State of the Bangladesh Economy in FY2010-11

(Second Reading)

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a civil society think–tank

CPD IRBD 2010-11 Team

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Acknowledgement

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The CPD-IRBD team alone remains responsible for the analyses and interpretations presented in this report.

Expert Group Meeting
on
CPD-IRBD 2010-11 (Second Reading)

As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation on 02 June 2011 at the CPD Dialogue Room. The working document of the First Reading of *State of the Bangladesh Economy FY2010-11* prepared by the CPD-IRBD team was shared at this in-house meeting with a distinguished group of policymakers and professionals. The CPD team is grateful to all those present at this consultation for sharing their views, insights and comments on the draft report. It needs to be mentioned, however, that expert group members do not carry any responsibility for the contents of this report.

A list of the participants of the meeting is provided below (in alphabetical order):

Professor Abu Ahmed	Department of Economics University of Dhaka
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STATE OF THE BANGLADESH ECONOMY IN FY2010-11
(Second Reading)

1. INTRODUCTION

The present volume of CPD's *Independent Review of Bangladesh's Development* takes stock of major economic developments experienced in fiscal year FY2010-11. The earlier reading of the state of the country's economy by CPD was released on 4 January 2011, covering the first half of this fiscal year.[1]

The content of the present volume had two core parts. The *first part* provides an analysis of the growth outcomes in FY2009-10 and FY2010-11 along with an overview of the macro-economic aggregates. The *second part* takes a close look at a set of issues which underpinned the overall performance of Bangladesh economy in FY2010-11. These issues are the following.

a. Annual Development Programme (ADP)
b. Financial Sector
c. Prices & Food Security
d. Power and Energy
e. Capital Market
f. Export Performance
g. Overseas Employment & Remittances

The volume closes with a brief discussion on the prospect for FY2011-12 in the context of the emerging challenges in the economy. In order to do so, the section seeks to articulate the lessons learnt from the revealed practice of macro-economic management in the elapsing year.

The analyses presented in the volume are based on the most recent official data as well as the information available in CPD-IRBD database. Some of the conclusions have been derived through the use of statistical techniques and debriefing of knowledgeable informants.

The volume is being put in the public domain before the announcement of the national budget for FY2011-12 so as to contribute to the post-budget discussions and debates. Earlier CPD had forwarded a comprehensive set of recommendations for consideration of the government in view of the national budget for FY2011-12 which was being drafted at the time. These recommendations are included in the current volume as the Annex.

[1] Published in "*State of the Bangladesh Economy in 2009-10 and Outlook for 2010-11*". Centre for Policy Dialogue (CPD), Dhaka. February 2011.

2. GROWTH OUTCOME AND THE MACROECONOMIC SITUATION

2.1 THE GROWTH OUTCOMES

Bangladesh successfully withstood the global economic crisis and recorded a 5.7 per cent growth in FY2008-09. The revised estimates for FY2009-10 indicates that the economy was able to escalate its growth performance to 6.1 per cent. The provisional figure for FY2010-11 suggests a GDP growth rate of about 6.7 per cent. Such successive improvements in overall economic performance, notwithstanding all the impediments affecting the economy, remain quite impressive. However, the credibility of GDP estimates in Bangladesh has often come under scrutiny during last one decade or so. Some of the observations in this regard relate to a systematic mismatch between the national accounts estimates and their corresponding proxy indicators, while others concern robustness of the methodology used and weaknesses and delay in data collection.

'Final' GDP Estimates for FY2009-10

In view of the weaknesses characterising the national income accounting in Bangladesh, a certain level of skepticism has always prevailed regarding the robustness of the GDP estimates carried out by the BBS. A recollection of the sequence of events with regard to successive revisions of the GDP growth rate for FY2009-10, leading to the production of the "final" estimates of GDP may illustrate the prevailing confusion.

- The Finance Minister in his budget speech on 11 June 2009 mentioned the target growth rate for FY2009-10 as 5.5 per cent. CPD, in the following morning, termed the target "conservative". The Minister in his press briefing in the afternoon of the same day announced that the target will be 6.0 per cent.
- In May 2010, BBS released the provisional growth estimates for FY2009-10 indicating a GDP growth rate of 5.5 per cent. The Ministry of Agriculture questioned the BBS estimate of growth rate for the crop sector, i.e. 2.8 per cent.
- Following a week long discussion, the Ministry of Finance revised GDP growth estimates upward, to 6.0 per cent, as was announced by the Finance Minister on the afternoon of 11 June 2010. Further, major upward revisions were made for the crop sector (from 2.8 to 4.4 per cent) and the manufacturing sectors (6.0 to 6.4 per cent).
- In November 2010, BBS released the "final" estimate of GDP for FY2009-10, which turned out to be somewhere between the earlier estimates of BBS and MoF's revised estimate, i.e. 5.8 per cent. This time growth rate of crop sector was further raised (from 4.4 to 4.9 per cent), while manufacturing sector's growth was marginally reduced.
- Finally, while publishing the preliminary GDP estimate for FY2010-11, in May 2011, BBS revised the GDP estimate for FY2009-10 for the third time. The latest estimate of GDP growth in FY2009-10 stood at 6.1 per cent, i.e. higher than the revised target. Crop sector's GDP growth rate was further raised by a whole one per cent to 6.1 per cent and growth rate of manufacturing sector was also increased from 5.7 per cent to 6.5 per cent.

Table 2.1.1 presents the record of revision of the GDP estimate and its components.

TABLE 2.1.1: VARIOUS ESTIMATES OF GDP GROWTH FOR FY2009-10

Sectoral	BBS 1st Estimate (%)	MoF Revised Estimate (%)	BBS 2nd Estimate (%)	BBS 3rd Estimate (%)
Agriculture & Forestry	2.8	4.4	4.9	5.6
Crops	2.2	4.2	5.1	6.1
Industry	6.0	6.4	6.0	6.5
Manufacturing	5.3	5.9	5.7	6.5
Service	6.6	6.6	6.4	6.5
Import Duty	1.4	4.3	3.5	1.8
GDP	5.5	6.0	5.8	6.1

Source: Compiled from BBS and MoF Data

CPD does not have the full set of information to prove or disprove the veracity of the most recent GDP growth figure for FY2009-10. However, examination of a number of proxy variables and correlates does give rise to some serious questions regarding robustness of the said estimates. For example, while the Crop sector's GDP estimate was raised sequentially to 6.1 per cent, foodgrains production data showed a growth of 3.1 per cent during the same period[2]. One wonders whether the recent unusual rise of food prices, notwithstanding such an impressive crop production, has to do with an overblown domestic supply estimate. Similarly, the upward revision of the GDP growth figure concerning Manufacturing, following a roller coaster ride, does not correspond to the lower export growth and the flow of inputs (e.g. electricity and gas use, import of intermediate and capital goods).

TABLE 2.1.2: GDP GROWTH, SECTORAL CONTRIBUTION TO GROWTH (2008-9 AND 2009-10)

Sectoral	Growth Rate		Share		Incremental Share	
	FY09	FY10	FY09	FY10	FY09	FY10
Agriculture	5.2	5.0	19.6	19.3	17.1	14.6
Crops	6.1	5.0	11.0	10.9	11.1	8.3
Industry	6.5	8.2	28.9	29.3	30.8	35.4
Manufacturing	6.5	9.5	17.3	17.8	18.5	24.8
Service	6.5	6.6	48.1	48.1	51.1	47.9
GDP	6.1	6.7	100.0	100.0	100.0	100.0

Source: Estimated from BBS and MoF Data

'Provisional' GDP Estimates for FY2010-11

Preliminary estimate prepared by BBS suggests that GDP is set to meet its target of 6.7 per cent in FY2010-11. According to BBS, a remarkable turnaround of manufacturing sector led by large and medium scale industries[3], a repeat strong performance by the crop sector, and anticipated momentum in public investment may be seen as the drivers of this estimated economic growth rate. Indeed, the ongoing global recovery also contributed towards improved economic growth through improved expansion of the export sector. If confirmed, the estimated GDP growth rate of 6.7 per cent for the elapsing year would be highest growth ever achieved in the post-independence history of the country. Indeed, this rate has been achieved back-to-back of a high benchmark of 6.1 per cent (2009-10). However, the not so transparent practice involving successive revisions of the GDP estimates may give rise to questions regarding the robustness of BBS's national accounts figures for FY2010-11.

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[2] Cereals producing sector provides about 60 per cent of crop sector GDP. However, in last five years there has been a systematic mismatch between foodgrains production and crop sector's GDP. The closest resemblance was found in FY2005-06 when growth of crop sector in GDP was 4.3 per cent and foodgrains production growth was 5.0 per cent.

[3] Growth performance of manufacturing sector is likely to be backed up by the export-oriented enterprises.

Sources of Growth. From the expenditure side, the GDP growth of FY2010-11 is largely driven by private consumption expenditure followed by public investment[4] (Table 2.1.3). Interestingly, despite stagnating remittance flow, private consumption has risen at a faster rate compared to GDP. The two components of external resource balance, export and import, have seen remarkable expansion. However, net resource balance has experienced a sharp decline.

TABLE 2.1.3: SHARE OF GDP COMPONENTS BY EXPENDITURE METHOD

Industrial origin sector	Share of GDP (%)		Incremental Share (%)
	2009-10	2010-11(p)	
Domestic demand	104.3	105.1	111.3
Consumption	79.9	80.4	84.2
Private	74.5	74.9	77.9
General Govt.	5.4	5.5	6.3
Investment	24.4	24.7	27.1
Private	19.4	19.5	19.9
Public	5.0	5.3	7.3
Resource balance	-6.6	-8.5	-22.6
Exports	18.4	22.7	54.7
Imports	25.0	31.2	77.3
Gross Domestic Exp. at m.p.	97.7	96.6	88.7
Gross Domestic Product at m.p.	100.0	100.0	100.0
Statistical Discrepancy	2.3	3.4	11.3

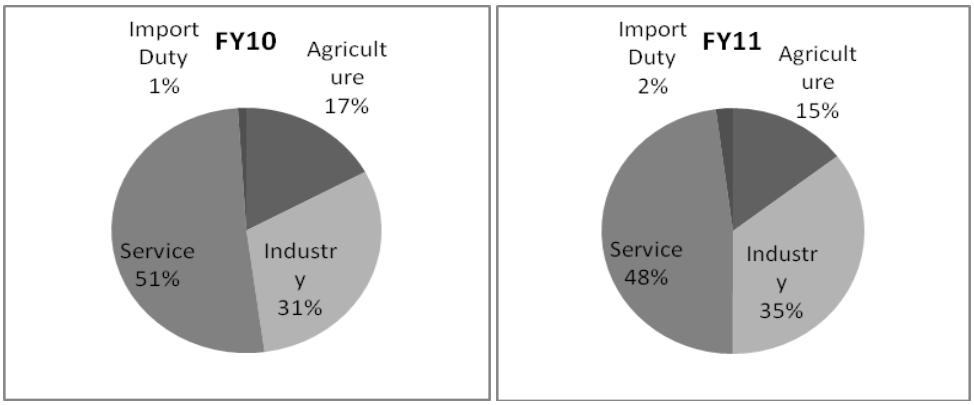
Source: Calculated from BBS data

One of the promising features of the economy's performance in FY2010-11 relates to the impressive growth of 7.0 per cent achieved by the tangible sectors[5]. Growth of manufacturing sector is expected to be 9.5 per cent, 3.0 percentage points improvement from growth attained in FY2009-10. Rapid manufacturing growth is mainly attributed to double digit growth of large and medium industries (10.4 per cent), backed up by strong export performance. The agriculture sector is expected to grow by 5.0 per cent. In the backdrop of previous year's growth of 6.1 per cent, the strong growth of crop sector is quite remarkable. However, it seems that the level of crop production has been delinked from prices of food as food prices continue to rise notwithstanding high production. Performance of the service sector has been consistently decent across the years (around 6.5 per cent). In FY2010-11, BBS estimate predicts the sector attaining a 6.6 per cent growth compared to 6.5 per cent in FY2009-10. Among the nine sub-sectors of the service sector, only financial intermediaries experienced lower growth performance compared to the previous fiscal year.

[4] While reading these numbers one should keep it in mind that there is a difference between GDP estimate based on expenditure method and GDP estimate based on sectoral contribution. As a matter of fact, this statistical discrepancy increased substantially in FY2010-11.

[5]Tangible sectors of the economy, as defined by the BBS, include Agricultural Sector (both Agriculture & Forestry and Fisheries), Mining & Quarrying and Manufacturing. The rest of the sub-sectors are defined as Intangible.

FIGURE 2.1.1: SOURCES OF INCREMENTAL GROWTH



Source: Estimated from BBS (2010).

In the incremental GDP of FY2010-11, the Industrial and Agriculture sectors contributed around 35 per cent and 15 per cent respectively – confirming the relatively stronger dynamics of the "tangible" (production) activities. Services as a group continued to be the front-runner with a total share of around 48 per cent.

GDP Growth Rate in FY2010-11: A Scrutiny

For most of the indicators of national income accounts, provisional estimates are usually calculated on the basis of economic performance during the first half of the on-going fiscal year. The provisional estimates are to be revised at a later date when data for the entire fiscal year will be available to the BBS. However, a number of apparent discrepancies regarding the (first) provisional estimate of GDP growth rate for FY11 has already given rise to a number of questions regarding its adequacy.

The *first set* of issues relates to the serious mismatch between the GDP growth and total investment figures. According to BBS, the total (gross) investment rate increased from 24.4 per cent of GDP to 24.6 per cent. Such a marginal increase in investment resulted in a real GDP growth of about 6.7 per cent. This implies that the incremental capital-output ratio (ICOR) is expected to be 3.7 in FY2010-11, a considerable improvement in one single year (4.3 in FY2009-10). If one projects, based on the average ICOR (3.94) of last five years (2006-10) and the stated level of investment, the GDP growth for FY2010-11, turns out to be about 6.3 per cent. One plausible explanation for this apparent discrepancy could be that in FY2010-11 a considerable level of the underutilised capacity available in the economy has been exploited leading to a higher growth even without higher investment.

Indeed, the final estimate of the gross investment will be obviously less than the currently stated one (i.e. 24.7 per cent of GDP) as the public investment (the Revised ADP) figure may fall well short of the envisaged level. In other words, stagnating gross investment level producing a spectacular 6.7 per cent GDP growth (based exclusively on improved ICOR) may prompt one to term the phenomenon as "investment less growth".

The *second set* of issues concerns estimation of the sectoral/sub-sectoral level growth performance. We have already provided our critical observations regarding crop sector estimation for FY2009-10; let us now look at the industrial sector. Assessment of a rebound performance of manufacturing sector underpins the optimistic growth projection figure for 2011. It is understood that figures of Quantum Index of Production (QIP) is treated as the proxy indicator of manufacturing sector's value addition. While the estimate of growth of

large and medium industries largely corresponds to the sector's growth estimate, the QIP for small industries suggests a considerable decline in production, i.e. by (-) 9.4 per cent during the first half of the fiscal year. In contrast, the growth of small manufacturing industries in FY2010-11 is projected to be 7.3 per cent. Consequently, this has biased the manufacturing sector's growth rate on the high side.

Third as mentioned earlier, the current GDP estimate for FY2010-11 is based on six month's data. A large number of aggregate level indicators suggest that the performance of the economy had not been largely constrained during the second half of the current fiscal year. Thus, there may be reasons for the BBS to revise the GDP growth figure downward when the full-year data will be available.

It may be mentioned here that anticipations about economy's performance in FY2010-11 by several concerned organizations including the World Bank (WB) and the Asian Development Bank (ADB) are not as optimistic as suggested the BBS[6]. Their conclusions considered a number of downside risks that may have been overlooked by the BBS estimate including lower acreage sown for the *aus*[7], shrinkage in acreage and inadequate rainfall for the *aman*[8], slow down in remittance growth, and continued gas and electricity shortage that stifles manufacturing growth. Considering all these downside risks, one may venture to assert that the (first) provisional estimate of GDP (FY11) may have provided an optimistic spin to the reality which may be somewhat above 6 per cent.[9]

GDP Estimation Practice

The practice of estimation and re-estimation of national account statistics in varying points in time, often in a non-transparent fashion, has given rise to a number of questions having both empirical and applied consequences.

First, weak estimates may provide very different signals to the policymakers, resulting in inappropriate policy advice.

Second, if publicly produced data loses credibility, it may also result in loss of confidence by market actors on public policy initiatives.

Third, one does not expect that figures on GDP growth rates to become a political score-sheet.

Thus, there is a need for an independent and professional scrutiny of the estimates to ensure their credibility and also the transparency of national accounting system. This is also important to establish consistency between national accounts estimate and its proxy indicators.

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[6] The projections of GDP growth rate for FY2010-11 by ADB and WB are lower than BBS estimate; 6.3 per cent and 6.2 per cent respectively.

[7] Preliminary estimate of BBS shows 14.5 per cent growth of aus production in FY2010-11. However, the share of *aus* is only 5 per cent in total foodgrain production.

[8] The growth of aman production, as per BBS estimate, in FY2010-11 is 4.8 per cent.

[9] Following the presentation of this report at a media briefing on 4 June 2011, a team of CPD researchers met high level BBS officials including the Director General, on 6 June 2011. An exchange of views took place in connection with provisional estimates of the GDP for FY2010-11.

CPD has, over the years, raised questions about the empirical basis, estimation methodology and process transparency of the national income accounts of Bangladesh. For example, earlier CPD (2007) showed that the average gap between provisional and revised GDP has substantially increased, particularly after the centralisation of GDP accounting with the abolition of district level GDP accounting in 2001. CPD's critical observations on GDP growth rate estimates on earlier occasions have resulted in high profile debate with the then Finance Minister.

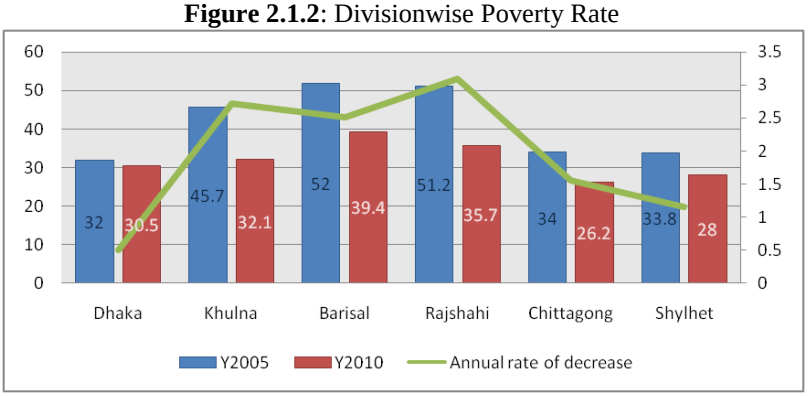
The BBS has recently initiated a programme to rebase the national accounts estimates. The government should take this opportunity to introduce estimates of quarterly GDP. At the same time, the exercise of estimating regional GDP also needs to be reintroduced. However, this on-going exercise should not preclude the government in setting up an *Independent Expert Group* to scrutinise the provisional estimates of GDP as provided for FY2010-11.

BOX 2.1.1: PROGRESS IN POVERTY REDUCTION

As per the preliminary findings of the Household Income and Expenditure Survey (HIES) 2010, poverty declined to 31.5 percent in 2010 from 40.0 percent in 2005. At the same time it is also expected that gini coefficients for income and expenditure, a measure of inequality, have also declined. The income gini coefficient declined to 0.46 in 2010 from 0.47 in 2005. On the other hand, the consumption gini coefficient declined to 0.32 in 2010 from 0.33 in 2005.

Divisionwise poverty reduction rate shows that the poorest divisions (western parts) performed astonishingly better than the capital and other moderately poor districts. Rajshahi, Khulna and Barisal have outpaced other divisions like Dhaka, Chittagong and Sylhet in terms of reducing poverty between 2005 and 2010. While the average poverty reduction rate per annum was 1.7 per cent at national level, it was recorded to be 3.1 per cent in Rajshahi, 2.72 per cent in Khulna and 2.52 per cent in Barisal, zones those are known as the poverty pocket of Bangladesh (Figure 2.1.2).

Figure 2.1.2: Divisionwise Poverty Rate



Source: HIES 2010

Performance of Dhaka in reducing poverty was the worst - only 0.5 percent a year, followed by 1.2 per cent in Sylhet and 1.6 percent in Chittagong. According to the HIES 2010, poverty was highest 52.0 per cent in Barisal in 2005, which came down to 39.4 per cent in 2010. Similarly, Rajshahi's poverty went down to 35.7 per cent in 2010 from 51.2 per cent in 2005 and Khulna's poverty declined to 32.1 per cent from 45.70 per cent five years back. The lowest rate of poverty was recorded in Chittagong at 26.2 per cent at the end of 2010 from 34 per cent in 2005.

It will be interesting to see what were the drivers of this significant reduction in poverty – increased wage rate, social safety net, remittances, booming construction across the country, microfinance or diversification of economic activities?

2.2 MACROECONOMIC TRENDS IN FY2010-11

Three Pressure Points of Macroeconomic Stability

Macroeconomic stability of Bangladesh economy was under strains in FY11, particularly in its second half. A review of macroeconomic correlates suggests that signs of stress became visible in all the three critical areas viz. fiscal, monetary and external sectors. These pressures were building up from the earlier year, but then became more explicit as the fiscal year progressed. While analysing stresses and strains which are weakening the macroeconomic fundaments, one has to separate the symptoms from their triggering factors. The symptoms are evident in the form of rising prices, increasing interest rate and falling foreign exchange rates. However, these negative trends are being triggered by deepening imbalances in the respective sectors – brought about by both domestic and external factors. However, the major policy challenge lies in addressing the three inter-related trends in an optimising framework.

Inflation Rate.[10] The upward trend in consumer prices that became visible in FY2009-10 continued throughout the current fiscal year. In April 2011, the inflation rate (twelve month moving average) was 8.5 per cent. Though the latest monetary policy forecasted inflation for FY2010-11at 7.0 per cent, it is expected to remain at about 8.0-8.5 per cent.[11]

The inflationary trend has been primarily driven by rise in food prices. The food price hike in the local market reflected the soaring international commodity prices. There had been two other important features of the consumer price behaviour. *First*, inflation rate had been higher in the rural areas in comparison to their urban counterparts. *Second*, inflation rate for non-food items had been curiously low in the backdrop of rising food prices.

High prices of rice, notwithstanding successive bumper harvests, suggest that at the end of the day cereal prices in local markets are defined at the margin by the import parity price. CPD's earlier studies have noted the major determinant of consumer price increase in Bangladesh had been driven by food inflation, international price hike and Information asymmetry, lack of infrastructure and weak institutional capacity.[12] Implications/significant growth of monetary aggregates beyond the programmed targets remains an issue for further investigation.

Interest Rate.[13] The interest rate in Bangladesh was capped for couple of years till May 2011. The partial withdrawal of interest rate cap (barring for interest rate on term loan, agricultural credit, credit for export financing and importing the essential food items) raised the market interest rate. It became imperative to withdraw the cap as the interest rates were no more able to protect the future value of money in the context of rising inflation rate. Relatively low rates were also affecting flow of deposits as other potential depositors sought out other more attractive sources of investment, particularly the capital market.

Regrettably, at the same time, liquidity in the money market seemed to be under pressure. Due to growing demand for trade financing and consumer loans, credit flow increased at a faster rate compared to deposit. Higher inflationary expectation and capital market bubble also influenced people's savings decisions. As a matter of fact, lax governance in capital

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[10] The issue has been addressed in details in Section 3.2 of the present volume.
[11] The original target as per the MPS (2010-11) of the Bangladesh Bank was 6.5 per cent.
[12] CPD (2011)
[13] The issue has been addressed more comprehensively in Section 3.2 of the present volume.

market and money market created havoc in the financial sector. To utilise the opportunities which appeared from the positive developments in the form of growing export demand in the face of global recovery and marginal improvement in power sector (even if at a higher cost) required credit at a favourable price. To attain the medium term growth targets, private investment needs to pick up. In the next fiscal year, it may be constrained by high interest rates. Towards the end of the fiscal year, rise of commodity prices in the domestic and global market forced the government to go for higher expenditure which is being financed by bank borrowing. This has also created some speculation in the financial sector with regard to whether this action would create a crowding-out effect or not.

Exchange Rate[14]. The third indicator of macroeconomic imbalance arises from the recent escalation in exchange rate. Bangladeshi Taka (BDT) has been depreciating more or less against all major currencies over the recent months (Figure 3.4.6). Increased import payment, low flow of foreign aid, decelerated remittance flow and sluggish net FDI have pushed the value of BDT further down. Consequently, import became costlier and further pressure was put on domestic prices and inflation. This is supposedly pushing interest rate upward and making growth and investment dearer.

In this backdrop, the macroeconomic policy analysis needs to address two important issues. *First*, what which were the triggering factor(s) behind the debilitating trends that are weakening the macroeconomic situation? Is it happening because of exogenous factors (i.e. these are beyond policy control) or due to internal policy lapses? *Second*, what are the available policy options in addressing the emerging situation or in other words where the adjustments can be made with a lower opportunity cost? To seek answers to these and other questions, the following discussion presents an analysis of the macroeconomic performance of the Bangladesh economy in FY2010-11 and the policy options for sustaining growth and consolidating stability in FY2011-12.

Fiscal Management

Fiscal management in FY2010-11 is characterised by a set of mixed developments. Revenue mobilisation efforts by the NBR rose to the occasion and managed to surpass the challenging targets set out for it. On the other hand, lacklustre performance of non-NBR tax and non-tax revenue sources subdued the overall revenue collection. Annual Development Programme (ADP) expenditure could not break the jinx of 'last quarter syndrome'[15] by making a late surge. Concurrently, non-ADP expenditures – mainly attributed to rising subsidy demand – continued to soar. However, the fiscal deficit should remain well within the programmed limit.

Overall Revenue Target. The two sources of revenue collection outside the NBR are not likely to achieve their targets for FY2010-11. Taking note of the progress achieved so far, the Finance Minister indicated his intention to reduce the targets for non-NBR tax and non-tax collection by Tk. 200 crore and Tk. 800 crore respectively. Consequently, aggregate revenue mobilisation target may not fall short from the original target, but NBR will need to offset the likely underperformance of the non-NBR sources.

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[14] The issue has been addressed more comprehensively in Section 3.4.1 of the present volume.

[15] The trend for last five years (FY2005-06 to FY2009-10) suggests that more than half of ADP expenditure was spent during the last quarter.

NBR Revenue. The NBR was able to collect about 82.0 per cent of the revenue target during the first ten months with a growth rate of 27.1 per cent, and is expected to comfortably cross the targeted amount for the full fiscal year (Table 2.2.1). While income tax collection is well on track to achieve its huge target, collection of indirect taxes from both domestic and external sources exceeded the expectation – thanks to rising commodity prices and vibrant economic activities. The government also responded with an upward adjustment of target for the NBR by Tk. 3,000 crore[16]. The targets for Income Tax, Value Added Tax (VAT) and Customs Duty (CD) have been raised by Tk. 1,100 crore, Tk. 1,200 crore and Tk. 7,000 crore respectively.

The revision of targets implies that the target for the NBR increased by 4.8 percentage points to 21.8 per cent for the full fiscal year. Although income tax collection was impressive (33.1 per cent during the first ten months), along the demonstrated trends of the recent past, the increasing intake may have been a result of intensification of tax collection from the existing base as against inclusion of new tax payers. During the first ten months, about 68 thousand additional income tax returns were submitted by individuals. However, as a share of total tax identification number (TIN), the number of tax return submitted is similar to that of the previous fiscal year (about 29 per cent). Income tax collection from capital market doubled during the first ten months, though accounting for only 2 per cent of total income tax collection. [17] CD collection will still require a big jump (40.4 per cent) to achieve its revised target in the remaining months of May and June of FY2010-11. In contrast, targets for VAT and Supplementary Duty (SD) collection have already been overachieved. Thus, any possible shortfall of revenue collection from CD may be partially compensated by higher than targeted revenue collection from VAT and SD. Whatsoever, only a 5.7 per cent aggregate growth will be required over the last two months to attain the target set out for the NBR. In the event of achieving the target, revenue collection from NBR will account for about 9.6 per cent of GDP in FY2010-11, up from 8.9 per cent of GDP in the previous year.

TABLE 2.2.1: TARGETED, ACHIEVED AND REQUIRED GROWTH RATES OF REVENUE COLLECTION FROM NBR (%)

Sources	Original Target	Revised Target	Achieved (Jul-Apr)	Required for Original Target	Required for Revised Target
Customs Duty	20.7	28.5	25.5	1.5	40.4
VAT Total	10.7	15.6	24.1	-37.3	-14.9
Supplementary Duty	19.2	19.2	27.5	-14.3	-14.3
Income Tax	23.3	29.7	33.1	4.1	23.1
Others	4.3	4.3	19.8	-129.2	-129.2
NBR Total	**17.0**	**21.8**	**27.1**	**-14.1**	**5.7**

Source: Calculated from NBR data

Non-NBR Sources of Revenue Collection. As mentioned earlier, collection of non-NBR tax and non-tax revenue has not been encouraging. The targeted growth rate for Non-NBR tax

[16] In March 2011, the Finance Minister, while informing the Parliament about the macroeconomic situation during the first half of the fiscal year, expressed his intension to raise the target for NBR by Tk. 1,000 crore (MoF, 2011).

[17] A latest media report claimed that about Tk 600 crore capital gains taxes from capital market remained stuck up due to a lack of clarity in the law. The report is available at: http://www.thefinancialexpress-bd.com/more.php?news_id=137234&date=2011-05-28

collection was 25.9 per cent (Table 2.2.2). During July-February period it could achieve only 16.9 per cent. Therefore, this head has to achieve a drastic growth rate of 39.4 per cent during the rest four months, which is quite unlikely. Barring tax collection from stamp duty, all other components of this head are lagging behind. Being a minor source of overall revenue collection, underperformance of Non-NBR component may not have significant impact on overall revenue collection target.

TABLE 2.2.2: TARGETED, ACHIEVED AND REQUIRED GROWTH RATES OF REVENUE COLLECTION FROM NON-NBR SOURCES (%)

Heads	Growth Target FY11	Growth FY11 (Jul-Feb FY11)	Required Growth FY11 (Mar-Jun FY11)
Non-NBR tax	**25.85**	**16.89**	**39.41**
Narcotics &Liquor	22.41	8.11	47.62
Vehicles	34.26	-12.99	103.42
Land	36.91	12.89	59.42
Stamp	19.93	29.05	4.17
Non-tax Revenue	**25.33**	**-13.26**	**118.43**
Dividend & Profit	-32.17	-46.05	166.19
Post Office & Railway	4.41	-2.19	8.63
Interest/Fees/Tolls & Other receipts	38.64	-4.67	133.02

Source: Calculated from MoF data

Non-tax revenue records portray a rather disappointing performance during the first eight months of the fiscal year. Non-tax revenue collection has fared even worse compared to non-NBR tax collection, declining by (-) 13.26 per cent against its formidable growth target of 25.3 per cent. Considerable fall in profit earnings from Bangladesh Bank and lower revenue collection by BTRC have been mentioned by the Finance Minister as the reasons for such disappointing performance. Ensuring SoE's efficiency and upward revision of government fees and charges need to be emphasised to augment revenue from non-tax sources[18] (see Box 2.2.1).

[18] It is however needs to mention that targets set for these two heads are more likely determined by residual targeting to keep the deficit figure at around 5 per cent of GDP.

BOX 2.2.1: NON-NBR SOURCES OF REVENUE COLLECTION

The Non-NBR revenue, comprising of *Non-NBR Tax* and *Non-Tax Revenue*, are often overlooked while analysing the revenue mobilisation situation and prospect in Bangladesh. Nevertheless, these two sources of government revenue yield more than one fifth of the total government revenue mobilisation[19]. Unlike NBR the Non-NBR revenues are collected by several government agencies and public enterprises[20].

Non-NBR tax sources portray very small portion of revenue base[21], but it includes some vital demanding components. Non judicial stamps earning caters a handy 59.5 per cent (5-years average) share under this head, though the trend is declining. Although land revenue and taxes on vehicle contribute very small proportion of non-NBR tax collection (12.7 per cent and 24.7 per cent respectively in FY2008-09) it is evident that there is a large gap between their actual and potential revenue collection. Performance of non-tax revenue is also far from reality. Interest, Fee & Tolls (IFT) is the major source of non-tax revenue which provided 78.1 per cent of non-tax revenue in FY2009-10. Collection from Dividends and Profits can also become a major source of revenue collection.

A number of inherent issues regarding Non-NBR tax and non-tax revenue collection are influencing the performances of these two sources. *First*, one has to recognise the fact that the preparation of budgetary framework is dictated by its expenditure side. Once the Government has been finalised an outline of expenditure, the target for NBR tax revenue is set with consultation with the NBR personnel. In contrast, such efforts are hardly considered in case of non-NBR revenue collection authorities. Subsequently, these heads fail against unrealistic burden of a residual target. Some back of the envelop calculations are envisaged which perhaps are not for the public dissemination. Definitely, this plan of action evokes speculation and questions fiscal transparency.

Second, while preparing the revised budget framework, a similar approach is followed. NBR target has been revisited with judicious choice; unlike non-tax revenues. For example in FY2008-09, NBR target was increased by Tk. 2,120 crore in revised budget and at the end they managed to augment Tk. 1,466 crore in addition to the revised budget target. On the other hand, for non-tax revenues, additional Tk. 1,064 crore was imposed and they failed by a margin of Tk. 1,190 crore.

Third, there is a need to revisit decades old government rates including the various fees, rents, stamp duty etc. The economy is growing but the government assets are not paying enough returns. There is a growing concern that revenue from public properties including land and water bodies are not leased in a competitive manner.

Fourth, performance of dividend and profit from state-owned enterprises is also below par. The efficiency of public enterprises needs to be revamped particularly considering government's decision in favour of any new privatisation effort. A more comprehensive plan also needs to be taken in order to estimate the reinvestment requirement for these enterprises.

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[19] Components of Non-NBR part of taxes include Narcotics & Liquor (NL), Taxes for Motor Vehicles, Land revenue and Non-judicial Stamps. On the other hand, Non-Tax head includes Dividend & Profits (DP), Post Office & Railway (PO&R) and Interest/Fees/Tolls (IFT) & other receipts. IFT includes a diversified range of revenue sources like interest, royalty and income from property, administrative fees, penalty and forfeiture, rent and leasing, tolls and levies, non-commercial sales, receipts from irrigation and defenses, capital receipts and other non-tax receipts etc. Until July 2008, the then Bangladesh Telephone and Telegraph Board (BTTB) (at present Bangladesh Telecommunications Company Ltd. (BTCL)) was also a part of non-tax revenue source, with a contribution of around 20 per cent of total non-tax revenue.

[20] Department of Narcotics Control under Ministry of Home Affairs collects *narcotics duty*, while Ministry of Land compiles *land revenues and taxes* though *Tahsil* offices, situated in administrative locales. The other government agencies involved in collecting *non-judicial stamps* and *motor vehicle tax* are respectively, Ministry of Finance and Bangladesh Road Transport Authority,(BRTA),under the Ministry of Communication,. Other registration fees and taxes are concerns of Registration Directorate of the Ministry of Law, Justice and Parliamentary Affairs. Bangladesh Post Office, a directorate of the Ministry of Posts and Tele communication monitors Post Office collections, whereas Bangladesh Railway (BR) under the Ministry of Communication is responsible for collecting railway related revenues for passenger services and freight.

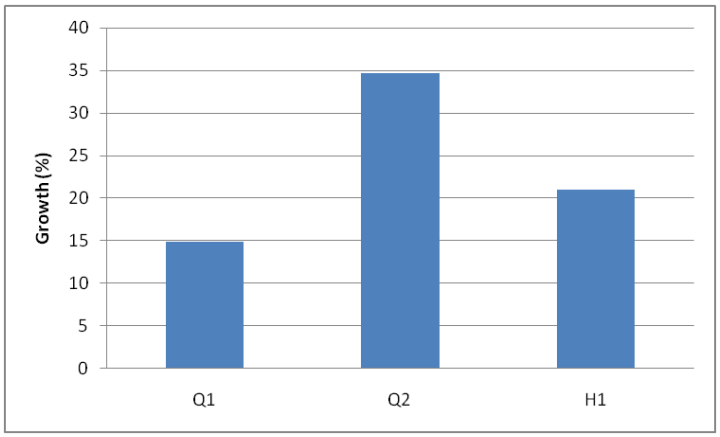
[21] The source augmented 4.8 per cent of the tax base and 3.8 per cent of revenue base on an average over last 10 fiscal years.

Fifth, these sources are incapable of getting enough attention from the stakeholders. Unlike NBR, the non-tax revenue collecting agencies are often not specialised in revenue collection. Human resource management and capacity building should, therefore, be emphaised. In view of this, inter and intra coordination and cooperation among the government agencies collecting non-tax revenue is essential.

Public Expenditure. The overall public expenditure was planned to increase by more than 3 percentage points from 13.7 per cent of GDP in FY2009-10 to 16.8 per cent. While full allocation for ADP is not going to be utilised, total expenditures outside ADP is expected to overshoot. However, these two broad heads together will still be less than the total public expenditures outlay.

Non-ADP Expenditure[22]. Government expenditure in FY2010-11 has been dominated by non-ADP expenditures, particularly by subsidy payments. About 33.3 per cent of non-ADP expenditure envisaged in the budget was spent during the first half of the current fiscal year and remained within the target (Figure 2.2.1). It needs to be mentioned here that, during the second quarter, expenditures on non-ADP accounts took a sharp upturn and increased by 34.5 per cent whereas growth figure for the first quarter (Q1) was only 14.8 per cent.

FIGURE 2.2.1: GROWTH OF NON-ADP EXPENDITURE IN FY2010-11



Source: Calculated from MoF data

It is evident that higher subsidy payments largely contributed to accelerating non-ADP expenditure[23]. The higher requirement of subsidy emerged from larger demand for subsidised commodities and rising commodity prices in both global and domestic markets. Major subsidy awardee sectors of Bangladesh include agriculture[24], export, food, fuel (Bangladesh Petroleum Corporation) and electricity (Power Development Board). Due to lower level of commodity prices, total subsidy payments in FY2009-10 was Tk. 9,334 crores (2.6 per cent of GDP) (Table 2.2.3). The highest ever subsidy was provided in FY2007-08 when the revised allocation for total subsidy reached at 4.3 per cent of GDP. Subsidy requirement could reach to a similar level (as percentage of GDP) in FY2010-11 as well.

[22] Government generally reports its expenditures under two heads, non-development and development expenditures. However it often raises confusion among the readers and some of the expenditures, albeit small in proportion, remains outside the report. Non-ADP expenditure is reported by the Finance Minister in the Parliament, and it considers all other expenditures outside of the ADP.

[23] The Finance Division does not report a complete estimate of subsidy expenditures.

[24] Subsidy in agriculture sector is provided in various forms including diesel and electricity for irrigation, fertilizer, seeds etc. Generally, about 40 per cent to 50 per cent of total subsidy goes to agriculture sector.

TABLE 2.2.3: SUBSIDY ALLOCATION IN REVISED BUDGET (TK. IN BILLION)

Sector	FY06	FY07	FY08	FY09	FY10
Food	4.96	6.99	7.36	10.16	9.84
Agriculture	6.00	10.41	39.00	57.85	42.00
Export	5.02	7.00	11.70	12.00	17.00
Others	0.23	6.32	0.15	0.64	3.50
Fuel (BPC)	-	6.00	75.23	15.00	9.00
Electricity (PDB)	-	-	6.00	9.81	12.00
Total Subsidy	16.21	36.72	139.44	105.46	93.34

Source: MoF Data

Some of the reasons for higher subsidy payments in FY2010-11 are as follows.

- According to the report presented by the Finance Minister before the Parliament in March 2011, subsidy for agriculture in FY2010-11 would require Tk. 1,000 crore in addition to earlier allocated Tk. 4,000 crore.
- Subsidy-eligible export products registered remarkable growth rates during this fiscal year.
- Government could not meet foodgrain procurement during last *Boro* season, whereas the plan to procure foodgrain during this *Aman* season was abandoned. On the contrary, government distributed an additional 400 thousand metric tonne (MT) rice during the first ten months of the fiscal year through various priced and non-priced channels[25]. To meet this high demand, government was forced to import rice from global market[26]. This explains the need for additional subsidy allocation for food operations.
- Demand for petroleum products took sharp upturn to serve the newly installed fuel fired quick rental and rental power plants, resulting in higher subsidy requirement.
- Besides higher demand, prices of food and fuel increased considerably – widening the gap between actual and subsidised prices. Recent adjustment of power tariff and administered prices of petroleum products and CNG could serve a little to arrest surge in subsidy expenditures[27].
- But it is the subsidy on power and fuel that is more likely to absorb large amount of tax money in later months[28]. CPD (2010) estimated that an additional Tk. 3,500 crore subsidy will be required in FY2010-11 for the new independent power plants (IPPs). A recent

[25] To restrain further rise of foodgrain prices, the government intervened in the market through open markets sales (OMS). During first ten months, rice sales through OMS already surpassed its annual target by more than 50 per cent. It may be noted here that, the difference between the price charged by government for one kilogram (kg) rice is lower by Tk. 8-10 compared to that by a private seller. The government also introduced a number of new channels of food distribution. Foodgrain distribution to Fair Price Card holders was initiated across the country where each card holder can purchase up to 20 kilograms of foodgrain at 24 Tk per kg for rice and 20 Tk per kg for wheat. Food grain distribution among fourth-class government employees also started in February 2011.

[26] During July-April of FY2010-11, government procured 990.4 thousand MT as against only 10.3 thousand MT during the same period of FY2010-11. Imported rice served about 55 per cent of total rice distributed by government during this period.

[27] A detailed discussion on price adjustments for electricity, petroleum products and CNG has been given in Section 3.5.

[28] As a matter of fact, the electricity supply from newly initiated quick rental and rental power plants receives dual subsidy. *First*, they receive subsidy for liquid fuel used to run the power plants under the universal subsidy provisions for petroleum products. *Second*, the buying cost of electricity from these power plants is much higher than that from the state-owned natural gas fired power plants.

media report suggested that total subsidy for energy sector could hit Tk. 7,500 crore in the current fiscal year[29].

Due to the factors stated above, requirement for total expenditures for subsidy is obviously going to beat the programmed outlay in FY2010-11. The Finance Division does not report a complete picture of subsidy expenditures. In total Tk. 5,000 crore may be required in addition to the budget allocation under total subsidy. This implies that total subsidy could be close to 4.0 per cent of GDP.

ADP Expenditure. Allocation for ADP remained as usual underspent compared to its allocation during early months of fiscal year. Particularly, sluggish implementation of foreign aided projects held back overall ADP expenditure. Consequently, while revising the ADP allocations foreign financing portion was slashed by Tk. 3,370 crore while the domestic financing figure remained untouched[30]. While finalising the ADP for FY2011-12, the revised ADP was pushed upward again by Tk. 700 crore. This additional amount is to be met from domestic financing. Considering this new RADP, ADP utilisation rate during the first ten months of FY2010-11 was 58.4 per cent compared to 58.6 per cent for the similar period of the previous fiscal year, portraying a sharp upturn during the latter half of the current fiscal year. During July-April period, the implementation rate for domestic financed part was 61.4 per cent (59.5 per cent in FY2009-10). However, for the reported period 52.2 per cent of revised project aid allocation could be spent (57.3 per cent in FY2009-10). This implies that about 42 percent of total RADP will now have to be implemented during the last two months (39 per cent of domestic financed and 48 per cent of project aid). The experience of last five fiscal years suggests that on average about 36.5 per cent of total ADP expenditure is spent during last two months (Table 2.2.4)[31]. However, the corresponding implementation figure for project aid is only 30.0 per cent. This implies that project aid part may not achieve its RADP target in FY2010-11, although it is not unlikely for the implementation of the domestic financing portion of ADP to be close to its RADP target[32]. In view of the recent performance, it appears that overall ADP implementation may fall short by about Tk. 2,000 crore at the end of the fiscal year[33].

