflation has emerged as the cornerstone of macro-economic stability of the Bangladesh economy in the recent times. However, it will be interesting to investigate whether the sustained low inflation has been a convoluted expression of depressed domestic demand.

Agricultural Production

Almost all the components of the agricultural sector have been demonstrating robust growth during the second half of the 1990s. However, against an average sectoral growth of 3.6% (1995/96-1999/00), the fisheries sub-sector has recorded the highest

average growth of 6.9%. In fact, during the recent past the fisheries sub-sector has been growing at the rate of 9-10% per annum.

Foodgrains. In FY00 the Bangladesh rural economy continued to maintain the impressive growth in foodgrain production registered in the last four years. During the last fiscal year the total foodgrain production reached a new all time high of 24.9 million m. ton recording a growth of 16.85% over the previous year. An all time record *aus* harvest (10.3 million m. ton) and a bumper *boro* crop (11.03 million m. ton) ensured this achievement. Rice production as a whole demonstrated a spectacular growth of 18.9% in FY00 contributing to the country's self-sufficiency in foodgrain production.

The total foodgrain production target for FY01 has been fixed at 25.70 million m. ton which is 3.2% more than the preceding year's record. Rice sector itself is projected to grow at about 2.8%. If the target figure (23.70 million m. ton) is achieved, a new record will be created in the country's annal of foodgrain production.

It is reported that *aus* production in FY01 has been about 2 million m. ton which is about 15.6% more than that of the earlier year. Early assessment of *aman* production for the current fiscal year suggests an output to the tune of 10.50 million m. ton which is a little above the last year's benchmark. This high level of *aman* crop has been harvested in spite of the damages caused by the recent floods in the South-Western part of Bangladesh.

If the year's production target for *boro* (11.20 million m. ton) is achieved then the country's flexibility with macro-economic management will increase significantly, particularly due to food price stability and absence of the need to import foodgrains.

Industrial Production

In contrast to the agriculture sector, growth in the manufacturing sector, in the recent past, has remained depressed in Bangladesh. During the flood year (FY99), the sector grew by a modest 3.2%, the growth rate of large and medium component of the sector being slightly higher (4.2%).

The post flood recovery process in the sector had been slow and it only picked up towards the second half of the FY00. Nonetheless, the annual industrial growth rate for FY00 still remained subdued – only 4.25%. During FY00, the small industries segment continued to grow at a slower pace (4.0%) in comparison to its larger and medium counterparts (4.35%).

Disaggregated analysis reveals that the average growth of a select set of major manufacturing industries (with a cumulative weight of 68.2%) during FY00 was less than 4% (see Table). One can observe that major sub-sectors such as jute textiles, paper, drugs and pharmaceuticals, and soap and detergent have posted negative growth during the elapsed period.

Trend in Production of Major Industrial Items in FY00

Sub-sectors	Unit	Weight	1998-99 July-June	1999-00 July-June	% Change
1. Jute Textile	Mt	14.07	367933	341881	-7.08
<i>Hessian</i>	<i>Mt</i>		88999	92760	4.23
<i>Sacking</i>	<i>Mt</i>		198184	183638	-7.34
<i>Carpet backing cloth</i>	<i>Mt</i>		38705	38206	-1.29
<i>Others</i>	<i>Mt</i>		42045	27277	-35.12
2. Cotton Textiles		7.83			
Yarn	Mt		54800	57343	4.64
Cloth	000' metre		11155	11810	5.87
3. Garments	million Tk.	9.13	143208	154436	7.84
4. Paper	mt	2.26	38289	37036	-9.98
5. Fertilizer	mt	11.34	1799357	1904022	5.82
6. M.S. Rod /Products	mt	1.91	133565	136954	2.54
7. Cement	mt	1.17	954763	999979	4.74
8. Petroleum products	mt	0.66	996240	1298841	30.37
9. Cigarettes	million no.	2.1	19558	19643	0.43
10. Matches	000' box	0.35	10937	12057	10.24
11. Drugs & pharmaceuticals	000" Tk.	7.01	12673773	12230106	-3.50
12. Tea	mt	7.87	43744	51445	17.60
13. Salt	mt	0.3	31002	37120	19.73
14. Edible oil	mt	0.44	25911	30569	17.98
15. Soap & detergent	mt	1.74	48940	47768	-2.39
Growth rate (weighted)	%	Σ = 68.18			3.98

Note: 1. mt means Metric Ton.

2. The growth of the cotton textiles reflects only the performance of yarn textiles. Hence, the calculated weighted growth rate is marginally on the lower side.

With respect to FY01, information on *Quantum Index of Production* (QIP) is available for the month of July 2000 only. The QIP for July 2000 depicts a cyclical fall in manufacturing production by 2.34% over the preceding month. The decline in industrial production has been most in case of chemicals (14.3%), food (5.5%) and wood (2.0%).

