State of the Bangladesh Economy in the Fiscal Year 2004-2005

Second Reading

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CENTRE FOR POLICY DIALOGUE (CPD)
B A N G L A D E S H
a civil society think-tank

House 40C, Road 11, Dhanmondi R/A, Dhaka-1209
Tel: 9141734, 9141703, 9145090; Fax: 8130951
E-mail: cpd@bdonline.com; Website: www.cpd-bangladesh.org

Credit

Dr. Debapriya Bhattacharya, Executive Director, Centre for Policy Dialogue (CPD) was the principal researcher and was in overall charge of preparing this report.

Lead contributions were obtained from *Professor Mustafizur Rahman,* Research Director, CPD, *Dr. Uttam Kumar Deb,* Senior Research Fellow, CPD, *Dr. Fahmida Khatun,* Senior Research Fellow, CPD, *Dr. Khondaker Golam Moazzem*, Research Fellow, CPD and *Dr. Ananya Raihan,* Research Fellow (on-leave), CPD.

Mr. M. Syeed Ahamed, Senior Research Associate, CPD was responsible for database management and preparation of macroeconomic analysis. Support was provided by *Mr. Shubhasish Barua,* Research Associate, CPD, and *Mr. Md Ashiq Iqbal,* Programme Associate, CPD.

Mr. Wasel Bin Shadat, Senior Research Associate, CPD and *Mr. Kazi Mahmudur Rahman,* Senior Research Associate, CPD, *Mr. Syed Saifuddin Hossain,* Research Associate, CPD, *Mr. Asif Anwar,* Programme Associate, CPD, *Mr. Narayan Chandra Das,* Programme Associate, CPD prepared drafting notes for the report.

Mr. Md. Masum Billah, Research Associate, CPD, *Ms. Nafisa Khaled,* Programme Associate, CPD, *Ms Farhana Rahman,* Programme Associate, CPD and *Ms. Dilshad Zaman,* Intern, CPD were responsible for data collection and processing.

Word processing support was provided by *Mr. Hamidul Hoque Mondal,* Administrative Associate, CPD, *Mr. A. H. M. Ashrafuzzaman,* Senior System Analyst, CPD and *Mr. Rabiul Alam,* Word Processor, CPD.

STATE OF THE BANGLADESH ECONOMY FY2005 (Second Interim Report)

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Second Reading

1 INTRODUCTION

The current analysis of the state of the Bangladesh economy during the fiscal year 2004-05 (FY05) is the tenth annual output of CPD's programme *Independent Review of Bangladesh's Development* (IRBD). This is the second reading of the state of the Bangladesh economy in FY05. The first reading of the review, a mid-year assessment, was released on 15 January 2005. The current updated version of the analysis (dated 4 June 2005) is being released on the eve of the National Budget for FY06 with a view to benchmark the budget related discussions.

Changes since Mid-year Assessment

The first reading of the IRBD for FY05 carried out in January 2005 mentioned that, "five major concerns for the economy during the next six months would include food price inflation, *Boro* production, ADP implementation, utilisation of foreign aid and new Initial Public Offerings (IPOs) in the capital market". As our subsequent analysis will reveal, only one of these concerns (i.e. *Boro* production) was to same extent assuaged during the last six months, while another (i.e. foreign aid utilisation) was marginally addressed. However, shabby implementation of ADP, rising food price level and lack of availability of new and good quality equities in the capital market continue to be concerns for policymakers.

During the last five months (July – May 2005), a number of new trends have become visible in the economy. An updated overview of the major features of FY05, presented in the following paragraphs, will allow us to situate these developments in the pre-budget context.

Major Features of FY05

The growth momentum of the Bangladesh economy was sustained in FY05 and the economy is poised to record a 5 per cent plus GDP growth rate. However, it is also evident that the poor has failed to benefit from this incremental growth since their income share got further marginalised.

Two exogenous shocks, *viz.* floods of August 2004 and phasing-out of apparel quota from 1 January 2005 underpin the economic performance of the elapsing fiscal year. It is evident that the economy has once again demonstrated its resilience in confronting the aftermath of the floods and has recorded an effective recovery. The economy, at least for the time being, continues to clock double digit export growth in the quota-free global clothing trade.

The other important positive developments in Bangladesh economy during this period include a bumper *Boro* crop of estimated 13.75 million MT, a $2.5 billion worth of foreign direct investment (FDI) proposal from Tata of India, reactivation of the Privatisation Commission with new off-loading mandate and increased liquidity flow to the capital market. High import of capital machineries in the wake of robust credit expansion in private sector as well as strong growth of agricultural credit energised the economy in FY05. Off take of foreign aid improved marginally. Remittance flow continued to be buoyant.

The major weakness of economic management in FY05 emanated from the systematic failure of the government to implement public investment programmes in the face of the runaway growth in its recurrent expenditures. Revenue collection experienced discernible shortfall from the target, with mobilisation of revenue outside the purview of the National Board of Revenue (NBR) performing very poorly. Fiscal balance remains under control by default as the target for the Annual Development Programme (ADP) remains far from being achieved.

The economy was dogged by the creeping rise in consumer price index, particularly due to holding out of foodgrain prices at a perceptibly high level. Volatility in the Call Money and foreign exchange markets generated unpredictability in the money market. One of the primary factors severely constraining the economic performance was electricity supply shortfall (on average 450 mw); often the quality of the electricity was poor. No power projects could go into implementation during this period.

Rise in inflation rate, largely underwritten by the price rise of strategic products (food, fuel and fertiliser) in global markets, supply shocks due to floods, price adjustments of public utilities, and expansionary monetary policy raised concern of “over heating” of the economy.

Recognising the fact of relative stability prevailing in the overall economic situation, it is also maintained here that pressures on the macroeconomic balances increased substantially in the second half of FY05. These pressures were particularly intense in case of the balance of payment of the country. Fragility of the apparent stability of macroeconomic situation was exposed as enhanced investment demand spurred by incremental credit flow led to high volume of imports. Increased demand for foreign exchange and the need to maintain an adequate level of foreign exchange reserve created tensions in the market as the real exchange rate did not absorb the full pressure.

Extraordinary growth of domestic credit coupled with reverse shortfall started to generate strains on the fiscal balance as well (particularly from the third quarter of the year).

Thus, at the end of FY05, the macroeconomic balances remain under pressure as dynamism in investment variables is exerting stress on the balance of payment, and fiscal balance is quite stretched.

The FY05 also witnessed the launching of a “still born” Anti-Corruption Commission (ACC). The government finally introduced trade union rights in export processing zones (EPZs). The government employees were awarded a new pay scale in June 2005 (with effect from July 2005).

The subsequent sections of the review take a closer and an in-depth look at some of the most critical issues highlighted in the foregoing paragraphs.

Layout of the Review

Following the introductory section, our analysis focuses on the following five major areas.

- Economic Growth and Poverty Alleviation
- Trends in the Fiscal Sector
- Developments in the Monetary Sector
- Performance of the Real Economy
- Behaviour of the External Sector

The review concludes by revisiting the macroeconomic framework and identifying the challenges for economic policy making in FY06.

CPD has reanalysed official data for the review and has supplemented it with some purposive background studies. A final version of the review will be prepared once data are available for the full fiscal year of 2004-05.

2 ECONOMIC GROWTH AND POVERTY ALLEVIATION

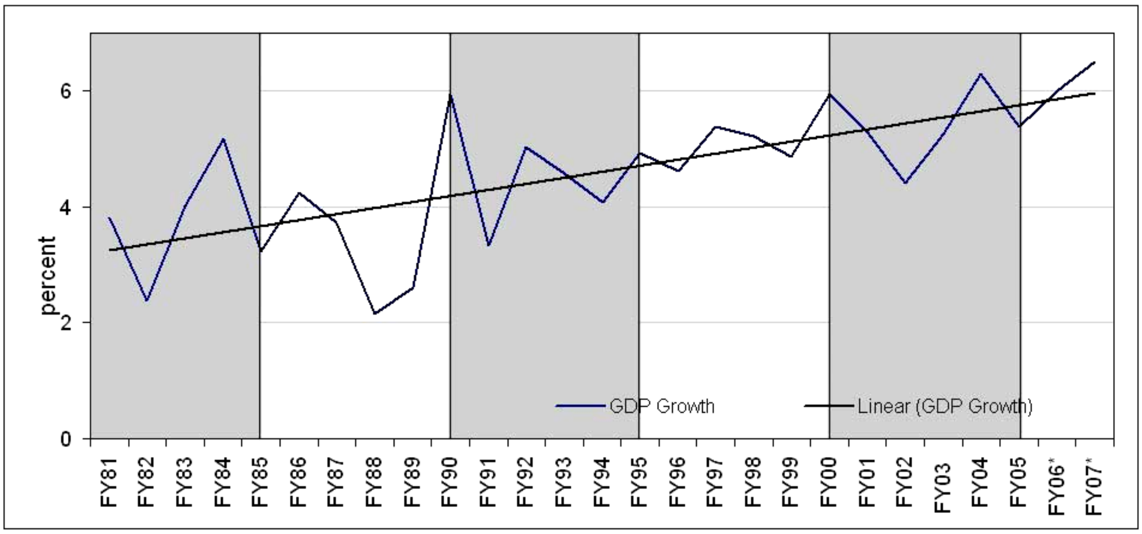
2.1 GDP Growth

It is by now well known that GDP grew at a relatively faster rate during the 1990s (4.6 per cent linear growth) in comparison to the 1980s (3.6 per cent linear growth). Within the 1990s, the growth momentum was higher during the second half of the decade in comparison to the first half. The linear growth rate of GDP during the period of FY91-95 was 3.95 per cent, while during the next five year (FY96-00) it grew at a faster rate of 4.79 per cent.