TABLE 2.2.4: TREND IN ADP IMPLEMENTATION DURING MAY-JUNE PERIOD

Period	Total	Domestic Financed	Project Aid
FY06	38.3	42.6	29.1
FY07	36.1	41.4	26.2
FY08	33.0	35.6	28.7
FY09	39.7	43.5	34.1
FY10	35.6	37.7	32.0
Average (FY06-FY10)	**36.5**	**40.1**	**30.0**

Source: Estimated from IMED Data

[29] The media report is available here http://www.thefinancialexpress-bd.com/more.php?news_id=133703

[30] Nevertheless, a considerable redistribution was made among the implementing agencies and projects. Even after this revision revised ADP (RADP) of FY2010-11 is 23.3 per cent and 35.5 per cent higher than RADP and ADP expenditure for previous fiscal year. Section 3.1 of this paper is dedicated to detailed ADP implementation analysis.

[31] As a matter of fact, in FY2008-09, of total ADP expenditure 39.7 per cent was spent during the last two months.

[32] If there is some shortfall, it may be due to the fact that some domestic financing allocations are attached with project aid.

[33] In this likely scenario, ADP implementation may stand at about 94 per cent of RADP allocation and 86 per cent of ADP allocation.

Budget Deficit. Satisfactory revenue collection and slower pace of expenditure, particularly for development, kept the budget deficit well within the programmed limit during the first half of the fiscal year. The overall budget deficit (excluding foreign grants) was 1.7 per cent of GDP at the end of first quarter of FY2010-11 (Table 2.2.5). In fact, budget deficit was lower in Q1 compared to the corresponding period of FY2009-10. However, budget deficit is obvious to increase in the coming months mainly due to higher public expenditure requirements originating from higher subsidy payments and pick up in ADP expenditure. Considering together all the factors related to underpinning revenue collection and expenditures, budget deficit figure at the end of the year may remain well below 5 per cent of GDP. Thus, the size of budget deficit will not be a matter of concern for FY2010-11. More importantly, the composition of deficit financing may have a greater bearing on the overall macroeconomic stability.

TABLE 2.2.5: FINANCING OF BUDGET DEFICIT IN FY2009-10 AND FY2010-11 (AS PER CENT OF TOTAL DEFICIT)

Sector	FY10	FY11B	FY10 H1	FY11 H1
Net Foreign financing	47.5	39.8	44.0	9.5
Grant	19.0	12.2	7.7	2.2
Loan	49.8	40.6	56.6	40.7
Amortisation (-)	21.3	13.1	20.3	33.5
Domestic Financing	52.5	60.2	56.0	90.5
Non-Bank Borrowing (net)	61.8	20.3	44.8	26.9
Bank Borrowing (net)	-9.3	39.9	11.2	63.6
Total Financing	100.0	100.0	100.0	100.0
Total Financing as % GDP	**3.2**	**5.0**	**3.4**	**1.7**

Source: Calculated from MoF data

Financing of the Deficit. In financing budget deficit during the first half of FY2010-11, contribution of foreign sources was dismally low. This is mainly due to the poor performance record in implementing foreign aided projects under the ADP. Once we consider amortisation, net foreign financing during the first half of FY2010-11 accounted for only 9.5 per cent of the total deficit. Within domestic sources of financing, bank borrowing had a greater role to play. With non-bank intake by the government taking a setback as a result of the diminished incentive to invest in National Savings Directorate (NSD) certificates by the small savers, financing requirements from banking sources increased drastically. With emerging tightness in the banking sector credit, there is a growing apprehension that it may create some "crowding-out" effect. Accordingly, financing the budget deficit in FY2010-11 will rely heavily on domestic sources, particularly on banking sources. In fact the government hardly had any choice in its deficit financing decisions in the current fiscal year as it ran out of options in this regard. In this backdrop, the Finance Minister will have to make a judicious call while laying out the budget plans for the next fiscal year.

Monetary Policy

The monetary policy in FY2010-11 was required to accommodate the projected fiscal expansion and it set a hefty growth target for the public sector (government plus other public sector)[34]. Nevertheless, the targets for other monetary aggregates were set at a much lower level with a view to rein in the flow of money supply in order to control rising price level. During the first quarter of FY2010-11, it emerged that achieving the central bank's objective

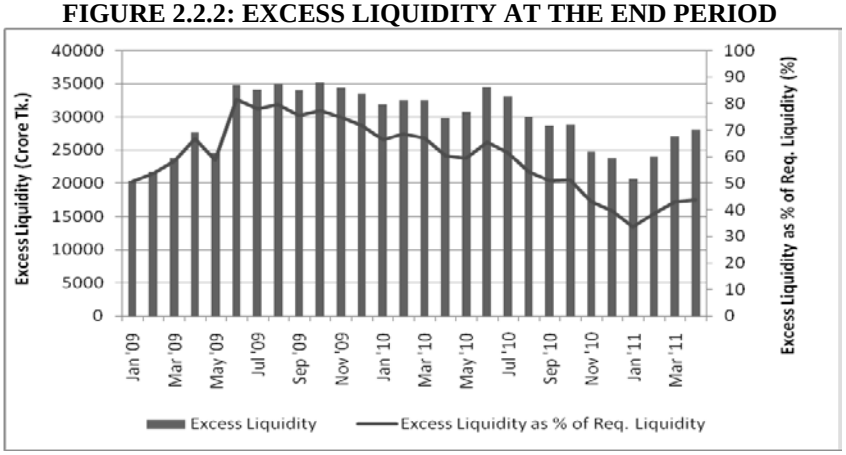
[34] A detailed analysis of monetary policy and financial sector is reported in Section 3.2. Section 3.3 is dedicated to inflation.

with respect to demand management would be a far cry. Indeed, at the end of the third quarter, it is obvious that all the monetary targets have gone topsy-turvy. In reality, systematic large gap between targets and actual outcomes raised questions about the objective, methodology and effectiveness of the central bank's targets for monetary aggregates[35].

However, one could see the central bank's subsequent attempts towards controlling the credit flow. During the last one year, the policy rates were increased twice. However, the actions did not make any immediate large impact on credit flow as sufficient excess liquidity was prevailing in the market. But the central bank had to use Repo auctions more frequently than ever to pump money into the financial system. Excess liquidity started to come down since the policy rates adjustment. Concurrently, higher demand for trade financing, growing investment demand and more importantly bubble in the capital market also consumed excess liquidity. In fact, as of end January 2011, the excess liquidity stood at Tk. 20,660 crore, recording the lowest level in last two years. This was right after the capital market crash. The end of capital market hype helped ease the liquidity pressure on the scheduled banks.

In recent months, government's demand for credit from banking system is increasing at a faster rate. At the same time the central bank partially withdrew the caps on interest rates. It seemed that there is once again a growing pressure on the liquidity in the banking sector. The business community is claiming that there is a liquidity shortage with the banks. Indeed, the current level of excess liquidity looks much higher than it is in reality. *First*, total amount of excess liquidity is always available for credit as the major share of it remains in the form of various unencumbered approved securities. *Second*, if we compare the relative level of excess liquidity in terms of excess liquidity as a share of required liquidity, it is considerably low compared to end of June 2010. Excess liquidity as percentage of required liquidity stood at 44 per cent as of April 2011, whereas it was 65 per cent as of June 2010 (Figure 2.2.2). The figure came down to 34 per cent as of January 2011 which was lower than the usual scenario of June 2008 when excess liquidity as percentage of required liquidity stood at 37 per cent. Moreover, the aggregate figure can be misleading due the fact that there may be large inter-bank differences. For example, as of April 2011 excess liquidity as percentage of required liquidity with the private banks stood at about 29 per cent. The recent rise of call money rate also supports this hypothesis.

FIGURE 2.2.2: EXCESS LIQUIDITY AT THE END PERIOD



Source: Estimated from Bangladesh Bank Data

[35]Failure of central banks to contain the monetary aggregates within their target bands is not unusual. And hence, many of the central banks around the world abandoned the policy of monetary aggregates targeting.

In order to service the investment demand of the country, it is important to secure a greater volume of financial resources – both through higher availability of bank credit as well as by reducing the borrowing cost of such credits. Both of these requirements seemed to be under pressure. With government's borrowing rising, there may be some scope of crowding our effect on private investment. Moreover the withdrawal of interest rate caps raised the interest rate considerably. This has also been disfavouring the growing investment demand arising from external demand and improved investment scenario. On the other hand, there will be growing pressure from some quarters to tighten the money supply in view of sustaining inflationary pressure. Overall the monetary policy needs to be revisited in line with the fast changing economic realities so as to redesign its stance in the forthcoming fiscal year.

Balance of Payment (BoP)

What has been an apprehension during the first quarter of the fiscal year, is now a reality at the end of third quarter of FY2011-12. Indeed, balance of payment situation has come under some strain. After ten long years overall balance in FY2010-11 may end up being in the negative terrain[36]. The robust export growth paralleled by surging import payments has not been able to deter weakening of the trade balance. Current account recorded a small surplus due to flat growth of remittance. Higher financial account deficit, owing to dismally low foreign direct investment (FDI) and foreign aid, made overall balance negative.

Export. FY2010-11 is marked by remarkable export growth. In the backdrop of the low export growth of FY2009-10, a 40.9 per cent growth in July-April of FY2010-11 is indeed encouraging[37]. Moreover, several prominent aspects of this performance can be highlighted. *First*, total export receipts recovered from the lagged impact of the global financial crisis. *Second*, the attained growth was broad based. Almost all export products, traditional and non-traditional, achieved impressive growth. There has also been an indication of some product diversification. *Third*, export growths in new markets were buoyant. Bangladesh may have inched towards market diversification. *Fourth*, the overall export growth was largely volume driven. Bangladesh may have faced considerable deterioration of terms of trade (ToT), but it also indicates a considerable production growth of export oriented sectors.

A number of factors contributed to the current export dynamics[38]. *First*, global economy made steady recovery in last one year. Total import and import of RMG products (HS code 61 and 62) in the United States (US) market during July 2010-March 2011 period increased by 19.4 per cent and 15.8 per cent respectively over the corresponding period[39]. Similarly during July 2010-February 2011 period growth of total import and import of RMG products in the European Union (EU) were 29.4 per cent and 19.7 per cent respectively[40]. *Second*, Bangladeshi exporters took advantage of the new facilities offered by the EU and Japan. *Third*, continued policy support for export oriented industries helped the export sector to recover at a faster rate. *Fourth*, depreciation of exchange rate against all major currencies

[36] FY2000-01 was the last fiscal year (before this year) when Bangladesh experienced a negative overall balance (USD 226 million). In FY2004-05, current account balance was negative (USD 557 million). However due to favourable financial account balance (thanks to significant inflow of net foreign aid and net FDI), overall balance turned out to be positive.

[37] Export growth for the corresponding period of FY2009-10 was 9.8 per cent.

[38] A detailed analysis of export performance is presented in Section 3.6.

[39] Whereas, a year ago, import growth figures were negative; (-) 10.3 per cent and (-) 8.1 per cent respectively.

[40] For the similar period of previous year total import and RMG import declined by (-) 17.0 per cent and 10.6 per cent respectively.

perhaps put some extra burden for domestic consumers, but lent a helping hand to the exporters[41].

Import. Concurrently, during July-March FY2010-11, import payments also registered remarkable growth of 40.9 per cent (Table 2.2.6). Deficit in trade balance during the first three quarters increased by about USD (-) 1,653 million compared to the same period of the previous year. Swelling import payments was the prime reason behind the present balance of payment pressure. The soaring global commodity prices along with higher demand for imported commodities contributed to this accelerated growth. Import of foodgrains (particularly rice) and consumer and intermediate goods increased drastically during this period (117.5 per cent and 54.5 per cent respectively). Import of rice, which was mostly procured by the government[42], was 16 times higher than previous fiscal year. Growth of export-oriented RMG related major intermediate products[43] (76.3 per cent) was even higher than growth of RMG export. Relaxation of Rules of Origin provisions in the EU and Japan may have contributed to this. Decomposition of import payments suggests that rice, raw cotton and yarn are three most prominent products accounted for incremental contributions which is larger than their share in total imports during July-March FY2009-10[44]. In fact, more than USD 2.2 billion additional import payments had to be made for these three items in FY2010-11. Hence, it can be concluded that soaring inflation in domestic and global market and robust export growth are the two major reasons behind the import growth. Imports of fertiliser, petroleum products and capital machinery also recorded significant growth (49.4 per cent, 42.1per cent and 37.9 per cent) during the reported period. Import bill for petroleum products may increase at an accelerated rate as more liquid fuel fired quick-rental/rental power plants are expected to start production in the coming months.

[41] Between May 2011 and May 2010, value of Bangladesh Taka (BDT) depreciated by 5.7 per cent and 20.2 per cent against USD and Euro respectively. Exchange rate against the currencies of eleven new markets of Bangladeshi exporters (Japan, Turkey, Australia, Chile, South Africa, Brazil, China, India, South Korea, Mexico and Russia) also depreciated considerably during this period with a range between 6.3 per cent (for Turkish Lira) and 32.4 per cent (for Australian Dollar). Depreciation of BDT against Chinese Yuan also helped export competitiveness of Bangladesh vis-à-vis Chinese counterparts in other markets.

[42] One may refer to the fact that the government procurement fell short of its target significantly during Boro season of last year. At the same time, the government decided not to procure rice from domestic growers during Aman harvest period during this year to ensure sufficient rice supply in the market with a view to tame the rising domestic price of rice. On the other hand, the public food distribution through price and non-priced channels was raised throughout the year to contain inflationary pressure. Together, all these factors left no other option for the government than procuring foodgrains from the global market.

[43] The definition used here Includes ‘raw cotton’, ‘yarn’ and ‘textile and articles thereof’.

[44] The differences between incremental shares in July-March FY2010-11 and shares in July-March FY2009-10 of rice, raw cotton and yarn are 7.3 percentage points, 11.9 percentage points and 3.7 percentage points respectively.

TABLE 2.2.6: IMPORT GROWTH RATES (%)

Items	Growth FY10 (July-March)	Growth FY11 (July-March)
Food Grains	**-16.70**	**117.45**
Rice	-85.98	1616.51
Other Food Items	**34.43**	**-5.98**
Consumer & Intermediate Goods	**-9.93**	**54.48**
Crude petroleum	-3.16	29.90
POL	-17.95	45.79
Chemicals	-2.34	32.27
Fertilizer	-27.01	49.37
Raw cotton	-3.38	126.67
Yarn	-17.03	92.50
Textile and articles thereof	-10.88	36.22
Capital Goods & Others	**-0.54**	**29.23**
Capital machinery	6.03	37.93
Others	**16.54**	**28.38**
Total Import	**-1.34**	**40.91**

Source: Estimated from Bangladesh Bank Data

Overall Balance of Payment. Despite escalating trade deficit, current account registered a surplus of USD 689 million during the first nine months of FY2010-11[45]. A slowdown in the remittance flow was an important factor in contracting the current account surplus. Lower level of FDI and lack of net foreign aid inflow created further pressure as financial account deficit increased by USD 830 million during the first three quarters of FY2010-11 (Table 2.2.7). The BoP situation has emerged as one of the most significant macroeconomic concerns. It was determined by trade balance and remittance inflow in recent years. Policy support has a very limited role in terms of propelling remittance and FDI in the short-term. The abovementioned discussion confirms that trade balance cannot be improved drastically, leaving foreign aid to be the only available tool to balance the situation.

TABLE 2.2.7: BALANCE OF PAYMENT (USD MILLION)

Items	Jul-Mar FY10	Jul-Mar FY11	Change
Trade balance	-3917	-5570	-1653
Current Account Balance	2643	689	-1954
Capital account	178	342	164
Financial account	-468	-1298	-830
Errors and omissions	-86	-262	-176
Overall Balance	2267	-529	-2796

Source: Bangladesh Bank data.

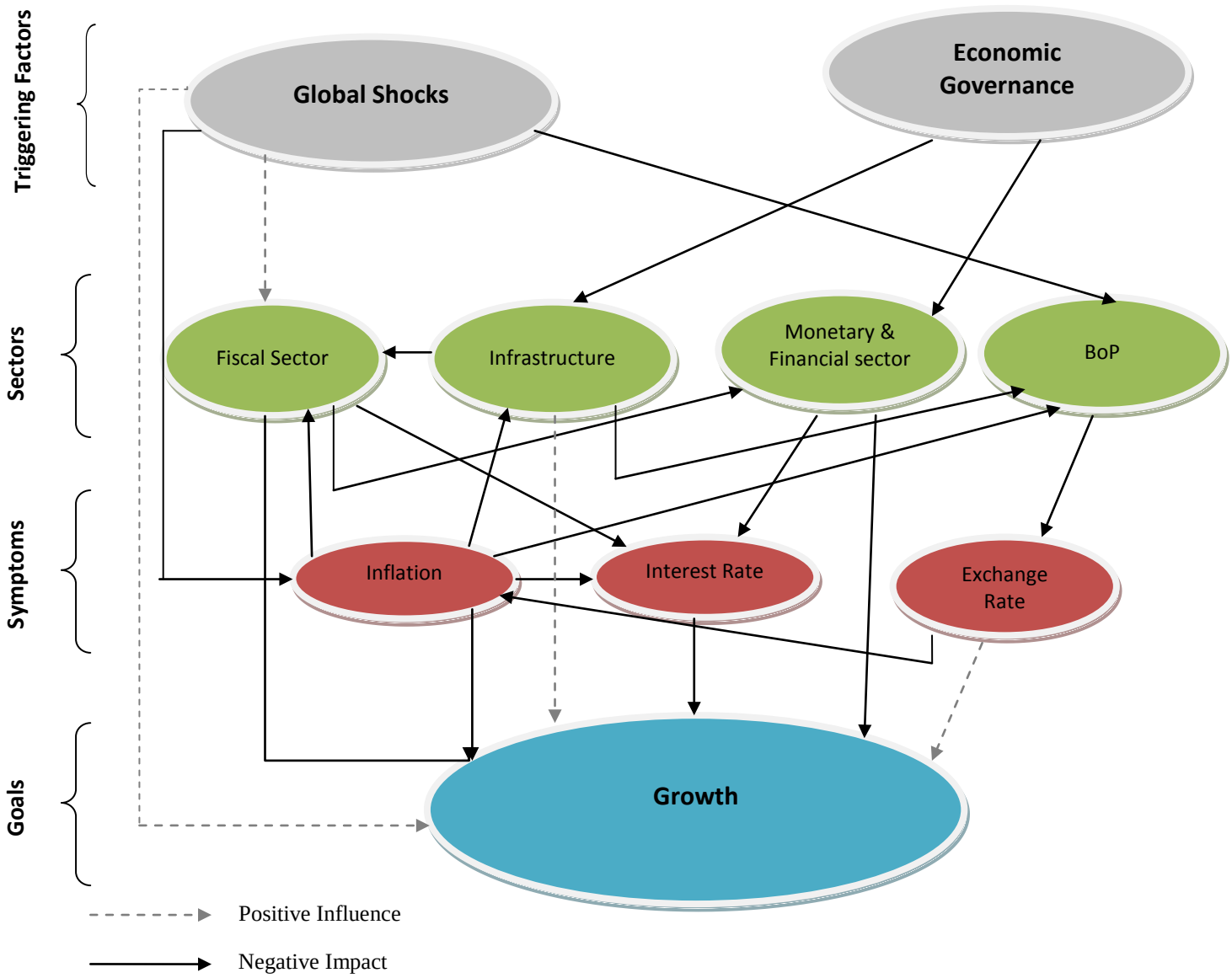
In absence of budgetary support and foreign grant, a decreasing amount of project aid remained the major source of foreign aid inflow in FY2010-11. It is expected that during the last quarter, foreign aid inflow will increase along with accelerated expenditure of ADP. However, the net foreign aid flow is unlikely to surpass last year's figure. During the first three quarters, inflow of net foreign aid was USD 782 million whereas it was USD 1271 million during the comparable period of the previous fiscal year. It is important to note that availability of project aid should hardly be an issue of concern. It is estimated that foreign aid to the tune of USD 12 billion is stuck in the pipeline. Efforts to release foreign aid in the pipeline may be also intensified. Foreign exchange reserves stood at USD 10.5 billion by the

[45]This was USD 2643 million during the same months of the previous fiscal year.

end of May of FY2010-11 which is equivalent to 3.9 months of import. The exchange rate of Taka against USD has been depreciating in recent months. The impact of growing balance of payment pressure on exchange rate is now evident. Falling value of BDT put some pressure on prices of imported consumer goods as well as intermediate and capital goods. Accordingly, it is also creating further strain on domestic price level.

The abovementioned review of the macroeconomic situation of Bangladesh economy reveals that at the end of FY2010-11, fiscal balance remains stressed, monetary aggregates are way out of the policy targets and balance of payment is under substantial pressure. Accordingly, it will be challenging to extract macroeconomic support in favour of the higher growth trajectory.

FIGURE 2.2.3: SIMPLIFIED SCHEMA OF MACROECONOMIC SITUATION IN FY2011-12



Source: CPD-IRBD Team

3. REVIEW OF A SET OF CRITICAL ISSUES

3.1 STRUCTURAL DISCREPANCIES IN ANNUAL DEVELOPMENT PROGRAMME

Despite the apparent increase in nominal figures, actual expenditure of Annual Development Programme (ADP) as percent of GDP declined from 6.5 percent in FY1999-00 to 3.2 percent in FY2008-09. After eight years of steady fall since FY2001, the size of the ADP, relative to the size of the national economy, has experienced an increase since FY2008-09. The revised ADP for FY2010-11 and target ADP for FY2011-12 are set to be around 4.5 percent and 5.1 percent of the GDP respectively (Figure 3.1.1). Actual expenditure of ADP as percent of budget target has also improved since FY2008. However, the latest figures for FY2010-11 indicate that the government has failed to keep up with that momentum, despite all the government directives and initiatives to expedite ADP implementation process. Each year, major impediments affecting the ADP performance get widely reported by the think tanks, government agencies and national media, and yet annually, on an average, about 15 percent of ADP target remains unutilised (Figure3.1.2). In this milieu, this section argues that mere administrative and political directives will not be effective to remedy the situation unless the structural discrepancies inherent in the development budget are addressed.

Actual ADP implementation as percent of GDP is rebounding since FY2008-09, after 8 years of steady fall…

… and actual ADP implementation as percent of target and revised ADP has also revived.

Figure 3.1.1: ADP as % of GDP

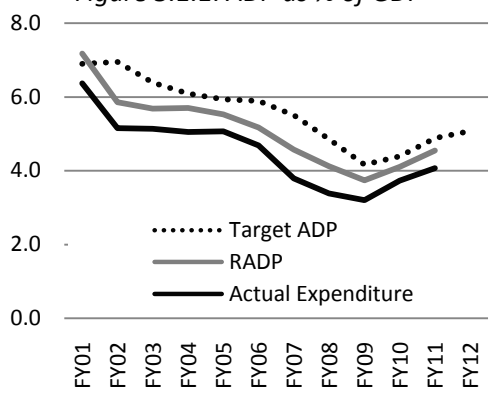
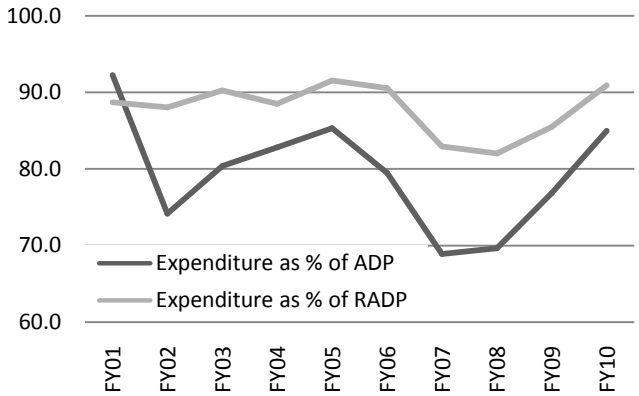


Figure 3.1.2: ADP expenditure as % of target



Note: Actual ADP for FY11 is estimated based on a business as usual implementation rate.

Source: authors' calculation based on MOF data

3.1.1 The revised development outlay for FY2010-11

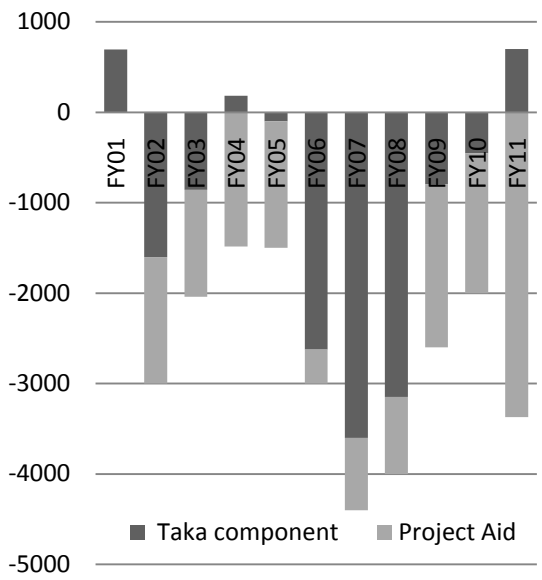
On a modest benchmark of ADP FY2009-10, that registered 31.8 percent increase in actual expenditure but fell short of the original target by 15percent, the government set the ADP

target for FY2010-11 at TK 38,500 crore. Nevertheless, failure to utilise Tk 3,370 crore of project aid resulted in a revised ADP of Tk 35,830 crore for FY2010-11 (Figure 3.1.3). Facilitated by a buoyant revenue mobilisation, an additional Tk 700 crore was allocated to the taka component during the second revision of ADP for FY2010-11[46].

There was some reshuffling of sectoral funds within the taka component of the ADP to counterweigh the forgone project aid and to finance newly approved projects[47]. An additional Tk. 700 crore was allocated to 18 projects, including a new one. A net amount of Tk. 723 crore was transferred from the taka component of development assistance (in special needs) to sectoral allocations— of which Tk. 513 crore was reallocated to power sector to counterbalance the loss of Tk. 491 crore in project aid[48]. Power sector became the third highest recipient (with 14.3 per cent) of RADP allocation, after transport (14.9 per cent) and education (14.4 per cent) sectors.

FY2010-11 witnessed the highest project aid cut in recent years...

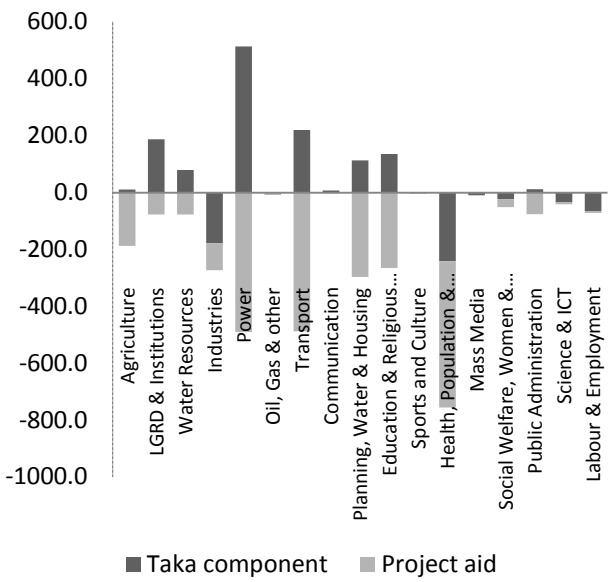
Figure 3.1.3: Changes in RADP during FY2001-11 (crore Tk)



Note: Negative figures denote cutback by RADP while positive figures denote increase in reallocation.

…though, reallocation of taka component counterbalanced some of the losses faced by priority sectors.

Figure 3.1.4: Reallocation of funds in RADP FY2011 (crore Tk)



Source: Authors' calculation based on MOF data.

[46] Initially a RADP of Tk 35,130 crore was approved by the National Economic Council on 27 February 2011 which slashed the project aid and kept the taka component unchanged. However, on 29 May 2011, the NEC approved the second revision of ADP with an added allocation of Tk 700 crore.

[47] Since the sectoral allocation data of second revision of the ADP is not available, the initial RADP of Tk 35130 crore has been used as a base to estimated these shares.

[48] In addition to project aid cut, some Tk 241 crore and Tk 178 crore were taken out from the development budget of health and industries sector respectively, while Tk 220 crore and Tk 187 crore of additional allocation was made to transport and rural development sectors.

Health, population and family welfare sector lost Tk. 514.4 crore in project aid and Tk. 241.2 crore of local financing from its original allocation. Industries sector also experienced a double-setback as Tk. 178.6 crore of local currency and Tk. 95.0 crore of project aid were taken out of its original budget (Figure 3.1.4). Rural development, power and communications sectors came up as the net gainers of ADP revision, while health and industries sectors witnessed the sharpest fall in their respective development outlays.

Despite the reduced foreign financing and a small increase in local financing, some 269 projects were added in the RADP for FY2010-11.[49] Thus, financing of these new projects also meant further slashing of budget allocations from the ongoing projects.

In the power sector, funds from small and long-run projects were reduced; while new priority projects were financed in the RADP[50]. Curiously, without any significant decrease in power shortage, five new projects with a total allocation of Tk. 226 crore for FY2010-11 were included in the RADP for extension and upgradation of rural electrification[51]. Keeping in mind the incumbent political party's stance against the mismanagement of rural electrification projects during the earlier political regime, one needs to be cautious when fifty percent of power sector's additional allocations (in RADP) are used for the similar projects.
In the transport sector, some 73 new projects were included in the RADP with an added allocation of Tk 370 crore for FY2010-11. Almost all of these projects are scheduled to end by the remaining tenure of the incumbent government. They are mainly for the construction and maintenance of roads and bridges and are entirely financed by local resources[52]. While CPD cannot emphasise enough the importance of new investments in local infrastructures, we can not ignore the fact that these rural infrastructure projects have been one of the major sources of fund mismanagement in the country and hurried expenditure on account of these projects towards the end of the fiscal year may only aggravate the situation.

Although 15 projects under supplier's credit from India are also included in the list of newly added projects of RADP, a mere Tk 65 crore of project aid is expected to be utilized during the current fiscal year.

The last-lap syndrome, yet again

During the first ten months (Jul-Apr) of FY2010-11, an amount of Tk 20908.4 crore has been expended which corresponds to 59.5 percent of the revised ADP, or 54.3 percent of the original ADP for the full fiscal year. While this is higher than the average expenditure figure of 48.2 percent for the corresponding periods of FY2006-FY2010 (Figure3.1.5), it is marginally lower than the performance of FY2009-10 that registered 54.8 percent expenditure during the same period. If the historical trend in monthly expenditure continues during May-June, then overall ADP expenditure for the full fiscal may stay close to 85 percent of original ADP, or 91 percent of RADP allocation. This would mean that almost

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[49]Of these new RADP projects, 236 were investment projects and 33 were technical assistance projects. The original ADP for FY2010-11 had 94 newly added projects, which include 68 investment projects, 12 technical projects and 14 were under Japan Debt Cancellation Fund (JDCF).

[50] Allocation for reconstruction of 1st and 2nd units of Ghorashal Power Plant was reduced from Tk 14.85 crore to Tk 10.00 crore, while allocation for the construction of 820 MW peaking plant was increased from Tk 1,000.00 crore to Tk 1,893.10 crore.

[51] Except for one upgradation project, which received Tk16 crore from JAICA, all four rural electrification extension projects are being financed by local resources.

[52] Except for the Tk 64 crore project for Ramgar Land Port connecting road which is being financed by Indian supplier's credit.

fifty percent of ADP will be spent during the last quarter of the fiscal year, yet again (Figure3.1.6). It's a pity that after all the government initiatives and directives, the current ADP lost the momentum of that was gained in FY2009-10.

Monthly expenditure of ADP for FY2010-11 seems to have lost the momentum that was gained in FY2009-10...

... and last quarter of the FY is expected to follow the usual last-lap syndrome.

Figure 3.1.5: Monthly status of ADP implementation FY2007-2011 (%)

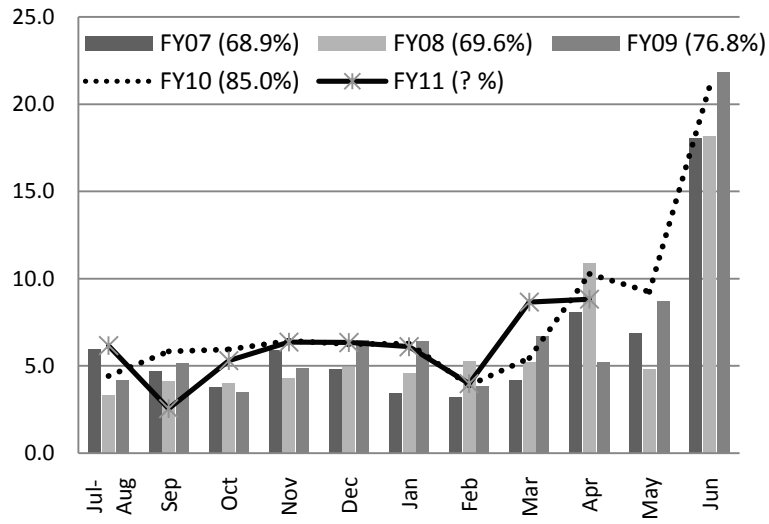
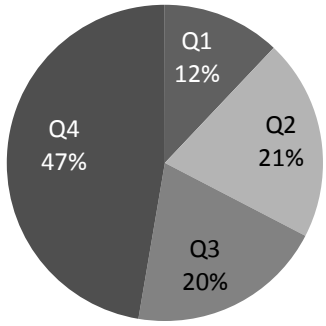


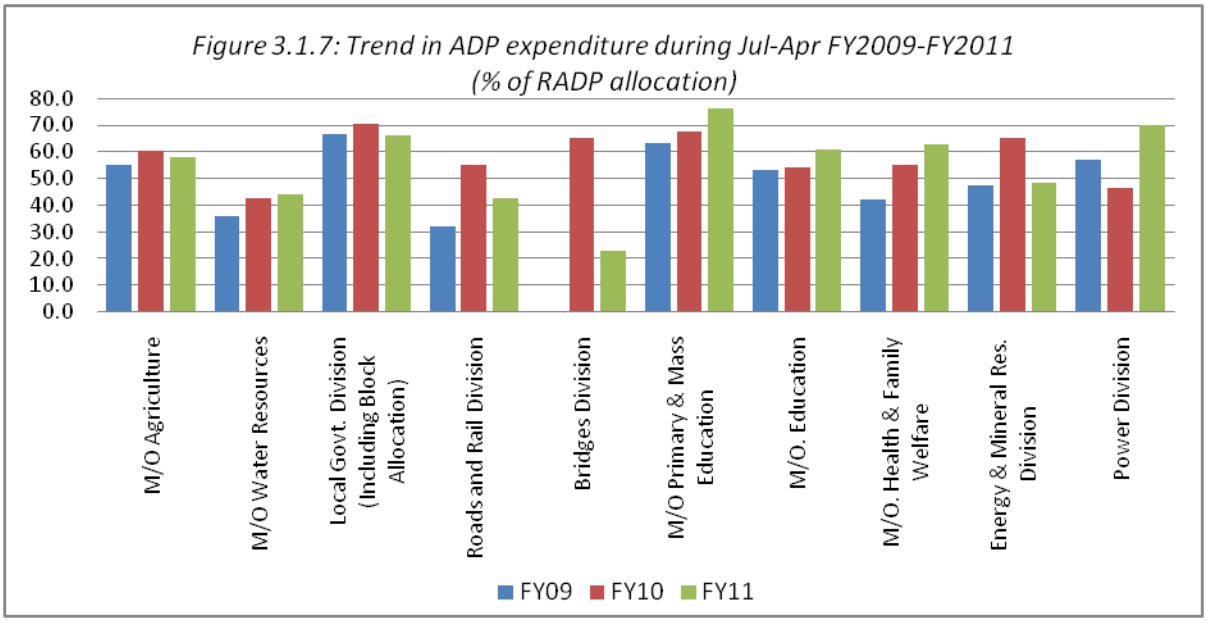
Figure 3.1.6: Quarterly share of average actual ADP expenditure FY06-10



Note: Figures in the parentheses denote annual implementation rate

Source: Author's calculation based on MOF data.

Ministries under the Medium Term Budgetary Framework (MTBF) spent about 60 percent of their budget allocation during the first ten months of the fiscal year, while non-MTBF ministries could spend only 53 percent of the same. Since traditionally better-performing ministries are also under the MTBF, it's difficult to assess the impact of MTBF in ADP expenditure. The five major ministries/divisions—which account about 60 percent of total ADP allocation—has spent 64 percent of their development budget during the July-April period of FY2010-11.



Since the ADP cut during FY2010-11 was larger than the previous two years, periodic performances of ministries look better than previous years, against the lowered benchmark of RADP (Figure 3.1.7). Among the major government agencies, power division was able to spend 70.2 percent of its marginally increased RADP allocation during the first ten months of FY2010-11. During the same period, Local Government Division spent 66.3 percent of its revised allocation. Bridges Division and Road and Rail Division spent merely 42.7 percent and 23.1 percent of their respective annual allocation. Ministry of Primary and Mass Education, being the top spender, could utilise 76 percent of its revised allocation during the July-April period of FY2010-11. Even after the 19.3 percent cut in this year's allocation, Ministry of Health and Family Welfare could spend only 63 percent of its revised allocation during this period.

3.1.2 Addressing the Structural Discrepancies in ADP

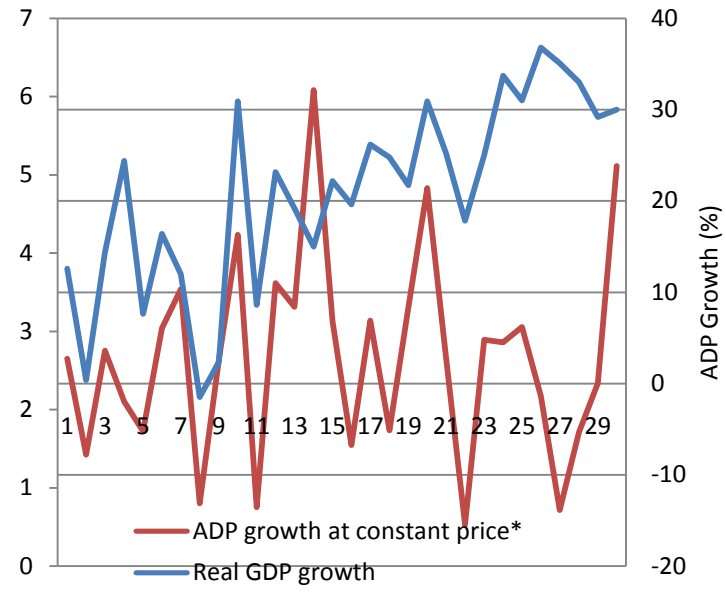
Why ADP expenditure failed to keep up with the momentum even after all the government directives and initiatives? In a previous report, CPD argued that poor implementation of ADP is caused by a combined consequence of *resource constraints*, *unrealistic targeting*, and *lack of implementation capacity* (Bhattacharya, Iqbal & Khan, 2009:20); and a number of way outs were suggested to improve the situation (see Choudhury, 2009; CPD, 2010). In this report, we address these problems from the perspective of ADP's structural discrepancies. Without addressing these structural issues, a breakthrough in ADP implementation will be difficult, if not impossible.

a. The growth-ADP nexus

While it is assumed that public investment in infrastructure, education and health contributes to higher GDP growth in the long run (World Bank, 2007), a big ADP in a defective set up may not get translated into real economic growth. Figures 3.1.8 and 3.1.9 show a classic example where changes in public investment seems to hardly influence GDP growth. There are a number of possible explanations for this.

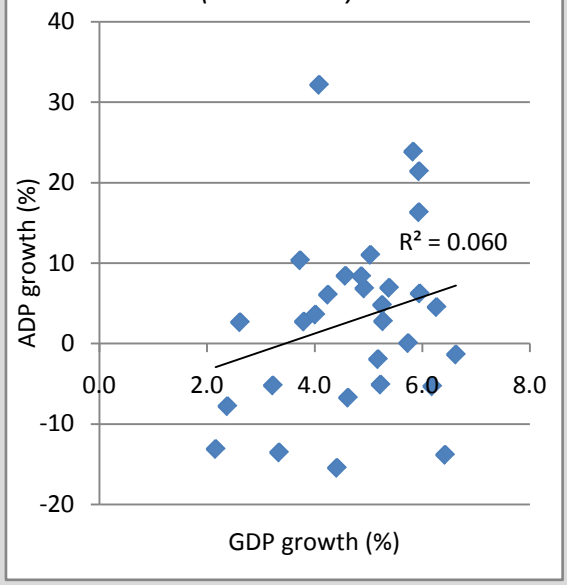
The influence of ADP appears to be rather insignificant on Bangladesh's GDP growth… … and these are not correlated as well.

Figure 3.1.8: ADP growth vs GDP growth during FY81-FY10



Note: Real ADP, adjusted with GDP deflator for construction

Figure 3.1.9: Growth of exchange rate adjusted ADP and GDP (FY81-FY10)



Note: ADP and GDP figures adjusted with exchange rate

A recent cross-country analysis showed that the increase in public capital stock does contribute to higher GDP growth. However, it is also assumed that the short-term effects of public capital stock are stronger for advanced economies, whereas the long-term effects are stronger for developing economies (Arslanalp, Bornhorst & Gupta, 2011:1-4). When the flow and stock of public capital is too low, they may fail to have a significant impact on growth. For instance, 2.5 percent annual loss of public capital stock is estimated to be due to wear and tear of roads and bridges, and a part of the ADP needs to be used up to replace that depreciated capital stock (Arslanalp, Bornhorst& Gupta, 2011:34-37). Due to frequent natural calamities and seasonal rain and floods, our roads and bridges get damaged too frequently. Hence the net contribution of ADP can be even lower than the reported figures. During years of natural disasters (e.g. FY91) ADP mainly contributes to the restoration of damaged public capital and is not enough to stimulate the economy. Therefore, over the past decade CPD has been arguing that Bangladesh remains an under-invested economy (Bhattacharya, 2006:20) and the usual sizes of ADP allocations are never 'big enough' to match its growing demand (CPD, 2010:13).

Approval and implementation of unusable construction projects also fail to contribute to the economy. Scores of bridges are constructed each year without any approach or connecting road[53]. Sometimes the connected roads also get washed away. These bridges then become inoperative. Its contribution will be recorded in the implementing year's GDP as new

[53] For instance, see news on two bridges at Kutubjom Union of Moheshkhali (Prothom Alo, 24.04.2011); 17 bridges in Rayganj Upozila of Sirajganj (United News, 31.03.2011); Poyshar Haatbridge on Agoijhara Road at Barishal (Samakal, (01.10.2009).

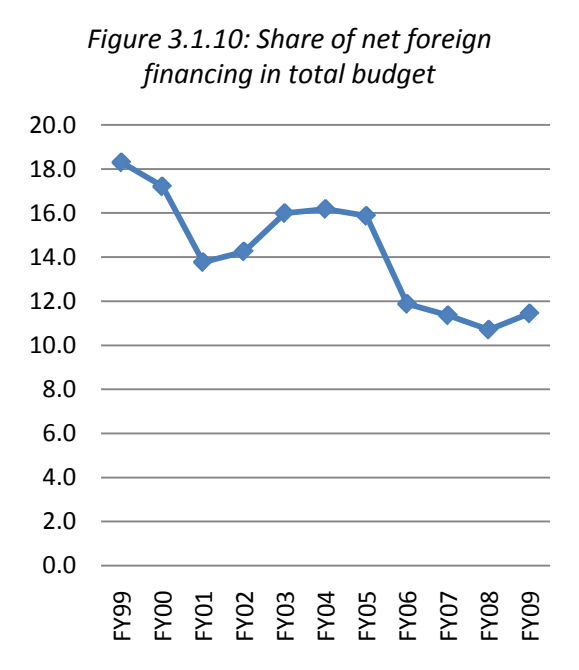
investment. But the economy fails to get the benefit of the bridge towards greater communications and economic activities in the long run.

b. Sustainable vs. self-reliant ADP financing

Although Bangladesh's budget dependence on foreign financing has gradually declined over the years from 13.1percent (of total budget) in FY2000-01 to 9.1 percent in FY2009-10 (Figure 3.1.10), about 30-40 percent of our ADP is still financed by project aid (Figure 3.1.11). Foreign assistance also plays a strategically important role in Bangladesh's public investment, particularly in the bigger projects in infrastructure and social sectors[54] (Bhattacharya, Raihan & Shadat, 2004:223). The gradual fall in foreign aid and recent cut back of project aid has reignited the discussion over the self-reliance of development budget. However, the proponents of 'self-reliant development budget' conveniently overlook the issue of financing *sustainability*.