However, on a point-to-point basis, the QIP (July 2000) shows an increase of about 10.6% over the index of July, 1999. Analysis of sub-sector specific data reveals significant annual growth in production of cement (69.3%), cotton cloth (22.2%), cotton yarn (11.1%), tea (11.5%) and M.S. rods (6.8%). It is interesting to note that the industries which have experienced some growth in Bangladesh in the recent past have been either directly or indirectly linked to export markets or cater to domestic demand through supply of intermediate inputs.

Foreign Investment

The melancholy performance of the manufacturing sector is partly explained by the state of foreign investment in the country. The net foreign investment, including *foreign direct investment* (FDI), *portfolio investment* and foreign investments in the *Export Processing Zones* (EPZs), registered a jump in FY98 recording a net flow of \$ 320.82 million. This measure took into account cash flow through bank channels as well as investments in the form of equipment brought in, particularly in the energy sector. The figures obtained (using the same estimation technique) recorded a fall in the flow to \$ 262.61 and \$ 228.68 during FY99 and FY00 respectively.

While the anarchic state of affairs in portfolio investment may be partly blamed for the emerging situation, it is also true that there had been slowdown in the flow of FDI during the last two years. The net FDI figures for FY98, FY99 and FY00 were \$ 273 million, \$ 200 million and \$ 184.4 million respectively.

These estimates clearly contradict the periodic claims made by the *Board of Investment* (BOI) about billions of dollars of FDI being invested in Bangladesh. The BOI has historically tended to confuse the registered intention of investors to invest with actual realisation of this investment.

However, one of the most worrisome developments in the foreign investment scenario relates to the EPZs. FDI (including local investments in joint-ventures) in the EPZs in FY00 had almost been half (about \$ 35 million) of that recorded in FY99 (\$ 70.6 million). The corresponding figure for the first quarter of FY01 is only \$ 7.84 million. One is inclined to believe that the prospect of introduction of traditional trade union activities in the Bangladesh EPZs has already started to take its toll.

Capital Market

The capital market is yet to recover from the boom and bust episode of October 1996. During the three years period of 1997, 1998 and 1999, the *Dhaka Stock Exchange* (DSE) experienced an erosion of market capitalisation to the extent of Tk. 121.33 billion, i.e. about \$ 2.5 billion.

However, during the first four months (July-October) of the current fiscal year, some feeble, but encouraging signs may be observed in the DSE as the market capitalisation increased by about 5% and *All Share Price Index* (ASPI) by another 11%. Two IPOs have been launched at DSE since June 2000.

It is important to note that all episodic floatations of Initial Public Offerings (IPOs) in the recent past have usually been oversubscribed indicating that small investors are ready to put their scarce capital in primary market, but not in secondary transactions. Basically, slow progress in strengthening the market-related institutions including enhancing their transparency and accountability has not allowed the capital market to recover.

Import

After, a long spell of sluggish import growth (6.6% and 4.8% in FY99 and FY00 respectively), imports seem to be picking up in FY01. Statement on opening and settlement of *letters of credit* (L/Cs) during July-September, 2000 indicates an import growth (in dollar term) of 22.2% and 25.9% over the matching figures for FY00. However, one should not miss the strengths and weaknesses of the emerging import composition while analysing the recent trends in import scenario.

Regarding the strengths, one may observe (as per opening of new L/Cs) the fall in foodgrain import (by more than 45%) and increase in imports of capital machinery (more than 52%) and “other machineries” (more than 76%). Perceptible upswing is also observed in case of imports of intermediate goods (12.7%) and industrial raw materials (10.4%).

The evolving pattern of imports is corroborated by the disbursement figures relating to both term loans and industrial working capital loans which increased by 22.3% and 35.1% respectively during FY00. (Information on industrial credit disbursement for the first quarter of FY01 was not available.)

The major weakness of the import composition relates to increase in payments by more than 81.4% (as per fresh opening of L/Cs) on account of import of petroleum and petroleum products subsequent to price like in the world market. Needless to mention, given its strategic nature, the government will have to continue underwriting the import demand of petroleum and its products, irrespective of global prices.

Whatsoever, the upsurge in imports during the first quarter of FY01 by more than 20% has also given rise to a number of concerns. The first relates to the prospect of over-invoicing of the imports as a conduit of capital transfer. If that really be the case, then one is dealing with a phenomenon of “investment illusion” driven by over-priced imports. Secondly, real imports or not, the current surge in import payments is definitely creating a debilitating pressure on the foreign exchange reserve situation. Under the circumstances the enhancing the inflow of foreign exchanges to the will increasingly gain in priority in the coming months.

Exports

During FY99 exports stood at \$ 5312.86 million which grew to \$ 5752.20 million in FY00 showing an increase of 8.27%. Thankfully, in the face of robust import surge, the growth in exports during July-September 2000 had been also impressive. During the said period, the export target was overachieved by 10.6%, recording a growth of 25.4% over the corresponding figure for FY00.