Following a decline of the GDP growth rate from 5.9 per cent in FY00 to 4.4 per cent in FY02, the national economy repositioned itself at a five per cent plus growth trajectory during the subsequent two years (FY03 and FY04). The GDP growth rate for FY04 was provisionally estimated to be 5.3 per cent as against 5.5 per cent projected in the Interim Poverty Reduction Strategy Paper (I-PRSP) target. *This figure has been recently revised upward at 6.3 per cent. (For a critique of the new GDP estimate for FY04 see Box 2.1).*

The provisional figures for FY05 suggest that GDP has posted a growth of 5.3 per cent during FY04, while the matching target of the I-PRSP was 5.5 per cent. This is a respectable economic growth rate in a flood year. But the revised GDP growth figure for FY04 (i.e. 6.3 per cent) will make the target of 6.8 per cent for the terminal year (FY07) of PRSP look quite pale.

Figure 2.1: Trend in GDP Growth



Source: Computed from Finance Division (2004c) and ERD (2003)

Note: * PRSP Targets.

Box 2.1: Revised GDP Estimates for FY2003-04

The large upward revision in GDP growth rate estimate of FY04 has renewed discussions about the empirical basis, estimation methodology and process transparency of the National Income Accounts of Bangladesh. Revising its provisional estimate of GDP growth rate for FY04 (5.52 per cent), the Bangladesh Bureau of Statistics (BBS) has recently reported a final figure of 6.27 per cent, i.e. an increase of more than 0.88 per cent of GDP. This revision has also attracted attention as it provides the *first ever* above 6 per cent growth in Bangladesh economy. It may be recalled here that in 2000-01 a 6.04 per cent provisional estimate of GDP growth rate was revised downward to 5.27 per cent which coincided with change of the then political regime.

With a view to validate the revised GDP estimates for FY04, CPD tried to relate physical production data to estimates of value addition of the sectors whose contributions have been significantly upgraded. These include Agriculture (crops, vegetables and livestock), Electricity, Gas and Water, and Import. While we did observe some acceleration in production during the last quarter of FY04 (i.e. after the provisional estimates were prepared), it was not evident to what extent this outcome was anticipated by the provisional estimate. This observation also remains true for the sectors where downward revision has been done (e.g. fishery and manufacturing).

Experience suggests that the GDP growth estimates are traditionally an ambitious projection based on nine months' data which are usually moderated downward during finalisation based on the full year data. As may be seen below, the last ten years, provisional estimates of GDP were lowered during finalisation in eight years. Excepting in FY04, only in FY00 (penultimate year of the then regime) the provisional estimate of GDP growth rate was increased from 5.47 per cent to 5.94, i.e. an increase of 0.47 per cent which is almost half of the increase estimated for FY04.

Trends in Revision of GDP Growth Rate

Indicator	Year									
	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Provisional Estimate (1)	5.1	4.7	5.7	5.6	5.2	5.47	6.04	4.8	5.3	5.52
Final Estimate (2)	4.93	4.62	5.39	5.23	4.87	5.94	5.27	4.42	5.26	6.27
Difference between 1 and 2	-0.17	-0.08	-0.31	-0.37	-0.33	0.47	-0.77	-0.38	-0.04	0.75

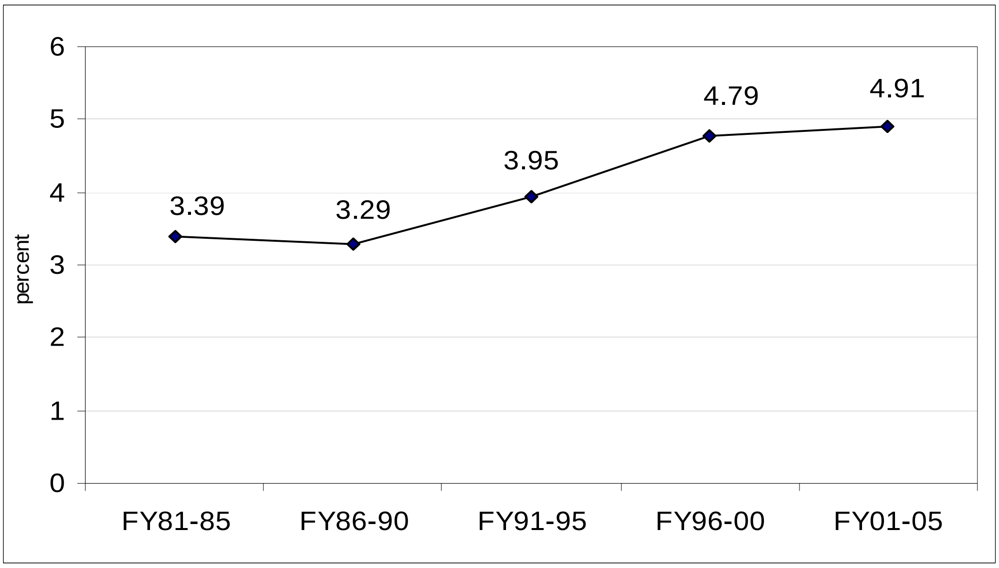
The Prolonged Period (about 12 months) taken by the BBS to prepare the final GDP estimates also raises question. Production data for the full year were already available towards the end of 2004. Was BBS waiting for any specific survey results? In that case, it is pertinent to notify the changes brought about in the data base.

One needs to be sure that identical estimation procedure was followed by the BBS in generating the provisional and final GDP figures of FY04. Without transparency as regards the estimation methodology, reliability and usefulness of GDP data will be constantly questioned. Recently government has constituted a Committee on National Income Account data. Did the Committee get an opportunity to scrutinise the new set of GDP estimates for FY04?

The prevailing wide discrepancy between provisional and final estimates also raises questions regarding credibility and usefulness of provisional GDP estimates for policymaking. Budgetary measures and the entire planning process depend on provisional data. If provisional data are far from the reality then how budgetary measures are realistic? The Mid-Term Macroeconomic Framework (MTMF) became suspect under the circumstances. Understandably, such large revision of GDP estimates is to have concomitant implications for other major macro variables including the investment and savings rate.

This particular situation also reinforces the importance of CPD's repeated call for semi-annual estimate of GDP and semi-annual reporting of the performance of the Bangladesh economy by the Finance Minister to the National Parliament.

Figure 2.2: Periodic Linear Growth Rates of GDP



Source: **CPD-IRBD Database, 2005.**

Curiously, compared with the major countries in the South Asia region, Bangladesh's growth scenario looks moderate. In FY04, the GDP growth rates of India (8.1 per cent), Pakistan (6.4 per cent) and Sri Lanka (6.5 per cent) have been higher than that of Bangladesh (even with its revised estimate 6.3 per cent). The GDP growth figures for Bangladesh for FY05 also appear to be restrained when compared with these South Asian countries which have targeted ambitious economic growth at 6.5 per cent (India and Pakistan), and even at 7 per cent (Sri Lanka). India, incidentally, recorded a 7.4 per cent growth during the first quarter of FY05. It seems South Asia as a whole is going through a spell of relatively high growth.

Sources of Growth

The ongoing structural transformation of the Bangladesh economy is characterised by falling share of the agricultural sector, with marginal increase of the manufacturing, in the backdrop of increasing contribution of the service sector. This trend continued through FY04 and FY05. The share of agricultural sector came down from 23.1 per cent in FY04 (revised) to 21.9 per cent in FY05. On the contrary, share of industry[1] and service sector[2] increased from 27.7 per cent and 50.9 per cent in FY04 to 28.4 per cent and 51.4 per cent respectively.

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[1] Industry includes Mining & Quarrying (Gas & non-refined oil, other mining); Manufacturing (Large, Medium and Small Scale); Electric, Gas & Water Supply; and Construction.

[2] Service includes Wholesale & retail trade; Hotel & restaurants; Transport & Communication; Financial intermediaries; Real estate & Housing; Public administration & defence; Education; Health & Social Works; Community, Social & Personal Services.

Subsequent to the adverse impact of flood 2004, Agriculture and Forestry subsectors experienced a negative growth of (-) 0.73 per cent in FY05. During this period fisheries subsector registered a marginal growth of 4.0 per cent. Thus, when the fisheries subsector is included, Agricultural sector shows a marginal 0.3 per cent growth in FY05. On the other hand, the Industry sector experienced an impressive 8.6 per cent annual growth in FY05. Within the Industry sector, Mining and Quarrying registered an 8.4 per cent growth, while Manufacturing experienced an 8.4 per cent annual growth during FY05. Electricity, gas and manufacturing also showed an impressive 9.1 per cent growth during the period under report.

Overall, the annual growth of the real economic sector[3] was only 3.8 per cent, while the service sector experienced a modest 6 per cent growth in FY05.