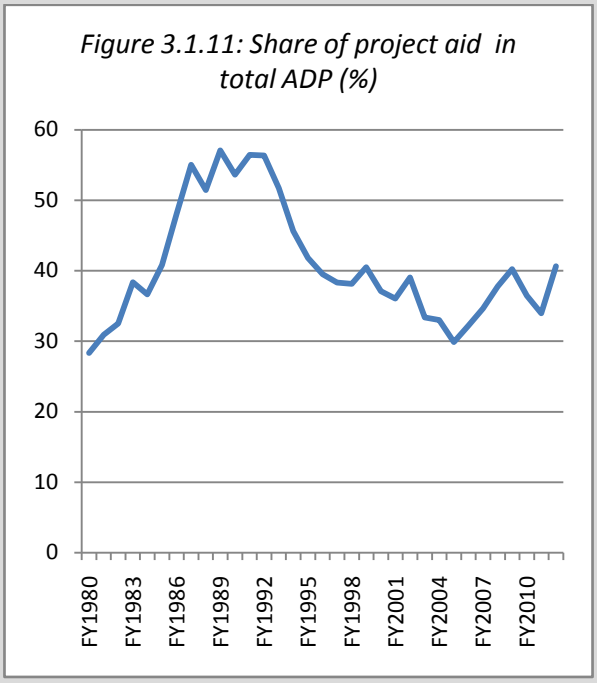
Though budget dependence on foreign aid is gradually declining...

Figure 3.1.10: Share of net foreign financing in total budget



a substantial share (30-40%) of development budget is still financed by foreign aid.

Figure 3.1.11: Share of project aid in total ADP (%)



Source: Author's calculation based on MOF data

Understanding of the sources of ADP financing is essential to set the policy debate on right course. Exact contribution of foreign aid in ADP financing is difficult to measure since post-amortisation net foreign aid is calculated in deficit financing, while pre-amortisation gross aid flow is calculated in ADP financing. Similarly, it's also difficult to differentiate the sources

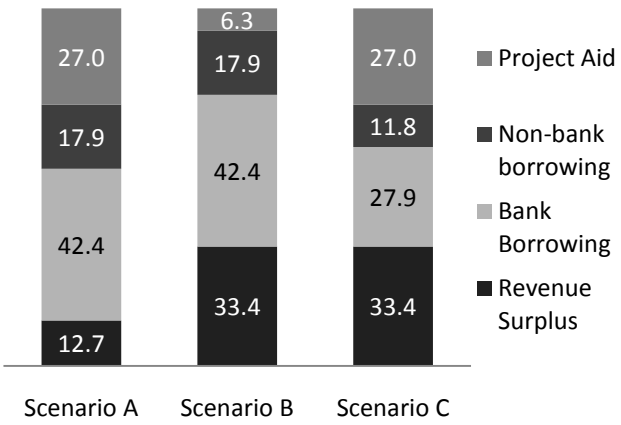
[54]e.g. transport, health, population and family welfare, power, education and rural development

of local financing in ADP since the government borrows for development and non-development expenditures[55].

However, based on some measurable assumptions, one may venture to delineate the financing of the ADP by its sources. Share of each source in total budget can also be used as a proxy to identify their respective shares in total ADP financing.

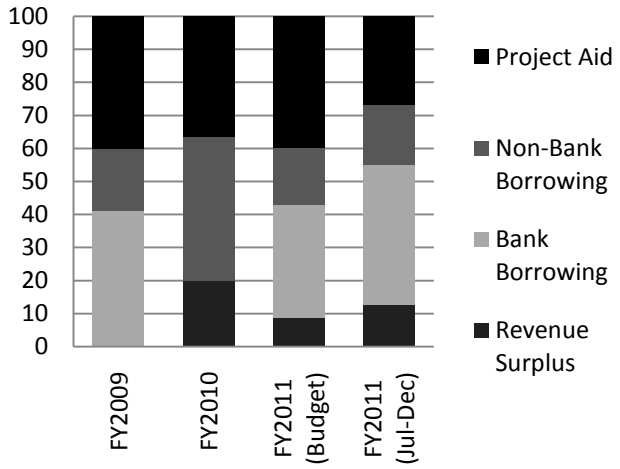
Domestic borrowing still pays the major share of ADP bills...

Figure 3.1.12: Hypothetical scenarios of ADP financing (Jul-Dec FY2011)



.. while project aid maintains a modest share in ADP financing.

Figure 3.1.13: ADP financing FY2009-FY2011



Note: a. Scenario A and C accounted gross project aid in ADP financing, and amortisation was excluded from revenue surplus and domestic borrowing respectively. Scenario B accounts only the net flow (post-amortisation) of project aid.

b. Scenario C denotes the most likely composition and Figure 3.1.13 is based on this.

Based on the half-yearly statistics provided by the Finance Ministry, Figure 3.1.12 provides three alternative hypothetical scenarios of ADP financing—alternatively accounting the amortisation of foreign loan from (A) revenue surplus, (B) foreign aid and (C) domestic borrowing. If only the net flow of foreign aid is considered, only 6.3 percent of ADP was then financed by foreign aid during the first half of FY2010-11 (scenario B). When the gross flow of project aid is accounted for, foreign aid contribution becomes 27 percent of total ADP (scenario A & C) and domestic borrowing constitutes the largest share in ADP financing. Owing to our low revenue-GDP ratio, fall in foreign assistance—project aid or budgetary support—is usually substituted by domestic borrowing. This fits with the high government borrowing registered during the matching period of the fiscal year (see monetary section for a detailed analysis on this).

[55] Net local financing comes from various sources, including revenue surplus, bank borrowing and non-bank borrowing and are spent on non-ADP areas as well. Since the source is not printed on the bill, exact decomposition of ADP financing is not possible.

According to Figure 3.1.13, non-bank borrowing became the major source of ADP financing in FY2009-10 (net bank-borrowing was negative in that fiscal year). Latest available figure shows a strong dependence of ADP on bank-borrowing in FY2010-11.

Major policy implications of these scenarios are three folds—

a. Diminishing foreign aid puts high pressure on local financing, but since high growth of revenue earnings failed to yield a high revenue surplus, domestic borrowing became the major source of ADP financing. It's now a trade-off between *high ADP-high borrowings* vs. *Low ADP-low borrowings*. Since the credit market is already under pressure, a self-reliant ADP is likely to cause imbalance in the credit market, if not crowd out the private sector investment. Hence, higher ADP may not be possible without higher foreign assistance.
b. The last-quarter syndrome of expenditure is particularly problematic for an ADP that depends highly on domestic borrowing. Uneven shocks and spikes in ADP expenditure, that is heavily dependent on domestic borrowing, are likely to destabilise the money market. Properly spread out ADP expenditure all through the year can help redistribute and normalise the credit pressure.
c. Nature of domestic borrowing is also important. Bank borrowing is low cost borrowing, but inflationary (as happened in FY2010-11), whereas non-bank borrowing is high cost borrowing, but non-inflationary (a scenario witnessed during FY2009-10).

Keeping in mind these trade-offs, the goal should not be self-reliance only, but having a sustainable and prudent mechanism for ADP financing.

c. Revisions by choice and the political plan

A low level implementation can be caused both by choice and by default.

Every year a number of approved and unapproved projects get included in the ADP—not to meet the economic demand, but to meet the political demand of various stakeholder groups. Sometimes the Finance Minister succumbs to political pressures to add development projects in the ADP with or without pre-approval. Many of these projects—mostly rural construction projects—gets fund allocation at the beginning, but are hardly implemented and either get slashed during the ADP revision or remains unimplemented. This would mean that— when a new ADP is announced, the government starts with a built-in assumption that they will not implement the full outlay, as if the Finance Minister virtually maintains a parallel core budget that is separate from the public announcement!

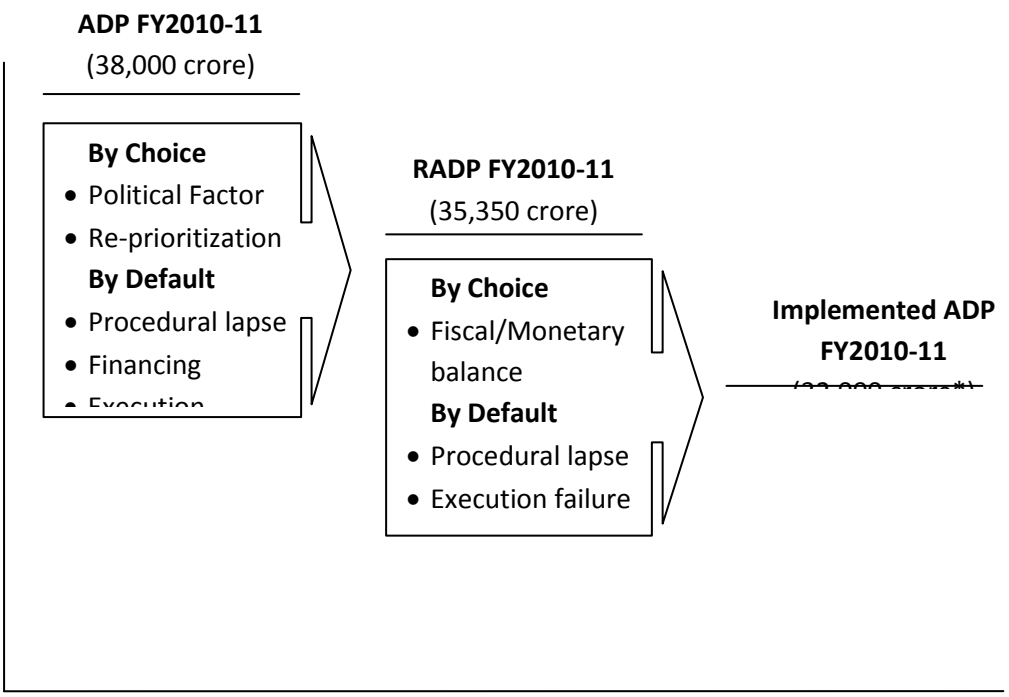
Re-prioritisation of development allocation during the middle of the fiscal year also influences the RADP. For instance, given the worsening power situation during the summer season, allocations of many low priority long-term projects were curtailed to finance priority projects such as the picking power plant. Sometimes response to natural disasters also requires fund re-allocation, in addition to expenditure from block allocations. Such revisions are by choice.

There is also a conjectural cause where development expenditures are often adjusted to bring fiscal and monetary balance in the economy. For instance, the government may choose to hold or cut back the implementation of some selected projects to reduce inflationary pressure from the economy. However, such adjustments are mostly observed in developed economies and are rarely seen in developing economies (apart from the response to global recession

when developing economies also had to revisit their development budgets to match their fiscal and monetary demands).

In Bangladesh, major setbacks to fuller ADP implementation usually comes by default, not by choice.

Figure 3.1.14:



Note: * ADP for FY2010-11 is assumed to be around 85 percent of original target

d. When high expenditure is bad expenditure

Procedural lapses—from initiation to completion of a project life cycle—have been identified as the major reason for curtailed ADP implementation. It begins with delays during the approval stage. Incomplete proposal, unreasonable expenditure target, improper feasibility study, etc. may delay the approval process. Corruption is also frequently blamed for delayed approval. Sometimes projects gets approved and included in the ADP well after the planned inception date. Post-approval procedural delays in land acquisition and procurement also hold back effective commencement. By the time the project takes off, spending the full fiscal's allocation becomes difficult. This creates a dilemma for the project manager—where full spending of funds towards the end of fiscal year would result is *wastage*, and non-spending would be reported as *implementation failure*. In such cases, the project aid remains unimplemented due to stringent rules and regulations by the donors, while the taka component witnesses a spending frenzy.

Sometimes the last moment jump in ADP expenditure is caused by late submission of bills by the contractors for the works done earlier. But often the ministries become reactive towards the end of every fiscal year and try to use up the remaining funds of ADP allocation. These quick expenditures during the last two months create opportunities for corruption and wastage of public funds. Unfortunately, quantitative criteria of monetary expenditure have become the only determinant of successful ADP implementation. Therefore, wastage of money may also be accounted for as 'implementation' of ADP in the record book.

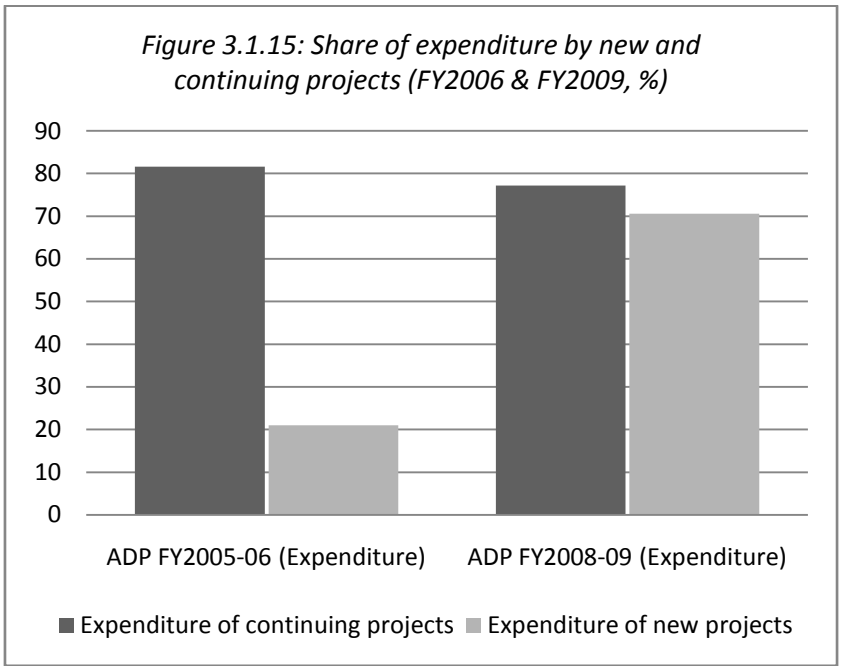
e. Scrutiny vs. non-implementation

Bureaucratic impediments—created by both the government and donor agencies—also cause procedural lapses and a blame-game goes on over these causes. Project personnel at government agencies informally criticize the donor agencies for repeatedly turning down payment and purchase requests citing various reasons. On the other hand, donor agencies flag fraudulent practices and incapacity of government agencies for the delayed release of funds at their end. Hence, ministries often prefer locally financed investment projects over foreign financed technical assistance projects. Delayed implementation of project aid often holds back the overall performance of ADP. For instance, only 41 percent of project aid was reported disbursed during the first ten months of FY2010-11 against 63 percent spending of local currencies (of respective total ADP allocations for the full fiscal year).

When over or lack of scrutiny gets identified as the distinguishing factor behind the differential implementation status of taka and project aid components, one gets to make an uncomfortable choice between '*less scrutinized high expenditure of taka component*' vs. '*well scrutinized low expenditure of project aid*'. Since reported expenditure doesn't necessarily represent actual implementation, it is difficult to judge which part of the ADP is well implemented.

f. The sluggish kick off phase

Most of the aforesaid procedural delays happen during the initial phase of a project when land acquisition, tender and procurements are initiated. As a result, continuing projects tend to perform better than new projects in any given ADP. This hypothesis was substantiated by a project level analysis of new and continuing projects of ADPs for FY2005-06 and FY2008-09 (Figure 3.1.15).



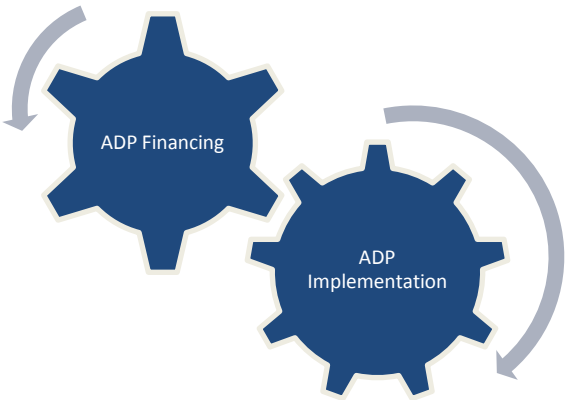
New projects recorded slower expenditure rate, at only 20.1 percent, whereas continuing projects (including carry over, continuing and ending projects) recorded 81.6 percent expenditure of total ADP allocation in FY2006-07. A less obvious but reasonable difference

in expenditure was also observed in FY2008-09 when the expenditure of continuing projects were also marginally higher than the expenditure rate of new projects[56].
Given the smaller share of new projects in ADP (around 4-5 percent), slower implementation of new projects holds back the overall performance of ADP only marginally. Nevertheless, special attention towards the new projects is necessary for the fuller implementation of ADP. Last year the Finance Minister proposed advance and pre-approval preparation for new projects in the ADP. However, because of the lack of transparent and straightforward approval and procurement framework, the initiative failed to yield any visible benefit.

g. Financing-implementation dependency

Lack of financing has also been identified as an impediment to fuller ADP realization. Low level of implementation may cause a delay in fund release. Then again, lack of funding can also cause delay in implementation (Figure 3.1.16). Hence, between financing and implementation—it's necessary to understand who dictates whom.

Figure 3.1.16: Financing & Implementation: Who dictates whom?



Trend in ADP revision also shows a positive relation between availability of local resources (i.e. revenue and domestic borrowing) and financing of taka component, indicating ADP's dependence on financing. On the other hand, release of project aid by donor agencies depends on satisfactory progress of development projects. Failure to show required progress resulted in the 22 per cent cut in this year's project aid (which brought down the total ADP by 8.8 percent).

In addition to all these situational causes, sheer failure to implement projects also slows down the ADP implementation. A number of reasons may be behind this including frequent transfers of project managers and personnel, price hike and lack of willingness on the part of suppliers to deliver products at previously agreed price, legal and social impediments in land acquisition, natural calamities, etc.

3.1.3 Outlook for FY2011-12

The government has set the new ADP expenditure target for FY2011-12 at Tk 46,000 crore—of which 40.6 percent is projected as project aid and 59.4 percent would be local currency (Figure 3.1.17). The target ADP for the next fiscal is 14.4 percent higher than the IMF projection and 4.5 percent higher than the draft Sixth Plan Projection. The new ADP is also

[56] FY2006-07 was the last full political regime and latest project level implementation data was only available for FY2008-09 during the time of analysis.

30.3 percent and 19.5 percent higher than the revised and original ADP of FY2010-11 respectively.

The size of the ADP for FY2011-12 is convincingly high...

... with incremental allocation for known priority sectors.

Figure 3.1.17: ADP for FY2011-12 (as % of comparable indicators)

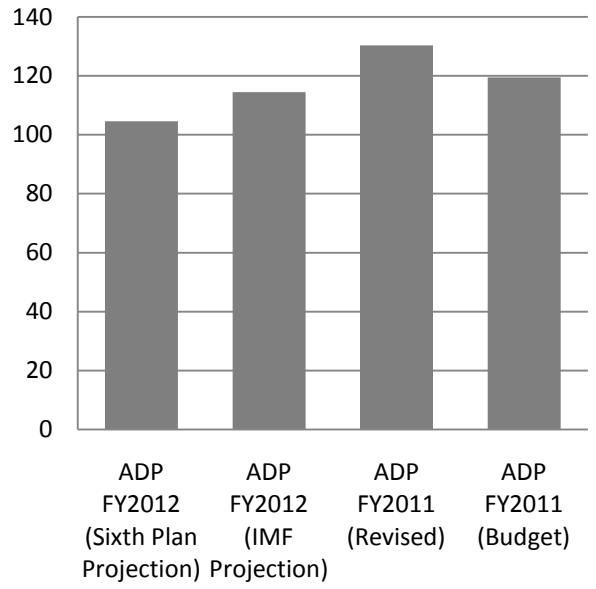
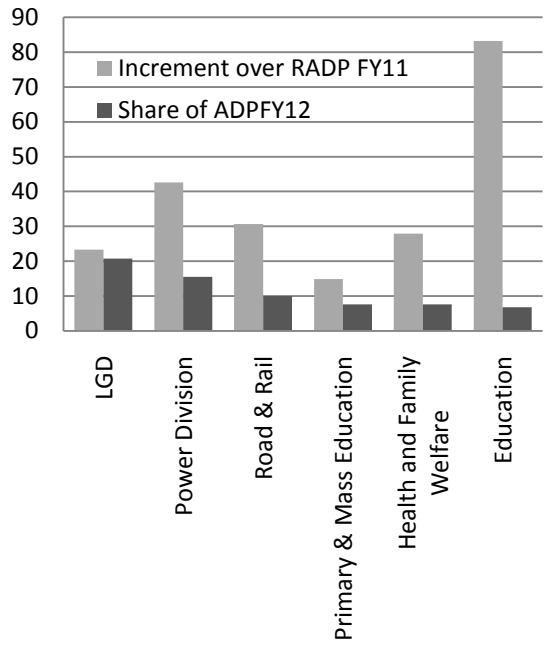


Figure 3.1.18:Top six reciepents of ADP FY2012



Source: Based on MOF data

As one might expect, the Local Government Division has received the lion's share (20.8 percent) of the annual allocation with an increment of 23.3 percent over the RADP of FY2010-11 (Figure 3.1.18). Power division obtained the second largest share of total allocation at 15.5 percent with a 42.6 percent growth over previous year's RADP allocation. Among others, Roads and Rail Division received 10.0 percent of total allocation while Ministry of Mass Education and Ministry of Health and Family Welfare were given 7.6 percent of total allocation each with a respective growth of 14.9 percent and 27.9 percent over their FY2010-11 RADP allocation.

3.1.4 Recommendations

1. ***Sustainable ADP Financing***: Recent trends in ADP financing indicate an impending predicament in fiscal and monetary balance where higher ADP financed by higher domestic credit may become unsustainable for the economy. On the other hand, about $12 billion of foreign aid remains stocked-up in the pipeline. Thus, we recommend setting up a high-powered Task Force to scrutinise and operationalise practical solutions to get immediate access to this committed foreign assistance.

2. ***Reviewing PPP initiative***: Except for the fast implementing *Jatrabari-Gulistan flyover* under build-own-operate-transfer (BOOT) arrangement of public private partnership (PPP), the budget for this much hyped PPP initiative remained unutilised during the last two fiscal years[57]. Fast-tracked consultation with prospective private sector investors is required to review the uneventful PPP initiative. Immediate setting up and operation of a functioning PPP office is mandatory in this regard. In order to encourage future investment in this sector, the 16 PPP projects included in the new ADP should be implemented as model projects with high priority.
3. ***Auditing of Project Expenditure:*** Government should use its existing auditing mechanisms, including the Office of the Comptroller and Auditor General, to monitor the existing bill payment system. A special *Project Auditing Wing* should be set up to scrutinize the last quarter's spending frenzy.

   In an ideal world, proper implementation of ADP and revenue surplus would supplement each other. However, this is only possible if increase in revenue earnings, coupled with controlled revenue expenditure and effective regulatory framework for the transparent transaction of public funds, are in place. CPD's suggestions with regard to ADP financing have been outlined above. In addition, the government needs to focus on the transparency of the ADP expenditure process itself. Experience of newly adopted public procurement rules should be monitored.
4. ***Development of Backward Linkages:*** The backward linkages of development projects remain an unexplored area in the ADP implementation process. Hence we get more power plants, but sources of alternative energy for those plants remain poor; we get bridges without link roads and rural electrification projects without actual power supply. Therefore, assessment of *usability* and *interdependence* of construction projects must be made an integral and mandatory component of project approval process. We also recommend special monitoring of this year's rural electrification projects to ensure that they do not follow the highly discredited '*khamba-projects*'.
5. ***Reforming the Approval Process:*** To facilitate the post-approval monitoring of development projects, monitorable implementation strategy (such as Critical Path Method) should be made mandatory for the projects. A *Task Force* needs to be established to scrutinize and rationalise the traditional project approval process[58].
6. ***Programme should be programme***: A programme, as the ADP is, should be a 'programme' with strict allocations and deadlines, not just a wish-list or political 'plan' (for which we have the Sixth Plan).
7. ***Implementation and impact analysis***: Expenditure does not necessarily mean implementation. Our ADP accounting only indicates the expenditure of development budget, not the actual implementation. In order to understand the real implementation situation, the *Project Completion Reports* should also be made public. Also, *impact analysis* of selective types of projects needs to be initiated to prioritize the approval of

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[57] The PPP budget for FY2009-10 and FY2010-11 (Tk. 2,500 crore and Tk. 3,000 crore respectively) remained unused.

[58]For instance, the format of Development Project Proposals (DPP) needs to be updated. The application form and requirements for attachments are very comprehensive, but incompatible for project assessment and evaluation. For instance, it requires the applicant to calculate and submit Net Present Value (NPV), Benefit-Cost Ratio (BCR), and Internal Rate of Return (IRR) for development projects—though in practice, these are hardly submitted. On the other hand, it lacks straightforward toolkits such as Critical Path Method (CPM) that helps monitoring of project performance during the implementation phase.

future projects. For instance, an impact analysis of previous projects on expansion of rural-electrification was necessary before this new round of expansion that has been proposed in the new RADP.

8. ***Project Monitoring Unit:*** The Implementation, Monitoring and Evaluation Division (IMED) has become an accounting wing for the project; actual monitoring of thousands of projects is impossible for such a small institution. In order to demonstrate long term commitment, and endow relevant agencies with skilled human resources capable of effectively monitoring project performances, special *Project Monitoring Units* need to be set up at the ministry level. These units should be authorised to suggest alternative and fast tracked implementation path for projects that are already behind the schedule.

   Delays in project implementation is often caused by the frequent transfers of senior project-personnel, lack of specialised project managers, and apparent reluctance of government bureaucrats to implement foreign aided projects due to the stringent regulations. Hence the government should consider appointing Project Heads and Managers for large technical assistance projects on contractual basis from outside the civil service pool to expedite the implementation of project aid.

3.2 FINANCIAL SECTOR

3.2.1 Introduction

The financial sector is considered to be an important source of economic growth. In the literature there are empirical evidence to suggest a positive association between financial development and economic growth (McKinnon, 1973; Shaw, 1973; Calderón and Liu, 1999; Rahman, 2004; Chakraborty, 2008; Khan 2011; Khan 2002; Khan and Senhadji 2000). In Bangladesh the financial sector has travelled through a journey where the sector has experienced several reforms[59] in an attempt to improve upon the structural constraints of the sector through liberalisation. However, the efficacy of the financial system in terms of maintaining macroeconomic stability and in promoting a sound and stable economic environment is yet to be achieved. Though there are mainly three major components of the financial sector in Bangladesh, namely money market, capital market and microfinance, the sector is typically dominated by the money market in which again the banking sector is the leading sector accounting for more than 80 per cent of total financial assets of the country. Total asset of the banking sector was 57.43 per cent of GDP and of non-bank financial institutions (NBFI) 1.47 percent of GDP in 2009 while the asset of capital market was 34 per cent of GDP in May 2011. The dominance of the banking sector makes the financial sector vulnerable on the one hand, but highlights the crucial importance of the sector in resource mobilisation and economic growth, on the other. This section of the report thus focuses on a few selected issues related to the banking sector which deemed important at the current economic and political context of Bangladesh.

3.2.2 Brief overview of the banking sector's performance

The role of the financial sector in accelerating growth is contingent upon the soundness and depth of the sector. The financial sector reforms which were driven by objectives such as increasing the capital adequacy of banks, streamlining guidelines for rescheduling of various types of loans, tightening provisions for non-performing loans, strengthening disclosure requirements and improving accounting system had been able to improve the soundness of the sector. Soundness of the banking sector which basically reflects on the quality of performance of the sector is measured by five indicators such as capital adequacy, asset quality management quality, earnings, and liquidity (CAMEL). Over the last few years the banking sector of Bangladesh has made significant progress on these indicators (Table 3.2.1).

TABLE 3.2.1: COMPARISON OF BANKING SECTOR PERFORMANCE WITH SOUTH ASIAN COUNTRIES

Indicators	**Bangladesh**			**India**	**Pakistan**
	2000	*2005*	*2010*	*2010*	*2010*
Capital to risk weighted asset (%)	6.7	5.6	7.9	14.5	14.0
NPL to total loans (%)	34.9	13.6	8.7	2.39**	14.7
Expenditure-Income ratio	99.9	92.1	73.1		
Return on asset (%)	0.0	0.6	1.6	1.05	1.7 (1.0*)
Return on equity (%)	0.3	12.4	22.9	14.31	16.7 (9.8*)
Liquid asset (%)	26.1	21.7	27.3	-	-
Excess liquidity (%)	7.5	5.3	8.8	-	-

*After tax; **Gross Non Performing Asset (NPA) as percent of Gross Advances (Scheduled commercial Banks 2009-10).
LA=Liquid Asset, EL=Excess Liquidity
Source: Bangladesh Bank Annual Report Various Years;
http://www.rbi.org.in/scripts/PublicationsView.aspx?id=12976; http://www.sbp.org.pk/ecodata/fsi.pdf

[59] Such as financial sector reform programme in 1990 by the GoB, Financial Institutions Development Project of the World Bank launched in February 2000.

In terms of the depth of the banking sector too there has been some improvement as is observed from Table 3.2.2. Both deposit and credit had increased by 4.8 and 4.5 times respectively during the decade of 2000-2010. The ratio of deposit to GDP has increased by 1.73 percentage point annually and reached 48.65 per cent in 2010 from 29.64 per cent in 2000. Credit- GDP ratio, however, increased by a relatively smaller rate, by 1.26 percent annually. On the other hand, credit-deposit ratio (CDR) of scheduled banks excluding the specialized banks was 0.83 at the end of June 2010 (Bangladesh Bank 2010).

Three ratios to represent the financial depth such as, money supply (M2) to GDP, total deposits to GDP and total domestic credit to GDP have shown steady increase over the years though compared to other South Asian countries the performance is not so encouraging.

TABLE 3.2.2: FINANCIAL DEPTH IN ASIAN COUNTRIES

Indicators	**Bangladesh**			**India**	**Pakistan**	**Nepal**	**Thailand**
	2000	*2005*	*2010*	*2010*	*2010*	*2010*	*2010*
M2/GDP	0.32	0.41	0.52	0.95	0.41	0.61	1.17
Deposit/GDP	0.29	0.38	0.49	0.77	0.36	0.50	0.69
Credit/GDP	0.25	0.32	0.39	0.44	0.44	0.39	0.83

Source: Bangladesh Bank and BBS Various Years; Website of respective central banks, visited on 31 May 2011.

Investigating the long-term trend of these indicators it is revealed that the financial development in Bangladesh causes economic growth. A recent study by CPD (2011) indicates that M2 causes economic growth. The study also found that increased domestic credit leads to economic growth and vice versa. Such findings imply that the performance of the banking sector is all the more important for Bangladesh.

BOX 3.2.1: DOES FINANCIAL DEVELOPMENT CAUSE ECONOMIC GROWTH IN BANGLADESH?

Using annual data covering the period 1975-2008 for Bangladesh the causal relationships between financial development and economic growth has been examined in a recent study by CPD (2011). The growth rate of gross domestic product (GDPGR) is used as proxy of 'economic growth'. 'Financial development' is defined by the extent of broad money supply as a percentage of GDP (M2/GDP), total domestic credit (public and private) (TDC) and domestic credit to private sector (DCPS). The M2/GDP ratio (%) reflects the currency in circulation and degree of monetization in the economy. Disbursement of total domestic credit and domestic credit to the private sector reflects the efficiency of banking institutions in providing credit which may lead to increased investment decision of an economy. The functional relationship between GDP growth rate, M2/GDP ratio, total domestic credit and domestic credit to private sector can be expressed as follows:

$$Y_t = \alpha_0 + \beta_1 \text{ M2G} + \beta_2 \text{ TDC} + \beta_3 \text{ DCPS} + \varepsilon_t$$

Where Y_t is GDP growth rate (GDPGR), M2G is the share (%) of broad money supply in GDP, TDC is total domestic credit, DCPS is domestic credit to private sector and ε_t is error term.

Employing the Granger causality test to examine the sources and directions of causal relationships between financial development indicators and economic growth in Bangladesh, the study finds that financial development generally leads to economic growth. This empirical relationship is consistent with Rahman (2004) and Chakraborty (2008). More specifically, the study reveals that M2G causes economic growth in one direction. Additionally, increased domestic credit (both total domestic credit and domestic credit to private sector) leads to economic growth and vice versa.

Source: CPD 2011.

In terms of financial inclusion, however, a vast majority of the population still remains outside the formal banking channel and financial services. Though population per bank branch has improved over the years, from 57,700 in 1972 to 20,566 in 2008, this is high

compared to an advanced economy. In India, population per bank branch was 15,000 in 2009 (RBI 2009). Sharma (2008) developed an index of financial inclusion using data on 3 dimensions of financial inclusion and compared it among 55 countries. Bangladesh ranked 43 while India ranked 29 in this index.

3.2.3 Recent developments in the financial sector

The financial sector of Bangladesh experienced some critical developments throughout the first three quarters of the current fiscal year. These were characterised by high inflationary pressure, liquidity crisis in the money market and drastic fall of share prices in the capital market. Such a situation has led the central bank to react through various policy interventions, including changing policy rates such as that of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

Monetary targets for the current fiscal year were set for achieving a 6.7 per cent GDP growth while maintaining the inflation rate within 7.0 per cent (Table 3.2.3). However, it is more or less obvious now that the actual annual moving average inflation rate will move upwards from the target by a large extent, as it has already reached 8.5 per cent in April 2011; point to point inflation in April 2011 was 10.7 per cent, highest since June 2008 (detail in section 3.3).

TABLE 3.2.3: GROWTH IN MONETARY INDICATORS (%)

Indicator	Actual March FY11	Target June FY11
Inflation	8.5 (April)	7.0
Broad Money (M2)	23.5	15.2
Domestic Credit	29.0	17.9
Net Credit to the Public Sector (Govt.+other)	28.2	25.3
Credit to the Private Sector	29.1	16.0

Source: Bangladesh Bank.

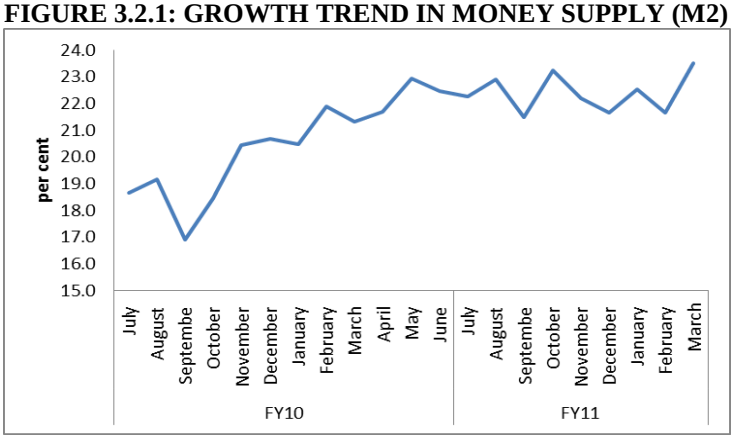
Despite the off-track movements of most of the monetary indicators at the end of the 2nd quarter of FY2010-11, Bangladesh Bank, in its Monetary Policy Statement (MPS) for the second half of the fiscal year did not make any mid-year correction for monetary targets.

Money supply and credit flow

Broad money supply (M2) continued to grow throughout the current fiscal year and remained well above the annual target of 15.2 per cent. In a bid to control the growth in money supply, Bangladesh Bank used several financial instruments available at its disposal such as Repo and Reverse Repo, CRR and SLR. These rates have been raised a number of times within a short period.

In December 2010 CRR and SLR were raised to 6.0 per cent and 19.0 per cent respectively from 5.5 per cent and 18.5 per cent. The increase in CRR to 6.0 per cent required that the reserve requirement of the banking sector has to be shot up to Tk. 2000 crore. Earlier in August 2010 Repo and Reverse Repo were increased by 1.0 percentage point; Repo from 4.5 per cent to 5.5 per cent and Reverse Repo from 2.5 per cent to 3.5 per cent. These two rates faced revisions again in March and April of 2011. At present rates of Repo and Reverse Repo are 6.25 per cent and 4.25 per cent respectively. These moves however, did not bring down the money supply. Rather the growth in M2 was 23.5 per cent in March 2011, highest during the current and previous fiscal years (Figure 3.2.1).

FIGURE 3.2.1: GROWTH TREND IN MONEY SUPPLY (M2)



Source: Bangladesh Bank.

Similar trend is observed in case of domestic credit. Domestic credit to both public and private sectors remained at higher levels than the targets by Bangladesh Bank (Table 3.2.4). The upward trend in domestic credit, which is observed since the beginning of the FY2010-11, particularly in the private sector could be the result of high export, increased momentum in domestic production and investment in the capital market by diverting credits from banks. High domestic credit to the government and other public sector may be due to higher payment for imports by the governments such as petroleum products in view of high prices in the international market.

TABLE 3.2.4: GROWTH IN DOMESTIC CREDIT AND ITS COMPONENTS

Months of FY11	Gov Net	Other Public	Private Sector	Domestic Credit
July	-6.7	18.1	24.8	18.2
August	-2.5	19.1	25.9	20.2
September	-5.1	20.7	26.6	20.3
October	-1.2	20.7	27.0	21.5
November	8.5	24.2	27.8	24.3
December	7.5	26.8	27.6	24.4
January	12.9	39.3	28.1	26.2
February	13.5	38.0	28.3	26.4
March	27.4	31.9	29.1	29.0

Source: Bangladesh Bank.

Between March 2010 and March 2011, the growth of the net credit to the government sector was 27.4 per cent while the growth of credit to the private sector was 29.1 per cent. These growth rates were higher than the previous year. Although deficit financing data for the July-February period indicates a net financing of only Taka 229 crore, government borrowing from the banking sector amounted to Taka 7,336.8 crore, mostly to meet its repayment liabilities to the non-banking sources; net non-bank financing was negative, amounting to Taka (-) 6,938.2 crore and net foreign financing was also negative to the tune of Taka (-) 169.6 crore.

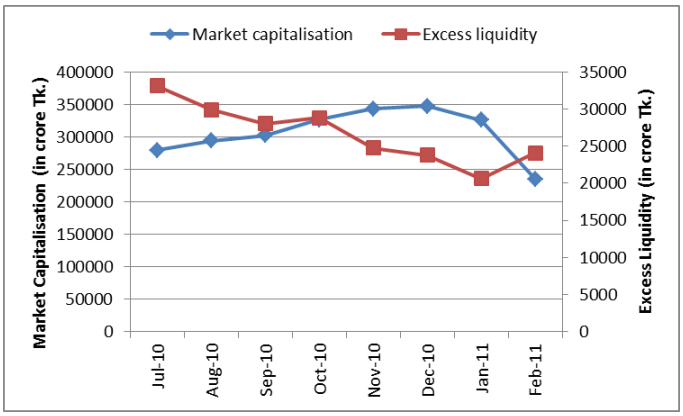
Liquidity surplus of the scheduled banks

Excess liquidity at the scheduled banks declined quite dramatically during the first half of the current fiscal year. At the beginning of the fiscal year, excess liquidity amounted to Taka 31,888.2 crore. It came down by 22.4 per cent in November 2010 and by 35.1 per cent in January 2011 compared to the end of June 2010. This decline was accompanied by a number

of developments, such as rise in indices of the stock markets (till December), rise in investment demand, high growth in imports, and sharp depreciation of Taka against US dollar. Among these movements in the stock market have direct implications for the liquidity situation of the banking sector in Bangladesh.

As Figure 3.2.2 indicates, decline in excess liquidity at the scheduled banks had significant inverse correlation with the gain in market capitalization of the DSE during the period under consideration of this report. This supports the hypothesis that the flow of credit might have moved towards the capital market, instead of productive sectors.

FIGURE 3.2.2: TREND IN EXCESS LIQUIDITY OF THE SCHEDULED BANKS AND MARKET CAPITALISATION OF THE DSE



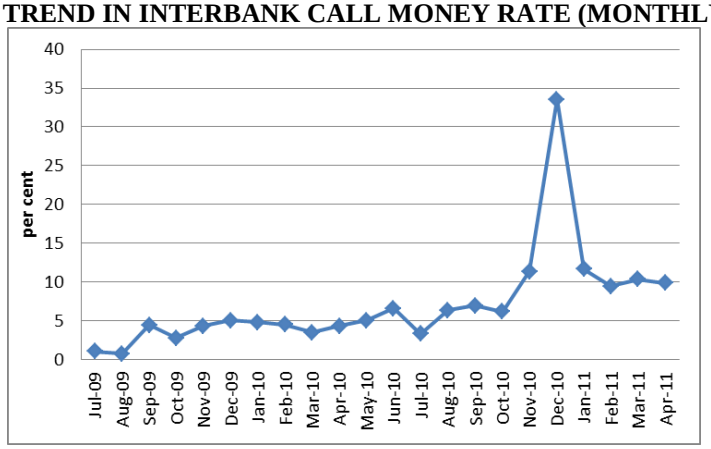
Source: Bangladesh Bank.

State owned banks have been facing higher liquidity pressure compared to the private commercial banks. State owned banks experienced a reduction in excess liquidity by 43.0 per cent between July and January of FY2010-11. Excess liquidity of the private commercial banks declined by 27.7 per cent and of foreign banks by 29.3 per cent during the same period.

The situation seems to have improved in more recent months with excess liquidity reaching Taka 28025.0 crore in April 2011 from Tk. 20705.2 crore in January 2011. The present amount is still lower than what was available at the beginning of the fiscal year by Taka 3863.2 crore. It may be noted that this improvement in liquidity situation has taken place in a situation when there was neither any significant change in the deposit trend, nor any sign of slowdown in imports. There was no reduction in investment demand as well. This improvement in the liquidity situation could be related to the crash of the capital market. More clearly, in view of the credit diversion from banks to the capital markets ignoring the liquidity requirements set by Bangladesh Bank. CRR was raised by Bangladesh Bank. This led to forced selling of shares by the over-exposed banks to comply with the CRR requirement. The immediate repercussion of this move by capital market – a huge bubble burst!

The wave of liquidity shortage was reflected in the money market, as expected. Call money rate (overnight lending rate) was significantly high in November 2010 (11.4 per cent) and January 2011 (11.6 per cent) compared to June 2010 (6.6 per cent); average lending rate was 33.5 per cent in December 2010, which was induced by an increase in CRR and SLR rates by the BB in that month. Though in April 2011 the liquidity situation improved to some extent, interbank lending rate still remains higher at 9.9percent compared to 4.35 per cent in April 2010.

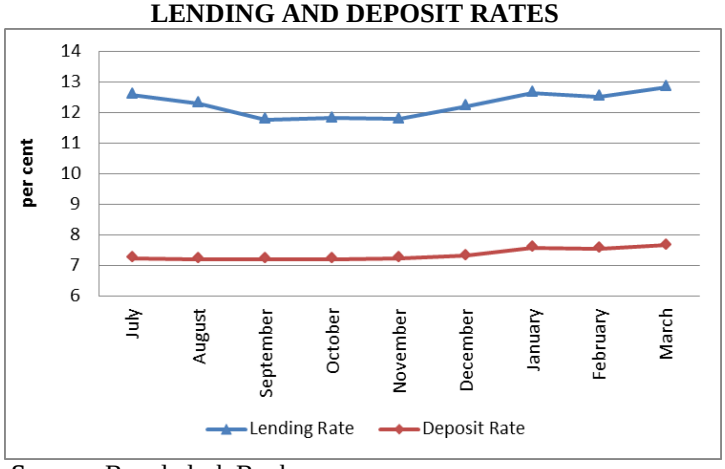
FIGURE 3.2.3: TREND IN INTERBANK CALL MONEY RATE (MONTHLY AVERAGE)



Source: Bangladesh Bank.

Liquidity shortage was also felt through high interest rates. Since July 2010, commercial lending rate was on the decline and in November 2010 it reached 11.78 per cent. In November 2009 the lending rate was 11.78 per cent. But since December 2010 the lending rate is again on the rise and reached 12.82 per cent in March 2011. While high lending rate is making credit costlier than before, banks are also offering higher rates to the depositors in their desperate attempts to meet up the liquidity gap. Thus deposit rate increased by 0.42 percentage points between July 2010 and March 2011 and reached 7.67 per cent. However, the gap between lending and deposit rates (the spread) has been in the range of 4.5-5.0 per cent during the current fiscal year, which is within the recommended limit by Bangladesh Bank.

FIGURE 3.2.4: MOVEMENT IN COMMERCIAL LENDING AND DEPOSIT RATES



Source: Bangladesh Bank.