An analysis of the export basket reveals that apart from raw jute and jute goods, almost all other items have registered an increase in export value during the first quarter of FY01. While the case of tea (105%) is to be particularly noted, the recovery of frozen food (54.6%) is also spectacular. More importantly, after a long recess, the woven-RMG has recorded an impressive growth (20.5%) along with RMG knitwear and hosiery (31.2%).

Foreign Remittances

During the last couple of years, the current account balance of the economy has enjoyed increasing flow of private transfers, particularly in the form of remittances by migrant workers. In FY00 the country received, \$ 1.95 billion on account of workers' remittances which was about 14.2% higher than matching figure for the preceding year.

Initial figures on FY01 indicate that a total amount of \$ 460 million has been remitted by the migrant workers during July-September 2000. This amount is 8.5% more than that of the corresponding figure for FY00. However, one notices from the monthly data, a declaration in the rate of growth of foreign remittances. For example, from the year closing monthly figure of \$ 196 million in FY00, the flow has subsequently declined to \$ 165 million, \$ 148 million and \$ 147 million during July, August and September respectively.

In the backdrop of the recent trend in import growth, propping up the workers' remittance flow will demand effective attention in the coming months given the draw down on foreign exchange reserve observed lately.

Foreign Assistance

The disbursement of foreign assistance in the form of food, commodity and project aids has registered a fall in Bangladesh during the 1990s. In FY00, the country received \$ 1.57 billion of foreign assistance which was, however, 2.5% more that of amount disbursed in FY99.

Data on FY01 reveals that during the months of July and August 2000, disbursed foreign aid amounted to \$ 155 million. This amount compares unfavourably (27.6% less) with figure for FY00. Given the evolving pressure on the balance of payment, the government will have to energetically resort to utilisation of the \$ 5.7 billion pipeline of foreign assistance available to the country. However, absorption of this potential resource, which is largely in the form of project aid, will greatly depend on improvement of economic and administrative governance in the concerned sectors.

Foreign Exchange Reserve

Foreign exchange reserve of the country has been sequentially depleting since its record level of \$ 2.98 billion in FY95. The closing balance of forex reserve in FY00 (\$ 1.56 billion) has been, however, about 4.9% higher than that of the comparable figure for FY99.

Monthly data on international reserve reveals that the volume of forex held by the government has been secularly declining during the first four months of FY01 (July-October). On November 14, 2000, the reserve position dipped to an all time low to less than \$ 1.26 billion, recording a point-to-point fall of more than 20.8%. The available amount with the government can presently cover less than two months of cash imports, although the government contends that it has import-coverage for another month thanks to the foreign exchanges (about \$ 400-500 million) held by different schedule banks.

Balance of Payment

Given the trends in the country external sectors fending pressure on the balance of payment (BOP) may come to the centrestage of macro-economic challenges of Bangladesh economy in FY01. Curiously, a scrutiny of the BOP statement reveals an increasing outflow of foreign exchange which is listed under “errors and omissions”. The figure on this account for FY00 was \$ 718 million. It is worth investigating to establish whether such outflows in fact presents capital flight in disguise.

It is now evident that government will have to devise on a urgent basis a programme to shore up its foreign exchange reserve through inter alia, export promotion, enhanced remittance flow, increased utilisation of foreign aid.

In this context, the government will have to also pursue an active exchange rate management policy as foreign exchange is being sold in the kerb market at a 8% premium, even after the 6% devaluation in August 2000. It is obvious that an overvalued exchange rate not only affects the export competitiveness of Bangladesh, but also encourage cheap imports resulting in a drain on foreign resources.

Whatsoever, it will be also prudent on the part of the government, as a precautionary measure, to have ready a quick-disbursing balance of payment support facility without jeopardising its other development objectives.

Challenges Ahead

Review of a select set of performance indicators on Bangladesh economy relating to the first quarter of FY01 definitely points to some encouraging trends – particularly in the areas of revenue collection, government borrowing, inflation, exports and foodgrains production.

The apparently positive development in import growth, however, is generating pressure on the foreign exchange reserve in the backdrop of deceleration in workers' remittance growth and slowdown in aid disbursement. Continued high level of monetary growth potentially contains seeds of inflation.

The situation in the manufacturing sector continues to remain ambiguous, while the capital market awaits resurrection and foreign investment flow has become weak. Given the sectoral benchmark estimates, manufacturing and non-crop agricultural growth has to play an important role in FY01 to achieve the target GDP growth rate of 6% or above.

However, the limits of the government's efforts to boost investment is being defined by the structural constraints characterising the economy. Absence of any perceptible improvement in investment and trade supportive infrastructure, including port, customs and utilities have, till date, has compromised all policy incentives offered by the government. Non-economic factors including law and order situation have done no good to improve the situation.

Accordingly, the three major macro-economic challenges which the Bangladesh economy has to confront in the coming months of FY01 relate to maintaining low inflation and stability of *taka* whilst pursuing economic growth.

November 28, 2000