The contribution of agricultural sector in the incremental GDP also experienced a significant decline from 14.8 per cent in FY04 to only 1.3 per cent in FY05, which was largely underwritten by the negative contribution (-7.8 per cent) of the Crop subsector. The incremental contribution of overall industrial sector increased to 42.3 per cent in FY05, when compared with its matching figure 31.8 per cent of the previous year. *Overall, the contribution of the real economic sectors to incremental growth declined from 33.6 per cent in FY04 to 27.3 per cent in FY05.*

Incremental contribution of service sector in real GDP growth also increased significantly from 44.6 per cent in FY04 to 60.9 per cent in FY05.

Per capita Income

Per capita GDP and GNI scenarios are gradually improving for louring   a decline in FY02. In FY04 the per capita GDP and GNI were recorded at US$421 and US$444 respectively. The annual growth was 8.2 per cent for per capita GDP and 8.0 per cent for per capita GNI in terms of US dollars.

Early projection indicates that the impact of floods of 2004 and the recent downward revision of exchange rate of Taka will slow down the growth of real per capita income in FY05. In dollar term, per capita GDP for FY05 may be lower, or at best almost same as the previous year ranging from $ 421 to $ 424.

[3] These include Agriculture (crop, fisheries and livestock), Mining & Quarrying and Manufacturing.

2.2 Poverty Situation

Absolute Poverty

According to the recent *Preliminary Report of the Poverty Monitoring Survey 2004,* the incidence of poverty at the national, urban and rural level has been reduced in 2004 compared to 1999. Incidence of poverty by head count ratio on the basis of Food Energy Intake (FEI) reduced from 44.7 per cent in 1999 to 42.1 per cent in 2004. On an average, the annual poverty declining ratio was about 0.5 per cent. During the same period, at the urban level, the poverty declined by about 1 per cent each year; while at the rural level, the trend of poverty reduction was much slower, only 0.32 per cent. This implies that the poverty alleviation rate at the national level has slowed down discernibly (from 0.8 per cent per annum during 1995/96-2000). This is particularly true for the rural areas.

Household income distribution also corroborates the marginal poverty reduction trend at the national level. Latest available figure shows, while the increase in per capita income has been marginal for the poor, per household income of the poor, on the other hand, declined over time. *Between 1999 and 2004 at the national level, per capita income of the poor increased by 4.8 per cent, while the increase was 19.4 per cent for non-poor*. In rural areas, per capita income of the poor increased by 0.54 per cent only as against 7.97 per cent increase in case of rural non-poor.

During the last five years (1999-2004), monthly household income of the poor has been reduced both at urban and rural levels, while non-poor households experienced significant increase in income. At the national level, monthly income of the poor households has decreased by (-) 3.56 per cent, while it has been increased by 13.36 per cent for the non-poor households. In rural areas, household income of the poor declined by (-) 7.32 per cent whereas it increased by 3.23 per cent for the rural non-poor households.

Relative Poverty

It is well known that per capita income and absolute poverty level do not fully capture as they do not reflect the relative position of the poor. The Preliminary Report of the Poverty Monitoring Survey 2004 revealed that gini-coefficient has deteriorated from 0.42 in 1999 to 0.45 in 2004, indicating a significant worsening of income inequality at the national level. During the same period, for urban and rural areas gini-coefficient increased from 0.46 and 0.41 to 0.49 and 0.43 respectively. The figures suggest that income inequality is higher in the urban areas and it is deteriorating faster these (in comparison to rural areas).

The widening income disparity in Bangladesh is explained most convincingly when we compare the income shares of top and bottom quintiles of the population. Between 1999 and 2004, national income attributable to the poorest 10 per cent of Bangladesh's population declined from the miniscule proportion of 1.7 per cent to 1.5 per cent. Conversely, the control on the national income by the richest 10 per cent of the population increased from 33.9 per cent in 1999 to 36.5 per cent in 2004. In other words, the *income differential between the poorest and the richest 10 per cent increased from 20.0 times in 1999 to 24.5 times in 2004. It can be recalled that in 1995-96 this multiple was 15.5 times*. The magnitude of this ratio is higher in urban areas as the said proportion increased from 24.0 times to 36.0 times during the same period.

CPD in IRBD 2003 and IRBD 2004 emphasized that the incremental growth in an economy does not automatically benefit the poor. In fact, using proxy indicators such as food price, wage rate, terms of rate in agriculture, CPD mentioned earlier that the economic growth process is very much urban-centric and benefits the non-poor social strata <u>disproportionally</u>.

Some of the sources of rising inequality in Bangladesh are linked to the following processes:

- Not all the rural landless and poor could benefit from the agricultural development through wage employment. Additionally, the rural poor could not fully participate in the non-crop sector (like fisheries and livestock) due to restrained access to resources (e.g. water-bodies and grazing land).
- The difference between wages of skilled and non-skilled workers in the non-farm sector has also widened. These have resulted in widening of income disparity.
- The magnitude of growth of the export-oriented sector could not significantly absorb the unemployed rural workforce.
- Modern service sectors that developed in the urban areas are not labour-intensive; this requires certain educational qualification that the poor segment lacks.
- Flow of remittance income also exacerbated the income differential between few migrant and many non-immigrant families.

The situation has been aggravated by corruption and rent-seeking behaviour which is pervasive in the Bangladesh economy and society. This increasing income inequality may emerge as a threat to social cohesion and inhibit democratic transition.

Spatial Poverty

The regional difference of poverty incidence is also a major concern for macroeconomic policies. The Preliminary Report of the Poverty Monitoring Survey 2004 further shows that incidence of poverty is most extreme in Rajshahi division, followed by Khulna division. For example, in Rajshahi 46.7 per cent of total population lives below the lower poverty line; and in case of more extreme poverty line this rate is 61.0 per cent. At the national level, the incidences of poverty for lower and upper poverty lines are 33.7 per cent and 49.8 per cent respectively. Due to absence of comparable data we could not identify the trends in regional disparity.

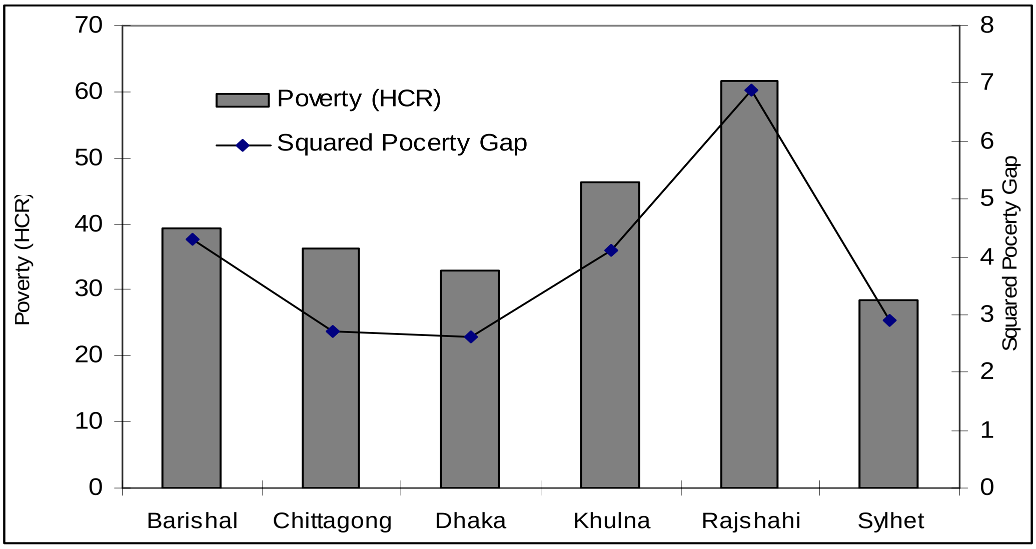
Table 2.1: Regional Disparity in Poverty Incidence (2000)

	Population Below Poverty Line (per cent)		Per Capita Income of the Poor	
Poverty Line>	Lower	Upper	Lower	Upper
National	33.70	49.80	495.19	573.72
Barishal	28.80	39.80	545.32	583.07
Chittagong	25.00	47.70	522.56	619.39
Dhaka	32.00	44.80	475.73	549.95
Khulna	35.40	51.40	543.46	641.07
Rajshahi	**46.70**	**61.00**	**468.89**	**526.44**

Source: Report of the Household Income and Expenditure Survey, 2000 (BBS, 2000).

Per capita monthly income of the poor living in Rajshahi is also the lowest - both for lower and upper poverty lines. The two monthly income figures are Tk 468.9 and Tk 526.4, while at the national level the figures are Tk 495.2 and Tk 573.7 respectively. The *poverty gap*, which is the indication of the average distance below the poverty line, and the *squared poverty gap*, which indicates the severity of poverty, is observed to be also maximum in Rajshahi division.

Figure 2.3: Regional Disparity in Poverty Incidence (2004)



Source: Preliminary Report o the Poverty Monitoring Survey, 2004 (BBS, 2004).

Along with the regional differences in agricultural production, the government also needs to monitor closely the regional disparity situation and its possible impact and correlations with the *Monga* in Rajshahi division.

Thus, we observe that while the overall poverty situation in Bangladesh is improving the pace of poverty reduction has slowed down in the recent past. It emerges that the process of increasing income inequality underpins the deceleration of poverty alleviation process. The process remains further flawed by growing rural-urban as well as broader regional disparity.