With increased CRR and SLR rates, scheduled banks will have less cash at their disposal to lend which is estimated to the tune of around Taka 2,500 crore. However, the Bangladesh Bank has been complementing this shortage with severe interventions for injecting money into the market through the use of Repo auctions. In April 2011 alone, Bangladesh Bank has made 16 Repo auctions (2 of 4 day tenor, 2 of 3 day tenor and 12 of 1 day tenor) each worth around Taka 20 billion, with no use of the Reverse Repo instrument. To compare, only 4 Repo auctions (ranging from Taka 0.25 billion to Taka 2.5 billion) were made in June 2010 with 7 Reverse Repo auctions (ranging from Taka 9.5 billion to Taka 15.4 billion), withdrawing money from the market in net terms. As such, despite the increase in CRR/SLR rates, Bangladesh Bank is making an attempt to ensure capital adequacy of commercial

banks. However, as is evident from the high call money and interest rate, banks are still suffering from liquidity shortage to some extent. Now that the government is considering to raise the rate of interest on its savings instruments, it is apprehended that commercial lending rates may face further upward pressure in the near future.

Loans and advances

The structure of advances during the first half of the fiscal year reveals that the flow of credit was largely influenced by high import demand and upbeat production and export performances. While outstanding advances increased by 26.7 per cent between December 2010-11 and December FY2009-10, majority of the increase was contributed by advances to the industrial sector (both working capital and others) and trade finance (Table 3.2.5). Within trade finance, outstanding advances made for export financing were over 12 times more in December FY2010-11, compared to that in the corresponding month of the previous fiscal year (December FY2009-10). Import financing increased by 26.6 per cent. Advances made for Import financing of Textile and Textile Products alone posted 59.4 per cent growth between December FY10 and December FY11.

TABLE 3.2.5: PURPOSE WISE DISTRIBUTION OF OUTSTANDING ADVANCES (DEC FY10 AND DEC FY11)

Purpose	Dec FY10	Dec FY11	Incremental share	Growth
Agriculture, Fishing and forestry	14,369.1	16,843.5	4.0	17.2
Industry (other than working capital financing)	50,502.0	61,093.4	17.0	21.0
Working Capital Financing	36,885.1	44,611.5	12.4	20.9
Construction	16,002.1	20,723.5	7.6	29.5
Water-works and Sanitary Services	6.6	36.7	0.0	455.5
Transport and Communication	3,428.3	4,289.8	1.4	25.1
Storage	475.6	618.7	0.2	30.1
Trade	85,904.4	112,830.2	43.1	31.3
Miscellaneous	25,906.5	34,834.0	14.3	34.5
Total	**233479.5**	**295881.2**	**100.0**	**26.7**

Source: Bangladesh Bank.

However, high growth in advances in sectors such as flat purchase (71.1 per cent) and consumer goods (65.1 per cent), included in the 'miscellaneous' head, is a matter of concern. It is also to be kept in mind that high growth in demand for consumer goods is in fact a reflection of an overheated economy. In a bid to divert flow of credit towards more productive sectors, Bangladesh Bank on 9 March 2011 withdrew caps from commercial lending rates, barring term loans and agricultural credit. The effectiveness of this measure is yet to be observed.

Disbursement of industrial loan

In the backdrop of substantial rise in exports, high growth in flow of credit to the industrial sector is observed during the July-March period of FY2010-11, compared to the corresponding period of FY2009-10. According to the provisional estimates of the Bangladesh Bank, for both term loan and working capital, in gross terms, disbursement was significantly higher – 30.1 per cent and 25.7 per cent respectively (Table 3.2.6). However, higher disbursement was accompanied by higher recoveries, particularly for term loan disbursement, resulting in lower net growth. In fact, term loan disbursement in net terms declined by 7.8 per cent during the period under review.

TABLE 3.2.6: GROWTH IN TERM LOAN AND WORKING CAPITAL DISBURSEMENT

Sources	Growth in Tern Loan (Jul-Mar FY11 over Jul-Mar FY10)			Growth in Working Capital (Jul-Mar FY11 over Jul-Mar FY10)		
	Disbursement	Recovery	Net Disbursement	Disbursement	Recovery	Net Disbursement
SCBs	243.1	155.2	549.6	25.3	32.3	22.6
PCB(D)	12.4	42.5	-37.3	23.1	28.6	5.5
PCB(F)	71.5	136.5	472.6	31.4	13.8	-149.4
SBs	98.6	13.9	-558.6	55.9	38.2	105.8
NBFIs	33.2	4.6	-507.0	74.4	54.6	359.2
Total	**30.1**	**46.2**	**-7.8**	**25.7**	**27.0**	**21.3**

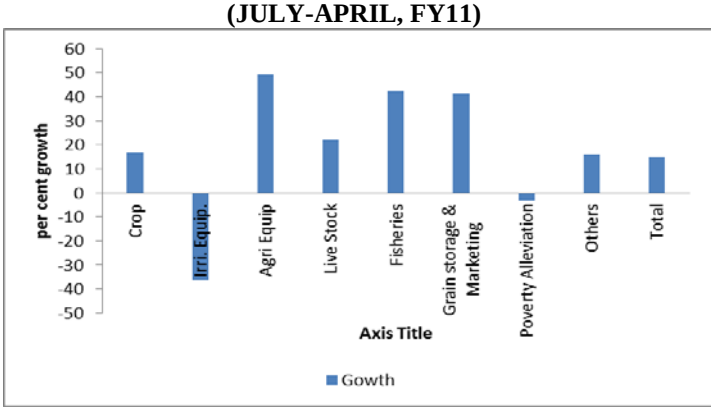
Source: Bangladesh Bank.

Net term loan disbursement was lower by Tk. 438.4 crore during the first three quarters of FY2010-11, compared to the same period of FY2009-10. On the other hand net working capital was Tk. 2,009.8 core higher. In sum, net flow of credit to the industrial sector (Tk. 16,619.7 crore) was higher by Tk. 1,571.4 crore (10.4 per cent) during the July-March period of FY2010-11.

Agricultural credit situation

As part of Bangladesh Bank's drive to make growth inclusive agricultural credit has been high on the agenda. Agricultural credit increased by 14.9 per cent during July-April period of FY2010-11, compared to the matching period of the previous fiscal year. This was however lower than the growth during July-April of FY2009-10 (15.79 per cent). On the other hand of the annual target of agri-credit 87.3 per cent has been disbursed so far, which was 77.7 per cent during July-April period of FY2009-10. However, after adjusting for recoveries, net disbursement of agricultural credit declined by 53.1 per cent during July-April period of the current year. Given that the current inflation is food price driven, and is influenced by global prices to a large extent, it is important to provide a supply side push to contain price hike through increased agriculture production. Hence the decline in net agriculture credit is a major concern from the perspective of food security.

FIGURE 3.2.5: SECTORAL GROWTH IN NET AGRICULTURAL CREDIT FLOW (JULY-APRIL, FY11)



Source: Bangladesh Bank

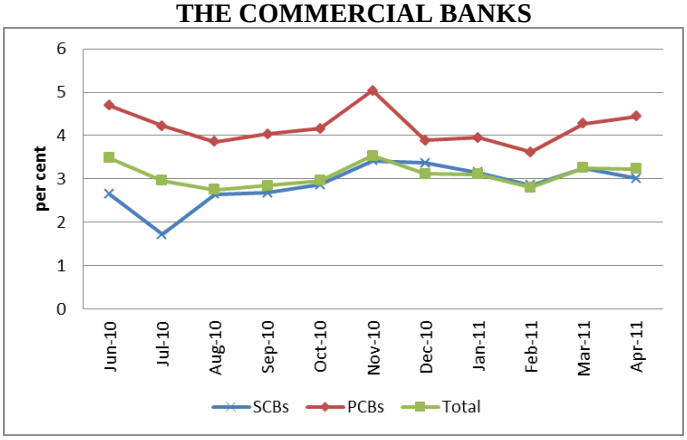
Capital market exposure of the banks

The central bank has fixed the limit of exposure of commercial banks in the capital markets[60] at 10 per cent. Although exposures of commercial banks remained lower than the limit,

[60]Capital market exposure is measured as investment in stock market by the banks as a percentage of their total liabilities.

average exposure of banks particularly, that of private commercial banks, demonstrated significant upward movement during August-November period of the current fiscal year, just before the stock market collapsed.

FIGURE 3.2.6: CAPITAL MARKET EXPOSURE OF THE COMMERCIAL BANKS



Source: Bangladesh Bank.

Although exposures of banks to the capital market were coming down after the collapse of the stock market, it is again on the rise in recent months (Figure 3.2.6). At the same time, for financing the operations of their subsidiaries (brokerage houses and merchant banks), commercial banks were reportedly running over the 15 per cent limit for 'single borrower exposure' set by Bangladesh Bank. Recently, Bangladesh Bank directed commercial banks to adjust their 'single borrower exposure' within the limit by 31 December 2011.

Non-performing loans and banks profitability

Higher involvement of banks in the capital market, however, did not result in any deterioration of the non-performing loan situation. In fact, compared to June 2010, overall NPL came down by 2.9 per cent in December 2010 (Table 3.2.7). Significant improvement in this period is evident for state owned banks, whereas NPL of private commercial banks also declined by 1.2 per cent. On the other hand, NPL situation of foreign banks and specialized banks deteriorated quite significantly during this period.

TABLE 3.2.7: OUTSTANDING NON-PERFORMING LOANS OF THE SCHEDULED BANKS

Bank type	As on June 2010	As on December 2010	Growth
SCBs	12065.66	10757.26	-10.8
PCBs	6511.14	6430.37	-1.2
FBs	390.89	553	41.5
DFIs	4411.22	4968.85	12.6
Total	23378.91	22709.48	-2.9

Source: Bangladesh Bank.

Profitability of banks on the other hand has improved to some extent during the first half of the current fiscal year, as reflected through the return on asset ratios. This is perhaps a reflection of the financial institutions making more profit through investment in the capital market. Anecdotal information suggests over 150 per cent growth in both Banks' and other financial institutions' profit in 2010, over 2009.

TABLE 3.2.8: RETURN ON ASSETS OF THE SCHEDULED BANKS

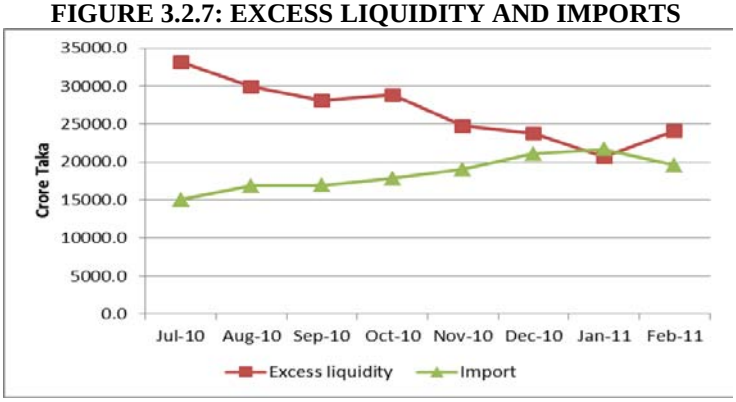
Category of banks	ROA	
	End June 2010	End Dec 2010
SCBs	0.7	1.1
PCBs	2.0	2.1
FCBs	2.9	2.9
SDBs	0.2	0.2
Total	1.6	1.8

Source: Bangladesh Bank.

Way forward: trade-offs and necessary adjustments

As was seen earlier, liquidity surplus situation has tended to move along the market capitalization of the stock market. However, as advances situation indicate, flow of credit has been driven mostly by trade finance. Figure 3.2.7 shows high correlation between movement in excess liquidity and imports. In business as usual scenario, the upbeat in import, export and investment situation should be reflected in the capital market. As such, in isolation, developments in the capital market and the real economy till December 2010 may appear to have been logically linked.

FIGURE 3.2.7: EXCESS LIQUIDITY AND IMPORTS



Source: Bangladesh Bank.

However, it is quite obvious that the asset market was illogically inflated (as evident from the PE ratio and sectoral distribution of growth in market capitalization that was observed till December 2010) which led to its collapse. Curiously, the money market is returning to normalcy despite no significant change in the real economy. The only change that occurred in the financial sector is in the capital market. This implies that the monetary sector has been highly influenced by the capital market in recent times. Thus the much talked about apprehension that credit flow was diverted to the capital market holds some ground.

Bangladesh Bank is apparently trying to accommodate the credit expansion through market interventions by using Repo auctions. Despite the increased CRR, SLR, Repo and Reverse Repo rates, the net impact appears to have been positive in increasing liquidity surplus of scheduled banks. As such, irrespective of the policy stance of increasing policy rates, a demand side management approach has not been put into action. A supply side effort, through support to the agriculture sector in particular, to contain inflation is more logical as the current inflation is food and global price driven. Significant decline in net agricultural credit disbursement during the first three quarters in the current fiscal year is a concern in this regard since it may hamper achievement of food security through higher of production (although gross disbursement improved). However, it is also to be considered, given the

current level of infrastructure and GDP growth, whether the over 29 per cent credit growth observed in the private sector, is contributing to overheating of the economy and needs to be reviewed and intervened. Perhaps a more proactive monetary policy towards diversion of money supply from unproductive sectors to more productive ones needs to be put in place.

Bangladesh Bank's selective withdrawal of lending rate caps may also help contain the flow of credit to the unproductive private sector. However, strong vigilance of the central bank will be needed to ensure the implementation of the cap set for industrial and agricultural loans.

3.2.4 Concluding remarks

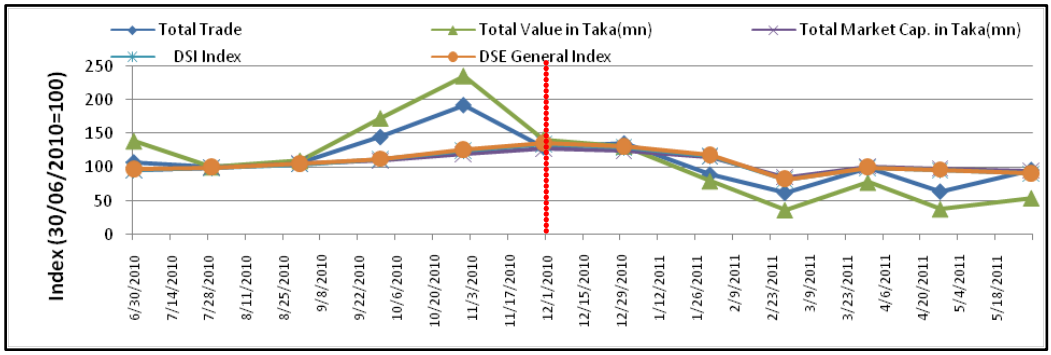
The preceding discussion indicates that measures by the central bank in the context of the movement of various monetary sector variables have not been synchronized properly. This had negative implications for the behaviour of the capital market and the inflationary trends. Additionally, weak supervisory role has led to poor portfolio management of commercial banks resulting in liquidity crunch. Several malpractices of commercial banks to divert funds to the stock market were overlooked the central bank. Indeed, all these developments, among others, made the MPS targets of little relevance. The current situation of the financial sector in Bangladesh is that of an inefficient one driven by less prudent decisions and low governance which has jeopardized the stability of the whole financial system. Given the critical role of the financial sector towards fostering economic growth, the sector has to be managed more effectively through strengthened oversight and deployment of coordinated measures.

3.3 RESTRUCTURING AND REFORMS IN THE CAPITAL MARKET: CHALLENGES FOR REDUCING INEFFICIENCY, MALPRACTICE AND VOLATILITY

3.3.1 Market Crash in December, 2010 and Subsequent Trends: Initial Measures

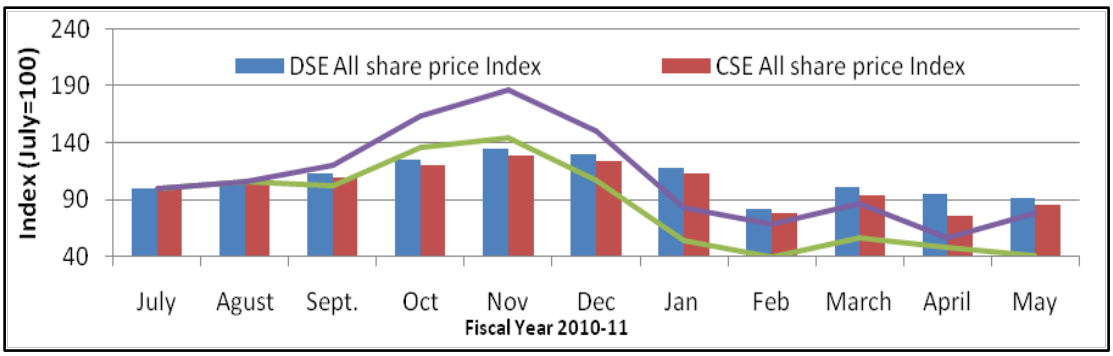
The capital market bubble which had been gradually gathering momentum for over two years finally bust in December 2011; since then all market related indicators have lost their values by a significant extent.[61] Between December 2010 and May 2011, the DSE General Share Price Index (DGEN) dropped by 35.4 per cent; market capitalization of the DSE decreased by 20.6 per cent; daily trade value declined by 77.5 per cent (Figure 3.3.1). The situation was same for the Chittagong Stock Exchange (CSE) as well (Figure 3.3.2). A large number of small investors have lost their capital due to this market crash. Offloading of new IPOs have slowed down, with a total of fourteen companies waiting in the pipeline with a combined capital stock of Tk.2800 crore.[62]

FIGURE 3.3.1: TRENDS IN MAJOR MARKET INDICATORS IN THE DSE DURING FY20010-11



Source: DSE

FIGURE 3.3.2: TRENDS OF MAJOR INDICATORS AT DSE AND CSE



Source: DSE/CSE

Since the collapse of the capital market, a number of measures were initiated. These involved interventions at two levels. *First*, the Securities and Exchange Commission (SEC) has taken a

[61] Islam and Khaled (2006), and Ainul and Mohammed Khaled (2006) had earlier reached the conclusion that the DSE was an inefficient market. Ahmed and Samad (2008) reported that rumor and non-declaration of any dividends also affect share price.

[62] Ten companies to be off-loaded under fixed price method and the remaining four companies were to be off-loaded under book-building method. The former group included four financial services (3 insurance and one bank), three other services (CDBL, Shipping and Hospital), one power generation and two manufacturing companies. The latter group included three construction companies and one financial service (Lanka Bangla securities Ltd.).

number of supportive measures primarily with a view to arrest the downfall of the share price index; the SEC has also taken some punitive measures on an 'ad-hoc' basis.[63]However, most of these measures were ineffective and some indeed had adverse impacts on the market. *Second*, the government took a number of measures of which the most important was forming a competent probe committee to investigate the activities in the market during the run up to the boom and bust, identify malpractices and manipulations and come up with policy suggestions to address the attendant problems.[64]Later the government announced a number of measures which reflected, albeit only partially, the recommendations of the probe committee report.

A list of preliminary measures taken by the government, the SEC and the Bangladesh Bank is shown in Appendix 3.3.1. These measures are by and large targeted to meet the gap between the demand and the supply in the capital market. The most important of these measures is the injection of capital in the stock market through measures including changing margin loan ratio, shifting the status of companies from the over the counter (OTC) market to main market and spot market, injection of capital through Investment Corporations of Bangladesh (ICB), formation of the 'Bangladesh Fund'(see Box 1), withdrawal of the order for immediate adjustment of commercial bank's credit exposure to the capital market and injection of funds through repo by the Bangladesh Bank. However, as CPD (2011) had earlier observed, inadequacy of capital was not the major problem in the country's capital market. Hence injection of capital was hardly likely to reduce market instability; rather it is apprehended that such injection of funds will inflate the market artificially.

It is reckoned that in order to make 'functional' an inherently and structurally 'dysfunctional' capital market, a number of corrective, painful, and 'unpopular' overhauling measures will need to be taken. This includes investigation of fraudulent activities and taking legal measures, restructuring of the regulatory and facilitating bodies, strengthening of

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[63]This includes shuffling companies to and from trading in the spot market, fining brokerage houses for unlawful activities (e.g. forced selling of its client's accounts), formation of an enquiry committee to investigate unusual movements in price and volume of listed securities, reduction of time gap to 15 days in between client's account opening and trading against that account, imposition of circuit breaker on movement of both individual company's price and overall share price indices, postponing the change of face value of listed companies in the stock exchanges, and postponing companies to be enlisted in the capital market through book-building method.

[64] On 26 January, 2011 the government formed a three member probe committee (another member joined later) headed by Mr Ibrahim Khaled, Chairman, Bangladesh Krishi Bank. The ToR of the committee includes 11 issues: a) whether individuals, banks, financial institutions, merchant banks, brokerage houses and listed companies were engaged in de-stabilizing the market by interrupting its normal activities; b) comparative analysis of return from long term banking investment and investment in government savings instruments at the beginning of 2010; c) analysis of the nature of upward trend in the capital market, concept of sustainability of the capital market and identification of nature of over valuation; d) entry of short term traders instead of long term investors in the capital market and their trading behaviour, and total traded amount of these types of individuals/groups and institutions and process of influencing the market and identification of them; e) identification of whether the existing laws, guidelines were appropriate or not in regulating the capital market and SEC's measures against different situations were adequate or not; f) identification of institutions/individuals who have withdrawn abnormal amount of money from the over-priced market by issuing IPO through direct listing, book-building and fixed price method and role of issue managers, regulatory authorities, audit firms, asset valuer companies etc; g) examination of how small investors have lost their investments by buying issuer companies' shares from IPO; h) assessment of liquidity situation in the market during the time of sharp fall; i) assessment of competencies of the regulatory authority of the capital market, whether their experience was enough or not etc; j) whether the infrastructure and governance of DSE and CSE were enough or not; k) other related issues like-whether money from the capital market transferred outside of the country and if so, then the amount of money and how this have been transferred. The committee was able to complete its work within the stipulated period of two months and submitted its report to the Ministry of Finance on 31 March, 2011.

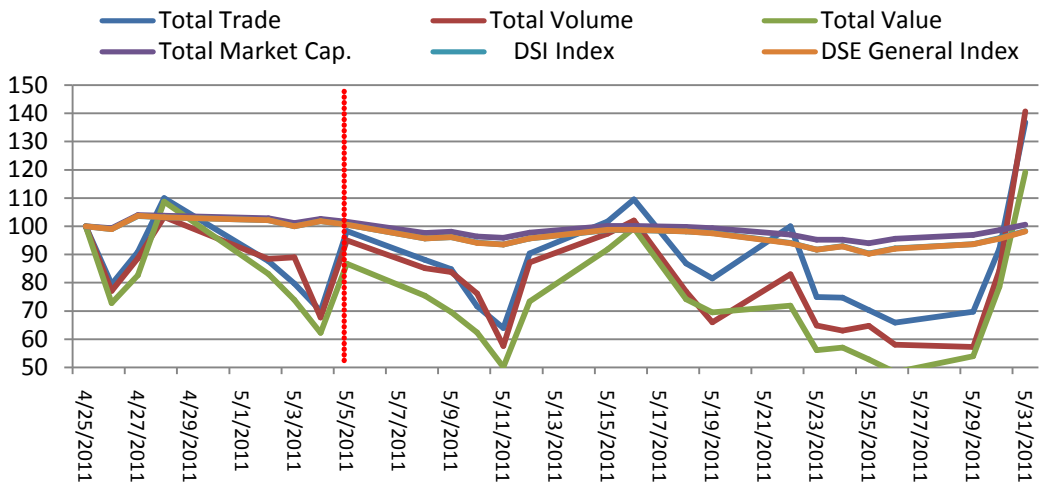
oversight mechanism of regulatory bodies, addressing the agency problems and ensuring effective enforcement of rules and regulations. These measures have been suggested for markets that are largely inefficient and dysfunctional (Davis, 1995; Yilmaz, 2008; USAID, 1999).

BOX 3.3.1: BANGLADESH FUND: IS THERE ANY IMPACT?

Having identified the demand-supply gap in the flow of capital as a major problem, the government had earlier decided to form a special mutual fund to conduct strategic trading in the market with a view to restoring stability to the market. In this process, an open-ended mutual fund titled 'Bangladesh Fund' was created under the sponsorship of the ICB and seven other state-owned banks. This fund formally started its operation on 5 May2011. This is an open-ended mutual fund with a target level of capital of Tk.5000 crore. However, the fund initially started with Tk.1500 crore. Of this fund, Tk.1300 crore was sponsored by eight state owned financial institutions including Tk.500 crore from ICB, Tk.200 crore each from Janata and Sonali Banks, Tk.100 crore each from Rupali Bank, Bangladesh Development Bank Ltd., JibanBima Corporation and Shadharan Bima Corporation. The rest of the Tk.5000 crore fund was to be mobilised from private sector institutional investors with ICB acting as the operator of the fund. As per the investment plan, 75 per cent of the fund will be invested in the capital market while the remaining 25 per cent will be invested in the money market. To make the fund attractive to investors, ICB sought several benefits/facilities. These included: allocation of an extra 5 per cent of the IPOs (along with the existing 10 per cent IPOs) for this fund; relaxation of the 10 per cent exposure rule for financial institutions which otherwise would made it difficult for banks to invest in this fund; a request to consider the fund as an approved security[65] and the provision of allowing undeclared money of individuals and institutional investors to invest at 10 per cent flat tax rate.

A number of questions may be raised as to the effectiveness of the aforesaid measures, authority of the ICB as an operator and the decision making system of the ICB with regards to participation in day-to-day trading. In a fundamentally weak market with fraudulent trading practices of market players, injection of capital was hardly played the expected role in stabilizing the market in the medium to long term. ICB's participation in day-to-day trading can also be questioned. It is not clear how transparently and efficiently this mutual fund will be managed by the ICB, particularly in a market situation where most of the shares are still overvalued. Figure 3.3.3 shows no change in the pattern of transaction in the DSE immediately before and after the initiation of the Bangladesh Fund; indeed till now the fund has not been able to create any stabilisation impact in the market.

FIGURE 3.3.3: PATTERN OF TRANSACTION BEFORE AND AFTER THE INTRODUCTION OF THE BANGLADESH FUND



Source: Based on DSE

[65] Approved securities would not have to deposit any security money to Bangladesh Bank.

3.3.2 'Toxic' Elements in the Capital Market: Case Studies on the Basis of CPD (2011) and the Probe Committee Report (2011)

Based on the analysis of the capital market behaviour, a number of anomalies, weaknesses and constraints were reported in the CPD report which was prepared in January 2011 (CPD, 2011). The Probe Committee Report (2011) also came up with a number of sharp observations and comments (Annex 2). These included: direct listing of companies in the IPO; revaluation of company assets; fixation of share value at a high level; improper use of the book building system; providing placement shares to selected persons/companies where issuers, issue-manager, valuer, auditor, dealer, brokers were involved; and operations of circular trading, block trading in the secondary market where dealer, brokers, investors were involved. Taking into consideration the possible adverse impact and implications of the identified activities, market behaviour and movements, an attempt has been made below to analyse the nature and consequences of selected set of these activities.

Use of multiple BO accounts: As per the securities law, investors are not allowed to maintain more than two BO accounts. The probe committee, while examining information with regard to those who gained most from the capital market in the recent past, identified a number of cases where more than two BO accounts were used for transactions by certain market players. As Table 3.3.1 shows, one investor in the sample selected by the probe committee was involved in transactions in the DSE through as many as 12 BO accounts. This was made possible through use of different names, contact addresses, professional engagements, bank accounts, brokerage houses etc. It was reported that such practices are quite common in case of many of the large market players. This reflects serious procedural flaws with regard to registration, opening of bank accounts and obtaining IDs with brokerage houses.

TABLE 3.3.1: MULTIPLE BO ACCOUNT HOLDERS

Particulars	BO 1	BO2	BO3	BO4	BO5	BO6	BO7	BO8	BO9	BO10	BO11	BO12
Account's status	Single	Single	Single	Single	Single	Single	Single	Joint	Single (comp)	Single	Joint	Single
Person(s) identity	X	X	X	X	X	X	P2	X+P2	C1=X+P4	P2	X+P5	X
Address of the person(s)	A1	A2	A3	A4	A1	A1	A2	A2	A5	A2	A2	A2
Profession of the person(s)	Pr1	Pr2	NA	NA	NA	NA	Pr4	Pr2+Pr3	Company	Pr3	Pr2+NA	Pr1
Bank information of the person(s)	B1	B2	B1	B3	B4	B5	B5	B1	B6	B3	NA	B5
Brokerage house for trading	Br1	Br2	Br2	Br3	Br4	Br5	Br2	Br2	Br3	Br5	Br5	Br5
Authorisation for operating the account	X	P2+P3	X	X	X	X	X+P3	P3	C1	P2	X	X

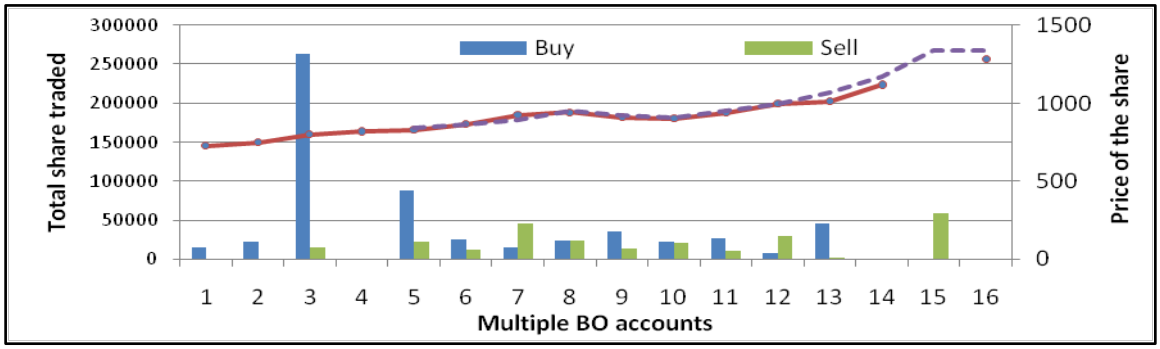
Note: X: Sample person; P1, P2, P3, P4 and P5: Relatives/known persons of X; C: Company; A1, A2, A3, A4 and A5: Addresses used for opening BO accounts; Pr 1, Pr 2, Pr 3 and Pr 4: Professions of the BO account holders; B1, B2, B3, B4, B5 and B6: Bank information in different accounts; Br 1, Br 2, Br 3, Br 4 and Br 5: Brokerage houses

Source: Based on relevant documents

Serial trading: Prevalence of multiple BO accounts gave market players ample scope to carry out serial trading. The probe committee found out that certain market players have

traded significant number of shares of particular stocks by using multiple accounts. Initially an artificial demand was created for particular shares through buying of shares; in the next few days when others also follow and start to participate in trading in the same share price of the shares tended to go up. This is the point when those market players sell off their shares and make a windfall capital gain within a short period of time (Figure 3.3.4 and Appendix 3.3.3). As appendix 3.3.4 indicates, these market players generally tend to have significant control over trade of particular shares and hence they were able to make large margins through trading in these shares. It may be noted here that such activities are illegal according to SEC laws.

FIGURE3.3.4: SERIAL TRADING BEHAVIOUR OF MULTIPLE BO ACCOUNT HOLDERS



Source: Based on relevant documents

Disbursement of margin loans over the limit: A number of merchant banks were found to be involved in disbursement of margin loans over the stipulated limit set by the SEC. Table 3.3.2 shows that a total of 19 banks were involved in breaking the limit on a particular sample date. As the table shows, both disbursement of credit and numbers of incidences were not negligible. To bring financial discipline in the capital market, activities of merchant banks in terms of providing margin loans should be thoroughly investigated.

TABLE 3.3.2: SAMPLE BANK'S DISBURSEMENT OF MARGIN LOANS OVER THE LIMIT (ON A PARTICULAR DAY)

Sample Banks	Margin Limit as per SEC	Range of Margin Ratios	Number of Overdrawn Accounts
1	1:1.5	1:2.0 -1:7.5	6
2	1:1.5	1:1.7 - 1:2	22
3	1:1.5	1:1.6	1
4	1:1.5	1:1.7-1:1.3	15
5	1:1.5	1:1.7 -1:3.1	4
6	1:1.5	1:1.6 - 1:4.0	6
7	1:1.5	1:3.4 - 1:6.2	19
8	1:1.5	1:1.8 - 1:19.5	3
9	1:1.5	1:3.5 -1:30.2	5
10	1:1.5	1:5.0 - 1:17.9	14
11	1:1.5	1:2.8 - 1:91.1	15
12	1:1.5	1:1.9 - 1:3.7	14
13	1:1.5	1:2.8 - 1:23.9	10
14	1:1.5	1:2.1 - 1:2.5	6
15	1:1.5	1:1.8 - 1:3.4	13
16	1:1.5	1:2.0 - 1:7.7	14
17	1:1.5	1:2.3 - 1:3.6	7
18	1:1.5	1:1.8 - 1:38.2	18
19	1:1.5	1:2.4 - 1:40.2	12

Source: Based on relevant documents

Audit of listed companies by unknown audit firms that lacked credibility: A major concern raised in the probe committee report and also in the CPD report related to the

reliability and authenticity of audit reports. A number of questions were raised in these reports particularly with regard to valuation of assets of new companies and also revaluation of assets of listed companies. Audit reports were found to be not reflecting the actual situation of the company and appeared to be prepared with certain intention and purpose (e.g. issuance of large number of right shares by several companies in 2010 through revaluation of assets which allowed these companies to mop up significant amount of cash involved audit reports of doubtful quality; this needs to be properly investigated). According to Table 3.3.3, only 19 per cent of total listed companies were audited by audit firms which have an affiliation with an international audit firm. About 60 per cent of listed companies were audited by audit firms which were listed with NGO Affairs Bureau/Bangladesh Bank. Interestingly, more than one-fifth of the listed companies were audited by firms which had no affiliation other than the Institute of Chartered Accountants of Bangladesh (ICAB). Absence of accredited institutions to monitor reporting standards of the audited firms leaves ample opportunities and scope for misuse of the audit system, to the detriment of the common shareholders. The SEC, DSE and CSE cannot avoid their respective responsibilities in failing to properly oversee the auditing practices. An appropriate mechanism should be developed on an urgent basis in order to ensure that audit reports are of high quality and reflect the reality with regard to the financial status and practices of the company. Punitive measures will need to be taken for providing false information and for misreporting of financial situation.

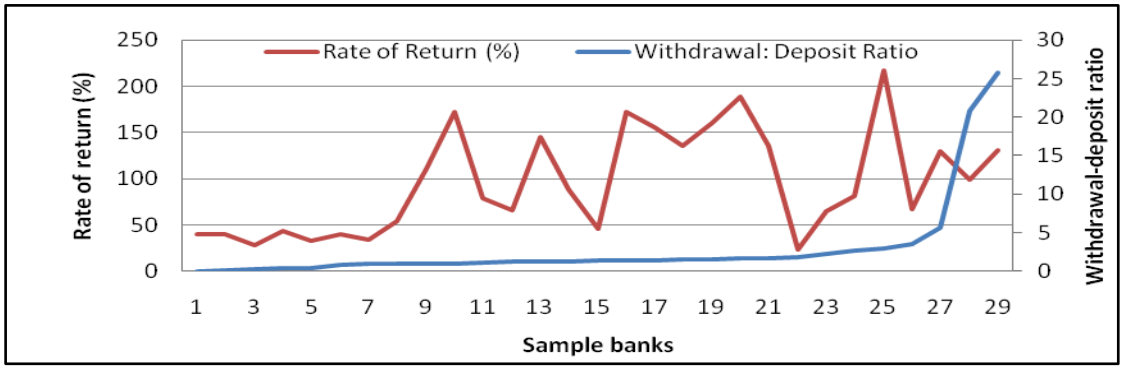
TABLE 3.3.3: LISTED COMPANIES AUDITED BY DIFFERENT TYPES OF AFFILIATION OF AUDIT FIRMS

Listed Companies Audited by	Number of Listed Companies	Percentage of Listed Companies
Audit firms affiliated with Internationally reputed firms	56	18.9
Audit firms listed in nationally reputed organisations (ICAB, NGO Affairs Bureau, Bangladesh Bank etc.)	177	59.6
Audit firms not listed outside ICAB	64	21.5
Total	297	100.0

Source: Based on relevant documents

Non-compliance of financial institutions: Some of the institutional investors, particularly financial institutions were found to be non-compliant on a number of accounts including involvement with retail trading, disbursement of credit over the limit of margin loan ratio, failing to maintain the exposure limit of liabilities of banks in the capital market and going beyond the single exposure borrower limit etc. Figure 3.3.5 shows that there were wide variations among the banks with regard to the pattern of trading and consequently rate of return received through these trading activities. A withdrawal-deposit ratio well over 1 indicates that financial institutions were most likely acting as retail traders in the capital market. Such trading behaviour allowed these institutions to enjoy significant gain from the market within the span of only one year. The allure of such high returns, received through this type of retail trading induced some of the financial institutions to bend and break some of the customary practices in the capital market. Evidently, there was an oversight failure with regard to ensuring that institutional investors in the capital market behaved responsibly; there was also lax monitoring of doubtful practices by the commercial banks and their associated merchant banks.

FIGURE 3.3.5: SELECTED BANKS WITHDRAWAL-DEPOSIT RATIO AND RATE OF RETURN

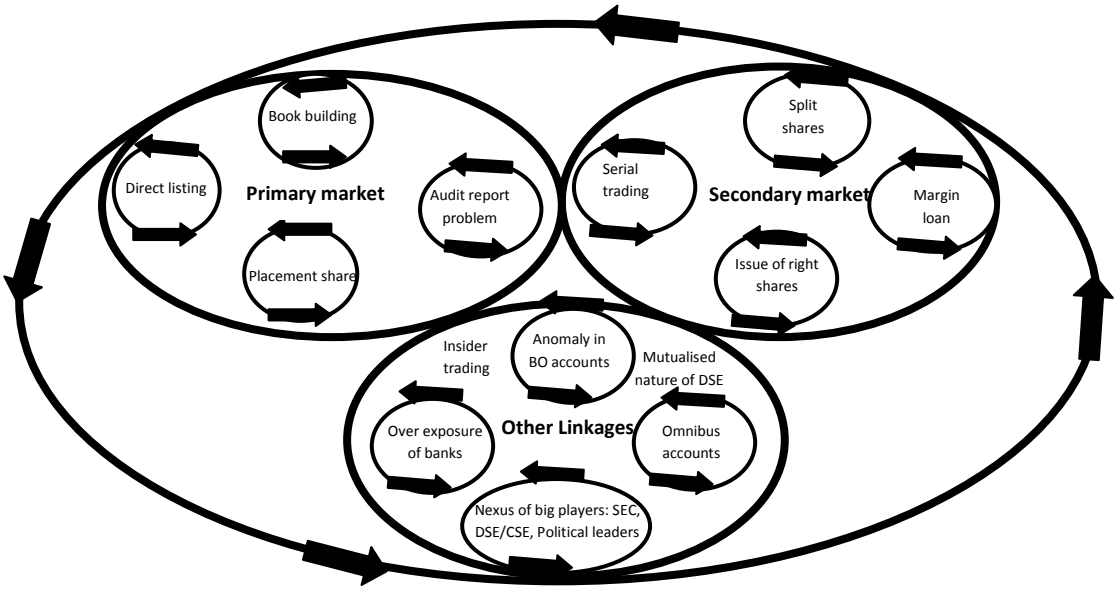


Source: Based on relevant documents

The above discussion reveals that Bangladesh's capital market has been seriously contaminated by 'toxic' elements in all three areas, i.e. primary market and secondary market and in terms of their linkage with money market. Although the SEC as a regulatory body bears the primary responsibility in failing to contain the toxicity in the capital market, weaknesses in enforcing financial discipline is also indicative of a lack of oversight on the part of the Bangladesh Bank and the Ministry of Finance. The coordination between different segments of the financial sector (i.e. money market, capital market and bond market) was not maintained as they should have been during the last two years. The 'National Coordination Council' under the Ministry of Finance was supposed to be the key body which was to meet on a quarterly basis to discuss these issues. Although the Council met periodically and discussed a number of issues, it did not, however, come up with any visible measures to contain the situation given its seriousness. It may be that these issues were not given due importance.

The interlinkages of fraudulent activities in different areas of the capital market in the end affected the overall operations of the market and made the market 'dysfunctional' to a large extent (Figure 3.3.6). A strong oversight mechanism could have discouraged this kind of activity. The expected restructuring and reform involving the capital market should be designed particularly to address the task of containing the aforesaid 'toxic' activities.

FIGURE 3.3.6: 'TOXIC' ELEMENTS IN THE CAPITAL MARKET



Source: Prepared by the authors

3.3.3 Overhauling of the Capital Market to Ensure Discipline in the Financial Sector: Challenges for Implementation

An overhaul of all aspects of the country's capital market needs to be urgently made in order to make it appropriately functional. This may be undertaken in several ways: a) strengthen coordination between different segments of the financial sector; b) investigation of fraudulent and illegal activities; c) restructuring and reform in the SEC, DSE/CSE; d) minimization of agency problems and other relations; e) proper enforcement of rules and regulations; and f) strengthening of regulatory measures.

The government has promised to act on the suggestions made by the probe committee and has disclosed its plan of action for the immediate, short and medium terms.[66]While the government has tried to address most of the issues raised in the probe committee report, the method of implementation, pace of progress and the outcome of the various measures undertaken till now, leaves doubt regarding the success of the action plan.

Maintaining financial discipline in the money market and strengthen its coordination with the capital market. There appears to be a serious misunderstanding which continues to pervade, with regard to the nature, role, function, management and governance of the capital market. This often explains some of the measures and policy positions taken by relevant institutions including the Ministry of Finance. The banking sub-sector of the financial market has a specific function to perform: mobilizing deposit and lending money and in general maintaining steady flow of money in the economy. Policy stance and policy support to other segments of the financial sector should not be at the cost of weakening the financial discipline in the banking sub-sector. Any measure targeting the capital market needs to be properly assessed by taking cognizance of its impact on the banking sector.

Investigation of fraudulent and illegal activities as identified in the probe report. A major test case in making the capital market properly functional would be the ability of the oversight body to safeguard small investors from manipulation by and unethical practices of operators.[67] It appears that the government has taken a 'go-slow' strategy in undertaking the required measures where more immediate measures were necessary. The government should immediately form a task force to initiate investigation into the fraudulent practices in the country's bourses(which could look into the following areas: direct listing of companies in the IPO; revaluation of companies shares; fixation of share value at a high level; improper use of book building system; providing placement shares to selected persons/companies where issuers, issue-manager, valuer, auditor, dealer, brokers were involved; and operations of serial trading, block trading in the secondary market where dealer, brokers, investors were involved). Considering the power-relations maintained by the big players within and outside

[66]The immediate actions were more related to disciplinary measures against some of the officials of the SEC and other organizations and enforcement of legal measures against government officials. Short term measures included introduction of new rules and regulations including making mandatory TIN documents to open BO accounts, preparing guidelines and regulations on several issues. Medium term measures include legal actions against institutions involved in fraudulent activities including merchant banks and formation of probe committee for further investigation on alleged cases identified by the committees.

[67] The probe committee has identified a number of cases of fraudulent activities including: a) direct listing of companies in the IPO b) revaluation of companies shares c) Fixation of share value at a high level d) improper use of book building system d) providing placement shares to selected persons/companies where issuers, issue-manager, valuer, auditor, dealer, brokers were involved; e) In the secondary market operations of circular trading, block trading, unexpected transactions where dealer, brokers, investors were involved.

the government, such investigations should be undertaken under the authority of the Ministry of Finance and legal measures can be taken under the SEC laws.

Restructuring and reform of the SEC. Management reform in the SEC should be geared towards strengthening capacity to perform its mandated tasks and capable of undertaking the required reforms. The size of the Commission could be increased to six to raise its functional capacity. The new management should act as a 'team' with individual and collective responsibilities. It is expected that the members of the new commission and all the officials of the SEC will submit themselves the disclosure with regard to their non-involvement in the capital market.[68]The new management may study cross-country experiences, particularly those of the Securities Exchange Bureau of India (SEBI) in such areas as monitoring of the market, market operations and management of the bourse.

The new management should immediately workout the major reforms to be undertaken under their tenure. The reforms should follow the work plan articulated by the Ministry of Finance and also take into account the outline mentioned in the Probe Committee Report. The SEC should admit that major anomalies have occurred in the capital market due to its oversight failure in terms of weak monitoring, poor surveillance, lack of ability to work effectively and also favouritism in certain cases. The probe committee report should be an important 'guidebook' in addressing the attendant tasks.