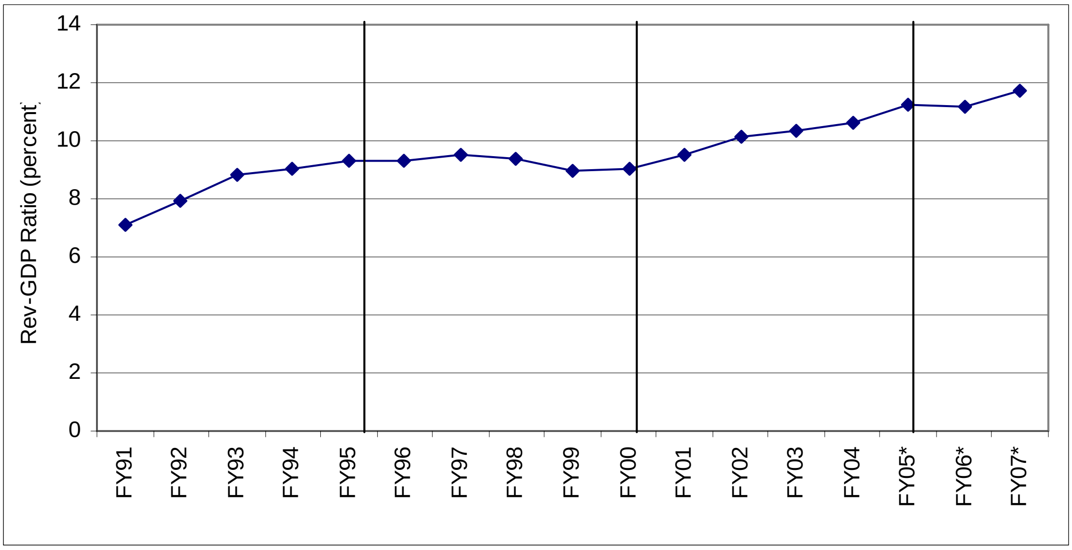
3 TRENDS IN THE FISCAL SECTOR

3.1 Revenue Collection

The periodic average of revenue-GDP ratio increased steadily from 8.5 per cent in FY91-95 to 9.2 per cent in FY96-00 to 10.15 per cent in FY01-04 period. The historically low revenue-GDP ratio of Bangladesh experienced a marginal growth during FY00-FY04, when the revenue-GDP ratio increased from 9.0 per cent in FY00 to 10.8 per cent in FY04. If the revenue target for FY05 is achieved, it would be about 11.2 per cent of the GDP. However, PRSP projected that the revenue-GDP ratio will decline to 10.7 per cent in FY05.

Tax revenue contributes about 82 per cent of total revenue, as 78 per cent are collected through the National Board of Revenue (NBR) and the rest (less than 4 per cent) comes from the non-NBR sources. According to the latest available statistics, though some progress in terms of growth is observed, performance of NBR in terms of collection as percentage of target has deteriorated during the first ten months of FY05 when compared with the corresponding figures of the previous fiscal year. Regrettably, both the non-NBR and non-tax revenue performed poorly in terms of achieving their fiscal target, though a marginal growth was observed during the first eight months of FY05.

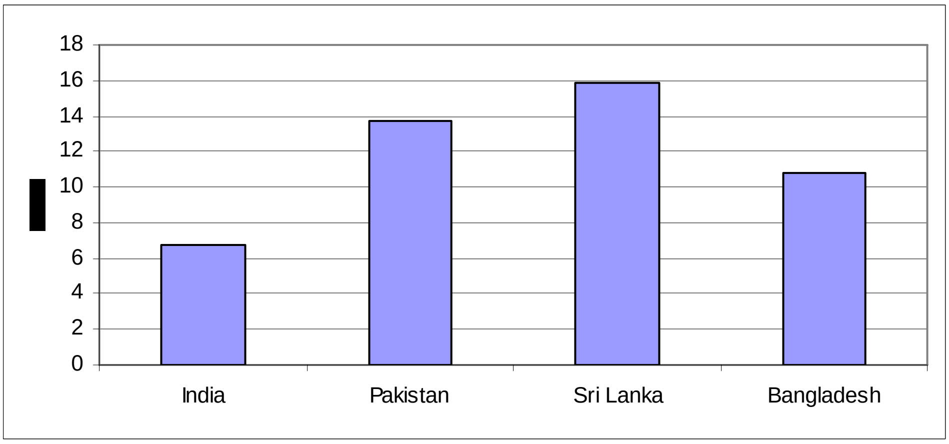
Figure 3.1: Revenue-GDP Ratio in Bangladesh



Source: **CPD-IRBD Database, 2005.**

Tax-GDP ratio in Bangladesh was 8.5 per cent in FY04 which is lower than that of Pakistan (13.70 per cent) and Sri Lanka (15.90 per cent) but higher than India (6.80 per cent). If the government achieves its fiscal target, the tax revenue as percentage of GDP will be 9 per cent in FY05.

Figure 3.2: Tax to GDP Ratio of Bangladesh, India, Pakistan and Sri Lanka (FY04)

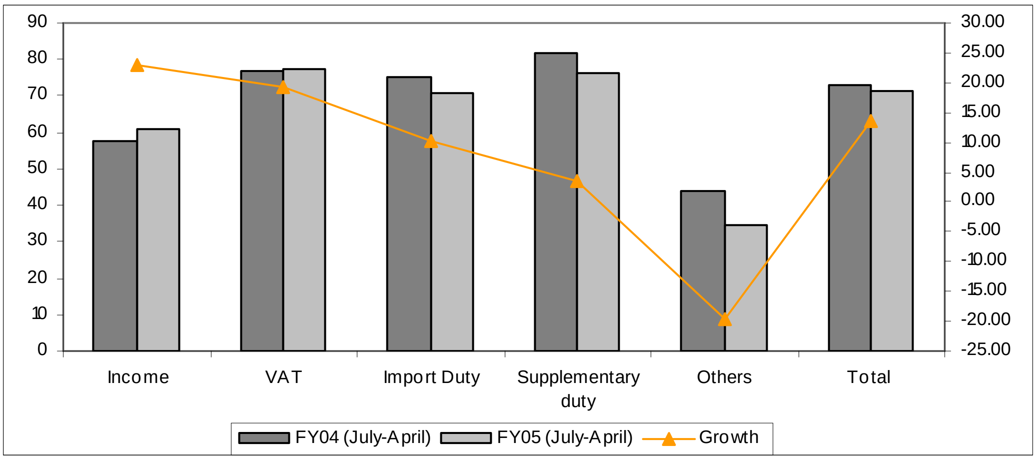


Source: **CPD-IRBD Database, 2005.**

NBR Component

Latest available figure for the July-April period of FY05 shows a moderate growth of revenue mobilised by the NBR, as it increased from Tk 20231.6 crore in FY04 to Tk 22963.8 crore in FY05, registering a 13.5 per cent growth over the corresponding period of the previous fiscal year. Since periodic targets are not available in the case of NBR, the collection to date as per cent of fiscal target can be taken as a proxy indicator to measure its periodic collection performance.

Figure 3.3: NBR Revenue Collection as percentage of Fiscal Target (Jul-Apr FY04 and FY05)



Source: **CPD-IRBD Database, 2005.**

During the July-April period of FY05, share of import related duty has marginally declined from 53.0 per cent in FY04 to 52.1 per cent in FY05. This observation contradicts the fact that during July-February period of this fiscal year, import experienced a robust growth of 25 per cent over the same period of FY04. While considering the growth performance of each of the components of import related tax, both supplementary duty (import related) and import duty performed poorly as regard their fiscal targets.

The significant growth of import related duty (11.6 per cent) is largely contributed by the growth of import duty (10.3 per cent), while supplementary duty (import) registered a marginal 0.4 per cent growth during the first ten months of FY05. However, the achievement of fiscal target during the July-April period (74.3 per cent) is lower when compared with the performance of the corresponding period of FY04 (77.2 per cent). Particularly, during July to April period, collection of import duty and supplementary duty (import) as percentage of fiscal target decreased from 75.0 per cent and 95.6 per cent in FY04 to 71.0 per cent and 85.8 per cent in FY05 respectively. The question that arises from this low performance of import related duty is "*why collection of import related direct taxes performed poorly despite robust growth in import*". Two possible answers to this question are: (i) Increase in import of zero duty or low tariff goods, and (ii) Increase in import of by mis-declaration as zero or low tariff items to get relief from import duty.

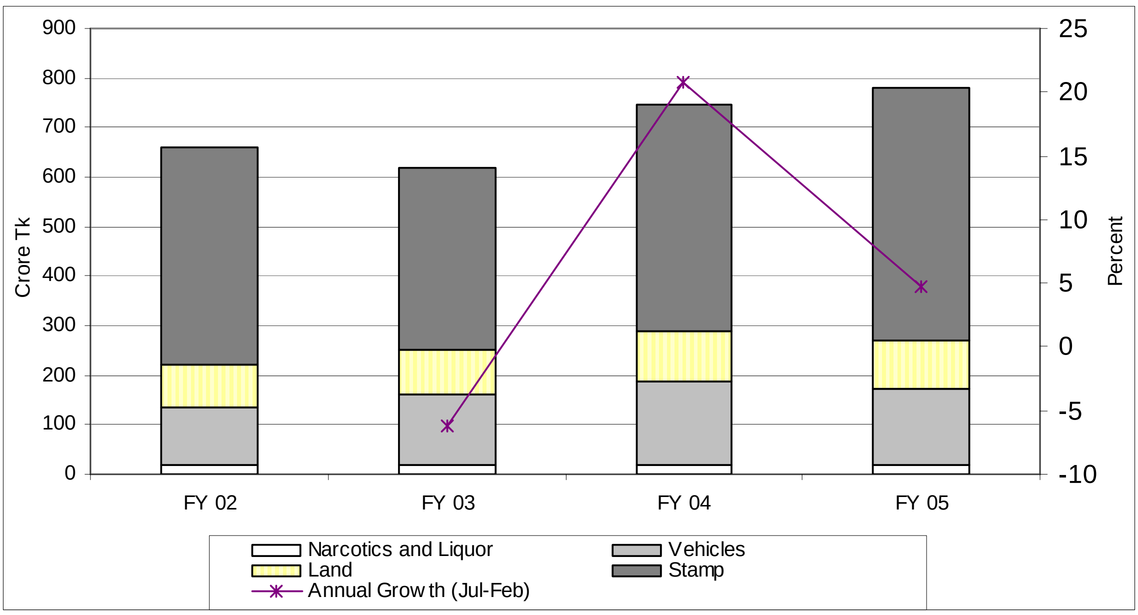
The encouraging point to be noted here is that during this period, direct tax (income tax) has registered a 22.9 per cent growth over the matching period of the previous fiscal year, which has increased its share in the total NBR revenue from 15.3 per cent in FY04 to 16.6 per cent in FY05 (July-April). It seems that the NBR's drive to enlist effective tax payees is yielding some result. However, this share of direct tax is still appallingly low and there is an urgent need for a shift in the composition of revenues away from tax on goods and services towards direct taxes on income and profit. Value added tax also registered a considerable growth during this period (19.3 per cent) as VAT (local) and VAT (import) registered 20.6 per cent and 18.2 per cent growth respectively.

During the first ten months of FY05, NBR has achieved 71.34 per cent of its annual target, whereas the matching figure was 72.91 per cent in FY04. Thus, it is highly improbable that NBR will be able to collect more than Tk 9200 crore in the last two months of the current fiscal year to rise to the occasion.

Non-NBR Component

Tax revenue collection of non-NBR during the July-February period of FY05 registered a marginal growth. As against Tk 1450 crore annual target, the realisation stood at Tk 781 crore till February 2005. Though the realised figure is 4.69 per cent (July-February) higher than its benchmark figure of FY2004, it is much lower than the comparable growth performance of FY04 (20.71 per cent). During the first eight months of FY2005 only 53.86 per cent of annual target has been realised, which was 56.47 per cent in FY2004.

Figure 3.4: Collection of Tax: Non-NBR Component in FY02-05 (Jul-Feb)



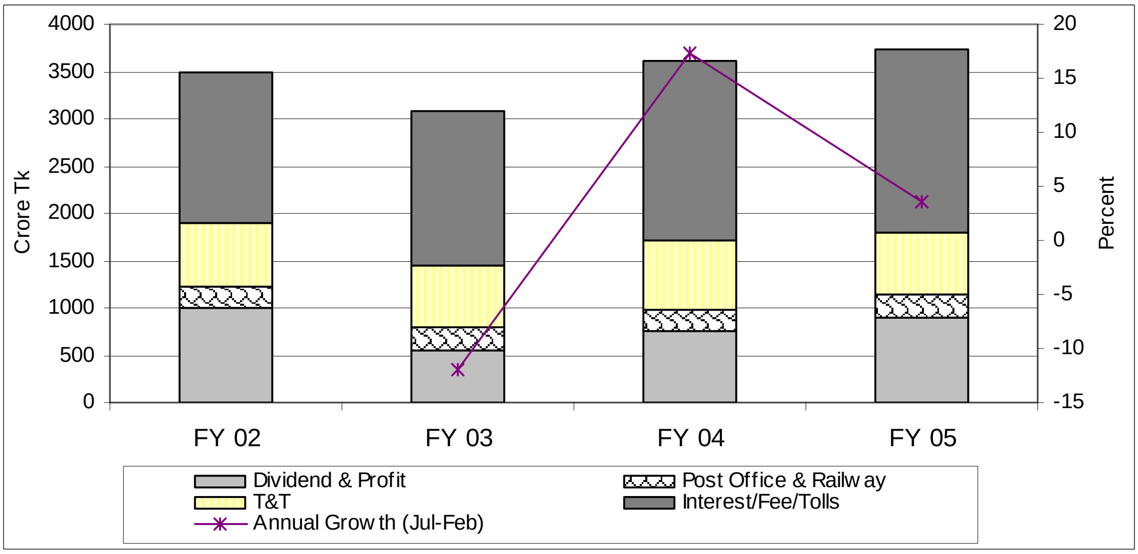
Source: **CPD-IRBD Database, 2005.**

Quite surprisingly, vehicles and land tax collection showed negative growth of (-) 7.8 per cent and (-) 5.9 per cent respectively during the FY05 (July-February), while these components registered 15.17 per cent and 14.24 per cent growth during the corresponding period of FY04. This is some what of a puzzle as neither has the land transport slowed down in this country, nor has the flow of new cars in Dhaka stopped. Narcotics and Liquor tax collection has also performed poorly with zero growth in FY05 in comparison to 11.11 per cent growth during the previous fiscal. Only taxes on stamps crossed previous year's realised figure by 11.82 per cent. These results indicate huge leakage in non-tax revenue sector.

Non-Tax Revenue

The collection of non-tax revenue performed somewhat poorly when compared with the tax components. As against the annual target of Tk 7548 crore, actual revenue earnings from non-tax sources stood at Tk 3742 crore during the first eight months of FY2004, accounting for a restrained 3.48 per cent growth over the corresponding period of the previous year (FY2004). However, this positive growth appears to be low when compared with the growth performance of FY2004, as during the same period it accounted for a 17.36 per cent growth. During the first eight months of FY2005 only 49.6 per cent of annual target has been realised, which was 51.7 per cent in FY2004.

Figure 3.5: Collection of Non-Tax Revenue in FY02-05 (Jul-Feb)



Source: **CPD-IRBD Database, 2005.**

Though there was positive growth in most of the duty areas, duties on T&T, which accounts for about one quarter of total non-tax revenue, showed a negative growth of (-) 11.8 per cent. Duties on dividend and profit and duties on post office and railway showed 17.4 per cent and 13.2 per cent annual growth respectively while revenue from other items (interest/fee/tolls etc.) accounted for marginal 2.6 per cent growth over the matching period of the preceding year (FY2004). One wonders while the government is leasing out an increasing number of land and structures, why the income on this account is failing to protect even its real value.

In the context of a declining trend in public investment and stagnated savings-investment scenario at the national level, a major challenge for Bangladesh's fiscal policy continues to be the strengthening of the effort to mobilise domestic resources to generate a larger share of resources for investment. Reforms of the tax management and providing of right incentives to stimulate domestic savings are essential to achieve this goal.

3.2 Public Expenditure

Revenue Expenditure

There is an upward trend in revenue expenditure-GDP ratio, whereby it has increased from 7.9 per cent in FY03 to 9.04 per cent in FY04, while the ratio for the FY05 has been projected at 9.3 per cent.

The targeted amount of revenue expenditure for FY2005 was Tk 32739 crore which was 2.9 per cent higher than the target figure (Tk 31826 crore) of FY2004.[4] However, latest available figure shows that the actual revenue expenditure during the first eight months of FY2005 was 19.19 per cent higher than the corresponding figure of the previous year (FY2004). Actual spending during the July-February period of FY2005 has been 52.13 per cent (Tk 17065.90 crore) of the total annual target, which was 44.99 per cent (Tk 14318.10 crore) during the same period in FY04.

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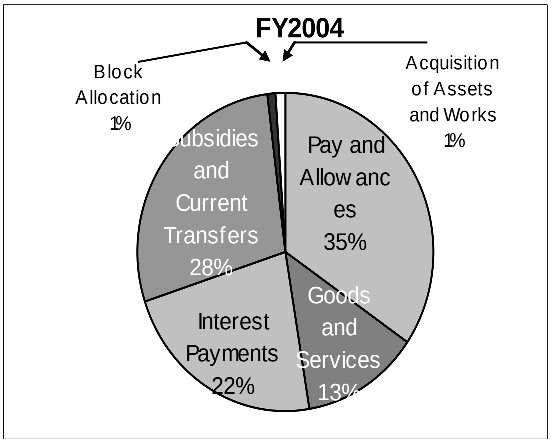
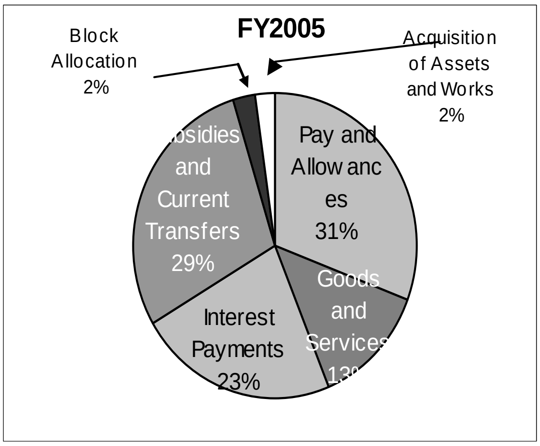
[4] Augmented revenue expenditure including requisition of assets and works and recoveries which is less than 2 per cent is not deducted here. Excluding the requisition of assets and works, revenue expenditure targets for FY2004 and FY05 were Tk 27726 crore and Tk 30518 crore. Deduction of recoveries was not accounted for in the available information about actual revenue expenditure during July-January period collected from finance division (Finance Division, 2005).