Anomalies in the secondary market were in many instances associated with anomalies in the BO accounts including use of multiple BO accounts by single account holders. The SEC should strengthen its internal inspection capacity to identify the problems related to BO accounts and take necessary legal actions against illegal activities under these accounts and ensure transparency in the use of the accounts. The SEC, in consultation with the government, should take necessary measures to make the submission of TIN document mandatory for all BO accounts. This would ensure transparency of transactions in the capital market and also submission of income statement to the NBR.

Furthermore strengthening SEC's human resource base should be a priority. This should be carried out in line with the professional requirements of the SEC in such areas as legal, audit, IT and inspection.[69]In order to attract competent professionals to the SEC, a market-based salary package should be offered to professionals.

Minimising agency problems involving various stakeholders/groups. Operations of the capital market were seriously affected by agency problems at different stages. This has happened because of the lack of distinction between responsibilities of different institutions, particularly with regard to non-separation of ownership and management, regulatory and facilitating activities, overall supervision and regulatory roles in the market. Consequently, small share holders' interests are not protected in the capital market. This needs to be reversed.

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[68] As per the office order of the SEC (issued on 11 April, 2010) none of the officials of SEC and their family members are allowed to be involved in the capital market. In India, SEBI has separate rules on this issue which is called 'code on conflict of interests for members of board'. Under this rule, the Commission members should immediately disclose information related to conflict of interests to the SEBI.

[69] The dearth of officials for the purposes of monitoring and surveillance is so acute that one round for monitoring of all the brokerage houses will require at least 10 years.

Demutualization at DSE/CSE with strong monitoring of the SEC. The separation of ownership and management of DSE/CSE from brokerage houses is required primarily to reduce problems associated with the day to day operation in the DSE. However, reports about malpractices by some members of the DSE management have raised doubt as to what extent the so-called demutualization will be able to address such concerns.[70]This implies that there will be a need for strong monitoring of the operation of the DSE after it is transformed into a private limited company. The process of demutualization should be completed within a stipulated time frame.

Strong coordination between SEC and DSE/CSE. Overlapping of activities of the SEC and the DSE/CSE needs to be avoided particularly with regard to market monitoring and surveillance and listing operations of companies etc. In case of market monitoring, the SEC should be fully equipped with modern computer-software system. In this context, the SEC should take necessary initiatives to implement the Asian Development Bank (ADB) project; the DSE and CSE need to improve market monitoring system by upgrading their respective computer systems.

Defining the nature and coordination of money market and capital market. In banking sector-led financial system, the nature and coordination between the money market and capital market should be well-defined. The capital market bubble in pre-December 2010 has had a deep impact on the operations of the money market and has damaged the integrity of the financial system. Although at the end of February 2011, the overall exposure of banks to the capital market was 3.72 per cent,[71] a number of banks were yet to comply with the mandatory level. The experience of the global financial crisis of the recent past and implementation of the BASELII rules have reemphasised the need for the separation of capital markets and the money markets. In this context, the government should amend the Bank Company Act with a view to reduce/stop banks' liabilities for investment in the capital market.

Reducing ambiguity in terms of responsibilities between Ministry of Finance, SEC and others. Given the current state of the market, the Ministry of Finance will need to play a proactive role in bringing discipline to the financial market and in strengthening the SEC. However, the ministry's role should not be involved with the day to day activities of the SEC as this may adversely affect the SEC's regular operations. Ministry of Finance should exercise its authority as the guardian of the country's financial health, without any pressure from any vested quarters. In view of the recent experience, the ministry should initiate investigation through forming of a dedicated task force. The Parliamentary Standing Committee of the Ministry of Finance could play an important role in overseeing the function of the ministry, but their advisory role should not create any conflict of interest with regard to

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[70] The probe committee report mentioned a number of weaknesses of the DSE. In case of listing of IPOs, DSE had a direct influence on raising initial price of the shares; there is conflict interest for DSE's involvement both as price fixer as well as enlistment of the companies, and also engaging officials of the alleged companies as investigators. The probe committee has reported the direct involvement of stock brokers and their employees in spreading rumors; serial trading, creating false demand for shares, leaking transaction information from DSE to influential peoples on a regular basis, leaking information from monitoring, surveillance and IT department as well as leaking information from CDBL. The delisting of companies have not properly undertaken by the two bourses. These fraudulent practices have raised concerns about the transparency and accountability of the DSE/CSE.

[71]The four state-owned banks held 3.21 percent of their liabilities or Tk 3,777 crore in the share market, and 4.84 percent of the 24 private commercial banks' liabilities or Tk 9,668 crore was invested in the capital market.

the primary task of maintaining discipline in the capital market, and the Committee will need to work within the parameters of its mandate.

Enforcement of rules and regulations

*Enforcement of rules and regulations in the SEC.*As yet **t**he SEC has not taken stern measures against fraudulent activities in the capital market as is evinced from the relevant records. In most cases the SEC has merely warned the companies/persons involved in such activities (51 per cent) or has provided directives asking the companies to comply with the rules and regulations (Table3.3.4).[72]In the past, the SEC's poor regulatory enforcement has allowed market players not to play by the rules and this will need to be corrected. More importantly, the SEC should be legally empowered to enforce appropriate measures at the proper time so that the market can work efficiently. The SEC, Bangladesh Bank and NBR should work together in order to ensure transparency in financial transactions in different segments of the financial system.

TABLE 3.3.4: VARIOUS LEGAL MEASURES UNDERTAKEN BY THE SEC AS REGARDS DIFFERENT COMPLAINTS

Year	Various Legal Measures Undertaken by the SEC (in percentage)										
	Stage 1 (Investigation stage only)	Stage 2 (Show cause)	Stage 3 (Warning)	Stage 4 (Directive issued to comply)	Stage 5 (Suspension/cancellation)	Stage 6 (Fine imposed)/ installment payable	Stage 7 (Prison sentence imposed)	Stage 8 (Petition rejected)	Stage 9 (Accused Acquitted / Case Withdrawn	Stage 10 Reduction in penalties/ other concessions	Total percentage
2002	0	0	14.3	0	0	60.7	0	25	0	0	100
2003	0	0	70.2	14.0	3.5	7.02	0	1.8	3.5	0	100
2004	0	7.1	21.4	45.2	0	14.3	0	2.4	9.5	0	100
2005	0	4.4	56.3	36.3	0	0	0	0.7	2.2	0	100
2006	0	0	59.7	31.2	0	0	0	3.0	3.3	2.7	100
2007	0.4	0.4	36.1	47.7	0	0.4	0	3.9	7.0	4.2	100
2008	0	0	58.9	28.3	0	4.6	0	1.7	6.4	0	100
2009	0.1	0.9	51.6	35.6	0.2	1.9	0	2.6	4.9	2.1	100
2010	0	6.3	46.6	29.4	0	0	0	10.9	6.7	0	100
Total in 10 years (%)	0.1	1.5	50.6	34.6	0.17	2.4	0	3.8	5.1	1.8	100

Source: SEC

Enforcement of rules and regulations by the commercial banks. Bangladesh Bank's stance at the early stage of rise of the crisis in the capital market has come under question, particularly in such areas as enforcing rules with regard to banks' exposure or single borrower exposure limit etc. This has happened because of weaknesses in oversight by the Bangladesh Bank and its failure to undertake timely decisions. Bangladesh Bank should restore financial discipline of defaulting banks particularly in terms of strict maintenance of the investment limit of bank's liabilities. More importantly, the Bank Company Act should be revised with a view to placing restrictions on investment of banks' liabilities in the capital market. It is hoped that Bangladesh Bank will take the necessary legal measures against the merchant banks which were involved in illegal activities.

[72] There have been very few cases over the years where companies have been fined or the chief executive has been imprisoned or suspended.

Strengthening the Legal Base of the Capital Market. The Probe Committee report speaks of a number of fraudulent practices in the capital market which appeared to be unethical but not illegal because of the absence of appropriate legislation. To address some of these, new legal provisions will need to be introduced such as in case of placement shares and preference shares. Provisions should also be there so that operation of all transactions under the omnibus accounts are carried out through specific BO accounts. Audit firms should operate under a legal framework that places responsibility for the financial statement of the company on the audit firm itself and includes punitive measures for providing inaccurate information and statements.

Appendix3.3.4 presents comparative analysis of legal measures currently in existence in some of the neighbouring countries. Bangladesh, as in many other countries, has the required laws in place to deal with most of the illegal activities. The punishment under these laws is also not much different than other countries. The issue in most instances is one of enforcement. However, in some cases, introduction of new laws may be necessary in view of the emergent situation and taking into cognizance fraudulent activities which are not covered by existing laws. In view of this, there is a need for giving more attention to overcome the weaknesses in establishing adequate discipline in the capital market.

3.4 INFLATION, PRICES AND FOOD SECURITY

3.4.1 Recent inflationary trends

The increasing inflationary trend that began to show up since the second quarter of FY 2009-10 continued throughout FY 2009-10 and FY 2010-11. The 12-month point to point consumer price index (CPI) inflation has again reached the double digit level, at 10.67 per cent in April 2011 compared to 8.54 per cent in April 2010. This is the highest level since July 2008 when 12- month point to point inflation rose to as high as 10.82 per cent. As before, the source of such high inflation is the high food inflation which reached 14.36 per cent in April 2011 as opposed to 10.47 per cent in April 2010. The weight of food items in the commodity basket of Bangladesh is as high as 58.8 percent, of which the share of rice is around 20 per cent. Hence the rise in food inflation affects the overall inflation significantly. Based on BBS data it has been estimated that the contribution of food inflation to overall inflation was 68.7 per cent in FY 2009-10 (CPD 2010). The global price hike of essential commodities and pressures on domestic demand have contributed to such high inflation.

Contrary to food inflation non-food inflation rate declined to 3.97 per cent in April 2011 from 5.46 per cent in April 2010. This is somewhat paradoxical since this trend does not follow the price behaviour of commodities in the market. Prices of food and non-food items tend to move along the same direction though at a different pace. Increase in food prices act as an impulse for non-food prices to be pushed upward. In case of Bangladesh this happens very quickly and visibly. The mystifying trend of non-food prices as opposed to food prices calls for a revisit of the methodology of categorising and weighing non-food items.

Another striking feature of recent inflation is that rural food inflation has surpassed urban food inflation which was not the case in Bangladesh till August 2010. Plausible causes for rural inflation could be high purchasing power of the rural population through increased agricultural production, higher labour wages, expanded social safety net programme and inflow of remittances.

In the South Asian context, Bangladesh stands second, next to Pakistan only, in terms of inflation. Though there has been gradual rise of inflation in all South Asian countries, Bangladesh surpassed them recently. Despite higher food price in the international market, India has been able to keep its food price index down through higher production of major crops and ensuring adequate supply in the domestic market.

3.4.2 Measures to rein inflation

In its Monetary Policy Statement of Bangladesh Bank for the period July to December FY2011, Bangladesh Bank targeted for an inflation rate of 7.0 per cent by the end of FY 2011 through discouraging credit flow to unproductive sectors. At the time of the announcement of the MPS monetary aggregates were already on increasing trends. But the MPS declared only an ‘accommodative policy for productive economic activities’ without any specific measures to control money supply.

At present both money supply and domestic credit remained above the target levels of Bangladesh Bank. This is due to commercial banks’ non-compliance to maintain the required credit deposit ratio (CDR) of minimum 81 per cent of their total deposits. Bangladesh Bank overlooked that some banks crossed the CDR and went up to as high as 94 per cent at some points of time. A large amount of money was diverted to the capital market exceeding the exposure limits of banks. It is also observed from the structure of loans and advances (Table

3.2.5 in section 3.2) that rise in consumer spending in unproductive sectors such as for real estate and flat purchase had contributed to high CPI inflation.

In a move to control such diversions and unproductive use of funds Bangladesh Bank used its monetary policy tools more frequently than before. The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), and rates of repo and reverse repo have been raised a couple of times in the current fiscal year (see details in the section on Financial Sector). These moves however, were effective neither in controlling liquidity expansion, nor in saving the capital market from its collapse. One of the reasons is that there was an oversight failure on the part of the central bank to take timely measures. When policy rates were raised the overexposed banks had to withdraw their investment from the capital market to be compliant. This created a pressure on the liquidity situation. To discourage loans to unproductive sectors Bangladesh Bank has also withdrawn the lending cap with the hope that this may give some respite on the high inflationary trend.

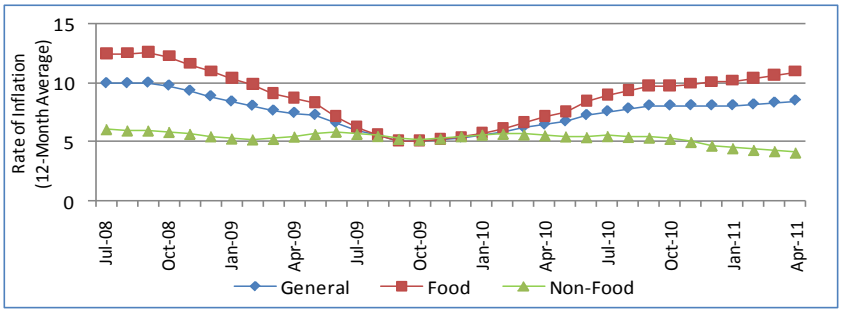
The other important tool for macroeconomic management, exchange rate, has been undergoing some changes as well. Taka has been depreciating almost against all major currencies during the last six months (November 2010 to April 2011). Exchange rate of Taka per USD increased to BDT 72.85 at the end of the April 2011 from Tk.69.36 at the beginning of the FY 2011. Taka depreciated around by 5 per cent in the first ten months of the FY 2011. Larger import payment, stagnating net FDI, lower flow of foreign aid and decelerated remittance have contributed to the depreciation of Taka. While good for exports, depreciation of taka will make imports costly which is likely to be transmitted to domestic prices and inflation.

Along with monetary measures a number of fiscal measures are being taken by the government to bring prices at a 'tolerable' level and make food available to a large section of people (detail in the section on Food Prices). While these have to be expanded in the short term, there should also be measure for medium and long term plans for increasing food productivity through technological innovation and increasing the purchasing power of people by way of ensuring sustainable employment and income.

3.4.3 No magic bullet to control inflation

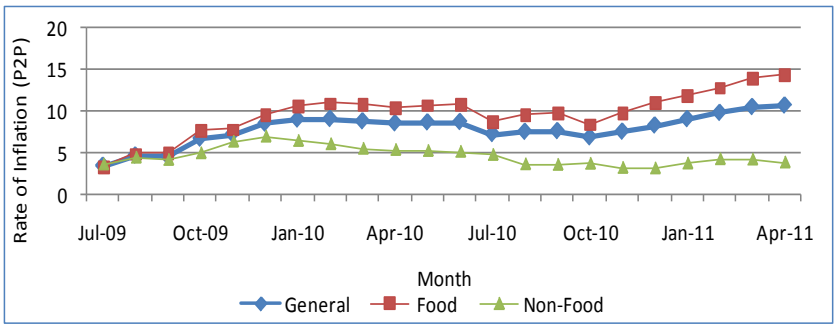
Given the present domestic and global economic situation, an isolated monetary policy measure will not succeed in controlling inflation. Also if not applied timely, monetary measures lose their effectiveness. The experience of the capital market and the liquidity pressure in the recent past indicate that the situation could be brought under control to a large extent by taking the measures at an opportune moment. As the nature of inflation in Bangladesh is one which is influenced by structural factors more than monetary factors a blend of fiscal and monetary measures and a timely coordination between the two are essential so that they fit into the overall macroeconomic management framework.

FIGURE 3.4.1: GENERAL INFLATION RATE (12-MONTH AVERAGE)



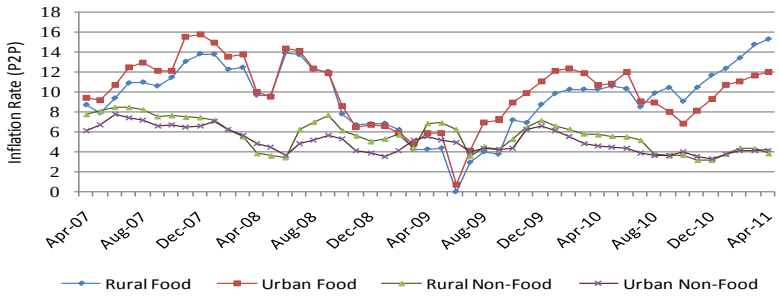
Source: Bangladesh Bank.

FIGURE 3.4.2: POINT TO POINT (P2P) INFLATION RATE



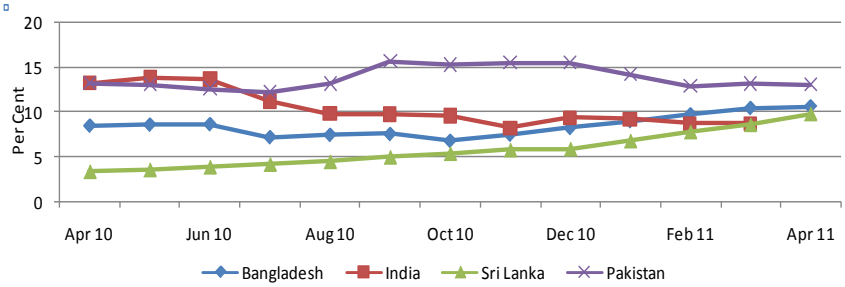
Source: Bangladesh Bank.

FIGURE 3.4.3: RURAL AND URBAN INFLATION RATE (P2P)



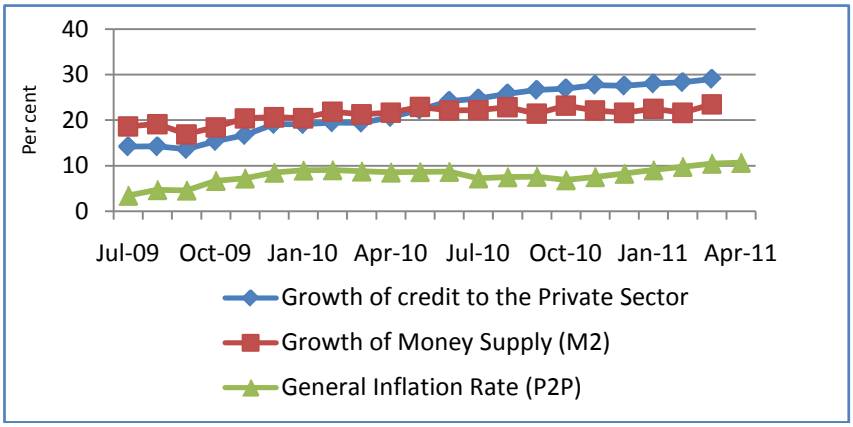
Source: Bangladesh Bank.

FIGURE 3.4.4: POINT TO POINT (P2P) INFLATION RATE IN SOUTH ASIA



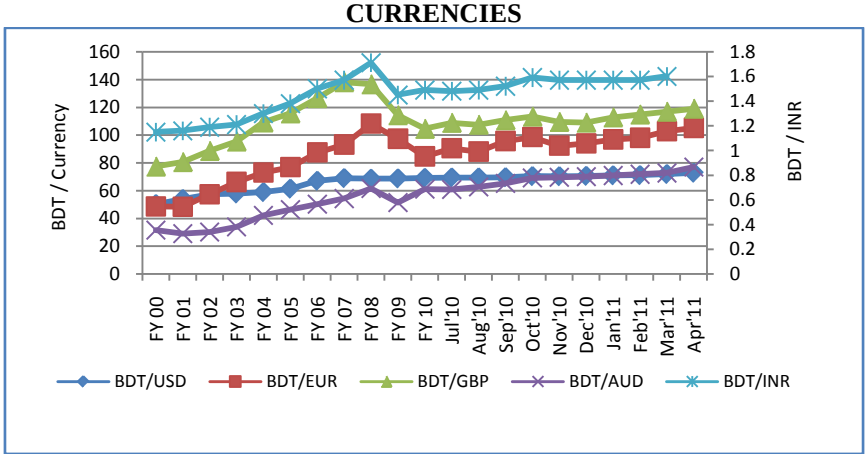
Source: Central Banks of Bangladesh, Sri Lanka and Pakistan; Ministry of Statistics and Programme Implementation of India.

FIGURE 3.4.5: GROWTH OF PRIVATE SECTOR CREDIT, M2 AND INFLATION RATE



Source: Bangladesh Bank.

FIGURE 3.4.6: EXCHANGE RATE OF TAKA AGAINST VARIOUS CURRENCIES



Source: Bangladesh Bank.

3.4.4 Volatility in the Prices of Essential Commodities

Prices of essential commodities have been increasing secularly in both local and global markets. This price hike reminds of the period of global food crisis of 2008 when prices of all essential commodities reached the ever highest level in Bangladesh. In this sub-section the extent and causes of the recent price hike of three essential commodities are examined. These are rice, wheat, and soybean oil which had been selected for analysis since there demand tends to be inelastic and a significant amount of these items are sourced from the international market.

Rice price increased due to inefficient market management

Rice market has been most volatile in Bangladesh. The retail price of coarse rice in local market has reached Tk.35.3/kg in January 2011, exceeding the price of April 2008 (Tk.34.57/Kg) which was the highest till this period. It may be recalled here that from November 2009, prices had started to decline; price was Tk20.42/kg in April 2010, lowest since this time. However, prices crossed Tk30/kg again in July 2010 and have continued to rise since then (Figure 3.4.7). It is observed that the extent of increase in average retail prices

of rice in the local market was higher in FY2011 than FY2008. Between July-May of FY2008 and July-May of FY2011 rice price increased by 23 per cent in the local market.

The conventional demand supply gap theory will not perhaps be adequate to explain the recent volatility in the rice market in Bangladesh. The rice price volatility during the food crisis in 2008 was mainly explained by the rise of prices in the international market, collusion of market agents (both at importers and intermediate level), institutional weakness, and dislocation of the market structure due to anti-corruption drive. However, the situation in FY2011has changed significantly.

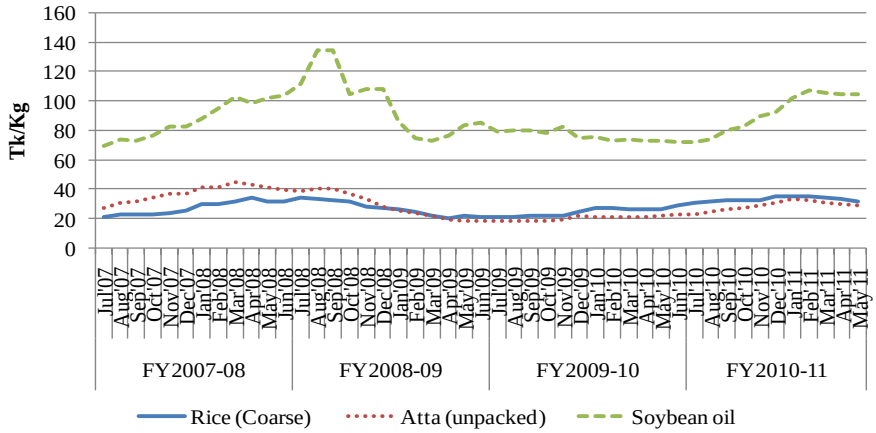
A closer look at the international rice market reveals that the market was comparatively stable in FY2011 compared to FY2008 when the price rose to USD1025/MT (in April 2008). The average price of rice (Bangkok, FoB, 5% parboiled) in the international market decreased by 3.1 per cent between FY2008 and FY2011 (Figure 3.4.8). Similarly, rice (FoB, 5% parboiled) price in Vietnam decreased sharply by 19.64 per cent between FY2008 and FY2011. However, comparison of international prices between April 2011 and April 2010 shows a rise of a mere 1.80 per cent. This implies that the recent rice price hike in the local market may not be fully attributable to the international market price.

The recent hike of rice price in Bangladesh thus could be the result of poor market management. The government has procured only 295 thousand MT of rice in FY2011 which was the lowest since FY1994. Instead, the government has gone for importing rice from the international market[73]at prices that were higher than is paid by the private importers. For example, it has signed an agreement to import 250 thousand MT of rice from Vietnam in March 2011 (through government to government contract) at a price of USD575/MT while private importers have imported rice from Vietnam at a price of USD420-430/MT (from private suppliers) which was much lower than the government's price.

Procurement price plays an important role in setting rice price in the local market. In the last boro season, the government initially fixed the rice purchase price at Tk.25/kg and that of paddy at Tk 17 per kg. The millers declined to procure rice at this price and demanded additional premium on the ground that the prevailing market price was higher than that of the procurement price. Afterward, in July 2010, the government revised the decision and offered an additional Tk 3.0/kg as premium price to the millers. This additional price played significant role in making the local rice market unstable. The movement in prices in the local market reveals that the retail price of rice started to rise at a higher pace after the said of the government (Figure 3.4.7). Between May and July 2010, rice price increased by 18 per cent, which was the immediate impact of this decision.

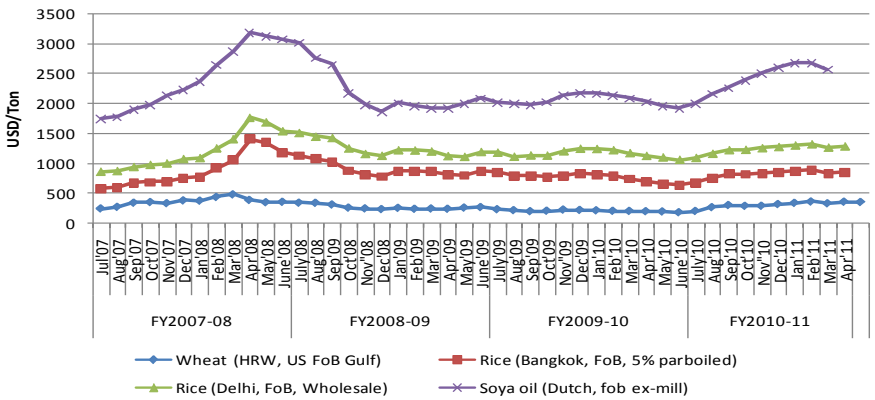
[73]It has imported 1068 thousand MT of rice until mid-May 2011 which was only 29 thousand MT during the same time of previous year, and 187 thousand MT in FY09.

FIGURE 3.4.7: MONTHLY RETAIL PRICE OF THE ESSENTIAL COMMODITIES



Source: Department of Agricultural Marketing.

FIGURE 3.4.8: INTERNATIONAL PRICES (FOB) OF RICE, WHEAT AND SOYBEAN OIL



Source: ERS, USDA for rice, FAO for wheat and soybean oil, and http://fcainfoweb.nic.in/Prices_Application/weekly_prices/front_data_of_month.asp for Delhi rice price.

Wheat and soybean oil prices followed global trends but at different extent

Bangladesh meets the demand for *atta* mainly by importing from the international market. For example, 71 per cent of wheat demand was met by importing from the international market in FY2009 which increased to 76 per cent in FY2010. In 2010, the production of major wheat exporting countries fell due to severe drought. As a consequence, global supply of wheat reduced significantly. Moreover, two major exporters, Russia and Ukraine restricted export of wheat from respective countries which aggravated the situation. The price of wheat in the international market has increased by 80.84 per cent between May 2010 and May 2011. The volatility in the international market soon transmitted to the local market as well. The retail price of atta (unpacked) in local market has increased by 30 per cent between May 2010 and May 2011. Prices reached the ever highest level in March 2008 which was Tk.45/kg (Figure 3.4.7). It is only after November 2008 that prices started to fall and reached the lowest level of Tk.18/kg in June 2009. However, the price of atta crossed Tk.30/kg since December 2010 and still continues to rise. The recent hike in prices of *atta* can be explained to a large extent by the rise of price in the international market. To keep the *atta* price at tolerable level, the government started to sell *atta* through OMS by increasing import of

wheat in the current fiscal. It has imported 797 thousand MT of wheat until the third week of May 2011 which was 60 per cent higher than that of last year. The intervention by the government through OMS helped to reduce volatility in the wheat market.

The retail price of Soyabean oil in the local market started to increase since August 2010; this has continued till now (Figure 3.4.7). Between July 2010 and March 2011, soybean oil price has increased by 44 per cent in the international market whilst it has increased by 46 per cent in the local market. The price hike in the international market was due to bad weather in major exporting countries.

Higher prices of crude oil and chemical fertilizer have pushed food prices further

Prices of agricultural input such as crude oil and chemical fertilizer are also increasing in the international market but at a slower pace than in 2008. Prices of Urea, DAP, TSP, and MoP have increased by 35, 32, 44, and 32 per cent respectively between April 2010 and April 2011. However, these prices were still lower by 28, 49, 48, and 13 per cent respectively in April 2011 when compared to the levels in April 2008. Political unrest in major oil exporting countries and speculations in commodity futures market have raised crude oil prices which encourages to use biofuels and ethanol as alternate sources of energy. This could have a negative impact on food supply and food security. The price of crude oil increased to USD120/barrel in April 2011[74] which was closer to the ever highest level of USD132.5/barrel in June 2008. It may be mentioned here that the price of crude oil increased by 54 per cent between May 2010 and May 2011. Between May 2009 and 2011 crude oil prices made a big jump, almost doubled from USD56/barrel to USD117/barrel. Indeed, globally, rise of food and fuel prices in tandem is a new phenomenon.

New factors played a significant role in pushing up prices in both local and global markets

During the period of global food crisis, prices increased mainly due to production shortfalls, excess demand from emerging economies, conversion of food items into biofuels and export restriction by leading food exporting countries. Some of these factors are still working as major catalysts to raise prices. However, political unrest in the Middle East has become an added phenomenon. High prices of crude oil increased the food transportation cost. It also encouraged the conversion of food items into biofuel production. Moreover, the strong recovery of many emerging economies from the global economic crisis also raised global demand which eventually pushed the prices of essential food items up.

3.4.5 Production and availability of food grains in FY2010-11

Bumper production and higher price: an apparent dilemma

Rice production is expected to achieve a growth rate of 5.20 per cent in FY2010-11. Bangladesh Bureau of Statistics (BBS) has recently released data on aus and aman production. According to BBS, the production of aus in the current season is 1.97 million MT which was 15.45 per cent higher than that of the last season (1.70 million MT). Aman observed a good harvest of 12.79 million MT in FY2010-11 which was 4.78 per cent higher than the previous fiscal year but 5.54 per cent lower than the target (Table 3.4.1). Farmers have already started to harvest boro in different parts of the country. Initial observation indicates that the boro production is going to achieve the target of 19.16 million MT. Various government measures (fertilizer and diesel subsidy, input assistance card, credit availability

[74] Prices have started to come down, albeit by insignificant amount, in recent weeks.

etc), favourable weather and the expectation of higher price have contributed towards achievement of the targeted production. However, wheat production may fail to achieve the target. Unofficial estimates of the DAE reveal that the production of wheat may fall below the amount of the previous year.

TABLE 3.4.1: AREA, PRODUCTION AND YIELD OF FOODGRAIN IN FY2010-11

(*area in '000 acres, production in '000 mt, and yield in mt/acre)*

	FY2008- 09			FY2009-10			FY2010-11			Growth in Production FY2010-11
	Area	Production	Yield (MT/acre)	Area	Production	Yield (MT/acre)	Area	Production	Yield (MT/acre)	
Aus	2633	1895	0.72	2965	1709	0.58	2990	1973	0.66	15.45
Aman	13585	11613	0.85	13994	12207	0.87	13952	12791	0.92	4.78
Boro	11654	17809	1.53	11861	18341	1.55	11985	19169	1.60	4.51
Total Rice	27872	31317	1.12	28820	32257	1.12	28927	33933	1.17	5.20
Wheat	975	849	0.87	1050	901	0.86	1025	1162	1.13	28.97
Total	28847	32166		29870	33158		29952	35095		5.84
Growth	6.5	8.03		3.55	3.08		0.27	5.84		

Source: CPD calculation based on data from BBS. ***Note:*** Figures of boro and wheat in FY2010-11 are projected.

In the backdrop of recent debate, an attempt has been taken to investigate the reliability of the rice production data. From the analysis, it is seen that the impressive growth of rice production in recent years is in line with historical trends. The average growth in production of rice was 3.71 in the 1970s, 3.03 in the 1980s, 3.09 in the 1990s, and 3.83 in the 2000s. Due to higher productivity, rice production has been on the rise. Access to second generation technology, higher factor productivity, availability of agricultural inputs, use of high yielding varieties, better irrigation facilities, and significant and continuing government support have played a crucial part in, and contributed to, this sustained growth. A closer look at the following factors may also clarify the argument further.

1. *Area:* The average growth in rice producing area has decreased to 1.08 per cent in the current decade (FY2002 to FY2011) from 1.24 per cent in the decade of FY1972-1982. Despite the lower growth of area in recent decades rice production has increased mainly due to higher productivity. It is observed that, the yield rate of rice has increased from 1.20 MT/hectare in the decade of FY1972-1982 to 2.61 MT/hectare in the current decade (FY2002 to FY2011).
2. *Use of chemical fertilizer:* Available data shows that the use of chemical fertilizer has increased significantly between the periods of FY1971 and FY2011. It is mentionable that consumption of different fertilizer in FY1971 was 3043 MT which increased to 4621 thousand MT in FY2010.The government started to provide heavy subsidy for chemical fertilizer since the beginning of 1990s. The average growth rate of chemical fertilizer use in the 1990s was 5.75 per cent. Though lower than the 1990s, it is still high (4.36 per cent) in the current decade. It may be noted here that the use of chemical fertilizer has increased by 2.26 folds between FY1990 and FY2010.
3. *Agricultural credit:* Availability of agricultural credit also played significant role in raising rice productivity over the last 20 years. For instance, the amount of agricultural credit increased by16.2 times between FY1990 and FY2010. The average growth of agricultural credit was 15.4 per cent throughout the last 2 decades. It may be mentioned here that, the present government has intensified agricultural credit disbursement. In the last three years (FY2008-FY2010), the average growth of agricultural credit was 30.0 per cent whilst it was only 9.9 per cent over the previous 3 years (FY2005-FY2007).

4. *Irrigation:* Similarly, rice area under irrigation has increased significantly in the last two decades. An area of 2,406 thousand hectares of land was under irrigation in FY1990 which increased to 4784 thousand hectares (almost doubled) in FY2008. Significant government subsidy for diesel also provided incentive in terms of more area under irrigation.

Even though the production of rice followed historical trends over the last couple of years, prices in the local market followed a somewhat different pattern. For example, the price of coarse rice in retail market went up by 6.49 times between FY1981 and FY2011. The average growth rate of rice price was 3.0 per cent in the 1990s which increased to 9.35 per cent in the 2000s and was 16.15 per cent in the last five years. Thus, even with a comfortable level of production, why such significant volatility in rice prices was being observed in the local market, over the last 5 years, is a puzzle that needed to be thoroughly investigated. The rice balance sheet of Bangladesh clearly indicates a surplus in rice production since FY2006 (Table 3.4.2). In a rice surplus situation a country should not be importing rice. Surplus in rice production in the country and import of rice at the same time give rise to some confusion as regards the actual population size and the attendant demand of the country.

TABLE 3.4.2: RICE AVAILABILITY AND REQUIREMENT IN BANGLADESH: 1991/92 TO 2010/11

(in thousand metric tons)

Fiscal Year	Domestic Production (Gross)	Net Rice Production (deduct 10% for Seed Feed and Wastage)	Mid-year Population (million)	Rice Consumption Requirement **	Rice (Surplus)	Private Imports	Public Distribution	Domestic Procurement	Net Domestic Availability	Per Capita Availability (gram/day)
1991-92	18252	16427	113	19497	-3070	0	759	959	16227	398
1992-93	18341	16507	115	19842	-3335	0	475	227	16755	393
1993-94	18041	16237	117	20187	-3950	74	350	148	16513	380
1994-95	16833	15150	119	20532	-5382	584	329	246	15817	349
1995-96	17687	15918	121	20506	-4588	650	592	330	16830	360
1996-97	18882	16994	123	20845	-3851	15	739	512	17236	379
1997-98	18862	16976	125	21184	-4208	993	529	399	18099	372
1998-99	19905	17915	127	21523	-3608	2660	530	496	20608	386
1999-00	23067	20760	128	21692	-932	428	876	756	21308	444
2000-01	25085	22577	130	21758	819	529	984	823	23266	476
2001-02	24299	21869	132	22092	-223	118	648	726	21909	454
2002-03	25188	22669	133	22260	409	1553	761	816	24167	467
2003-04	26189	23570	135	22595	976	797	496	828	24035	478
2004-05	25157	22641	137	22929	-288	1197	1103	898	24043	453
2005-06	26530	23877	139	22303	1574	498	803	944	24234	471
2006-07	27312	24581	141	22560	2021	695	1288	1139	25425	479
2007-08	28931	26038	142	22849	3189	1681	1309	870	28159	501
2008-09	31317	28185	144	23137	5048	187	1788	1449	28712	536
2009-10	32257	29031	150	24004	5027	37	1311	703	29676	532
2010-11*	33933	30540	151	24293	6247	291	1453	295	30267	553

***** Figure of boro rice in domestic production in FY2010-11 is projected. Private import, domestic procurement, and public distribution data are up to mid May 2011.

****** (439.6 gm/day/capita from 2005/06 and onward, 458.54 from 2000-01 to 2004/05, 464.3 from 1995/96 to 1999/00, and 472.7 from 1191/92 to 1994/95).

Source: CPD estimation based on data from FAO, BBS, DAM, DAE, and FPMU.

3.4.6 Policy responses and challenges ahead

Fiscal and policy tools to arrest the rise in price. Earlier the GoB had banned export of rice in December 2009; this ban is still in operation. The government has allowed the duty-free import of rice and wheat since 2008. These decisions should be continued. Sugar export has also been banned in February 2011 when prices started to rise in the international market. It is expected that this export ban will help to keep the sugar price at a tolerable level during the upcoming Ramadan. The government also reduced VAT on edible oil by 5 per cent in FY2011. Considering the volatility in the global market, the government may reduce this rate further as was done during the global food crisis in 2008. Bangladesh Bank has instructed commercial banks to provide credit at a subsidized rate to food importers. In order to increase government intervention in the market of essential commodities, the government may create a new agency which could be named as "Department of Market Surveillance (DMS)" with a mandate to supervise the daily essential commodities market. Moreover, strengthening of the trading corporation of Bangladesh (TCB) still remains an unfinished agenda.

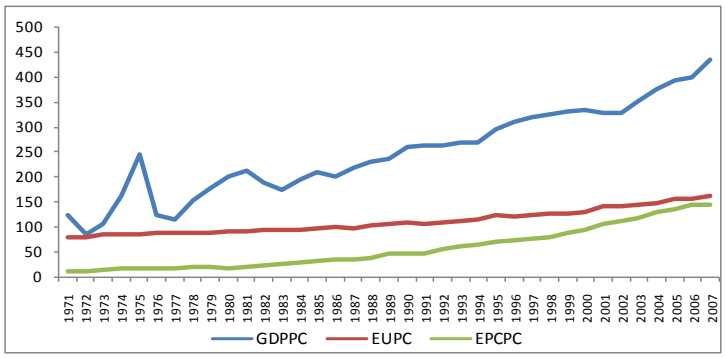
Higher boro procurement will help to increase government's command over rice market. Increasing domestic stock is an important mechanism to influence the market. The government decided not to procure aman in the current season on the ground that it may push up the price and inflation further. The existing market price was also adequate to ensure fair price to farmers. But at looking back, it appears that the decision of not to procure aman was not a justified decision. The government had to import rice from the international market at a higher price which created pressure on the BOP account and pushed inflation further. However, the government has now decided to procure six lac MT of boro rice at Tk.29/kg. It has decided to purchase rice, not paddy, which is likely to benefit the millers more. Millers will have a considerable say on the price at which they will purchase paddy from the farmers. In order to ensure the benefit of farmers, the government should procure both rice and paddy. Since the government's rice storage capacity is limited in the current season it may keep the paddy in the chatal (storage facilities of millers) and may give a premium of Tk1/kg for to millers for expenses in connection with storage.

Widened social safety-net programes help to ease the burden of price hike. In order to ensure food security, the government is conducting intensive public food distribution operation throughout the country, with higher coverage in the current fiscal year. It has targeted to distribute 2.73 million MT of foodgrain in FY2011 which is 39.28 per cent (1.96 million MT) higher than the previous fiscal year. During the first ten months of the current fiscal year, 1.80 million MT of foodgrains had been distributed under various channels of Public Food Distribution System (PFDS) which was 1.42 million MT during the same period of the last year. During the first ten months, 66 per cent of the distribution target has been achieved. This is 27 per cent higher than that was distributed in the same period of last year. In this season, the government has begun Open Market Operation (OMS) program at an early date in response to the price hike. OMS was introduced in Dhaka city, Gazipur, Narsingdi, Narayanganj and Savar on 25 December 2010, and elsewhere on 01 January 2011. The government is also distributing foodgrains among the fourth-class government employees since February 2011. Besides, foodgrain distribution is taking place among the Fair Price Card holders across the country through which each card holder can purchase up to 20 kilograms of foodgrain, rice at a price of 24 Tk/kg and wheat at 20 Tk/kg.

3.5 ENERGY AND POWER

It goes without saying that for an emerging economy such as Bangladesh, availability of and access to energy and power is crucial to her economic growth and development. Although the economy has been able to achieve a moderate GDP growth since 1990s, per capita consumption of both energy and power has continued to remain one of the lowest in the world. A decomposition of the rate of growth in energy consumption shows that over the past years growth of energy was even lower than that of power in Bangladesh (Figure3.5.1). On the other hand, though power consumption in recent years has been higher than energy consumption, it is rather very low compared to the demand.

FIGURE 3.5.1: PER CAPITA GDP (GDPPC), ENERGY USE (EUPC) AND ELECTRICITY CONSUMPTION (EPCPC) IN BANGLADESH (1971-2007)



Source: Using data from WDI (2011)

Power and energy sectors continued to remain as one of the most challenging areas in Bangladesh, despite many recent initiatives. It is true that a basic economic infrastructure such as the power and energy sectors did not receive the required policy attention in Bangladesh until 2008, when the then Caretaker Government took some important policy decisions in this connection. The present government has designed a 'mega power plan'[75] to increase investment in power generation and distribution, mostly in the private sector. Besides meeting immediate requirements by commissioning a number of rental and quick rental power plants, the plan has also given high priority in establishing some large combined cycle and coal-based power plants in the country for a long term solution of the on-going power crisis. Despite certain visible success in power generation capacity in the country (by 1553 MW since 2009), failure in terms of timely delivery by a number of rental and quick rental plants and production stoppages of many of the aged power plants have watered down the success in power generation recent months. Questions have also been raised with regard to the effectiveness of increasing power subsidy, particularly for quick rental plants. The delay in initiating local coal-based power generation, has also come under scrutiny as also the slow progress with regard to the required infrastructure development to facilitate fuel import and supply. On the other hand, the slow progress in the energy sector continues to take a heavy toll on the economic performance of the country. The main reason for current energy crisis is the lack of availability of primary energy and indecision in extracting local energy resources in time. On a positive note, the present government has taken a number of initiatives to strengthen the capacity of BAPEX for gas exploration and extraction and also invited some foreign firms to explore energy in some of the off-shore and on-shore blocks in

[75] Despite the 'Mega- Plan' an over ambitious one and seems to be very difficult to implement within 2016, given the power crisis in the country it was largely welcomed as it expected to improve the situation fast.

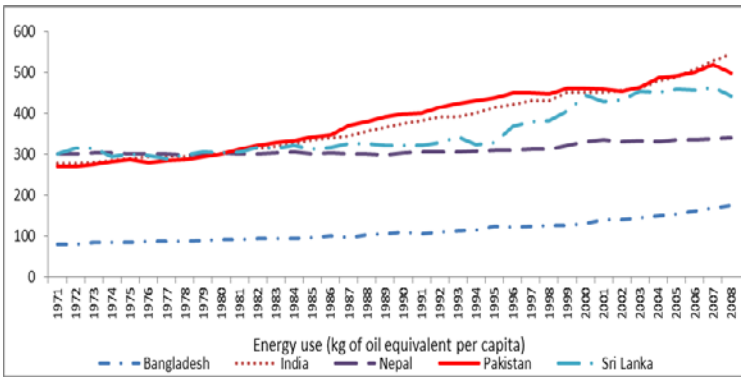
recent months. If things go smoothly, it can be expected that by the end of 2012 the situation would improve somewhat; from 2015 the gas shortage is also expected to be reduced. As it happens, extraction and use of local coal for energy and power generation remains a taboo subject, with no clear indication as to the thinking of the government. This indication may prove to be costly and may seriously undermine the long term growth prospects in power and energy sector of the country.

3.5.1 Energy Sector

An Overview of the Energy Sector in Bangladesh

Bangladesh remained one of the least per capita energy consuming economies in the world, even after 40 years of its independence. Energy consumption by many South Asian economies, such as Nepal (340 kg of oil equivalent), is more than what Bangladesh consumes (175 kg of oil equivalent in 2008). A comparative picture of energy consumption by some selected South Asian economies is presented in Figure3.5.2.

FIGURE 3.5.2: A COMPARATIVE ANALYSIS OF ENERGY USE AMONG THE SELECTED SOUTH ASIAN ECONOMIES



Source: WDI, 2011

The average annual growth of energy consumption in Bangladesh for the period of 1971 to 2008 is found to be a mere 2.17 percent. On the other hand, the demand for energy consumption in the country has tended to increase at a much faster pace than the supply. Moreover, the recent emphasis on power generation through rental and quick rental plants has only exacerbated the crisis, as these are mostly small scale enterprises which have limited capacity to make a dent on energy gap.

Energizing the Energy Sector in Bangladesh: A Hard Time Ahead!

Poor energy consumption in the country is perceived to have serious implications for her economic growth as power generation and GDP growth are closely related. An attempt has been made by CPD to estimate the short and long run causality between per capita energy consumption and per capita GDP in Bangladesh using data covering the period of 1971 to 2007. It is observed that a 1.0 per cent increase in per capita energy use could lead to an increase in per capita GDP by about 0.23 per cent in the long-run, and 0.45 per cent in the short-run. Results also show that the relationship between per capita energy use and per capita GDP is unidirectional. This would indicate that energy use is critical to per capita GDP growth of Bangladesh. This would also imply that strengthening energy situation would be a pre-requisite for achieving the projected high GDP growth envisaged in the Sixth Five Year Plan. This appears to be quite daunting and challenging at this moment unless things do not improve drastically over the coming months.

In this backdrop, an analysis has been carried out here to estimate required change in energy use to attain the GDP growth targets envisaged in the Sixth FYP period (for the remaining four fiscal years only). Results of this analysis are presented in Table3.5.1.

TABLE 3.5.1: REQUIRED CHANGE IN ENERGY USE IN BANGLADESH TO ACHIEVE GDP GROWTH TARGETS FOR FY2011-12 TO FY2014-15[76]

FY	Energy Use-Base Case (%)	Energy Use-Medium Case (%)	Energy Use-High Case (%)
2011-12	10.69	11.19	12.02
2012-13	11.19	11.69	13.36
2013-14	11.52	12.53	14.20
2014-15	11.86	13.36	15.03
Average	11.16	11.92	13.09

Source: Author's estimation using data from WDI, 2011

As per the findings presented in Table3.5.1, in the base case scenario, ***the average energy use in the economy should be increased by about 11.0 per cent, whereas for achieving the high case GDP growth targets, energy use should be increased by over 12 per cent per year.*** In view of the slow growth in the energy sector, the projected high GDP growth rate in the SFYP will be hard to achieve.

Moreover, the current practice of energy use composition in Bangladesh with its high dependence on imported liquid fuels, as well as locally produced natural gas make the situation much more difficult. Such difficulties arise in part from fiscal limitations that inhibit more intensive exploration of primary energy; increasing oil price in the international market is also another contributing factor. On the other hand, generation of energy from renewable sources and achievement of higher energy efficiency in the economy will also not be very easy given other limitations. Recent initiatives taken to revamp power sector and increased dependency on liquid fuels for quick rental plants have put an extra pressure on the demand for energy in the economy, and thus will require additional subsidy. Thus, it appears that maintaining a balance between a comfortable energy supply and a reasonable level of subsidy for the sector will entail a difficult balancing act on the part of the government.

An Assessment of the Recent Initiatives Taken in the Energy Sector

Recently the government has taken a series of initiatives to overcome the energy crisis through strengthening of local exploration and production of gas in both on-shore and off-shore blocks, including additional extraction from the existing fields through workover. Since 2009, daily gas production in the country has been increased by 284 mmcf, mainly from gas augmentation by workover, remedial works in major gas fields such as Bibiyana (140 mmcfd), Habiganj (32 mmcfd), Bangura (30 mmcfd) and Titas (22 mmcfd). The present government has taken a number of short-term, mid-term and long term initiatives to reduce the gap in gas supply thrugh workover in wells at Habiganj, Titas, Meghna, Kailastilla, Bakhrabad and Sylhet (short-term). An increase in gas production by 1285 mmcfd has also been targeted from the two new wells, 5 explorations wells at Sundelpur, Senetra, Srikail, Kapasia and Mobarakpur, 24 development/ appraisal wells and 3 more workovers at Semutang and Rashidpur. In spite of this increase, the demand-supply gap at present remains over 500 mmcfd. Given the fact that country's gas use has increased from 10.05 per cent from the period between FY2001-02 and FY2007-08 to 13.76 per cent between FY2007-08

[76] This exercise is based on the energy elasticity to GDP growth for Bangladesh as 1.67, estimated by CPD for the period of 1971-2007.

and FY2009-10, and demand for gas is expected to be intensified further in the coming days, ensuring the required quantum of gas supply appears to be difficult. To ease the situation, the country plans to import 500 mmcfd of LNG from June 2013. On the other hand, from December 2015, additional 680 mmcfd gas production is planned through 20 new development wells and a number of other exploration wells from the off-shore blocks recently allocated to ConocoPhillips and Santos. It is expected that these initiatives will increase daily gas generation capacity by 2528 mmcf from December 2015, in addition to the current generation of about 2000 mmcfd.

Use of Local Coal Remained an Ignored Option!

A decision with respect to the use of country's vast coal resource for power generation and other forms of energy use has been in abeyance for some time. As is known a 'Coal Policy' and coal use guideline were prepared in 2010. Commercial production of coal in Bangladesh started in 2005 from the Barapukuria coal mine; however, due to policy indecision and resistance from local people who oppose open pit coal mining on account of higher costs in terms of human, environmental and other adverse affects, coal mining could not be started in other areas. Besides, it has not been possible to intensify coal extraction for power and other commercial use from the Barapukuria site over the last six years. In fact, the lone thermal power plant at Barapukuria site with 250 MW installed capacity uses coal imported from India and capacity utilisation was only two-thirds of the generation capacity. The two large coal-fired power plants proposed to be established in Chittagong and Satkhira (in collaboration with NTPC of India) are expected to be run on imported coal. However, development of the required infrastructure, including development of the Mongla and Chittagong ports for importing coal has not received any visible positive nod from the government.

Given the fast depleting proven reserve of gas in the country and high domestic demand for energy, on the one hand, and increased demand for subsidy and ever-growing fuel prices at the international market, on the other, development of the energy sector will need an all-out effort on the part of the government.

3.5.2 Power Sector

Power sector has been identified as another priority sector by the present government. The 'Mega Power Plan', unveiled along with the Budget of FY2010-11 to revamp the power sector in the country, is going to complete its first year in June 2011. This is, perhaps, an appropriate time to review the implementation situation and suggest a few policy measures.

Overview of the Recent Performance

At present Bangladesh has a capacity to produce 6350 MW of electricity from 62 power plants, of which 19 are managed by public sector enterprises and the remaining 43 plants are run by the private sector. Power generation capacity in recent months has increased due to additional generation, mainly from quick rental power plants. Since January 2009, 26 plants with 1553 MW capacity have started commercial operation. Another 6 plants with 486.7 MW capacity are currently under test run and are expected to come under commercial generation before July 2011. Of the new addition, 422 MW has been added in 2011, in addition to another 6 plants which are currently under test run. Despite a significant increase in power generation capacity in the country, power crisis still continues to take a take a toll on the economy. This is mainly due to a huge shortfall of production in the state-run aged power plants which are impeded by technical faults and renovation activities.

Moreover, many new rental and quick rental plants are undergoing technical problems on a regular basis, which undermine the actual power generation capacity of the country. On the other hand, overall pace of progress in setting up the two large coal-fired and a few combined cycle power plants in the country have been rather slow. Thus, the success in power sector in FY2010-11 looks rather unimpressive, even though some improvements are visible, particularly in generation capacity.

Some Key Policy Challenges in Power Sector

Quick Rental Power Plants: An Expensive Delayed Choice Indeed!

Quick rental power plants were thought to bolster the short run power situation in the country. It was argued that despite being an expensive[77] and ambitious step, these would be the best available alternatives to address the power crisis over the short term. By 2010, generation of 792 MW and by 2011 another 920 MW of electricity were projected, mainly from rental and quick rental power plants. Out of the 18 quick rental and 4 rental power plants commissioned by the present government, 7 quick rental plants with 622 MW generation capacity are currently under commercial operation. Another 4 plants with 486.7 MW are now running under test. Remaining 7 plants are under construction, where all the 4 remaining quick rental plants are expected to start their production by June 2011. At least five of these plants could not meet their respective deadlines to begin commercial operation. Three out of 4 rental plants (signed under the current regime), on the other hand, are already under commercial operation and Noapara rental plant, with 105 MW of generation capacity, is currently under 'test run'.

Besides delay in delivery, many quick rental power plants are frequently facing technical problems and their actual generation is found to be lower than expected. For example, ***in May 2011 the under operation 7 quick rental power plants could generate only about 75 per cent of their planned capacity. This meant that a daily loss of Tk. 2.80 to 5.25 crore is being incurred due to the deficit generation of 224 MW.*** Performances of some of the quick rental plants are quite unusual. For example, the average actual daily generation in the 50 MW quick rental power plant at Pagla, Narayanganj was found to be only 14.29 MW in May 2011. On the other hand, the actual generation in 55 MW plant in Khulna by Aggreko, 100 MW plant at Shiddhirganj by Desh Energy and 70 MW capacity plant at Brahmanbaria were found to be only 44.94, 58.39 and 60.37 MW, respectively over the same period. Such under-performance of these plants is a matter of concern considering the amount of subsidy that has to be borne on their account. Considering that over one million applications for power connection are currently pending with the authorities (Power Cell, 2011) and over 10,000 ready flats could not be handed over to their owners, the hidden cost of quick rental power would be very high. It is, thus, important to understand the reasons[78] why these plants are not being able to work at maximum capacity.

Power Tariff Adjustment: A Re-calculation of Subsidy for Quick Rental Plants

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[77] CPD (2010) estimated year-wise (FY2010-11 to FY2015-16) fiscal burden on account of quick rental plants. It also cautioned that implementation of the plan and ensuring timely delivery from the quick rental plants would be a matter of serious concern for the country as any delay in delivery would not only put a fiscal burden on the country but would also have an impact on the economic performance through less investment and weak performance in the economy.

[78] Technical inefficiency and inexperience on the part of the producers and failure on the part of BPC to deliver fuel and also lack of interest of BPDB to purchase expensive power from quick rental plants are suspected to be some possible reasons for this.

In February 2011 Bangladesh Energy Regulatory Commission (BERC) announced an increase of power tariff by 5.0 per cent at the retail level, and by 11.0 per cent for the bulk purchase. This was to somewhat reduce subsidy for rental and quick rental power plants. At present the government needs to pay two rounds of subsidy to quick rental power plants, one for providing cheaper fuel supply, and the other for high purchasing cost of power produced by the quick rental plants which is then delivered to the consumers at lower prices. This is creating a fiscal pressure on the economy and is expected to continue up to FY2013-14. An exercise has been carried out to assess the volume of power subsidy required for FY2011-12 and to understand the impact of the recent power tariff adjustment. ***The findings suggest that with the 5.0 per cent increase in tariff at the retail level, the fiscal burden in FY2011-12 would be to the tune of Tk.6,300 to.Tk.9,843 crore[79].*** However, actual subsidy to quick rental power plants is expected to be much higher, as the subsidy for the fuel which is supplied to them is not included in this calculation.

Repowering the Aged State-run Power Plants: A Diagnostic Assessment

Performance by the country's age-old power plants has emerged as a matter of serious concern in the recent months. Although the country was able to add up to1553 MW of power since 2009, the actual supply remained below expectations, mainly because of the shortfall on account of many of the older plants has increased in the recent months. Thus, the gap between generation capacity and actual generation has also widened since 2009.

At present the country has two power plants with a capacity of 208 MW (two units of Karnafuli Hydro and two units of Ashuganj) which are over 40 years old. Four plants with 177 MW are 31 to 40 years old and another 14 plants with 1827 MW are 15 to 30 years old. Power generation by many of these plants is regularly disrupted due to overhauling, maintenance and machine failure. For example, on 31 May 2011, there was a production shortfall of 1,775 MW due to overhauling, maintenance or machine failure. Most of the shortfalls were attributed to the aged plants and some quick rental plants[80]. It is to be expected that a power plant can operate for only a number of years, its generation capacity reduces with time. However, delay in any renovation could make the situation worse. The rationale of the strategy of power generation through expensive quick rental plants, thus, becomes doubtful. Given the current status, it is not impossible to regain some of the actual generation capacity in many of the existing plants through renovation and upgradation. Moreover, inefficiency in energy consumption by these plants, through proper and timely renovation, could also be reduced. In view of understanding the economics informing such renovation, CPD has carried out an exercise, considering some possible scenarios:

TABLE 3.5.2: POSSIBLE BENEFITS FROM INCREASING GENERATION EFFICIENCY IN COUNTRY'S 14 AGED POWER PLANTS UNDER DIFFERENT SCENARIOS

[79] Production from the quick rental power plants for FY2011-12 is assumed to be 1852 MW, which is scheduled to be in operation by June 2011. Out of this, 705 MW will come from diesel-based power plants, 910.5 MW from furnace oil based plants and the remaining 236.5 MW from gas based quick rental plants. Per unit purchasing cost of power from the quick rental plants, by the government, for diesel based-powered plant is taken as Tk. 13/KWh, whereas for furnace and gas based plant it is taken as Tk. 7.0 and Tk. 4.0, respectively.

[80] Moreover, gas shortage and reduction in normal water flow have also contributed to a shortfall of 494 MW on that particular day.

Problem	*Shortfall in Generation Capacity***	Considering Tariff as Tk. 14.0/KWh		Considering Tariff as Tk.7.7/KWh	
		Increased generation capacity by 10%	*Increased generation capacity by 25%*	*Increased generation capacity by 10%*	*Increased generation capacity by 25%*
Overhauling	360	12096000	30240000	6652800	16632000
Maintenance	512	17203200	43008000	9461760	23654400
Machine Problem	197	6619200	16548000	3640560	9101400
Overhauling+ Maintenance	360	12096000	30240000	6652800	16632000
Water	92	3091200	7728000	1700160	4250400
Gas	351	11793600	29484000	6486480	16216200
Total	1872	62,899,200	157,248,000	34,594,560	86,486,400

* Considering power tariff as Tk. 14.0/ KWh and Tk. 7.7/KWh which represents the minimum price of purchasing power from diesel and furnace oil-based quick rental plants.
** considering the generation shortfall for 26 May 2011
Source: Author's own calculation

Table3.5.2 shows some possible benefits of renovating the aged power plants of the country which are currently over 15 years old (some are as old as 40 years). As Table3.5.2 shows a 10 per cent increase in daily generation capacity will generate a daily benefit of Tk. 3.46 to Tk. 6.29 crore, while a 25 per cent increase will provide a benefit of Tk. 8.65 to 15.72 crore. ***This will result an annual savings of Tk. 1,263 to Tk. 2,296 crore for a 10 per cent efficiency increase, while the benefits would be to the tune of Tk. 3,157 to Tk. 5,738 crore for a 25 per cent efficiency increase.*** This indicates that renovation of the old power plants has high economic significance and the government may consider this option in the next fiscal year.

An Assessment of the Progress in PPP Initiated Power Projects

In FY2010-11, five large power projects were considered under the PPP initiative. Out of these, three were combined cycle projects (1200-1300 MW) and the other two with 2640 MW capacity were coal-fired power plants. These plants were considered very important for the long-term power security of the country and were expected to raise the level of efficiency in power generation keeping in mind the current expensive quick rental plants, and the inefficiency in liquid fuel use. However, the work progress of all the five plants appears to be quite sluggish (Table3.4.3). Apart from some preliminary works conducted, no further steps were found to have taken place to accelerate their construction process. Moreover, it is also ironical that in a resource-scarce economy such as Bangladesh, an allocation of Tk. 2500 crore made in the budget for FY2010-11 under the PPP initiative remained unutilized, including the allocations meant for some of these power plants.

TABLE 3.5.3: STATUS OF THE POWER PLANTS UNDER THE PPP INITIATIVE IN FY2010-11

Power Sector Projects	Capacity (MW)	Ownership	Fuel	Expected Commissioning Date	Current Status
Sirajganj CCPP	300* [450]	EGCB	Gas	October 2013	PQ received and under evaluation
Khulna	1300** [1320]	PPP (Joint Vent) / IPP	Coal	December 2015	NTPC will start feasibility study
Chittagong	1300* [1320]	PPP (Joint Vent) / IPP	Coal	June 2015	PQ received and under Evaluation
Meghnaghat CCPP	100* [450]	IPP	Gas/HFO	January 2014	LoI issued
Shiddhirganj CCPP	450* [300-400]	EGCB	Gas	October 2013	Tender evaluation report sent to World Bank

* These are the estimates from the BPDB.
** This estimate has been revised downward to 600 MW due to shallowness of water.
Source: BPDB, 2011 and National Budget, FY 2010-11

3.5.3 Recommendations

In view of the importance of power and energy for the economic development of Bangladesh and the prevailing (power and energy) crisis, a number of policy recommendations can be made:

a. The capacity of BAPEX should be significantly strengthened to increase local energy production, particularly to generate additional gas in the country. In this regard, there should be adequate allocation in the budget so that BAPEX can improve its scientific and operational capacity for gas exploration and extraction with a view to enhancing the supply of primary energy in the country. In addition to that, other relevant institutions, such as BPC, needs to get favourable fiscal allocations to reinforce and strengthen their capacity.
b. There is a need to draw up a long term 'Road Map', of at least 10 years' duration, for developing both power and energy sectors of Bangladesh. The five year "Mega Power Plan' and a target of producing 15,000 MW of electricity appears to be not only an over-ambitious step but also impossible to achieve in time, mainly due to time and resource constraints. Whilst necessary for immediate relief, option other than quick rentals should be perceived as medium to long term solutions to power crisis. Exploration and exploitation of coal and gas resources should be encouraged towards power generation based on local sources of energy. On the other hand, the country should have a clear 'energy-use policy'. This is not only needed to achieve energy use efficiency in the country and to reduce misuse of energy resources, but also to attract higher investment (including FDI) in the economy.
c. The government should try to find a way-out to rationalise the subsidy on power and energy. This can be in the form of rationalizing both power and energy tariffs, reducing imported energy-based power generation through quick rental and rental plants, and creating disincentive with regards to misuse of energy and power in the country. It is also recommended that once the contract periods of the quick rental plants are over, no renewal should be granted on the existing terms and conditions.
d. It is also suggested that the government should not permit any further quick rental power plant and ensure the timely delivery from the remaining plants which are currently under construction. Moreover, penalty for failure to supply agreed capacity should be imposed as many quick rental plants, under commercial operation, have failed to deliver the required amount of electricity as per contracts signed with the government.

e. Renovation of the old power plants should be given a high priority. This will not only increase the level of efficiency in terms of actual generation capacity, but will also save a lot of resources currently being diverted towards 'rental and quick rental plants'. Moreover, inefficient use of energy by old power plants could be reduced through renovation. This will also help reduce country's high energy import bill.

3.6 EXPORT PERFORMANCE: EXPLAINING THE RECENT GROWTH TRENDS

3.6.1 Export Performance

A robust export growth of 40.9 per cent during the first ten months of FY2010-11 provided a welcome departure from low growth posted during the corresponding period of FY2009-10 and gives some indication that the country's export sector has started to recover from the adverse effects of the global financial crisis. The recovery was fairly broad based, shared by both RMG, and the non-RMG sectors such as raw jute, jute goods, frozen food and leather. With 42.3 per cent growth for the RMG, and 36.0 per cent growth for the non-RMG exports, total export over the first ten months of the current year was ahead of the target set for FY2010-11 (Table 3.6.1). Even when we account for the export-related imports, a 38.1 per cent net export growth[81] was attained during the first ten months of FY2010-11.

It needs to be mentioned here that some of Bangladesh's competitors in the global export market (e.g. China, Vietnam and Cambodia) have also been doing well. For example, China's export posted a 39.0 per cent growth in March 2011while export of India in FY2010-11 (April-March) was 37.5 per cent and of Sri Lanka in FY2010 (July-December 2010) was 17.3 per cent. Apparel export of Vietnam posted a 30.0 per cent growth during the first four months of 2011; Cambodia, during January-March 2011, has been able to register a 49.6 per cent growth in terms of total export and 45.5 per cent in RMG export.

TABLE 3.6.1: GROWTH RATES OF EXPORT

Product	Growth Target for FY2010-11	Growth in FY2010-11 (July-April)	Growth in FY2009-10 (July-April)
RMG	10.0	42.3	-1.8
Knit	10.0	45.9	-2.1
Woven	10.0	38.6	-1.4
Non RMG	28.2	36.0	11.6
Raw Jute	30.0	69.2	45.1
Leather	30.0	36.4	15.8
Frozen Foods	1.1	53.6	-13.6
Home Textile	40.0	97.8	21.7
Total	**14.2**	**40.9**	**1.0**

Source: Estimated from EPB (2011) data.

It has to be conceded that the low benchmark growth of the previous year has underpinned this year's high export growth.[82] Not everything can be explained by this alone. Export growth during Q3 of FY2010-11 (39.6 per cent) was attained in the backdrop of the relatively high 9.8 per cent growth posted during Q3 of FY2009-10; indeed, for the month of April FY2010-11, a 45.6 per cent export growth was attained against the higher benchmark of 19.0 per cent in the corresponding month of FY2009-10.[83]

It is to be noted that the attained export growth in FY2010-11 has continued to be volume-driven (Figure 3.6.1). Despite the falling unit price, knit-RMG was able to record a 45.9 per

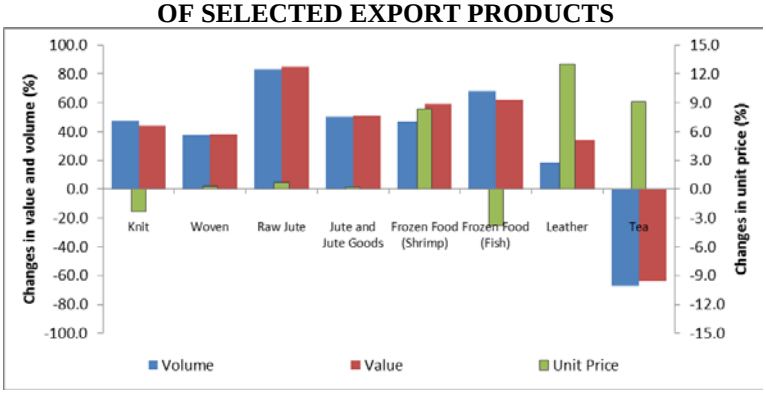
[81] Net Export = Gross export – (back-to-back LC settlement).

[82] Due to the lagged impact of the financial crisis, export registered a growth of only 1.0 per cent during the first ten months of FY2009-10.

[83]Even if export growth during FY2009-10 had attained a 16.6 per cent growth (similar to the average growth rate during the four post-MFA years), export growth registered in FY2010-11 (for the first ten months) would be a quite impressive 23.7 per cent.

cent growth, thanks mainly to growth in export volume.[84] Woven-RMG growth was also predominantly volume-driven (38.6 per cent) with unit price remaining mostly unchanged. Similarly, the growths in export of raw jute, jute goods, leather and frozen food were also primarily volume-driven. This would indicate Bangladesh's export oriented sector's ability to go for strong supply-side response whenever there was robust global demand. This is manifested in both investment in capacity-building (e.g. growth in L/C settlement for RMG machineries in July-March period was 27.0 per cent) and also in the ability to manage higher volume of production by using existing factors of production (higher overtime).

FIGURE 3.6.1: CHANGES IN VOLUME AND UNIT PRICE OF SELECTED EXPORT PRODUCTS



Source: Estimated from EPB (2011) data.

North America (USA and Canada) and EU continued to remain the largest export markets for Bangladeshi products with a share of about 78.8 per cent of the country's global export during the first nine months of FY2010-11. However, it may be noted that this share had come down from about 95.3 per cent in FY2006-07, indicating some market diversification. Exports to non-traditional destinations such as Japan, Turkey, Australia, Chile, South Africa, Brazil, China, India, South Korea, Mexico and Russia have experienced promising performance with export of RMG during FY2010-11 (July-March). Share of these non-traditional markets in Bangladesh's total export rose to 43.3 per cent as against 36.6 per cent for the North American market and 41.2 per cent for EU market.

[84] In volume terms, knit RMG export increased by 47.3 per cent during July-February of FY2010-11.

BOX 3.6.1: TURKISH SAFEGUARD DUTY ON RMG IMPORT

In recent times, Turkey, one of the major emerging importers of RMG from Bangladesh, has imposed a 17 per cent duty on apparels imported from the LDCs. This duty was imposed on the ground of import surge (import of apparels to Turkey rose by 28 per cent in FY2009-10). As is known, Bangladesh, along with other LDCs, has been enjoying duty-free market access in Turkey which provides EBA-parity as part of conditionalities for entry into the EU. It may be recalled here that export of Bangladeshi products to Turkey, mainly driven by RMG items, has risen by about 45 per cent in FY2009-10 compared to the previous year. Exports recorded a 58.9 per cent growth in the first nine months of FY2010-11compared to the matched period of FY2009-10, reaching US$494.1 million (Table 3.6.2).

TABLE 3.6.2: BANGLADESH'S EXPORT TO TURKEY

	FY2007-08	FY2008-09	FY2009-10	FY2010-11 (July-March)
Export (million US$)	237.7	331.6	478.2	494.1
Growth	41.9	39.5	44.1	58.5
Share of total RMG export	2.2	2.6	3.8	3.4

Source: Estimated from EPB (2011) data.

Initially the safeguard duty was proposed to be 27 per cent for LDCs, instead of the duty-free market access. Following negotiations between the governments of Bangladesh and Turkey, the duty was revised downward to 17 per cent. Safeguard duty imposed by Turkey on developing and developed countries were 27 per cent and 30 per cent respectively. Implications of the safeguard measure could be two-fold. *First*, Bangladesh's competiveness against that of domestic producers of Turkey is likely to suffer significantly due to the imposed duty. It needs to be explored whether Turkish apparels producers were facing competition from Bangladesh in the same categories and items and were being threatened by imports from Bangladesh. If this is not the case, Bangladesh should not worry much. *Second*, it is important to look at the changes in tariff rates for the LDCs, developing countries and developed countries in a comparative setting to identify any possibility of loss in Bangladesh's (LDC) competitiveness originating from the duties imposed. However, interestingly as Table 3.6.3 reveals, Bangladesh (and LDCs in general), will, as a matter of fact, gain as the situation with regard to competitive advantage over its counterparts (developing and developed countries) will be changed in Bangladesh's favour, albeit, not in any significant manner. The apprehension of some of the entrepreneurs appears to be rather misplaced.

TABLE 3.6.3: CHANGES IN TARIFF RATES AND IMPLICATIONS FOR LDC COMPETITIVENESS

Tariff Rates	LDCs	Developing Countries	Gap Between BD and Developing Countries	Developed Countries	Gap Between BD and Developed Countries
Previous Rate	0.0	9.6	9.6	12.0	12.0
Current Rate	17.0	27.0	10.0	30.0	13.0

Source: Various News Sources.

The current surge in Bangladesh's export appears to have originated from several factors including the recovery of the global economy, Bangladesh's traditionally strong market presence in the EU and the ability to take advantage of the changed rules of origin (RoO) in the EU, particularly manifested in the third quarter export performance in this market. Both the US and the EU data show a return of market demand to the pre-crisis level, particularly for RMG products. Rise in China's production cost is also perhaps another contributing factor, which has been explored further in the latter part of this section of the report. At the same time, the current fiscal year experienced a significant devaluation of Taka by almost 5 per cent (between July 2010 and March 2011), raising export competitiveness of Bangladeshi producers and providing additional incentives to exporters. On the other hand, the one-stage GSP rule of the EU may also lead to increased pressure on the domestic backward linkage industries through higher imports of inputs, necessitating some incentive provisions to remain competitive in the market.

3.6.2 Product Diversification

Bangladesh's export sector performance over the past decades has been stellar by any standard with the total export increasing from only about US$1.5 billion in 1989-1990 to about US$6 billion in 1999-2000, and crossing the US$16 billion mark in 2009-2010. In the ongoing FY2010-11, exports are expected to cross US$20 billion. However, a flip side of this achievement was growing export concentration favouring the RMG. Export of RMG constituted almost 75 per cent of the total export in recent years, rising from only 12 per cent in FY1984-85 and 41 per cent in FY1989-90. Indeed, since the end of the 1990s RMG has been contributing a consistent three-fourth of Bangladesh's total merchandise export.

Non-RMG items contributed to only about one-fourth of Bangladesh's total export with traditional items such as frozen food, raw jute, jute goods, chemical products and leather and leather products accounting for the highest shares in the total non-RMG export. Bangladesh's aspiration to attain higher GDP growth of 8 per cent and beyond, as envisaged in SFYP, will hinge critically on the performance of her export sector with its multiplier impacts in terms of investment, output, employment generation and foreign exchange earnings. Both intra-RMG and extra-RMG diversification will be crucial in this context. Based on experience of developed and newly industrialized countries, ESCAP (2011) suggested that product diversification tends to be the case in initial stages of development whereas specialisation is more effective as economies mature. This indicates that horizontal diversification, around products in which Bangladesh has strong global footprints, will perhaps be the more logical way for Bangladesh to go forward in this context. This would mean that Bangladesh should be putting more emphasis on textile-related diversification. Bangladesh's recent good performance not only in RMG but also for home textile and other related items would strengthen this argument. However, this should not preclude exploiting, to the fullest extent, the emerging global opportunities for Bangladesh in other products including ship-building, leather and footwear, and pharmaceuticals.

Diversification in Non-RMG Export Basket

The structure of non-RMG export has changed in recent years when compared to that of FY1999-2000 (Table 3.6.4). A comparison of exports of non-RMG items in FY1999-00 and FY2009-10 reveals that though the traditional items continued to remain amongst the top exported non-RMG products, their share in total non-RMG export has indeed experienced some decline. On the other hand, agriculture products, home textile, pharmaceuticals and engineering products have gained in share in total exports. As is known, in a welcome development ship-building industry has been a recent addition to the country's export oriented industry. A number of other non-traditional items, though small in share, have contributed to diversification of exports favouring non-RMG export items.

TABLE 3.6.4: CHANGES IN THE SHARE OF SELECTED NON-RMG EXPORT ITEMS

Export Items	Share in Non-RMG export inFY1999-00	Share in Non-RMG export inFY2009-10	Change in Share
Engineering Products	0.5	8.4	7.8
Home Textile	6.9	10.9	4.0
Jute Yarn & Twine	7.9	10.7	2.9
Footwear	3.7	5.5	1.8
Tobacco	0.2	1.4	1.3
Frozen Fish	1.5	2.4	0.9
Pharmaceuticals	0.4	1.1	0.7
Fruits	0.0	0.5	0.5
Vessels	0.0	9.3	9.3
Vegetables	1.0	1.3	0.3
Raw Jute	5.1	5.3	0.2
Glass & Glass ware	0.0	0.2	0.2
Ceramic Products	0.7	0.8	0.2
Handicrafts	0.4	0.1	-0.3
PVC Bags	1.8	0.8	-1.0
Tea	1.3	0.2	-1.1
Specialized Textiles	6.9	5.0	-1.9
Leather Product	3.9	0.8	-3.1
Chemical Fertilizer	4.3	1.0	-3.2
Leather	13.9	6.1	-7.8
Frozen Food	24.6	12.0	-12.6
Frozen Shrimps	23.1	9.4	-13.7
Share of non-RMG in Total Export	***24.3***	***22.8***	***-1.5***

Source: Estimated from EPB data.

Intra RMG diversification: Emergence of the sweater industry

One important development of recent years has been diversification within the RMG sector. As is known, the first intra-RMG diversification took place when knitwear segment emerged as a major item within the apparels sector.[85] Export of sweater items has increased from US$0.6 billion to US$2.7 billion between 2002 and 2009, indicating a 340 per cent growth in 7 years.[86] During the first six months of the current fiscal year another US$1.4 billion worth of export has been recorded. At present about 15 per cent of RMG export earnings comes from export of sweaters.[87]

The Case of Sweater Industry

A global export market for sweater is worth over 45 billion (2009), and growing at a fast pace.[88] A review of present market structure shows the predominance of US, EU and Canada. Hong Kong is the fourth largest importer of sweaters with import share of 7.7 per cent in 2009. US, Japan and Germany ranks as top importers with respective import shares of 27.6 per cent, 9.3 per cent and 9.2 per cent.

As for exporters, China and Hong Kong tops the rank with market shares of 35.4 per cent and 13.3 per cent, respectively. Bangladesh, with a market share of 6.4 per cent, was the third largest exporter in 2009, having moved up from the sixth position in 2002 (Figure 3.6.2).

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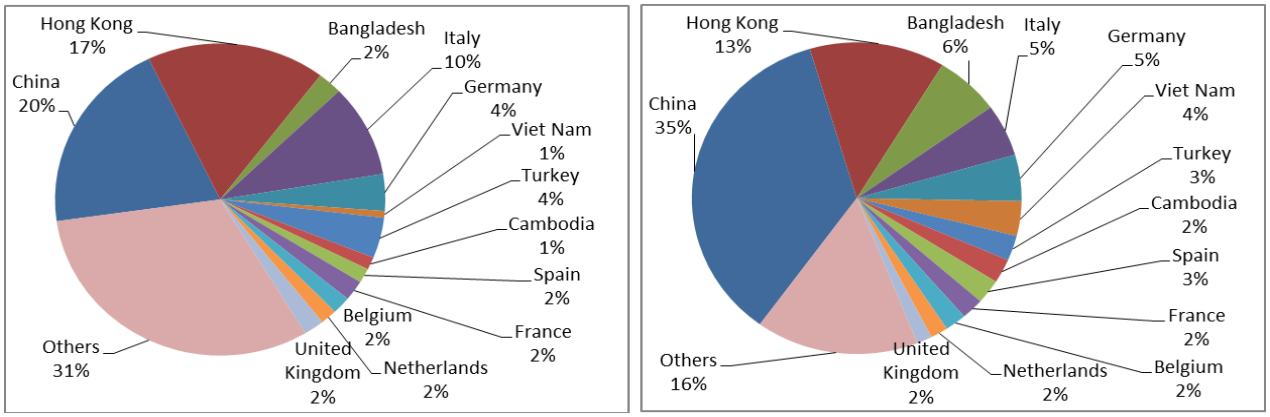
[85] The share of knitwear in total apparels export was 17 per cent in FY1994-95 and 29 per cent in FY1999-2000, which changed to 52 per cent in FY2009-10.

[86] Calendar year based export statistics of TradeMap database.

[87] Sweaters constitute over 11 per cent of the total export of Bangladesh.

[88] The size of the global market increased by 63 per cent between 2002 and 2009.

FIGURE 3.6.2: SWEATER EXPORTERS AND THEIR SHARES OF THE MARKET



2002 ***2009***

Source: Estimated from TradeMap and US ITC database.

Feature of Bangladesh Sweater industry. As distinct from other RMG sub-sectors, sweater industry is characterised by high seasonal variation in demand. The fact of predominance of *piece rate* payment system as against *monthly wages* is a reflection of this. There is a surge in production during few months of the year whilst for the remaining months the demand is slag; consequently, the workers are retained (only partially) with a relatively low monthly wage. During the high production season piece rate allows workers to earn more than what is the case for other RMG sectors; the opportunity for working overtime is also high. Piece rate payment system in the sweater industry also contributed to dominance of male workers in the sector in contrast to the female dominance in other RMG sub-sectors.

With its piece rate system of employment, the sector enjoys the advantages that comes with it, and also suffers from formidable constraints. Studies indicate that the piece rate system allows for price control in two ways: a) by allowing adjustments to be made with respect to the number of workers that are employed between seasons, and b) through the ability to negotiate the rate with the workers. The advantage of the system is that enterprises can scale up and down the workforce in tandem with structure of order. However, the negative side is that since the system allows for flexible working hour for the workers, enterprises often tend to suffer from poor working conditions, excessive overtime and exploitation. It also makes it difficult for factories to change their product profile and quality management often becomes difficult. Various studies have also found that management efficiency stagnates and even deteriorates in factories that operate on piece rate based system.

Bangladesh's competitive advantage in the global market. The global market for the sweater industry is characterised by certain unique features which has allowed Bangladeshi producers to take advantage of. With the exception of China, Bangladesh and Vietnam, all of the top 13 exporting countries are developed nations. As such, from the perspective of price competitiveness, Bangladesh enjoys certain degree of advantage over others. With production cost rising in China, particularly on account of wage bills, and the new GSP – RoO in the EU, the potentials for raising her share in the global sweater market have indeed become more robust for Bangladesh. Responding to the emergent market opportunities, sweater industries have extended their investment to scale up their production capacity. Reportedly, major producers have made investments worth more than Tk. 10 billion during the first six months of the current fiscal year to cater to the increasing global demand to source sweaters from Bangladesh.

In view of the emerging global market opportunities and potentials, the sweater sub-sector should be given high priority by the policymakers. New industrial zones may be set up with the required logistics and skill and production development facilities particularly geared to the strengthening of this sector, particularly in view of the unique features of this item within the broader knitwear sectors.

3.6.3 Post-Crisis RMG market in the US and the EU

Current surge in RMG export from Bangladesh has taken place in the backdrop of the recovery from the global financial and economic and the associated rise in global demand. The *China plus one* policy pursued by major buyers has been another factor. Apart from these, the new GSP rule of the EU has also played an important role in recent months as is evident from the significant rise in Bangladesh's export in the third quarter of the current fiscal year. What was the impact of the GFC on market composition and concentration? Who has gained at whose expense from the GFC? How have China and other major competitors of Bangladesh in the global RMG market fared in comparison to Bangladesh? A comparative analysis of the relevant export data for the pre and post GFC period would provide some useful insight with regard to these queries.

The US market

In the US market, for Knit RMG, Bangladesh ranked 16th with 2.1 per cent market share in 2006. China was at the top with 22.7 per cent share while Mexico (6.0 per cent), Honduras (5.3 per cent), Hong Kong (4.2 per cent), Indonesia (4.0 per cent) and Vietnam (3.9 per cent) were among the top 6 exporters to the US market. At the end of 2010, Bangladesh has moved to the 10th position, with the share registering only some improvement to 2.8 per cent. On the other hand, China made its presence even stronger with her share increasing to 36.8 per cent; a rise of 14.1 percentage points compared to 2006. Among the top ten exporters of knitwear to the US market, largest loser was Mexico, losing her share by 2.6 percentage points (to 3.4 per cent), ranking 8th. Vietnam and Indonesia ranked 2nd and 3rd in terms of market share (8.8 per cent and 6.6 per cent respectively), gaining by 4.8 and 2.5 percentage points respectively.

For woven wear, Bangladesh ranked 5th position with 5.6 per cent market share in the US in 2006. China was the lead exporter with 31.5 per cent share in 2006. In this case as well, China was the highest gainer (by 11.8 percentage points) when the pre and post-GFC periods are compared. Bangladesh's success has also been quite remarkable. She moved up to the second position (although a distant second in the backdrop of China) at the end of 2010 with 8.4 per cent market share (gaining by 2.8 percentage points). Competitive wages, capacity to handle large orders and short lead time (thanks to strong backward linkage) have helped Bangladesh in this. In contrast to knitwear market, among the top 10 woven wear exporters apart from China, Bangladesh and Vietnam, all others lost market shares between the GFC period. Indeed, if the apparels sector as a whole is taken, Bangladesh's rank in 2010 would be fourth after China, Vietnam and Indonesia; and she had the fastest growing apparels export in US in 2010.[89]

[89] However, this robust performance should not be held against Bangladesh in her quest for Duty Free-Quota Free (DF-QF) market access to the US. One argument favouring this position is that there were high costs involved in keeping Bangladeshi products competitive in the US/global market – incentives to the sector and other fiscal and monetary support provided by the government.

The EU market

For the knitwear market, China (27.4 per cent), Turkey (19.5 per cent) and Bangladesh (11.2 per cent) ranked top in 2006; these relative positions have been sustained in 2010. However, major changes in their respective market shares have taken place between pre and post GFC period: China gained by 15.0 percentage points, Turkey lost by 3.7 percentage points and Bangladesh gained by 2.0 percentage points. China now accounts for 42.4 per cent of market share in the EU for knitwear products. Indeed, apart from China and Bangladesh, almost all other major exporters have seen their respective market shares come down, in various degrees.

With regard to the woven wear items, Bangladesh has managed to improve its share by 2.1 percentage points to 9.3 per cent between 2006 and 2010. On the other hand, China, in this case as well, was not only able to maintain her topmost rank, but also increased her share by 5.2 percentage points. As of now, almost half (48.9 per cent) of the EU demand for woven wear is met from imports from China alone.

As it would appear, in both US and EU markets, there is no sign of imports from China coming down or any sign of buyers moving away from China. Rather it is the loss of market share by some of the other exporters, mostly the relatively small players, that has helped Bangladesh to make the gains she has made during the recovery phase following the GFC. As the analysis above indicates, indeed there has been further market concentration favouring China with her market share going up further. This fact holds even if the analysis is extended to the disaggregated level, for the RMG sector. For the US market, RMG export of Bangladesh, at six digit level, was compared with that of China (for both woven and knitwear, products for which Bangladesh had an export of at least US$10 million in 2010 were selected for this purpose). For the selected items, China's US market share went up by 15.4 percentage points (from 18.9 per cent to 34.3 per cent) between 2006 and 2010; in contrast Bangladesh's share rose by only 2.3 percentage points (from 5.2 per cent to 7.5 per cent).

Market concentration can be measured using the Herfindahl-Hirschman Index (HHI).[90] Table 3.6.5 reveals that both the US and the EU market has become much more concentrated following the GFC, but primarily owing to the higher market share gained by China.

TABLE 3.6.5: HERFINDAHL-HIRSCHMAN INDEX FOR THE US AND EU MARKET: RMG

Product	US Market		EU Market	
	2006	2010	2006	2010
Woven Wear	1247	2125	2199	2635
China's contribution to the HHI	*994*	*1876*	*1906*	*2387*
BD's contribution to the HHI	*31*	*70*	*25*	*31*
Knitwear	750	1602	1375	2287
China's contribution to the HHI	*516*	*1354*	*750*	*1800*
BD's contribution to the HHI	*5*	*7*	*124*	*172*

Source: Calculated from USITC and EUROSTAT datasets.

[90]If the measured HHI value for a specific market is below 1000, it implies low market concentration (close to equal distribution of market share between a large number of suppliers). If measured between 1000 and 1800, the market is moderately concentrated, and a higher than 1800 HHI value would indicate a highly concentrated market (one or a few suppliers holding major share of the market, creating tough completion for others).

What the table implies is that although Bangladesh has been able to make some inroads into the EU & US market in post crisis period, it was China which has been able to make the most gains in terms of market share. In view of this, to what extent the so-called *China plus* one strategy is actually in operation, or also the impact of cost escalation in China driving away buyers, should be looked into in more detail. A more plausible hypothesis is that as total demand rose, more players could take advantage of this, without displacing China.

3.6.4 Market diversification

Japan as a potential export destination for Bangladesh

Japan as an export destination for Bangladeshi products has been growing in importance in recent time. Although her share is still low, Bangladesh's export to Japan has increased quite significantly in the recent past. Between FY2006 and FY2010 Bangladesh's total export and export of apparels to Japan increased by robust 2.3 and 9.7 times. In FY2009-10, Bangladesh's total export to Japan amounted to 330.6 million, increasing by over 62 per cent when compared to FY2008-09. As Table 3.6.6 indicates, export growth to Japan during the first three quarters of FY2010-11 was also high, which is impressive particularly in view of the high benchmark growth achieved during the previous year.

TABLE 3.6.6: BANGLADESH'S EXPORT TO THE JAPANESE MARKET

(in million USD)

Export to Japan	FY09	FY10	Growth FY10	July-March FY10	July-March FY11	Growth Jul-Mar, FY11
Total Export	203.4	330.6	**62.5**	236.49	301.1	**27.3**
RMG Export	74.4	173.3	**132.8**	119.94	159.4	**32.9**
Non-RMG Export	128.9	157.2	**22.0**	116.6	141.7	**21.6**

Source: Estimated from EPB data.