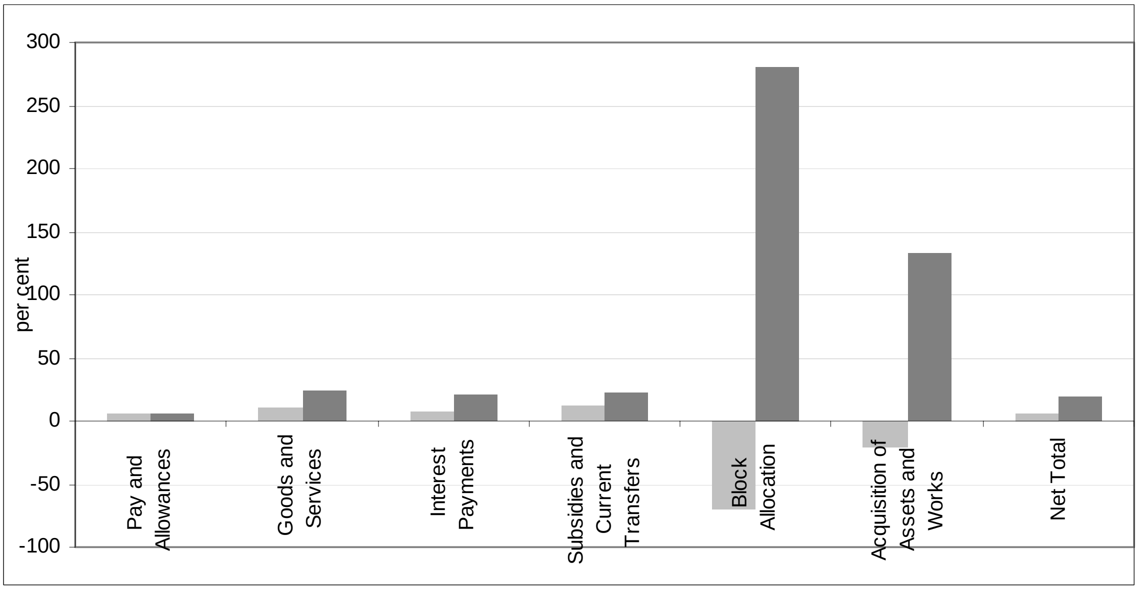
Figure 3.6: Revenue Expenditure by Economic Classification FY2004-05 (Jul-Feb)





Economic analysis of the composition of revenue expenditure indicates that only three heads, namely "salary and allowances", "subsidies and transfers" and "interest payments" accounted for about 86 per cent in the total actual revenue expenditure of FY2004. Actual spending under these three heads marginally came down to 82 per cent during the first eight months of FY05.

Figure 3.7: Growth of Revenue Expenditure by Economic Classification FY2004-05 (Jul-Feb)



Source: **CPD-IRBD Database, 2005.**

During the July-February period of FY2005, actual expenditure on account of pay and allowances was Tk 5263.30 crore, a 5.50 per cent increase when compared with the expenditure of Tk 4988.90 crore during the matched period of FY2004.

The recently declared pay scale will impose significant weight on government revenue budget. In fact, this pay scale would increase the share of "pay and allowances" in the total revenue budget from 25.0 per cent (budget FY05) to 27.5 per cent. Government will have to reorganise its resource allocation pattern in order to compensate this increased expenditure. The government also needs to reduce its size to be able to pay adequately to a smaller but efficient workforce, as against carrying the burden of a huge workforce with inadequate salary. Special measures need to be taken to increase the tax-GDP ratio, especially by increasing the share of direct taxes in total revenue.

Actual expenditure owing to goods and services (Tk 2217.70 crore), interest payments (TK 3878.30 crore), and subsidies and current transfers (Tk 4923.10 crore) showed high growths during the first eight months of FY05, accounting for 23.27 per cent, 20.59 per cent and 21.71 per cent growth respectively over the corresponding figures of the previous year. It should be noted that during the July-February period of FY05 block allocation increased three times over the same period of the previous fiscal year.

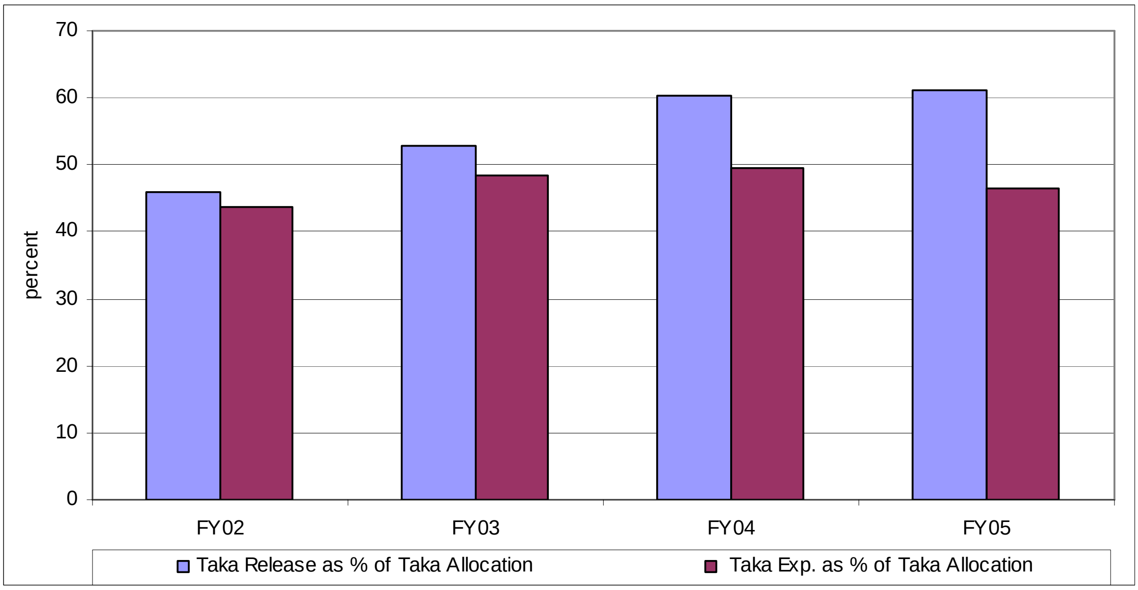
Admittedly, it is not possible to distinguish the development and non-development allocations of the budget from the existing reporting system of the budget, since several development related expenditures (e.g. allocations for safety net programmes) are also included in the revenue budget.

Annual Development Programme (ADP)

The size of the Annual Development Programme (ADP) for FY05 was fixed at Tk 22000 crore, which was 15.8 per cent higher than the revised ADP of FY04 and 30.3 higher than the actual (implemented) ADP of FY04. During FY04 only 83 per cent of the original size of the ADP i.e. 89 per cent of the revised size was implemented. The government has set the revised ADP target for FY05 at Tk 20500 crore, reducing it by 7 per cent from the original target.

Latest available figure for FY05 indicates that during the first three quarters, only Tk 10302 crore was spent for ADP implementation, of which Tk 6794 crore (65.95 per cent) was funded from internal resources (Taka) and Tk 3508 crore (34.05 per cent) was underwritten by project aid. This indicates a 46.8 per cent realisation of the target ADP during the first three quarters of FY05. During the same period of FY04, the realisation was 45.3 per cent.

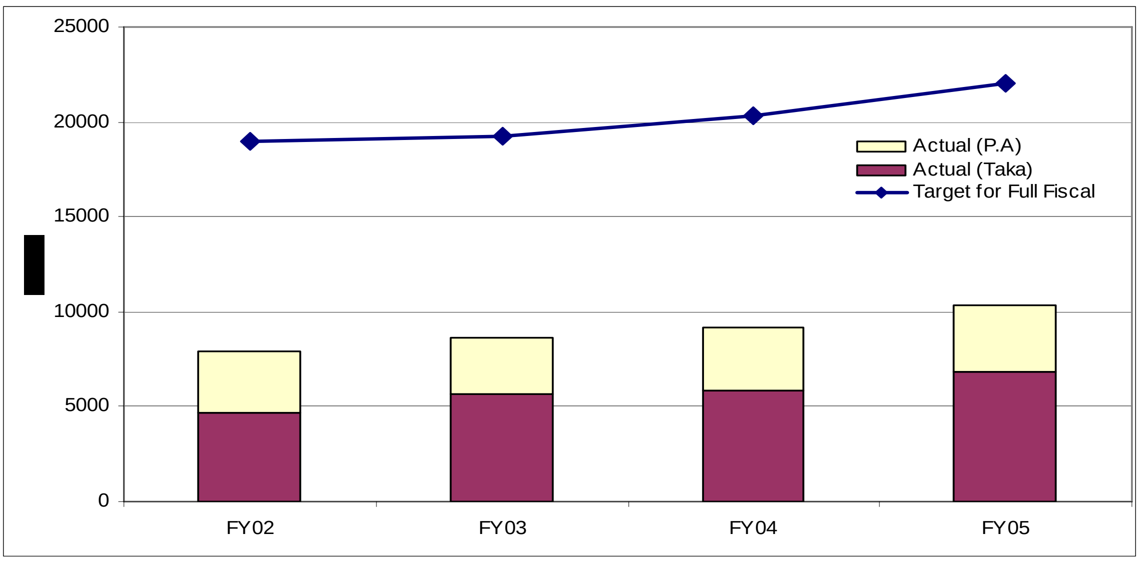
Figure 3.8: Taka Release and Expenditure of ADP during July-March of FY02-05



Source: **CPD-IRBD Database, 2005.**

While the performance of ADP implementation during the first three quarters of the current fiscal year remains comparable with the experience of previous years, it also suggests that the much anticipated "big push" necessary to achieve the aggregate target in general, and to augment the domestic demand in post flood situation was not forthcoming.

Figure 3.9: ADP Target and Actual Implementation during July-March of FY02-05

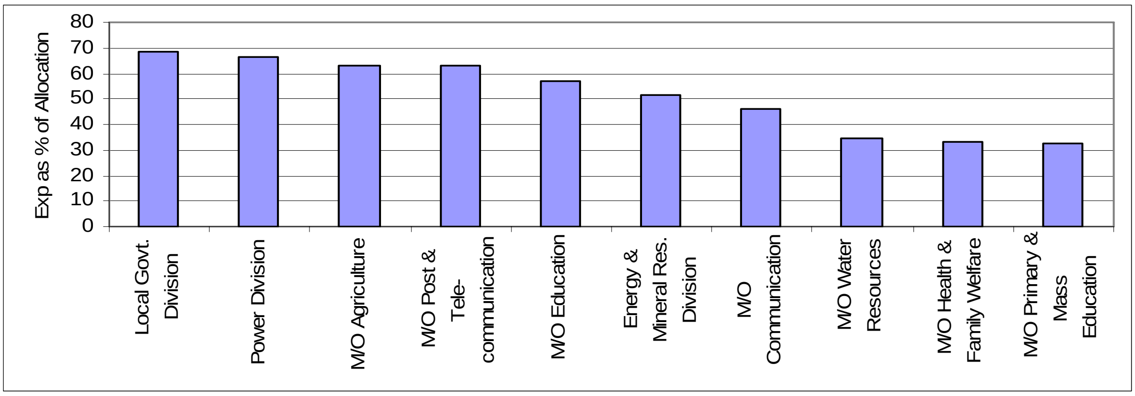


Source: **CPD-IRBD Database, 2005.**

It should be noted that the implementation of ADP as percentage of Taka release has decreased significantly from 82 per cent during July-March of FY04 to 76 per cent during the same period of FY05. To be precise, during the FY02-04 period, on an average, 89.4 per cent of the total released Taka was spent during the first three quarters of each fiscal year, while only 76.3 per cent has been spent during the same period of FY05.

A closer look at the ADP implementation reveals that among the ministries/divisions which received the highest allocation in the target ADP, the Ministry of Primary and Mass Education implemented the lowest level of spending, only 32.77 per cent of its allocation during the first three quarters of FY05. Among others, Ministry of Health and Family Welfare and Ministry of Water Resources implemented only 33 per cent and 35 per cent of their respective allocations.

Figure 3.10: Performance of Top 10 Ministries (in terms of allocation) During July-March of FY05



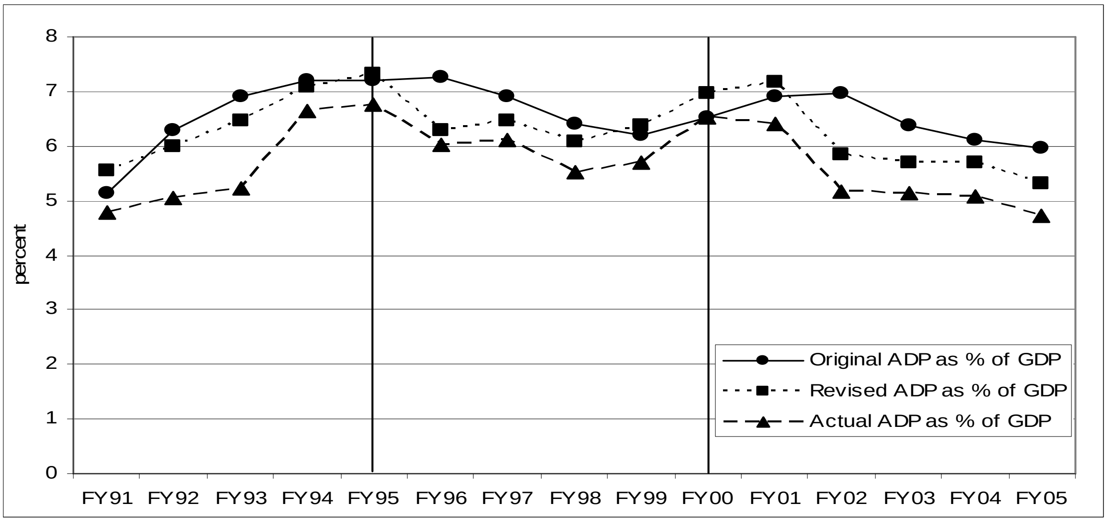
Source: **CPD-IRBD Database, 2005.**

Other sectors performed only moderately during this period: Power Division 66.4 per cent, Ministry of Education 57 per cent, Local Government Division 68.5 per cent and Ministry of Communication 46.2 per cent. One interesting point to be noted here is that, the Local Government Division secured top position both in terms of ADP allocation and implementation, which is interesting in view of the fact that the government is approaching a national election.

Though it may appear that the present government has sequentially increased the size of ADP, in real terms the ADP is nearly equivalent to or sometimes even lower than that of the earlier years. For example, in dollar terms, the actual ADP during FY04 (i.e. US$ 2880 million) was respectively (-) 9.1 per cent and (-) 7.2 per cent lower than the actual ADP of FY00 (US$ 3080 million) and FY01 (US$ 3010 million). The periodic averages of ADP (as percentage of GDP in terms of its original size) show marginal variation between the periods of FY91-95, FY96-00 and FY01-05 (6.5 per cent, 6.7 per cent and 6.5 per cent respectively). More importantly, the periodic average of actual ADP as percentage of GDP has fallen from 6.0 per cent during FY96-00 to 5.3 per cent during FY01-05 whereas the figure was 5.7 per cent during FY91-95.

As shown in the following graph, during FY91 actual (implemented) ADP as per cent of GDP was 4.8 per cent, which was increased to 6.8 per cent in FY04. In FY96 this ratio was 6.0 per cent and after some fluctuations during FY96 to FY00 it reached 6.5 per cent in FY00. But actual (implemented) ADP as percentage of GDP showed a significant negative trend during FY01-05 period, while it decreased from 6.41 per cent in FY01 to 4.73 per cent in FY05. While ADP as percentage of GDP, in terms of its original and revised size, stood at 6.0 per cent and 5.3 per cent during FY05 from 6.1 per cent and 5.7 per cent during FY04, actual ADP is expected to go farther down to around 4.7 per cent in FY05 whereas the figure was 5.1 per cent in FY04.

Figure 3.11: Original, Revised and Actual ADP as per cent of GDP (FY91-FY05)



Source: **CPD-IRBD Database, 2005.**

The government has set the new ADP target for FY06 at Tk 24500 crore, which is respectively 11.4 per cent and 19.5 per cent higher than the original and revised ADP of the previous year. CPD in its post-budget reflection pointed out that this so-called ambitious ADP target needs to be seen from the perspective that Bangladesh remains an under invested economy and as such a large ADP target is worth chasing for. Thus, implementation of a fuller ADP became a major challenge compared to targeting a bigger ADP. The second aspect, which needs to be underscored in this respect, is that the issue of quality is no less important than the issue of size of the ADP.

Table 3.1: Top Sectors in ADP Allocation During FY05-06

Sectors	FY05 Total	FY05 per cent of ADP	FY06 Total	FY06 per cent of ADP	Annual Growth	Change in share
Education and Religion	3141.61	14.28	3297.70	13.46	4.97	-0.82
Power (Electricity)	3243.38	14.74	3120.00	12.73	-3.80	-2.01
Local Government	2333.83	10.61	2996.35	12.23	28.39	1.62
Transport	3189.79	14.50	2989.00	12.20	-6.29	-2.30
Health, Popu. & Family Welfare	2156.26	9.80	2268.70	9.26	5.21	-0.54
Total	22000.00	100.00	24500.00	100.00	11.36	

Source: **CPD-IRBD Database, 2005.**

According to the new ADP, education and religion followed by power (electricity) and local government got the most allocation for FY06. Within the top gainers in ADP of FY06, local government experienced the highest increase (28.4 per cent) in allocation compared to the previous years. While other major sectors lost their respective sectoral share in ADP of FY06, sectoral share of local government increased by 1.62 per cent.

However, to label the budget as *pro-public*, the government used to manipulate the sectoral allocations to show higher share for some populist sectors. For example, allocations for some distinct sectors such as “Education” and “Religion” are added together to demonstrate a bigger share for education; on the other hand, allocation for some other sectors such as “Power” is shown separately (e.g. separate allocation for electricity) to make their allocation proportionately smaller.