Studies indicate that Bangladesh enjoyed competitive advantages in the Japanese market which can be made use of further enhance her market share, particularly for apparel export. Analysis based on the 2008 data shows that Bangladesh enjoyed significant advantage over her competitors in three of the six major RMG items of export to the Japanese market. Bangladesh had significant price advantage over competing countries such as China (18 to 86 per cent), Vietnam (8 to 86 per cent) and India (5 to 84 per cent) (Moazzem and Rahman, 2010).

Given the potential, Bangladesh needs to pursue aggressive marketing strategy in Japan where targeted joint efforts by the Bangladesh mission in Japan and Bangladeshi entrepreneurs will be required. This is particularly important in view of the 'China plus one' strategy being pursued by mainly of the Japanese businesses, which are in search for alternative suppliers and are envisaging to relocate at least 30 per cent (worth over US$6 billion) of Japanese apparel orders from China.[91]

South-South Trade

Trade among the developing countries has been growing in a significant manner over the last decade. The value of South-South trade has increased from about US$0.5 trillion to over 3 trillion between 1995 and 2008, a six-fold increase. Almost one-fifth of the global trade now occurs between the countries of the South.[92]

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[91] It is to be noted that major Japanese brands such as UNIQLO are shifting a significant share of their shares to Bangladesh in recent times.

[92] It is to be noted that LDC's at present export more than 50 per cent to other Southern countries – mostly primary commodities, non-manufactured products.

TABLE 3.6.7: TREND IN SOUTH-SOUTH TRADE

(in million USD)

Year	*Global Trade*	*South-South Trade*	*South's share in global trade*
1995	*5,080,211*	***545,227***	***11%***
2000	*6,476,208*	***794,817***	***12%***
2005	*10,508,914*	**1,696,566**	***16%***
2008	*16,204,930*	***3,088,750***	***19%***

Source: UNCTAD SSTIS database, sited in International Trade Forum.

Table 3.6.7 indicates that developing countries have emerged as major markets of their own products. This has implications not only from the perspective of market diversification, but it also provides an important opportunity towards product diversification given the diverse nature of consumption between the developed and developing countries, and also within the developing nations. Whilst many countries are harnessing important benefits from this growing market, less than 20 per cent of Bangladesh's export is destined to the developing countries. What is of high interest to note here that almost 90 per cent of Bangladesh's export to developing countries is comprised of non-RMG export, which would imply immense potentialities for Bangladesh towards the much-desired product diversification away from the current highly apparels-centric export structure. This also offers Bangladesh an opportunity to maximize the benefits from the various preferential schemes on offer by various developing countries.

3.6.5 Terms of Trade

With the rising global commodity price (particularly for fuel) and falling export prices of major commodities, Terms of Trade (ToT) of Bangladesh has been on secular decline over past years, before plateauing over the last three years.

In the months of 2010-11, unit prices of woven-RMG have remained almost unchanged where as that of knit RMG fell by 2.3 per cent. On the other hand, prices of raw jute, frozen shrimp and leather have increased. Nevertheless, as share of these products are rather small, while RMG contributed to almost three fourth of the country's total export, the fall in Bangladesh's ToT could not be arrested in recent times. Table 3.6.8 shows the falling trend of ToT for Bangladesh over the last decade.

TABLE 3.6.8: TERMS OF TRADE OF BANGLADESH

Year	Export Price Index	Import Price Index	Commodity ToT
FY2000	120.31	136.17	88.35
FY2001	123.15	146.41	84.11
FY2002	126.23	157.76	80.01
FY2003	135.19	164.15	82.36
FY2004	139.6	169.96	82.14
FY2005	142.38	176.66	80.6
FY2006	149.28	183.09	81.53
FY2007	165.7	232.52	71.26
FY2008	171.29	241.15	71.03
FY2009	178.23	248.33	71.77
FY2010*	190.07	264.27	71.92

Note: Base year FY1996=100

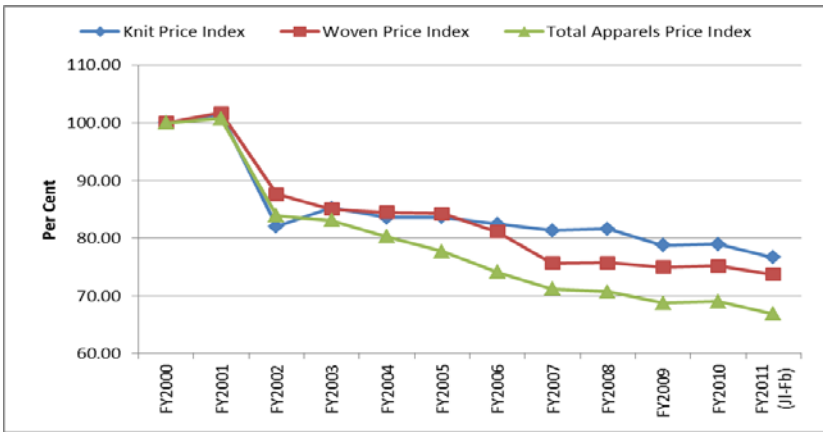
* Estimated

Source: Bangladesh Bank Annual Report 2009-10.

As was mentioned earlier, prices of RMG products are on the decline (Figure 3.6.3). While the major RMG importing economies were making their way out of the global economic

crisis, a marginal rise in unit price for apparel was evident in FY2009-10. Early this year, even with the all-time record high cotton price, average RMG prices had continued to fall. As a result of declining price of cotton, which is anticipated to go further down by the end of the current fiscal year, prices of apparel items may fall further, with consequent adverse effect on the ToT of the country. However, falling RMG prices could also reflect productivity gain in which case explanation of the falling ToT will have to be nuanced.

FIGURE 3.6.3: TRENDS IN APPAREL PRICE INDEX



Source: Estimated from EPB data.

Table 3.6.9 reveals that in 2006, to import a barrel of crude petroleum, Bangladesh had to export 2.29 dozens of RMG; by 2009, due to falling oil price this declined to 1.77 dozens. Due to increase of international oil price, and falling export price of RMG, this has again increased to 2.96 dozens in 2010 and reached 3.77 dozens in 2011 (April). Similarly, in 2011, Bangladesh has to export 19.39 dozens, 12.76 dozens and 51.52 dozens of RMG to buy one metric ton of rice, one metric ton of wheat and one metric ton of soybean oil, respectively. Table 3.6.9 corroborates this trend and shows how the purchasing power of two of Bangladesh's major export items, apparels and jute goods, have fallen vis-à-vis some of the key import items including food and fuel.

TABLE 3.6.9: PURCHASING POWER OF EXPORTS

Items	Dozens of RMG				Tonnes of Jute Goods			
	2006	**2009**	**2010**	**2011**	**2006**	**2009**	**2010**	**2011**
1 barrel of oil (fuel)	2.29	1.77	2.96	3.77	0.11	0.11	0.13	0.16
1 Mt of rice	10.76	15.93	18.21	19.39	0.53	0.95	0.83	0.85
1 Mt of wheat	6.92	6.43	8.33	12.76	0.34	0.38	0.38	0.56
1 Mt of soybean oil	20.75	24.35	37.42	51.52	1.02	1.45	1.70	2.26

Source: Estimated from various sources including Food and Agriculture Organization (FAO), World Bank, and Export Promotion Bureau (EPB).

BOX 3.6.2: MOVEMENT OF COTTON PRICE VOLATILITY: A CONCERN FOR BANGLADESH'S APPARELS EXPORTERS

An upward trend in cotton prices in the international market (Inter Continental Exchange (ICE), New York Futures) was observed since the later months of 2010 and reached historic high at US$ 2.19 per pound in early March 2011. With a slowdown in demand, especially by China, along with the outlook of good production in the coming season, global cotton prices started to fall and reached between US$1.44 and US$1.48 in mid-May 2011. According to US Cotton Market Monthly Economic Letter (May 2011), the July futures contract fell nearly to US$1.50 per pound which is expected to be contained within a range between US$1.20 and US$1.30 per pound in December 2011.

When the price of cotton was on the rise, concerns about a fall in net export earnings were growing in Bangladesh as unit price of RMG did not increase. Now, with the falling cotton price, the same concern about reduced net export is again mounting, but from a different angle. International buyers are delaying their orders in anticipation of the decline in cotton price and consequent fall in RMG price. The fall in placement of RMG orders in the recent months is likely to show up in slowdown of export growth in the first quarter of FY2011-12.

As the analysis in this section of the report makes evident, export performance of Bangladesh in FY2010-11 reflects a number of positive developments including robust growth, strengthened market presence in both EU and US, and indications of both product and market diversification. The performance also reveals a number of concerns including stagnating price levels in spite of higher input costs and falling terms of trade of major exportables against key imports. Bangladesh's stellar performance in RMG exports, backed by competitive wages, capacity to cater to mass-produced segment of the demand curve and reduced lead time for certain items (knitwear and sweater), thanks to strong backward linkages, is likely to continue to give the competitive edge in near-term future. However, sustaining the current high growth will depend on a number of factors including ability to go for efficiency enhancing production measures, catering to higher priced and high value-added items, enhancing south-south trade and getting Bangladesh strongly placed in the context of the "*China plus one*" policy pursued by major buyers. Both product diversification within and without RMG, and market diversification, beyond the EU and North America should receive high priority. In view of the emerging opportunities for such sectors as pharmaceuticals, footwear and shipbuilding, specific strategies and incentives will need to be drawn up to realize potential opportunities. In the backdrop of high export growth of FY2010-11 and the recovery of global demand in this year, it is likely that sustaining the current robust growth will be rather difficult in the next year. However, it is reckoned that maintaining double-digit growth (16.0 per cent in the MTMF) is possible if Bangladesh is able to address the aforesaid challenges.

3.7 OVERSEAS EMPLOYMENT AND REMITTANCE INFLOW: WHAT IS AT STAKE?

Remittances earned from overseas Bangladeshi migrants have traditionally played an important role in terms of the overall balance of payments situation of the country (Table 3.7.1). Remittances also played a significant role in the economy when export was experiencing deceleration during the post-Global Financial Crisis (GFC) period.[93] As is known, remittances also have a positive impact on consumption and poverty alleviation[94] in the country by way of generating large multiplier effects as remittances are "more likely to be spent on domestically produced goods" (World Bank, 2008). Besides, the welfare impact of international migration, both in terms of reducing pressure on the domestic labour market and injection of foreign currency into the economy is well established.[95] Latest figures show that since independence more than 7.31 million[96] people had left for jobs abroad through formal channels.[97] A cumulative US$ 82.7 billion has been sent to the country by them as remittances since 1976, through the formal channels.[98]

TABLE 3.7.1: IMPORTANCE OF OVERSEAS MIGRATION AND REMITTANCES FOR BANGLADESH ECONOMY

FY	Remittances (Million US$)	No. of expatriates ('000')	Cumulative No. of expatriates ('000')	Remittance as % of				
				Total Export	*Total Import*	*Total ODA*	*GDP*	*FOREX Reserve*
FY2000	1949	248	2865	33.9	3.0	362.0	17.8	99.1
FY2005	3848	250	4051	45.6	1.9	565.7	21.8	131.3
FY2007	5979	564	4906	49.2	3.3	745.4	25.1	117.8
FY2008	7915	981	5887	56.2	4.5	683.4	27.2	128.7
FY2009	9689	650	6537	62.2	43.0	524.5	10.8	129.7
FY2010	10987	427	6964	67.8	46.3	507.7	11.0	102.2
FY2011*	8611	299	7263	53.1	35.6	666.0	-	-

Source: Calculation based on data from Bangladesh Bank and BMET
* July - March

A number of issues including gender and skill mix of migrant workers, cost of migration, and the crisis in the Middle-East and North Africa (MENA) have emerged as major concerns in recent times. However, whether or not the crisis in the MENA countries will have any significant adverse impact on Bangladesh's labour export and remittance earnings needs careful investigation.

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[93] Increase in oil prices and expansion of economic activities in the Gulf Cooperation Council (GCC) countries helped Bangladesh maintain a decent performance in manpower export and remittance earnings in the post-GFC period.

[94] According to *Khondker* and *Raihan* (2007), growth in remittances accounted for 1.7 per cent out of a 9 per cent decline in headcount poverty during 2000–2005. The study also found that the probability of a household becoming poor decreases by 5.9 per cent if it receives remittances.

[95] About 2.2 million people get into the labour market each year. Capacity to absorb this number within the domestic economy is rather limited. Migrant workers account for between 20-30 per cent of the annual incremental labour force. Thus, manpower export contributes to both poverty alleviation and economic security of the country.

[96] Data till April 2011

[97] Total number of migrant workforce from Bangladesh at present, however, remains somewhat unclear as many have left through various informal channels and some have also come back.

[98] The cumulative remittance inflow since January 1976 till March 2011 was US$ 81.7 billion. This was 1.6 times the foreign aid (US$ 51.4 billion) received by Bangladesh during the same period.

The following discussion presents an analytical review of the emerging state of overseas migration (in *Section 1*) and remittance situation (in *Section 2*) of Bangladesh with focus on the first ten months of the current fiscal year (FY2010-11). The analysis provides some insights into the current dynamics and future outlook for the sector in the backdrop of the Sixth Five Year Plan (SFYP), being finalised by the Government of Bangladesh (GoB) and also the forthcoming national budget for FY2011-12.

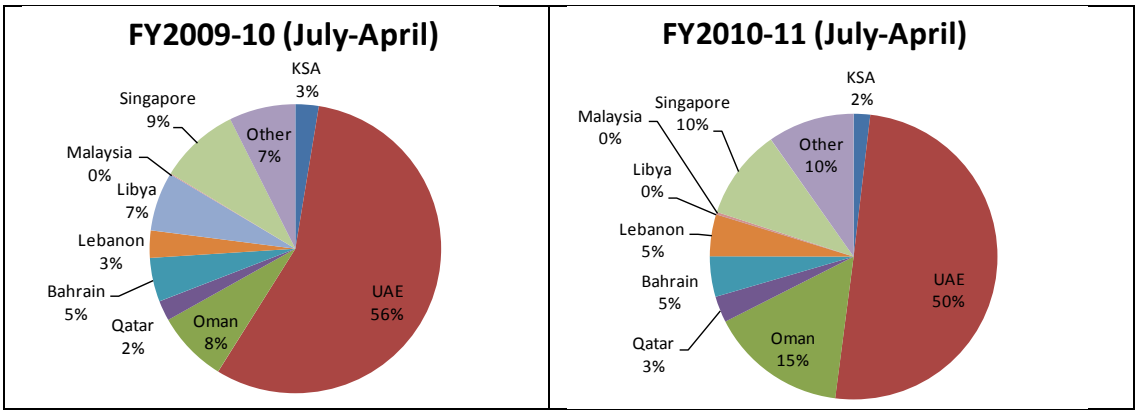
3.7.1 Overseas Migration: Decelerating Growth is a Key Concern

Official data show that total number of migrant workers went abroad during the first ten months (July-April) of the current fiscal was 341,811. This is (-)4.8 per cent lower than that of the corresponding period of the previous fiscal when a total of 3,59,165 workers went abroad. Indeed, the indicator is better than the (-)37.6 per cent negative growth registered during July-April period of FY2009-10 over the same period of FY2008-09. However, there is there is no scope to lose sight of the continuing fall in manpower export from Bangladesh since FY2008 in the backdrop of the secular rise of the earlier years. Besides, another 2,35,189 workers will need to be sent abroad over the last two months of the current fiscal if Bangladesh is to meet the target of about 0.58 million which was set out in the National Budget for FY2010-11. Given the current scenario, attainment of this target is highly unlikely.

Market concentration of Bangladeshi migrant workers has also shown some variations in recent times. Figures 3.7.1a and 3.7.1b reveal that while share of some of the traditional markets (such as KSA, UAE, and Libya) in terms of manpower export by Bangladesh has declined during July-April period of FY2010-11, a number of other countries (including Oman, Qatar and Lebanon) have witnessed a rise in their respective shares. Particular mention may be made here of Libya where no workers from Bangladesh went during the first ten months of the current fiscal, whereas a total of 23,604 job seekers from Bangladesh went to the country during the corresponding period of the previous fiscal. Libya accounted for 7 per cent of total overseas migration from Bangladesh in FY2009-10. The evolving situation in Libya has raised demand for a *Contingency Plan* to address the needs of the migrant workers in times of crisis in the host countries (more on this in Box 3.7.2).

FIGURE 3.7.1: CHANGE IN MARKET COMPOSITION FOR MANPOWER EXPORT FROM BANGLADESH

Figure 3.7.1a ***Figure 3.7.1b***

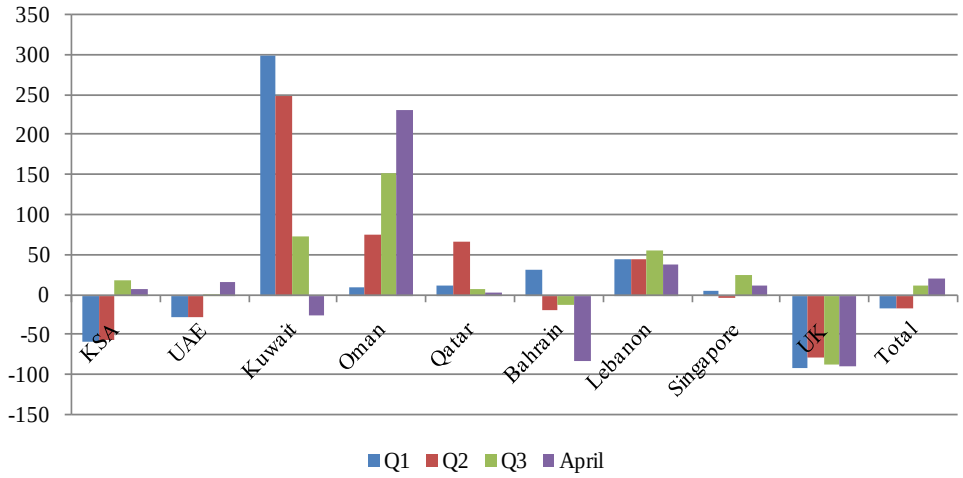


Source: Based on BMET data

Apart from Libya, continued deceleration in overseas migration to Malaysia appears to be a major concern. While Malaysia took about 85,600 (more than 15 per cent of total) Bangladeshi workers during the July-April period of FY2008-09, the number for the corresponding period of the two successive fiscal years were a mere 366 and 951 respectively. As a result Malaysia's share became negligible during the first ten months of FY200-10 and FY2010-11. In a welcome development, some negotiations have recently been initiated by the two governments to facilitate labour migration from Bangladesh through government-to-government (G2G) arrangements.[99] However, the process is still in its early stage and any tangible outcome is yet to be seen.

Bangladesh has experienced negative growth in manpower export also to KSA (-32.1 per cent) and UAE (-15.1 per cent) during July-April, FY2010-11 as against the same period of FY2009-10. The corresponding growth rates for FY2009-10 vis-à-vis FY2008-09 were (-)69.6 per cent and (-)32.8 per cent respectively. A large part of this could be attributed to the stringent regulatory measures in these labour importing countries. The continued declining share of KSA, UAE and Libya in the total number of migrant workers from Bangladesh has contributed significantly towards the current deceleration in manpower export growth.

FIGURE 3.7.2: COMPARATIVE GROWTH (FY11 VS FY10) IN OVERSEAS MIGRATION



Source: Based on BMET data

Some respite is, however, evidenced by the positive growth achieved in overseas migration from Bangladesh to KSA (19.7 per cent) and UAE (0.8 per cent) during the third quarter of the current fiscal when compared to the same period of FY2009-10 (Figure 3.7.2). Besides, KSA has recently expressed its intention to take workers from Bangladesh under four categories namely drivers, gardeners, doormen, and domestic help. Besides, the island countries of Maldives and Mauritius are reported to have expressed their willingness to host increased number of migrant workers from Bangladesh in the coming days.[100] While demand in the former is known to be for skilled and professional manpower specially doctors, nurses

[99] Under the G2G arrangement, Malaysia will import manpower from Bangladesh through the Bureau of Manpower, Employment and Training (BMET). The initiative also envisages sending workers to Malaysia at a migration cost not exceeding BDT 84,000. The GoB is currently in the process of finalising the necessary modalities with registered recruiting agencies (though they initially disagreed with the proposed migration cost) so that the offer by the Malaysian government can be meaningfully utilised.

[100] http://www.newstoday.com.bd/index.php?option=details&news_id=28982&date=2011-06-01 (accessed on 01 June 2011)

and teachers, preference of the latter is semi-skilled and skilled workers in garments, construction and fish processing industries. These offers will need to be appropriately met. It may be mentioned here that the month-on-month growth of overseas migration in April 2011 was 20.6 per cent. Thus, if no major upset occurs within the next two months, overseas migration from Bangladesh in FY2010-11 is likely to match the figure attained during the previous year.[101] Assuming that the average monthly migration of workers from Bangladesh during May-June, 2011 period would be 43,800 (equivalent to the average for the March-April, 2011 period), annual growth rate for FY2010-11 over FY2009-10 will be 0.5 per cent. However, the growth will be negative (around -3.2 per cent) if the average number of migration for the first ten months of FY2010-11 sustains for the rest of the fiscal.

3.7.2 Remittance Inflow: Unable to Match Previous Growth Performance

Remittance earnings have increased more than five times during the past decade and it is currently the single largest foreign exchange earner for Bangladesh. Inward remittances to Bangladesh during the first ten months of FY2010-11 stood at about US$9.6 billion which is 4.6 per cent higher than the comparable period of the previous fiscal, but much lower than the 16.7 per cent achieved in FY2009-10 over FY2008-09. Hence, there is a significant deceleration in remittance inflow in the current fiscal. With the existing growth rate it is estimated that at the end of FY2010-11 total remittance inflow will stand at around US$ 11.5 billion, compared to the $10.9 billion of the last year.

A positive change has been observed during the third quarter of FY2010-11 when growth of remittance inflow reached 11.8 per cent over the corresponding period of FY2009-10. If this growth rate sustains over the April-June quarter, remittance could reach about US$ 11.7 billion in the current fiscal.

Estimates suggest that while the highest growth rate for FY2010-11 over the previous fiscal in a business-as-usual scenario (4.6 per cent during the first ten months) could be between 4.7 and 5.0 per cent, this could change into around 6.5 per cent in an optimistic scenario (assuming that the last quarter of the current fiscal will maintain the growth rate of third quarter). This indicates a significant deceleration in the current fiscal against the 13.4 per cent growth achieved in FY2009-10 over the previous fiscal. The growth figures also fall short of global projections. World Bank projections for average annual growth in remittances for South Asia for the calendar years 2010 and 2011 are 8.2 per cent and 9.1 per cent respectively (Mohapatra, *et al*, 2011). However, Bangladesh could only manage a mere 2.7 per cent growth in remittances in 2010 over 2009.[102] Given the current dynamics, one can only hope as to how better the sector would need to perform to get even close to the projected regional average growth rate for 2011.

The target for remittance earning in FY2010-11 is US$14 billion, as has been set out in the *Medium Term Macroeconomic Framework* (MTMF) for FY2010-11. In view of this, it is likely that there will be shortfall of about US$2.0 – 2.5 billion in remittance earnings in the current fiscal which should be a cause for concern for the policymakers.

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[101] Total migration during FY2009-10 was 4,27,202. To match this figure, another 85,391 persons will need to be sent abroad during May-June period of 2011. It may be noted here that the average number of persons going abroad from Bangladesh during February-March 2011 period was more than 43,800.

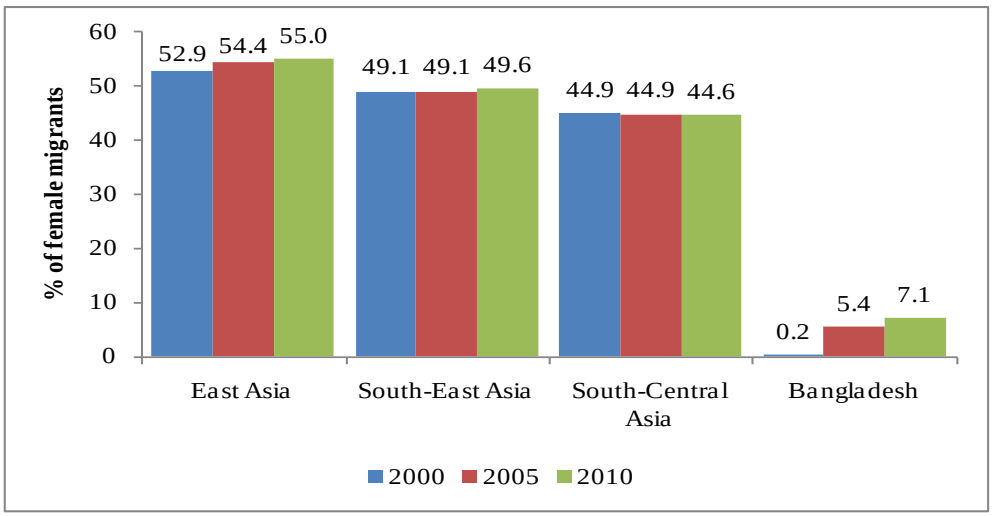
[102] Comparison between calendar years

3.7.3 Current Challenges in the Manpower Export Sector

Gender dimension of migration: Some emerging opportunities. In terms of gender composition of migrant workers from Bangladesh, share of women have consistently remained dismally low compared to their male counterparts. There seems to be an upturn in this regard recently.

Available data suggests that a total of 1,51,979 female workers went overseas during 1991 to 2010 period, accounting for a paltry 2.4 per cent of the total overseas migration during the last two decades. In 2000, share of female migrants in total overseas migration from Bangladesh was only 0.2 per cent which increased to 5.4 per cent and 7.1 per cent respectively in 2005 and 2010 (Figure 3.7.3). To compare, these figures for East Asia were 52.9 per cent, 54.4 per cent and 55.0 per cent respectively. As for the first ten months of FY2010-11, about 10,900 female workers went abroad which was roughly 8 per cent of the male migrants and about 7 per cent of the total (male and female combined). UAE, Jordan, Lebanon and Mauritius have been the most important hosts of female workers from Bangladesh in recent years.[103]

FIGURE 3.7.3: SHARE OF FEMALE MIGRANTS IN TOTAL OVERSEAS MIGRATION



Source: Adapted from IOM (2010)

In view of the recent Saudi proposition for hosting female workers as domestic help, and also the growing demand for nurses and care givers in the European countries, there is a need to give special attention towards skill development of women to enhance their share in overseas migration from Bangladesh. Discussion with BMET officials reveals that the Saudi government has proposed to pay US$800 per female worker in advance to facilitate their migration in the domestic help category.[104] As per the proposal, this cost of sponsorship will be later adjusted with the wages of the respective workers in the host country.

High cost of migration: Reduction is the call of the day. Average cost of migration from Bangladesh to most countries is known to be between Tk. 0.2-0.3 million.[105] When this cost

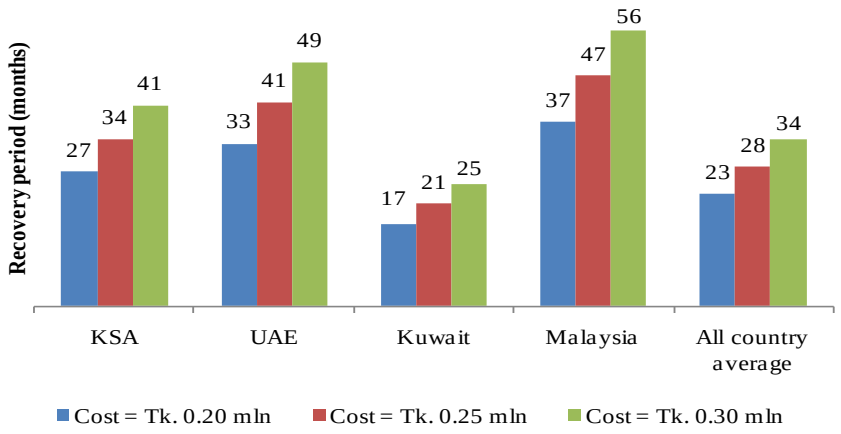
[103] Rate of female workers' migration to KSA fell drastically since 2009 when only 389 female workers went to the country from Bangladesh compared to more than 4,000 in 2008.

[104] A similar initiative has been reported to be in place on earlier occasions, but malpractices by some recruiting agencies in the form of charging additional fees from aspirant migrant workers inhibited success of the endeavour.

[105] This is more than double the cost incurred by workers going overseas from other South Asian countries.

is compared with the per capita monthly remittance earnings by the migrant workers, one gets some idea with regard to the approximate recovery period of the cost incurred by these workers to go abroad.[106] CPD estimates, based on official data on migration and remittance inflow taking place through formal channels, show that if a Bangladeshi migrant worker had to spend Tk. 0.20 million to go to KSA in 2010, it would have taken him/her about 2 years to recover the cost (Figure 3.7.4).[107] On the other hand, if the migration cost was Tk. 0.25 million the recovery period would have been about 3 years and for Tk. 0.30 million it would be 3.5 years. However, the actual figure could be significantly different as official data for both the stock of migrant workers in the particular country (because of workers returning, and also going through informal channels) and the flow of remittance (because of sending remittance through informal channels) tends to be unable to capture the real picture.

FIGURE 3.7.4: MONTHS REQUIRED TO RECOVER COST OF MIGRATION FOR SELECTED DESTINATIONS IN 2010



Source: Authors' calculation

Unfortunately, a large number of aspirant migrant workers become victim of the unethical profit-seeking motives of a section of the recruiting agencies, operating in collaboration with the so called *dalals* (middlemen), and are forced to pay an excessively high cost of migration. Anecdotal information suggests that there are more than 50,000 middlemen currently active in the manpower export sector of Bangladesh. These people intermediate between the aspirant migrant workers and the recruiting agencies. Often the migrant workers 'change hands' several times with attendant cost escalation at each stage. There is a need to raise awareness amongst migrant workers about not taking assistance from the middlemen through various awareness raising campaigns. Recruiting agencies should also be asked to provide necessary information to aspirant migrant workers in a more comprehensive manner. District level BMET offices (known as *District Manpower and Employment Office* or DEMO) will have to play a lead role here. Assistance may also be sought from local NGOs in this regard.

The GoB has recently been trying to address the issue of migration cost through various ways. The government has recently set up the *Probashi Kalyan Bank* (Expatriate Welfare Bank) which will be providing low interest loans to these people (see Box 3.7.1 for details).

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[106] As a matter of fact, the recovery period will be higher as a part the money spent is collected through borrowings at exorbitantly high interest rate.

[107] Per capita monthly remittance earning from KSA is estimated to be about US$ 107 (Tk. 7384.5) for 2010. The recovery period is calculated by dividing migration cost by per capita monthly remittance earning. Similar calculations have been done for the other countries.

Besides, recent information suggests that the government is in the process of consultations with the Bangladesh Association of International Recruiting Agencies (BAIRA) to finalise destination-specific maximum cost of migration. However, any decision on this will need to be backed up by appropriate legislative initiatives. Reduced migration cost, coupled with cash support, loan on easy terms and financial assistance programmes for aspirant migrants, will help migration from poor families and also poverty prone areas reducing the existing regional disparity in the context of overseas migration from Bangladesh.[108]

BOX 3.7.1: PROBASHI KALYAN BANK (PKB): A COMMENDABLE INITIATIVE

Bangladesh government has established the state run *Probashi Kalyan Bank* (PKB) to fund workers going abroad for employment, facilitate sending remittances and reduce migration cost. The PKB was inaugurated on 20 April 2011, on the eve of the 4th ministerial level conference of the Colombo Process. The initiative goes back to May, 2010 when the Cabinet gave nod to introduce an 'Expatriate Welfare Bank' to serve the needs of the expatriate workers. In July, 2010 the draft Expatriate Welfare Bank got approval from the Cabinet and the Jatiya Sangsad passed the Act in October, 2010. The paid up capital of the PKB is Tk.100 crore of which Tk.95 crore came from the Wage Earners' Welfare Fund and the rest from the government exchequer. The authorised capital for the bank has been proposed at Tk.500 crore.

The bank will be providing soft loans to aspirant overseas migrant workers to meet travel/processing cost at 9 per cent interest rate which is lower than that of any other commercial bank. Currently the bank is providing loans to jobseekers to UAE, Bahrain, Lebanon, South Korea, Oman and Mauritius. It has been reported that up to 70 per cent of their total cost is provided as loan. There is difference in the amount of PKB loans for male and female expatriates. According to BMET, cost of migration for male workers is higher than the female workers as in most cases the cost of visa fees/air fares for female migrant workers are paid by the employers from destination countries.

Another important objective of this bank is to finance returnees to start new business after returning home. The PKB will collaborate with Bangladesh Post Office in order to reach the poor people in rural areas enabling them to collect their remittance from post offices. The new bank also envisages to collaborate with different 'money/remittance transferring' agencies (e.g. Western Union, Moneygram) in order to reduce the cost of sending remittances.

Falling purchasing power of remittance. Growth figures often do not reflect the actual purchasing power, in local currency, of the remittance sent back home because of domestic inflation. Table 3.7.2 bears this out very clearly. As the table indicates, there was indeed a negative growth in remittances sent to Bangladesh in calendar year 2010 in terms of domestic purchasing power. This has also been the case for South Asia as a region and a number of other countries. Indeed, the Bangladesh situation would have deteriorated further had there not been some depreciation of taka in recent times.

[108] An analysis of HIES (2005) data indicates that Barisal, Khulna and Rajshahi, the three divisions with higher poverty rates in 2005, received comparatively lower levels of remittances than the relatively more developed rest three divisions of Dhaka, Chittagong and Sylhet (*Rahman* and *Hossain*, 2011).

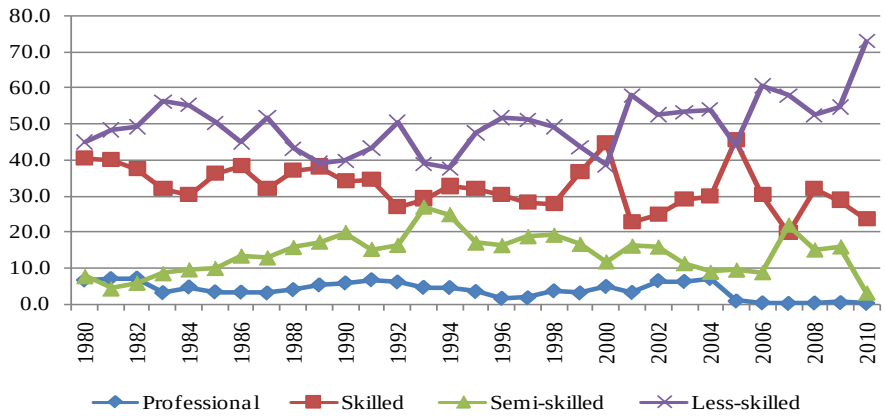
TABLE 3.7.2: GROWTH OF REMITTANCE IN 2010 IN LOCAL CURRENCY TERMS ADJUSTED FOR INFLATION

Region /Country	Remittance inflows in 2010 (US$ bln)	Growth of remittance in 2010 over 2009		
		US$ terms (%)	*local currency terms (%)*	*local currency terms adjusted for inflation (%)*
South Asia	81.2	8.2	4.6	-6.3
Bangladesh	11.0	2.7	3.6	-4.5
China	51.3	5.3	4.3	1.0
India	53.1	7.4	1.5	-10.4
Pakistan	9.7	11.1	15.8	3.7
Philippines	21.4	8.1	2.3	-1.4

Source: Mohapatra, *et al*. (2011)
Note: Data updated for Bangladesh

Skill composition of Bangladeshi migrant workers: Need for skill development. Another key aspect in overseas migration is the skill composition of the workers. Bangladesh has traditionally been an exporter of workers in the semi-skilled and less-skilled categories. The scenario has barely changed over the last two decades (Figure 3.7.5). The proportion of less-skilled workers alone in 2010 was more than 73 per cent[109] while the rest comprised of semi-skilled, skilled and professional workers. This is also reflected in the lower average per capita remittance sent by Bangladeshi workers when compared to other countries.[110]

FIGURE 3.7.5: SKILL COMPOSITION OF BANGLADESHI MIGRANT WORKERS SINCE 1980



Source: Based on BMET data

The average share of less-skilled workers rose from 52.4 per cent during 2001-2005 period to about 59.8 per cent during 2006-2010. The comparable figures for semi-skilled (from 12.5 per cent to 13.1 per cent), skilled (30.5 per cent to 27.0 per cent) and professional workers (4.7 per cent to 0.2 per cent) suggest that relatively lower number of skilled workers and professionals have gone overseas from Bangladesh in recent times. From the demand side, this has been particularly due to the slowdown in the construction sectors in the traditional markets, particularly in the Middle East. On the other hand, growth in the less-skilled category is partially explained by the growing demand for workers in the agriculture sector both in the Middle East and non-Middle Eastern countries (including Lebanon, Jordan, Sudan, Libya, Egypt and Brunei).

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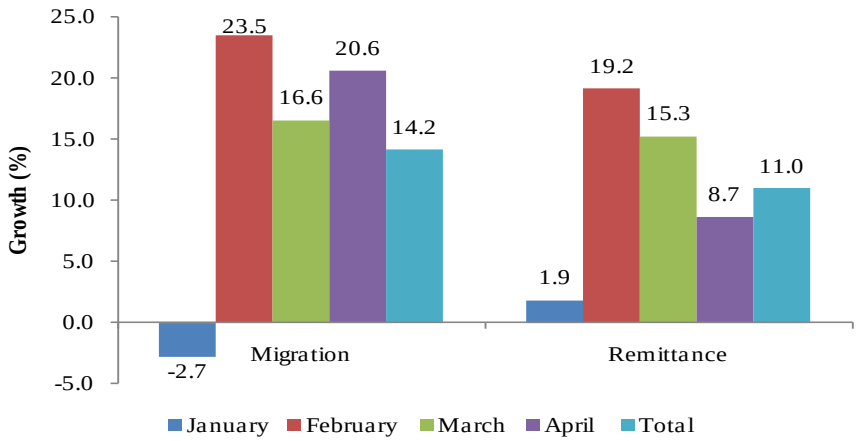
[109] This share in 2009 was 54.8 per cent

[110] Average per capita remittance sent by Bangladeshi workers in 2010 was about USD 1,600; to compare for Philippines the figure was about USD 2,300 (*Rahman* and *Hossain*, 2011).

Demographic momentum of OECD countries, characterised particularly by the growth in ageing population resulting into increased demand for caring services and shortage of workers in the health care sector, is likely to create significant job opportunities for developing countries, particularly in such areas as physicians, nursing, medical technicians and caring services (Aminuzzaman, *2007*; OECD, *2008*; Simoens, Villeneuve, and Hurst, *2005*; Kumar and B, *Undated*). This reinforces the need to create more skilled and professional migrants. At the same time, with new opportunities arising in countries such as KSA and Malaysia, technical training centres (TTC) should be strengthened both in terms of manpower and logistics. It may be noted here that the government has recently allocated about Tk.900 crore to set up 36 new TTC across the country in view of the growing demand for skilled migrant workers in the global market.

Crisis in the MENA countries: How much to worry about? There are serious concerns regarding possible negative impacts on both manpower export and remittance earnings if there is widespread dislocation and disturbances in major host countries in the MENA region. It is a matter of some relief for Bangladesh that the available data suggests that the impact has so far been not very significant.

FIGURE 3.7.6: MONTH-ON-MONTH GROWTH (JANUARY - APRIL) IN MIGRATION AND REMITTANCES IN FY2010-11 OVER FY2009-10



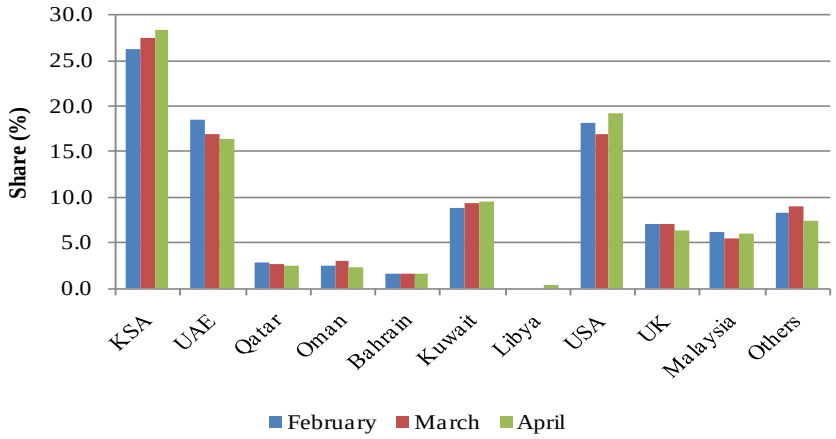
Source: Based on BMET and Bangladesh Bank data

As Figure 3.7.6 depicts, both overseas migration and remittance inflow have been able to maintain reasonable growth during the January – April period of 2011 vis-à-vis the comparable period of 2010, a period which coincided with the unrest in the MENA countries. During the February – April 2011 period, when the crisis was at its peak, Bangladesh earned nearly US$3.1 billion in remittances. This was about 14.2 per cent higher than the comparable period of 2010. Besides, the share of Libya in total remittance inflow has traditionally been very low and the scenario has barely changed in recent months (Figure 3.7.7).[111] It may be noted here that remittance earnings from Libya in April 2011 was US$2.9 million, the highest ever remittance from the country to Bangladesh in a single month. This appears to be due to one-time transfer of savings by Bangladeshi migrant workers in anticipation of uncertainty over job security and earnings in future. With more than half of

[111] Libya's share in total remittance inflow to Bangladesh for the months of January, February and March of 2011 was respectively 0.0 per cent, 0.1 per cent and 0.3 per cent.

the stock of Bangladeshi workers returning home from Libya, remittance from the country in the coming months is expected to be much lower.

FIGURE 3.7.7: MARKET SHARE OF REMITTANCE INFLOW INTO BANGLADESH DURING FEBRUARY-APRIL, 2011



Source: Calculation based on Bangladesh Bank data

As was noted, crisis in MENA did not have serious adverse impact on Bangladesh. However, if there is a contagion effect, or if in future such crises engulf countries such as KSA, UAE, Qatar, Oman, Kuwait and Bahrain, the impact is likely to be quite serious.

Possible impact of *Saudisation*.[112] The recently proposed move by KSA to put a six-year cap on the residency of foreign nationals has raised serious concerns for labour exporting countries like Bangladesh as implementation of the decision will result in significant fall in remittance earnings.[113] It may be noted here that KSA currently accounts for about 28 per cent of the total remittance flow into Bangladesh. Considering the current total stock of Bangladeshi migrants in the country to be 2.5 million (more than 34 per cent of the global stock of migrant workers from Bangladesh), there are only about 0.5 million Bangladeshis in KSA with less than six years of residency. At present scenario, about 2.0 million Bangladeshi nationals will have to leave KSA in near future if the proposed measure is implemented within this year. The estimated number of Overseas Filipino Workers (OFWs) expected to be affected by the decision is 0.35 million.[114] Besides, the Egyptian government is also concerned about the future of more than 70 per cent of its 2.5 million migrant workers in KSA as they have crossed the six years residency threshold.[115] Hence, like Egypt and many other countries including our South Asian neighbours, there is widespread apprehension that in addition to falling remittances, the *Saudisation induced return migration* may create additional pressure on the Bangladesh labour market.

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[112] The 'Saudisation' policy was approved by Saudi policy makers in 2006 to tackle growing unemployment among Saudi nationals (currently, unemployment rate is KSA is 10.5 per cent). The decision to discontinue renewal of work permits of foreign workers spending six years in that country is part of a 10-point programme to intensify *Saudisation* of jobs in the private sector to reduce unemployment. The policy requires private sector companies operating in Saudi to allocate 10 per cent of their total workforce for Saudi nationals. Those having less than that, will not be issued new work permits (*akama*). The Saudi government has given a five months grace period to the country's private companies to comply with the requirement.

[113] http://gulfnews.com/news/gulf/saudi-arabia/saudi-arabia-plans-six-year-cap-on-expat-visas-1.814794 (accessed on 30 May 2011)

[114] http://www.mb.com.ph/articles/320681/350000-ofws-may-lose-jobs (accessed on 31 May 2011)

[115] https://www.arcamax.com/politics/politicalnews/s-894783 (accessed on 31 May 2011)

3.7.4. Immediate to Mid-Term Doables

Reducing cost of migration. Immediate measures need to be taken to reduce the cost of migration for Bangladeshi workers. In this context, it is of utmost importance that the consultation process between the government and BAIRA is concluded immediately and in a fruitful manner. Besides, every measure has to be taken to ensure effective functioning of the PKB. Recruitment of required permanent manpower for the bank should be done on an urgent basis. Besides, the government should play pro-active role to carry out negotiations with major labour importing countries to expedite the process of setting up branches of the PKB in those countries. This can play a major role in reducing the cost of sending remittances back home by the Bangladeshi migrant workers.

Designing a *Contingency Plan*. The unwholesome developments in the MENA countries have highlighted the urgency to devise a *Contingency Plan* to address the needs of overseas Bangladeshi migrant workers, particularly in times of crises. Since the crisis broke out in Libya, around 36,400 Bangladeshis returned home aided by International Organization for Migration (IOM), GoB and, in some instances, by their employers. [116] IOM alone facilitated repatriation of about 28,627 Bangladeshis from Libya till 6 April 2011 (IOM, 2011).[117]

BOX 3.7.2: CONTINGENCY PLAN FOR EMERGENCY SITUATIONS

The government should consider designing a Contingency Plan, on an urgent basis, which could include the provision for setting up a Contingency Fund (CF). A certain part of the Wage Earners' Welfare Fund (WEWF), which currently amounts to about Tk.300 crore, could be earmarked for the CF. The Fund could be used towards meeting the expenses for providing emergency food, clothes and shelter to Bangladeshi migrant workers in host countries as well as facilitating their safe repatriation. Besides, addressing the needs of the returnee migrant workers is another important aspect which, as is envisaged, could be taken care of by the PKB. The Contingency Plan should be able to address the following concerns in times of crises:

- Ensuring safety and security of the Bangladeshi migrant workers in the host countries
- Immediate relief in the form of food, shelter, medicine, etc.
- Emergency evacuation
- Safe repatriation
- Rehabilitation upon return to Bangladesh
- Reintegrating returnees into domestic labour market
- Facilitating re-migration of the returnees on a priority basis

Taking advantage of new market opportunities. The importance of the Saudi proposal for hosting workers under certain categories can hardly be overemphasised in the context of the continuing deceleration of manpower export to the country from Bangladesh in recent times. Besides, such GCC countries as KSA and Qatar are likely to be in high demand for workers in the construction sector in the coming year.[118] The G2G initiative with Malaysia is another important window of opportunity to revive the growth in overseas migration. While the demand of these countries are for less and semi skilled workers, opportunities for skilled and professional migrants are expected to be quite high in the OECD countries. Besides,

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[116] Discussion with BMET officials

[117] The WB has given a loan of $40 million to Bangladesh under the project entitled *Repatriation and Livelihood Restoration for Migrant Workers Project* to service the attendant costs. Bangladesh will be paying IOM about US$14 million against its support for repatriation. Besides, each of the returnees from Libya will receive a one-time cash grant of Tk. 50,000 to meet immediate expenses including family maintenance.

[118] While KSA has recently approved a project to build the mile-high 'Kingdom Tower' (http://www.emirates247.com/property/real-estate/kingdom-tower-gets-green-light-2011-04-13-1.380638), Qatar will be building nine fully air-conditioned stadiums for hosting the 2022 FIFA World Cup.

opportunities have also emerged for enhancing worker migration to Maldives and Mauritius. Hence, time bound and strategic policy initiatives will need to be taken to garner maximum benefits from these emerging market opportunities. In view of the potential impact of *Saudisation*, the need for market diversification has become even more urgent.

Facilitating overseas migration from poverty prone regions. The more the number of migrant workers from disadvantaged areas, the greater the effect on poverty alleviation. According to BMET, at least 4 per cent of the migrant workers going abroad through recruiting agencies should come from *Monga* prone areas. As a matter of fact, this is hardly the case. It is, however, encouraging that the draft-SFYP mentions about giving special attention to export of manpower on a large scale from *Monga* and other underprivileged areas. Appropriate measures will need to be put in place to ensure proper implementation and effective monitoring of these provisions. In its loan disbursement, the PKB should give priority to aspirant migrant workers from poverty prone regions.

Addressing overseas migration as a priority sector in the SFYP. As of now, the draft-SFYP document deals with this sector in a somewhat disjointed manner. However, given the importance of the sector in Bangladesh economy, issues related to overseas migration and remittances deserve to be treated in a more substantial and holistic way. Initiatives such as finalisation of the Comprehensive Migration Policy or enactment of an Overseas Employment Act should be included in the agenda of actions in the SFYP. Besides, specific guidelines and work plans to strengthen the capacity of Bangladesh missions abroad to facilitate manpower export will need to be prioritised in the Plan document. A number of other issues including strengthening human resource capacity in both the Ministry of Expatriate Welfare and Overseas Employment (MoEWOE) and BMET, as well as enhancing budgetary allocations for these institutions, should receive due attention in the final SFYP.

Finalising the *Comprehensive Migration Policy*. Recent reports suggest that GoB is in the process of devising a Comprehensive Migration Policy. In this context, the Emigration Ordinance of 1982 and the Overseas Employment Policy of 2006 are currently being revisited. One would expect that the final outcome document, whether in the form of a Comprehensive Migration Policy or as an Overseas Employment Act, will adequately address the issue of streamlining cost of migration. Appropriate operational modalities for ensuring full compliance with the law by the recruiting agencies will need to be clearly spelt out in the document.

Strengthening bilateral, regional and multilateral collaboration. The recently concluded 4th Ministerial Meeting of the Colombo Process has reinforced the need for strengthened collaboration not only with the labour exporting countries, but also with the recipient countries.[119] Besides, the GoB has ratified the *UN Convention on the Protection of the Rights of Migrant Workers and Members of their Families* in April 2011.[120] Efforts should now be strengthened, in collaboration with the 10 other partner countries of the Colombo Process, to pursue the labour importing countries to ratify the relevant UN and ILO conventions to

[119] The Dhaka Declaration of the Colombo Process shows much promise in identifying areas of meaningful collaboration among the Member countries. Critics, however, argue that the existing and growing competition among the labour exporting countries might work as a deterring factor in the context of meaningful implementation of the commitments articulated in the Declaration.

[120] The Convention was initially signed by Bangladesh in October 1998. At present, Bangladesh is the third Asian country, after Sri Lanka and the Philippines, to have ratified the Convention.

safeguard the interests of our migrant workers. Technical and strategic support from these organisations could also be sought to facilitate such negotiations. Bangladesh must also play a proactive role in the WTO-GATS negotiations with a view to ensuring an LDC friendly outcome to augment services export to the global market, particularly under GATS Mode-4.

3.7.5 Concluding Remarks

In view of the current deceleration in overseas migration and remittance inflow, Bangladesh is now faced with a number of challenges to sustain future growth of the sector. While the crisis in the MENA countries has not led to significant adverse impact, it is already evident that because of the downward trend in migration to traditional labour importing countries the target for overseas migration and remittance earnings set for FY2010-11 will not be reached. In view of this, realising the emerging opportunities in KSA, Malaysia, Maldives, Mauritius and OECD countries have become even more urgent and necessary. Bangladesh will also need to prepare itself to tackle the possible adverse effects of *Saudisation* on overseas migration and remittance inflow. A number of areas will require attention and initiatives on the part of the policymakers in this context.

Reducing cost of migration should receive highest priority. A number of steps will need to be taken towards this. These include discussion with host countries to underwrite cost of migration, enforcement of government decision with regard to maximum country-specific migration cost, removal of middleman through more field-level DEMOs and awareness raising programmes, and taking advantage of the newly established PKB in providing loans to aspiring migrants. Special programmes will need to be initiated for women and those coming from economically disadvantaged areas. The PKB can play a facilitating role in this context.

Government must also take immediate measures to finalise the proposed Comprehensive Migration Policy and the Overseas Employment Act 2011, and ensure strict compliance with the provisions by the recruiting agencies. A Contingency Plan, with the required funding, should be designed and put in place in view of recent experiences with the MENA countries. Bearing in mind the falling purchasing power of remittance earning, the need for reducing cost of migration and going for higher-income earning sources, backed by the needed skill endowments, has become even more urgent as Bangladesh enters a new fiscal year.

4. MACROECONOMIC PROSPECTS AND CHALLENGES FOR FY2011-12

4.1 OUTLOOK FOR FY2011-12

Stresses and strains experienced by macroeconomic fundamentals during FY2010-11 are expected to persist, if not aggravate further, in the upcoming year. However, in the backdrop of BBS's preliminary GDP growth estimate of 6.7 per cent (FY2010-11), the government has already set out its intention to achieve GDP growth rate to the tune of 7.0 per cent in FY2011-12.

TABLE 4.1.1: MACROECONOMIC FRAMEWORK FOR FY2010-11 AND FY2011-12

Indicator	FY11			FY12		
	MTMF	Provisional	IMF	MTMF	SFYP	IMF
Real Growth (%)	6.7	6.7	5.9	7.2	6.9	6.4
National Savings (% of GDP)	NA	28.4	24.7	NA	29.9	25.3
Gross Investment (% of GDP)	26.4	24.7	25.5	28.4	28.4	26.6
ICOR	3.9	3.7	4.1	3.9	4.1	4.2
Total Govt. Outlay (% of GDP)	16.9	16.8[1]	16.7	17.2	17.4	18.2
ADP (% of GDP)	4.9	4.5[3]	4.0	5.3	5.0	4.5
ADP as % of total Govt. Outlay	29.0	26.6	33.1	30.8	28.7	24.7
Inflation (annual average %)	6.5	8.5[2]	8.8	6.3	6.5	7.4
Export (% change)	15.0	40.9[2]	27.0	16.0	22.5	19.6
Import (% change)	16.0	40.6[2]	36.1	17.5	29.8	15.0
Remittances (billion USD)	14.0	14.0[1]	10.8	17.1	-	11.2

Source: BBS data, Budget Documents, Draft SFYP and IMF.
Note: 1/ Budget target. 2/ Latest available data. 3/Revised Budget.

As may be observed from the table, the target for GDP growth rate for FY2011-12 has been downsized compared to 7.2 per cent as was previously envisaged in MTMF (Table 4.1.1). The SFYP mentions a 6.9 per cent GDP growth rate for FY2011-12.[121] All these projections stipulate a sharp rise in the investment as per cent of GDP (by 2-4 percentage points) to attain a growth rate of around 7.0 per cent, allowing for no drastic improvement in ICOR. Even if the observed remarkably improved ICOR (as per the preliminary GDP estimate of 2010-11) is sustained in the coming year, investment as a share of GDP needs to be raised by at least one percentage point from the current level. This would imply radical improvement in the ADP implementation rate.

One may recall that the GDP for FY2010-11 could achieve 6.7 per cent growth (provisional estimate) thanks to incremental contribution by the industry sector, particularly by its manufacturing component. Attaining a 7.0 per cent GDP growth target in FY2011-12 will once again depend on continued good performance by the agriculture sector and at the margin, on added contribution from the manufacturing sector where exports has to grow as good as in the elapsing year. Given the current sectoral structure of GDP, economic growth beyond 5.0 per cent is mostly determined by manufacturing sector's level of output Growth of the small and medium enterprises will be important in this respect.

We should not lose sight of the fact that projections suggest that export-import operation as well as remittance flow will be quite subdued in FY2011-12 compared to the preceding year.

[121] An IMF projection indicates a GDP growth rate of 6.7 per cent in FY2011-12. Indeed the IMF provides systematically a much more subdued prospect on all count compared to the government's expectations.

Based on all available evidences, it can be safely said that inflation rate (moving average) will not be less than 7.0 per cent in FY2011-12.

Indeed, to exploit the country's medium-term growth potential, removing the infrastructural impediments, availability of investment finance, enhanced supply of skilled labour force and maintaining political stability will remain critically important.

Global Environment. It needs to be pointed out that the growth prospect of Bangladesh economy in FY2011-12 will also critically rest on a number of factors related to developments in the global economy. The global GDP expansion is expected to be below 2 per cent, which previously had been forecasted to be 3.1 per cent in 2011 and 3.5 per cent in 2012, respectively. The global economy, after a patchy recovery from the global financial crisis, is apprehended to lose some of its momentum in 2012. Performance of the global economy is likely to get mostly affected by the developed economies, since performance of majority of these countries remained low due to drastic fiscal cuts, whereas some of the others were still in recession. In addition to that, the risks associated with uncoordinated fiscal and monetary policies will not only slow global growth but also widen the global imbalances which in turn could add more instability back into financial markets.

World trade is expected to grow by about 6.5 per cent in both 2011 and 2012, moderating from the 10.5 per cent rebound in 2010. Thus, the Bangladesh export growth may decelerate in FY2011-12 from the peak of this year. In contrast, strong export growth is anticipated by the projections made by MTMF and SFYP in face of faltering global recovery.

However, despite the relatively strong push through export rebound, a slowing remittance expansion may damp domestic demand in FY2011-12. Remittance flow is expected to follow the current trend and grow at a low rate in FY2011-12, though a large of this will depend on the current unrest developed in the Middle East.

Apart from the risk allied with sovereign debt and fiscal austerity, the failure to maintain exchange rate stability among the three major international reserve currencies is also likely to affect the currencies of emerging economies i.e. further depreciation of BDT against some of her major importing sources including China and India.

In the backdrop of this resuscitation in the global economy, outlook for more generous aid delivery seems bleak, especially for the developing countries. While Bangladesh currently has around USD 12 billion in the pipeline, it is still in need of budgetary support as well as specific assistance for meeting the MDGs.

4.2 THIRTEEN LESSONS FOR FY TWELVE

Fiscal year 2010-11 turned out to be a challenging period for macro-economic management in Bangladesh. The disquieting signs which appeared during the early months, turned more entrenched during the second half of the elapsing year putting serious strains on the macro-economic balances. The macro-economic tensions projected by consumer price hike, rising bank interest rates and falling exchange rate of national currency were underpinned by global economic shocks as well as by domestic policy and institutional weaknesses. While the relatively good economic performance in FY11 provides a good basis for pursuing the growth target for the coming year, one should not be oblivious of the increasingly visible fault-lines in the macroeconomic fundamentals. It is from this perspective that we need to internalise the lessons those are to be learnt from the experience of FY2010-11 for an improved macroeconomic management and higher economic growth in FY2011-12.

Rebalancing the Demand. In the aftermath of the global financial and economic crisis, almost all countries in the world has rediscovered the role of internal demand in sustaining economic growth in the face of falling external demand. To the credit of Bangladesh, it has been quite successful in lining up policy support for the sectors that essentially cater to domestic demand. Thus, one observes that during FY2010-11, the government continued its support to the crop sector, to rural non-farm activities, to small and medium size enterprises etc. Significant disbursement of micro credit also stoked up domestic demand. Moreover, government also pursued policies for greater regional and sub-regional integration for accessing the concerned markets. Indeed, all these were done without losing focus on export promotion. It will be advisable to continue with this approach in FY2011-12.

Inclusive Growth. Notwithstanding everything, FY2010-11 witnessed an impressive GDP growth of 6.7 per cent (provisional figure). More importantly, a larger incremental contribution to this achieved growth is attributable to the “tangible” sectors, i.e. agriculture and industry. Admittedly, agriculture growth promotes rural income and industrial growth essentially creates labour-intensive employment in Bangladesh. Thus, it may be concluded that growth in FY2010-11 had been more “inclusive” (pro-poor) than in FY2009-10. However, further analysis has to be done to ascertain the employment, income and equity implications of the actual GDP growth in FY2010-11. In this connection, it needs to be emphasised that while targeting higher level of GDP growth in FY2011-12, we should also remain mindful about the inclusiveness of that growth and its implications for poverty alleviation and equity.

Inflation Mitigation Effort. One of the major lessons of FY2010-11 had been related to the inflation mitigation efforts, particularly concerning food prices. It is now obvious that an almost self-sufficiency in food production, frequent open market food sales, extensive food distribution programmes for the disadvantaged group and holding of large foodstocks are not enough to stabilise food prices under the current scenario. In all probability, inflation rate will continue to remain high in FY2011-12.

Arguably, there is no magic bullet for containing the current inflationary trend in an open and small economy such as Bangladesh. Indeed, the trend has to be dealt with a judicious mix of macroeconomic tools in a dynamic fashion. Improvement of the BoP leading to strengthening of Bangladesh Taka is important in this respect. No less important is reining in the domestic credit expansion rates by keeping these within the monetary policy targets.

Till date, the efforts to control the food price volatility had been mostly focussed on supply-side measures. There is now a much greater need to intensify efforts to maintain and improve the purchasing power of the low and middle (fixed) income citizens through creation of more gainful employment. Addressing this aspect will take us to issues of investment environment.

Revenue Generation. The governments' tax collecting agency, namely NBR has done a stellar job in terms of mobilising direct and indirect taxes from the citizens in FY2010-11. Yet fiscal realities suggest that even a continued robust performance of the NBR will not be enough for the exchequer until and unless the government starts getting due returns from the large stock of its tangible and intangible assets. In other words, the government will have to more effectively tap the non-NBR tax and non-tax sources to replenish its resource basket. These sources have dwindled overtime; yet they account for around 20 per cent of total revenue intake.

In the backdrop of growing demand on government expenditures coupled with reduced absorption of foreign aid, revenue collection effort has to be intensified further in FY2011-12. The emphasis on direct tax collection has to be maintained. Concurrently, the government has to cease treating the non-NBR taxes and non-tax sources residually and take guided efforts in setting their targets so as to utilise their potential. This process has to be complemented by revision of various rates for government services, strengthened financial accountability for state-owned enterprises, reduce leakages in government's receipt in railways and other public services and corruption-free leasing of government assets (e.g. *ghats* and water bodies). An enhanced revenue effort will have positive impact on improved macro-fundamentals through, inter alia, reduced government borrowing from banking and non-banking sources.

Energy and Power Supply. The government, with a view to improving the investment climate by way of urgently developing the power sector, has resorted to quick-disbursing, but high cost rental power plants. As commissioning of these expensive and supposedly "quick" rental sources got "delayed", the expected relief was not forthcoming. Because of systematic shutdown of the old PDB units, net electricity supply did not improve significantly. Given the present nature of energy pricing coupled with petroleum price hike in the global market, the current dispensation of the expensive rental power is building up an unsustainable pressure on both fiscal and external balances. The commissioned power plants are also not operating at full capacity. Regrettably, the "breathing period" has not been adequately used to operationalise commissioning of large size power plants that would be built on both public and private investment. Modernisation of the old power plants should also be the top priority of the government as cost-effective medium term solution.

However, currently lack of supply of primary energy has emerged as the binding constraint of the energy sector. Without significant early success in gas exploration and a credible resolution of domestic coal extraction issue, power sector development will not generate expected momentum. The need for rationalisation of energy prices at all levels has to be addressed as well.

Subsidy. Provision of public subsidy for productive purposes as well as for extending safety net to the poor is considered to be an important determinant of pro-poor growth. However, the ability of an economy to provide such "good" subsidy also depends on the size of the fiscal space available in the economy, at any point in time. Alternatively, the continuously growing subsidy demand may weaken the macroeconomic fundamentals of the economy. In

FY2010-11, subsidy payments including those for food operations, fertilizer, irrigation, electricity and petroleum supply as well as for export-oriented industries accounted for around 4 per cent of GDP.

Subsidy related expenditures are expected to increase further in the coming fiscal year. While these expenditures are considered to be inflation-reducing, it should not transcend fiscal possibilities. The government should be well advised to revisit the rationale of these expenditures in the context of changing market realities, make a critical assessment of the actual impact of these payments and explore opportunities for retionalisation and harmonisation of these outlays. One needs to be always mindful about the opportunity costs of these expenditures and the attendant trade-offs involved. If necessary, price and tariff adjustment may have to be considered to maintain fiscal balance.

Capital Market. The collapse of the capital market brought home the important lesson that in the absence of a credible and effective regulatory body that is embedded in a sound macroeconomic management system, the market will not be able to sustain the investors confidence very long. Mismanagement of capital market had negative spill over for the financial sector which in turn has undercut the overall macroeconomic stability. Constrained by the limited availability of investment and employment opportunities, the new entrants in the markets declined to accept that equity market is not for speculative short-term gains, but for long-term steady returns. More importantly, it is not advisable to take risk in the capital market with limited household savings and/or with borrowed finance including from the bank.

One of the major economic challenges for FY2011-12 will be to stabilise and rejuvenate the capital market. Admittedly, only swapping officials in the SEC will not do the trick. The issue is that without the necessary strengthening of accountability and transparency of operations of all market players, the threat of another possible large loss of market value in the future will always loom large. It will be a matter of great interest to observe whether the government put in place a comprehensive reform programme for the capital market, in line with the Probe Committee's report or indulges into discrete, low value measures.

Financial Sector. Capping lending rates and depressing depositors' returns turned out to be not a suitable way towards greater financial deepening and more efficient financial intermediation in FY2010-11. This was particularly so in the face of rising inflation rate and soaring imports. Indeed, such an approach to price setting has led to diversion of funds from their intended use as well as liquidity crunch in the banking system.

Return on equity in Bangladesh's banking sector remains almost the highest in the region around 23 per cent in 2010, which is significantly higher than the average rate of return in the manufacturing sector. The large volume of profits earned by the commercial banks in FY2010-11, particularly through the beyond mandate speculative trading in the capital market indicates failure of proper oversight by the central bank as well as perpetuation of an inefficient and segmented financial market in the country. The collapse of the capital market had a contagion effect on the banking sector as well. Thus, there was a strong need to strengthen the oversight function of the Bangladesh Bank regarding compliance in the banking sector as well corporate management of the schedule banks to provide competitive services to the clients. At the end of the day, the government has to ensure that prospective productive activities are not priced out by high cost bank loans.

Financing Investment. Given the size of the investment demand of the country, particularly in view of its development needs, it is not possible for Bangladesh to service such a huge resource requirement exclusively from domestic sources. In FY2010-11, due to its inability to adequately utilise committed foreign aid and attract additional FDI, Bangladesh has to finance almost all of its private and public investment exclusively from domestic sources. These sources included revenue surplus, bank and non-bank borrowing and market equity. This trend had generated a concomitant negative pressure on fiscal balances, financial sector and balance of payment. Indeed most of the imports of the rental power projects were financed by local banks (not by FDI). This resulted in liquidity crunch in the financial sector and delay in implementation of ADP. Thus, accessing additional foreign finance is imperative for future investment growth.

Accordingly, effective off-take of the ODA in pipeline should be a top priority of the government in FY2011-12. The amount of foreign aid waiting in the pipeline has reached USD 12 billion. This is particularly pertinent as a number of large foreign-aided projects including the Padma Bridge have been earmarked for implementation in the upcoming fiscal year. Given the fiscal situation envisaged for FY2011-12, the government may have to look for more foreign aid in the form of grant and budgetary support. Ensuring flow of foreign aid is of critical importance for both from the perspective of deficit financing and supporting the balance of payments. For strengthening the external balance, inflow of foreign direct investment will also be of special importance.

Financing Imports. While one may not complain much about the composition of the import since a large part of it was reflection of high prices of commodities including those of fuel, fertilizer and foodgrain in the global market. Increased import of capital machineries (partly for the power projects) also contributed to rising trade deficit. During FY2010-11, exports and imports experienced equally high growth. Export growth in Bangladesh entails a high level of import of inputs. In the face of decelerating remittance flow, dwindling FDI and low absorption of ODA, the experience of FY2010-11 reveals that the balance of payment of the country can not withstand import demand only with buoyant export growth. To service enhanced consumption and investment demand, the trade balance will need support from the current account and capital account. Thus, in order to sustain higher level of growth in FY2011-12, forex flow from sources other than exports have to be ensured.

Exchange Rate. Exchange rate management continued to remain a tricky issue in FY2010-11 as it needed to balance conflicting objectives of, *inter alia*, export and remittance growth vis-à-vis price stabilisation. As the pressure on balance of payments is expected to be intensified in FY2011-12, maintaining an effective exchange rate will emerge as a major macroeconomic challenge. Using the present foreign exchange reserve to control demand and supply of foreign currency had several risks involved and could be considered only in a limited scale. Large shocks are to be avoided in case of readjustment of exchange rates and significant difference between bank and curb market rates will not be helpful. However, pursuing a prudent exchange rate policy in a time of high inflation will also need to keep in mind the interests of the consumers.

Development Administration. Delivering of development outcomes during FY2010-11 had been largely constrained by the weak designing and implementation, management and monitoring capacity of the state agencies. It further became obvious that without substantial improvement of the development administration, it will be almost impossible for the

government to scale up its development work including effective realisation of the ADP targets.

Failure of the PPP to get off the ground is largely attributable to inadequate administrative capacities of the government. Inability to strengthen local government structure deprived the government from the opportunity to channel resources to demand-driven projects. The development administration also could not meaningfully expand its linkages with non-government development agencies in line with the development objectives of the government. A certain degree of uncertainty prevailing among the government officials with regard to career prospects and upward nobility also hindered fuller utilisation of the existing capacities. Thus, possibility of achieving higher economic growth in FY2011-12 will be defined to a great extent on the ability of the development administration to improve capabilities and demostrate its professional resilience.

Quality of Macroeconomic Management. As mentioned earlier, FY2010-11 had been a challenging year from the perspective of macroeconomic management. Notwithstanding the achieved high economic growth, the economy has closed the current year with weaker macroeconomic fundamentals. Experience of FY2010-11 suggests that emerging negative trends in the economy were often not acted up through pro-active policy and institutional interventions. For example, benign policy neglect was most visible in case of dealing with the capital market situation. Confusing signals were also given in case of the government's attitude towards privatisation of state-owned enterprises. In many cases, it appeared that the nodal public agency is either indifferent or had lost policy initiative. Weak performance of the line ministries further aggravated the situation. Lack of coordination among different policy agents often became most apparent. On occasions it seemed there is poor synchronisation between fiscal and monetary policy in dealing with the triple menace of inflation, interest rate and exchange rate. In this connection, one aspires for a greater leadership role from the Finance Minister.

Our review indicates that tensions in the macroeconomic environment will intensify in the coming months. Under these circumstances, the quality of economic management will be of crucial importance in maintaining macroeconomic stability, while pursuing higher growth ambitions.

To conclude, it may be pointed out that FY2010-11 has enjoyed a relative calm in the socio-political front. With the revealed increasingly restive mood in the political situation of the country, one wonders to what extent the development efforts in FY2011-12 will get affected by possible political instability and uncertainties. Thus, it is to be seen how successfully the government uses its political skills in negotiating a congenial space so as to sustain the opportunity to deliver the development outcomes that were promised in its election manifesto.

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APPENDIX 3.3.1: LISTS OF MEASURES UNDERTAKEN BY SEC, DSE AND THE GOB SINCE DECEMBER 2010

Issues	Steps/Measures
Measures undertaken by the SEC	
Margin loan ratio	• A total of eight decisions have been taken including amended rule regarding margin loan facility, providing maximum credit facilities by the merchant bankers (portfolio managers) to each of their approved individual clients
Sport market trading	• Directed the DSE to place 14 companies under spot market trading. • Repealed the directive of spot market for trading of Grameen Phone Ltd. and Marico Bangladesh Ltd. • Directed the DSE to transfer 10 companies from the OTC Market to the main market.
Forced sell	• Formed enquiry committees against 6 DSE members to investigate aggressive selling of different listed securities.
Netting facilities	• Directed all stock brokers and merchant bankers/portfolio managers to stop unauthorized activities like misusing netting facilities through advance financing to their clients for purchasing securities. • Repealed its Directive in connection with the netting facilities in respect of trading in share of Grameenphone Ltd. • Withdrew its earlier restriction on netting facilities on the trading of shares of 14 companies.
Others	• Formed an enquiry committee to investigate in to certain unusual movement in price and volume of listed securities. • Given waiver to the government and organizations from the compliance of Prohibition of Insider Trading Rules, 1995 till December 31, 2011. • Declared that the registered Asset Management Companies are also permitted to participate in the price discovery process for specific mutual fund, under the Book Building Method. • Reduced time gap to 15 days in between client's account opening and trading against that account. • Postponed the effectiveness of the provision of Merchant Banker and Portfolio Manager Rules, 1996 till June 30, 2011. • Postponed the effectiveness of item no. 2 and 5 of the 5th Schedule of rule 56 of Securities and Exchange Commission (Mutual Fund) Rules, 2001 till March 31, 2011. • Imposed further condition to exercise of the Book Building Method. • Suspended the effectiveness of Stock Dealer and Stock Broker Registration Certificates of 10 Member Companies for a period of 30 days. • Prohibited 6 persons from performing their all sorts of duties/activities as Managing Directors/Chief Executive Officers of the respective stock dealer/stock brokers of the DSE/CSE for 30 days. • Reduced the prevailing circuit breaker by 50% with effect from 25.01.2011. • Postponed the change of face value of listed companies in the stock exchanges. • Withdrawn the suspension of the effectiveness of Stock Dealer and Stock Broker Registration Certificates of 6 Member Companies of DSE and CSE. • Decided to withdraw the prohibition on the Managing Director of Alliance Securities and Management Ltd. from performing duties.
Measures undertaken by the Bangladesh Bank	
	• Initiated measures for withdrawal of industrial loans diverted to the market by December 31, 2010 • The Bangladesh Bank on 10 January, 2011 asked the commercial banks to purchase shares • The Bangladesh Bank assured the commercial banks that it would be soft on bank's investment over the allowable limit • Increased the Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR) both to 6 per cent and 19 per cent respectively to contain the money supply. • Bangladesh Bank has found over-exposure of eleven banks in the capital market.
Measures undertaken by the DSE	
	• Formed committee for demutualization of DSE.
Measures undertaken by the Government	
	• Decided to stop offloading of all government shares. • Provided fund to Sonali, Janata, Agrani, Rupali Bank and ICB to buy shares from the Stock Exchanges. • Sanctioned Tk.200 crore to ICB to buy shares from the Stock Exchanges. • Formed Probe committee to investigate the anomalies in the capital market.

Source: Various documents

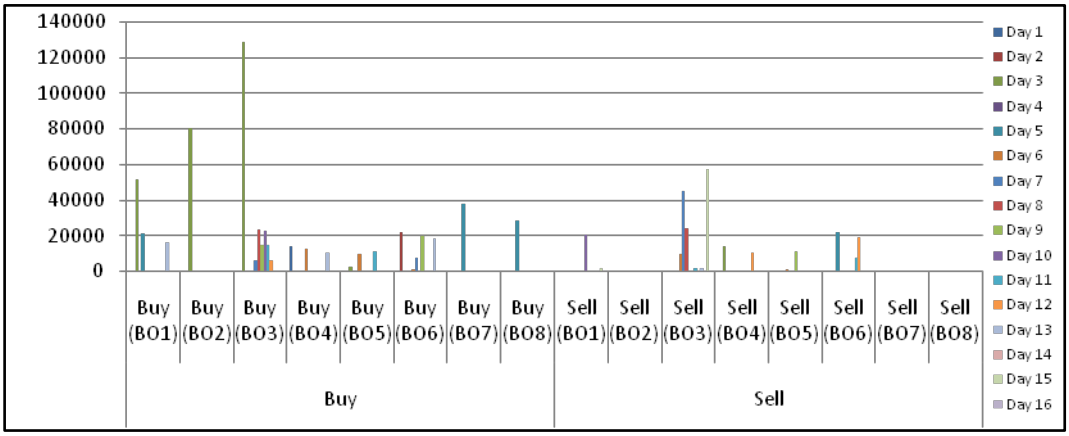
APPENDIX 3.3.2: IDENTIFICATION OF PROBLEMS AND SUGGESTED MEASURES IN VIEW OF THE REFORM IN THE STOCK MARKET

SL No.	Issue	Nature of Problems (identified by CPD and Probe Committee)	Suggested Policies (by CPD and Probe Committee)
1	Direct listing in primary Issue		• Direct listing system should be rejected. (Former DSE Members).
2	Assets revaluation/valuer /auditor	• Manipulation starts from accounts. (DSE management). • Lack of expertise in case of auditing. (CPD). • Financial analyst is a cry need for stock market. (DSE Management)	• Re-counting is necessary. (DSE management). • Dividend of companies given from unrealized income needs to be examined. (CSE)
3	Issue manager		• Investment of mutual fund should be increased. (estate Management Company)
5	Involvement of dealer		• Artificially rise of share price of z category shares should be taken into consideration. (Public listed companies)
6	Right Share	• 9 companies collected Tk 12,000 crore from the market through right/bonus shares. (DSE Brokerage house)	
7	Preference share	• There is no definite regulation for the issue of preference share. (Reporters outside the Forum)	
8	Book-building	• High value of share in book building method. (Probe Committee)	
9	Serial/ Block trading and scam		• Enquiry will be carried out on the secondary market's contribution to price spiral, block placement and 50 over-valued stocks in 2009 and 2010. (Govt. short term)
10	Uniform of face value of share	• Changing face value of shares from Tk 100 to Tk 10. (public listed companies) • 81.5% of the market has been distorted due to stock splitting. (Probe Committee)	
11	IPO process	• 30 lac new BO accounts, 590 branches of 238 brokerage houses have been opened in last 4yrs. (Public listed companies) • 13 lac new investors entered in the market. (Reporters Forum) • SEC accepts any asset in spite of unrealistic re-estimation value. This gives rise to inflation in creation of Kerb market and placement of IPO. (Probe Committee)	• Transparency of IPO placements. (Probe Committee). • Provision for TIN number for opening of BO account. (Probe Committee) • Submission of TIN will be made mandatory for opening BO account. (Govt. short term)
12	Placement Share	• Application of lock in period in case of sale of placement shares. (CPD). • 5 companies collected tk 1552 crore through private placement. (reporters outside the forum) • In most cases, placements are authorized at a lower value than IPO value. (Probe Committee)	• Private placement should be closed. (CSE) • Placement should not be more than 25% of IPO share value. (Probe Committee)

SL No.	Issue	Nature of Problems (identified by CPD and Probe Committee)	Suggested Policies (by CPD and Probe Committee)
13	Omnibus account	• It is difficult to identify placement holders and omnibus accounts bear the names of merchant banks. (Estate management company). • In one omnibus account, there can be up to 12 thousand scribers included. (Bangladesh merchant banks association)	• There should be separate BO accounts that were included in omnibus account; Trading of shares should be done through BO accounts. Merchant banks can keep a shadow account. (Probe Committee)
14	Banking investment in stock market		• Regulations for bank's investment in the stock market should be set taking in consideration of the neighboring countries guideline and also BASEL. (Probe Committee) • The government suggests that Bangladesh Bank take actions against the banks that were overexposed. (Govt. medium term) • Amendment of the banking companies laws with regard to investment in the stock market. (Govt. medium term)
15	Demutualization of stock exchange		• Though DSE has formed a demutualization committee but no time frame was provided. The government can advise DSE to provide 3 months time for the report. • The government can also seek advice from other organizations regarding demutualization planning. (Probe Committee)
16	Restructuring of SEC	• Inadequate capacity of SEC: frequent changes of rules & regulations, delay in implementation of guidelines, weak monitoring and surveillance system. (CPD). • Continuous changing of decision by SEC is a problem for market distortion. (DSE brokerage house)	• Strengthen management of SEC, Demutualization of stock exchanges. (CPD). • Restructuring of top management. A ' restructuring plan' prepared by SEC can be placed to the government. There should be a powerful inspection division who would inspect all dealers, brokerage houses, merchant bankers, asset management company etc. (Probe Committee) • Filing of departmental cases against top SEC officials for their reported involvement in manipulation. (Govt.-immediate)
17	Monitoring of implementation		• Formation of a study team to make a to do list for overlap activities and grey areas of stock exchange and SEC. (Probe Committee) • There can be a market stabilization fund (CSE) • All employees of Bangladesh Bank, SEC, DSE, CSE, and CDBL should not be involved in share trading. However they can investment in shares. (Probe Committee). • Institutional arrangements to coordinate actions of the bourses, SEC and Bangladesh Bank. (Govt. immediate) • The government will look into the probe committee's recommendations on omnibus accounts, serial trading and manipulation, suspected transactions of top players, shadow accounts of individuals and institutions that trade under omnibus accounts and the players who sold out their shares in December and January. (Govt. short term)

Source: Various documents

APPENDIX 3.3.3: CIRCULAR TRADING BEHAVIOUR OF MULTIPLE BO ACCOUNT HOLDERS



Source: Based on the background analysis of the Probe Committee

APPENDIX 3.3.4: CONTROL OVER DAILY TRADING THROUGH TRANSACTION IN MULTIPLE ACCOUNTS

Sample days	Total trade of a sample company's share	Total trade using multiple accounts	Percentage of total trade of a sample company
1	97,700	14,500	14.84
2	95,040	22,000	23.15
3	418,990	277,780	66.30
4	204,590	120	0.06
5	255,970	109,200	42.66
6	218,089	35,780	16.41
7	276,980	59,680	21.55
8	200,470	47,340	23.61
9	162,880	48,460	29.75
10	173,126	43,500	25.13
11	192,529	36,880	19.16
12	142,240	37,400	26.29
13	211,545	47,700	22.55
14	318,926	1,000	0.31
15	211,202	59,420	28.13
16	257,340	1,400	0.54
Total	3,437,617	842,160	24.50

Source: Based on the background analysis of the Probe Committee

APPENDIX 3.3.5: DIFFERENT MEASURES UNDERTAKEN AGAINST FRAUDULENT/ILLEGAL ACTIVITIES IN THE CAPITAL MARKET OF THE SELECTED COUNTRIES

	Attributes	Penalty measures/Punitive Scopes				
		India	Pakistan	Thailand	Sri Lanka	Bangladesh
1	Insider trading	• Fines of up to 25 crore rupees or 3 times amount of profit made & including prison sentence	• Fines of up to 10 millionrupees or 3 times profit made & cancellation of registration & extra fines may be imposed	• Fine of a hundred thousand baht or more, & daily fine of 300 baht per day for duration of offence	• Fine up to one million rupees & prison sentence of 2-5 years	• Imprisonment of 5 years & fine of BDT 0.5 million
2	Fraudulent/Unfair trade practices	• Fine of 25 crore rupees or 3 times amount of proft made	• At least 2 years fine & prison sentence of to 3 years can be expected	• 3 years in prison & up to 3 hundred thousand baht fine	• Cancellation of license/ registration & fine of up to one million may be imposed	• Imprisonment of up to 5 years with/or fine of at least 5 lakh taka
3	Non-compliance with regulatory framework	• Penalties of up to 1 crore rupees or/and a prison sentence	• Up to 5 years imprisonment & fine of 500,000 rupees	• Up to 5 years imprisonment & fine of 500,000 baht.	• Non-registration/ no granting of license	• Fine of 1 lakh taka & in case of continuing default, 10,000 taka per day
4	Business Takeover rules	• Fines of up to twenty five crore rupees	• penalties of 50 million rupees & 200,000 rupees per day in case of continuing default.	• Cancellation of license, 100,000 baht fine & 3000 baht for duration of offence	• All firms are strictly mandated to follow	• N/A
5	Failure to furnish information, return, etc	• Fine of a crore or more	• fine of one million rupees & prison sentence of up to 3 years	• 6 months imprisonment & of 60, 000 baht or more	• Suspension of license & fine of 1 million rupees &/or a prison sentence	• Fine of 1 lakh taka & in case of continuing default, 10,000 taka per day
6	Failure to comply with listing provisions	• Fine of up to 25 crore rupees & prison sentence of up to ten years	• Up to 5 years of imprisonment & up to 5 lakh rupees fine	• Up to 5 years prison sentence & up to 5 lakh baht fines	• Liable to penalizing by fines	• All firms are strictly mandated to follow; Penalties & fines in place as well

7	Non-inclusion of key words in name/ Use of such words without authorization	• N/A	• Fines of up to 5 lakh rupees & 10 thousand rupees per day for length of offence.	• Fine of up to one lakh baht & 3000 baht per day for the length of offence	• Fines of up to one million rupees may be imposed.	• N/A
8	Stock Brokers/Players failing to discharge responsibilities	• Suspension of certificate & fines of 1 lakh rupees for length of continuing offence.	• Up to 5 years of prison & 5 lakh rupees fine	• Fines of one lakh baht & a 3000 baht per day fine in case of continuing offence.	• Cancellation of license/registration	• Strictly forbidden
9	Registered/paid up capital not in amounts prescribed	• N/A	• N/A	• Up to one lakh baht & in case of continuing offence a daily fine of 3000 baht is imposed.	• N/A	• N/A
10	Capital/market manipulation	• Strict penalties in place	• Fines of up to maybe 2 million rupees may be imposed	• Penalties of one lakh baht & possible prison sentence	• N/A	• N/A
12	Auditing Irregularities	• Fine of one crore rupees or one lakh rupees for length of offence.	• Up to one lakh rupees & a further fine if offence is a continuing one.	• imprisonment of 2 to 5 years & a fine of 2 to 5 lakh baht	• Strictly forbidden; liable to penalties	• Liable to penalties
13	Offence for which there is no specific penalty	• Fines of up to one crore rupees	• Fines of up to one million rupees & another fine of 1 lakh rupees in case of continuing offence	• N/A	• Fines of up to 50 thousand rupees & a prison sentence of up to 5 years	• N/A
14	Certain default in case of mutual funds	• Fine of one lakh rupees for length of offence	• N/A	• N/A	• N/A	• N/A
15	Flotation of rules intended for Modaraba' firms	• N/A	• Fines of up to one lakh rupees & a further fine of 1000 rupees per day for continuing offence	• N/A	• N/A	• N/A

16	Fraud by officers of firms gone into liquidation	• N/A	• Imprisonment of up to 2 years maybe imposed	• N/A	• N/A	• N/A
17	Accounting/ Bookkeeping irregularities	• Fines extending up to one crore rupees can be imposed	• Fine of one million rupees to be imposed & a further fine of 10,000 rupees for each day for continuing offence.	• Fine of 1 lakh baht & 3000 baht per day for length of continuing offence.	• Liable to be penalized by fines & possible prison sentence	• Liable to be penalized by fines.
18	Transaction of insurance business on other than stated terms	• N/A	• Fines of up to two million rupees can be imposed on the guilty party.	• N/A	• N/A	• N/A
19	Violation of rules/regulations relating to borrowing/receiving money from pubic	• N/A	• N/A	• One lakh baht & a further fine of 3000 baht each day if offence is continuing	• N/A	• N/A
20	Proportion of company shares to be held by nationals	• N/A	• N/A	• Violation of this rule means a fine of up to one lakh baht.	• N/A	• N/A
21	Failure to answer before authorized person	• Fines of up to one lakh rupees can be imposed.	• Fines of up to fifty thousand rupees can be imposed.	• Prison sentence of up to six months & fines of up to 60 thousand rupees may be imposed	• Prison sentence of up to 5 years & fines of up to one million rupees can be imposed	• Liable to be penalized by fines.
22	Non authorization in setting up office of a foreign established company	• Strictly prohibited; potentially liable to fines.	• Strictly prohibited; potentially liable to fines.	• Up to 3 years of imprisonment & fines of p to sixty thousand & also additional fines can be imposed.	• Strictly prohibited; potentially liable to fines.	• Strictly prohibited; potentially liable to fines.

23	Carrying on of 'ultra-vire' business	• N/A	• For transaction made beyond firm's power, then fine of five lakh rupees may be imposed	• N/A	• N/A	• N/A
24	Failure to modify company capital within mandated time	• N/A	• N/A	• Imprisonment of up to 3 years & fines of up to 3 lakh baht & also other fines may be imposed.	• N/A	• N/A
25	Contravention regarding no. of shareholders/ directors in company	• N/A	• N/A	• Fines of up to one lakh baht may be imposed in addition to further fines	• N/A	• N/A
26	Wrongful Obtaining or Withholding of property	• N/A	• Up to one million rupees fine & a prison sentence of up to 2 years.	• N/A	• N/A	• N/A
27	Fictitious and multiple applications for new issues	• Strictly prohibited; penalties may be imposed	• Strictly prohibited; penalties may be imposed	• Strictly prohibited; penalties may be imposed	• Strictly prohibited; penalties may be imposed	• Strictly prohibited; penalties may be imposed
28	Failure to segregate securities/money of client/clients	• N/A	• One crore rupees may be imposed.	• N/A	• N/A	• N/A
29	Short Selling	• Greatly restricted in India; Liable to penalties	• Liable to penalties	• Penalties of up to 50,000 baht may be imposed.	• Liable to penalties	• Strictly regulated; Liable to penalties

Source: Various documents collected from the websites