Budget Deficit and Financing

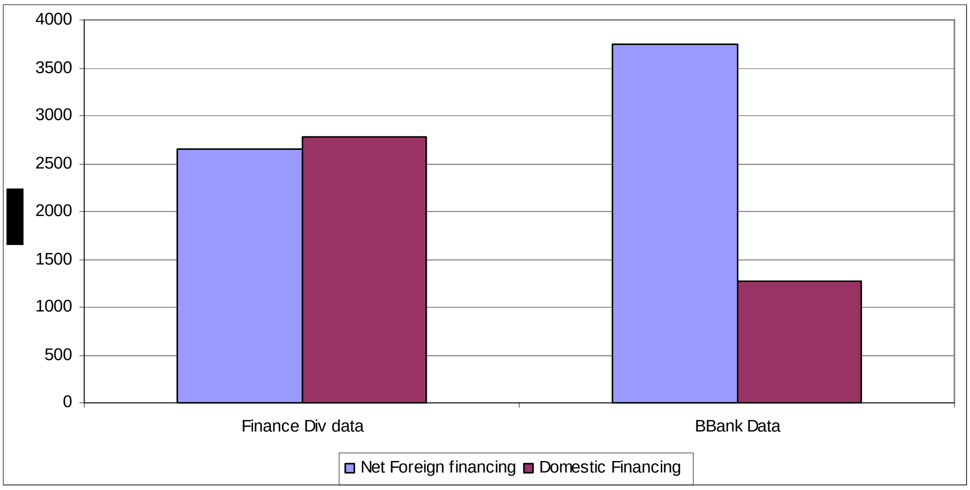
After a systematic fall in actual budget deficit[5], as percentage of GDP, during the previous years from (-) 5.16 per cent in FY02 to (-) 4.78 per cent per cent in FY04, government may once again face actual budget deficit in FY2005. In the Budget for FY05, the targeted balance was set at (-) 4.3 per cent of the GDP.

[5] Budget deficit reported in the budget announcement is revised, not actual. Since there is a lag between actual expenditure and budget proclamation, actual budget deficit often remains unpublicised.

Box 3.1: Mismatch in Deficit Financing Data: Finance Division Vs Bangladesh Bank

There is a significant inconsistency in terms of fiscal deficit accounting between the two government institutions- Finance Division and Bangladesh Bank. While Finance Division reports that during the July-February period, the domestic and foreign financing ratio of budget deficit has been 49:51, according to Bangladesh Bank, the respective ratio is 75:25.

Mismatch of Deficit Financing Figures: Finance Div Vs Bangladesh Bank



However, as latest available figure shows, while the actual budget deficit as a share of GDP was (-) 1.1 per cent during the first eight months of FY04, the overall balance during the same period of FY05 accounted for (-) 2.3 per cent of the GDP.[6] Low domestic resource mobilisation following the flood 2004 is leading the economy towards an increased budget deficit in FY05.

According to the Finance Division, for the shortfall in revenue collection, foreign financing contributed to 48.8 per cent of total deficit financing during the first eight months of FY05, when compared with its 16.4 per cent share for the equivalent period of FY04. It should be noted that the share of net flow (loan minus amortisation) of foreign loan in total budget financing during July-February period has increased from 8 per cent in FY04 to 41 per cent in FY05. The rest 51.2 per cent of financing during the July-February period of FY04 came from domestic sources, i.e. bank borrowing, non-bank borrowing and privatisation receipts.

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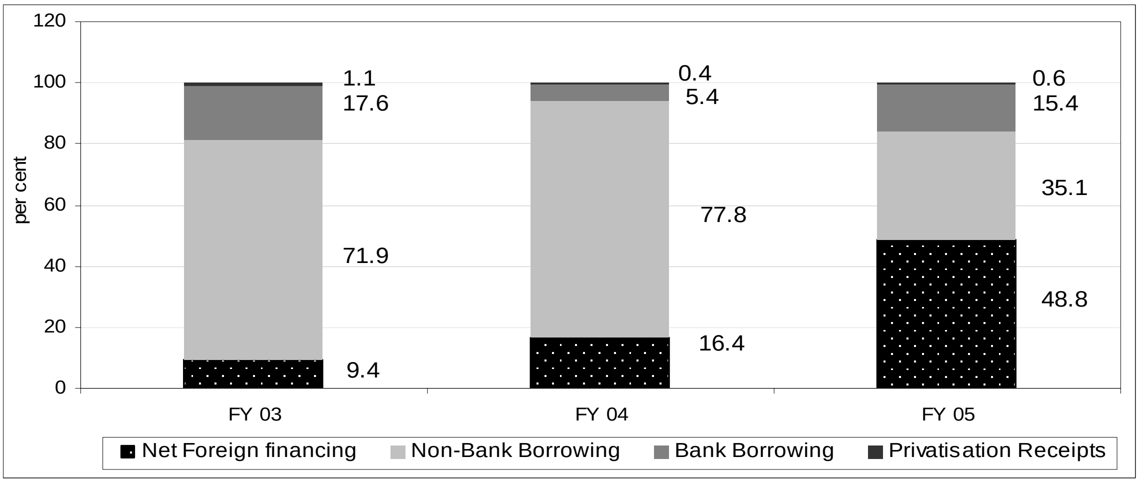
[6] GDP during the first eight months of fiscal year has been estimated as the 8/12th share of total current GDP for respective fiscal years.

Table 3.2: Sources of Financing

	Budget			Actual (Jul-Feb)			Growth
	FY03	FY04	FY05	FY03	FY04	FY05	FY05-04
1. Net Foreign Financing	6173.10	9309.30	8849.10	339.90	626.40	2657.20	324.20
Grant	3041.30	2596.30	1889.00	750.00	329.20	410.10	24.57
Loan	6139.20	9805.50	9441.00	1378.20	1804.60	3801.80	110.67
Amortisation	3007.40	3092.50	2480.90	1788.30	1507.40	1554.70	3.14
2. Domestic Financing	5913.10	6500.00	7099.00	3269.90	3183.50	2783.30	-12.57
Non-Bank Borrowing	4038.50	3460.00	4500.00	2596.60	2962.90	1912.20	-35.46
Bank Borrowing	1358.00	3040.00	2599.00	633.70	204.50	838.30	309.93
Privatisation Receipts	516.60	0.00	0.00	39.50	16.10	32.80	103.73
3. Total Financing (1+2)	12086.20	15809.30	15948.10	3609.80	3809.90	5440.50	42.80

Source: CPD-IRBD Database, 2005.

Figure 3.12: Decomposition of Deficit Financing During FY2003-05 (Jul-Feb)



Source: CPD-IRBD Database, 2005.

Finance Division's figures for the first eight months of FY05 indicate that the government had to mobilise about Tk 5440.5 crore to finance the fiscal deficit which is 42.8 per cent higher than the comparable figure for the preceding year. During this period an amount of Tk 410.10 crore (i.e. 7.5 per cent of total deficit) came as foreign grants while another Tk 3801.8 crore (i.e. 69.9 per cent of total deficit) came as foreign loan. After amortisation of Tk 1554.7 crore, a net amount of Tk 2657.2 crore was used to fill the 49 per cent of the total budget deficit. Thus, within the foreign financing component, foreign grants contributed 15 per cent while net foreign loan (loan minus amortisation) added 85 per cent to the total foreign financing.

Within the domestic resources part– the major source was net borrowing through non-bank instruments that accounted for Tk 1912.2 crore, which is, however, 35.5 per cent less than the corresponding figure of previous year. Another Tk 838.3 crore was borrowed from the banking source, which is about three times higher than the matched period of FY04. The rest Tk 32.8 crore was received from the privatisation process. Share of bank borrowing in total deficit financing has increased from 5.3 per cent during the first eight months of FY04 to 15.4 per cent during the same period of FY05. On the other hand, share of non-bank borrowing has reduced from 77.8 per cent in FY04 (July-February) to 35.2 per cent in FY05 (July-February). Bank and non-bank sources account for 30.1 per cent and 68.7 per cent of total domestic financing respectively during the July-February period of FY05, which were 6.4 per cent and 93.1 per cent respectively during the corresponding period of FY04.

From the above discussion it is clear that during the July-February period of FY05 the government has used both its foreign sources (mainly loan) and domestic banking sources as a major source of deficit financing. According to traditional theory of government debt, "budget deficit leads to lower national saving, lower investment, and trade deficit. In the long run, it leads to a smaller steady-state capital stock and larger foreign debt."[7] It is worth mentioning that trade deficit-GDP ratio has increased from 3 per cent during FY04 (July-February) to 5 per cent during FY05 (July-February). This trend in trade balance may further deteriorate the fiscal balance.

4 DEVELOPMENTS IN THE MONETARY SECTOR

4.1 Domestic Credit Expansion

Outstanding amount of domestic credit at the end of March 2005 stood at Tk 137194.1 crore of which Tk 106559.1 crore (77.7 per cent) was in the private sector and the rest Tk 30635.0 crore (22.3 per cent) was in the public sector. The recorded share of the private sector (77.7 per cent) is quite high when compared with the average share of 72 per cent as was observed during the past five years.

Total domestic credit during the first nine months of the current fiscal year registered a substantial 18.4 per cent growth over its matching figure for FY04. This is significantly high when compared with the average credit growth of 15 per cent during the FY01-05 period. In the recent past, the economy observed such high growth only at the year closing point of FY04 when the growth rate was as high as 20.7 per cent.

[7] Mankiw, N. G. (2000), "Macroeconomics", Worth Publishers & Macmillan Press Ltd.

However, expansionary trend of credit in FY05 was observed mainly during the third quarter (January-March): average credit growth during this quarter was 18.3 per cent, as against 15.4 per cent average growth during the first two quarters (July-December) of FY05.

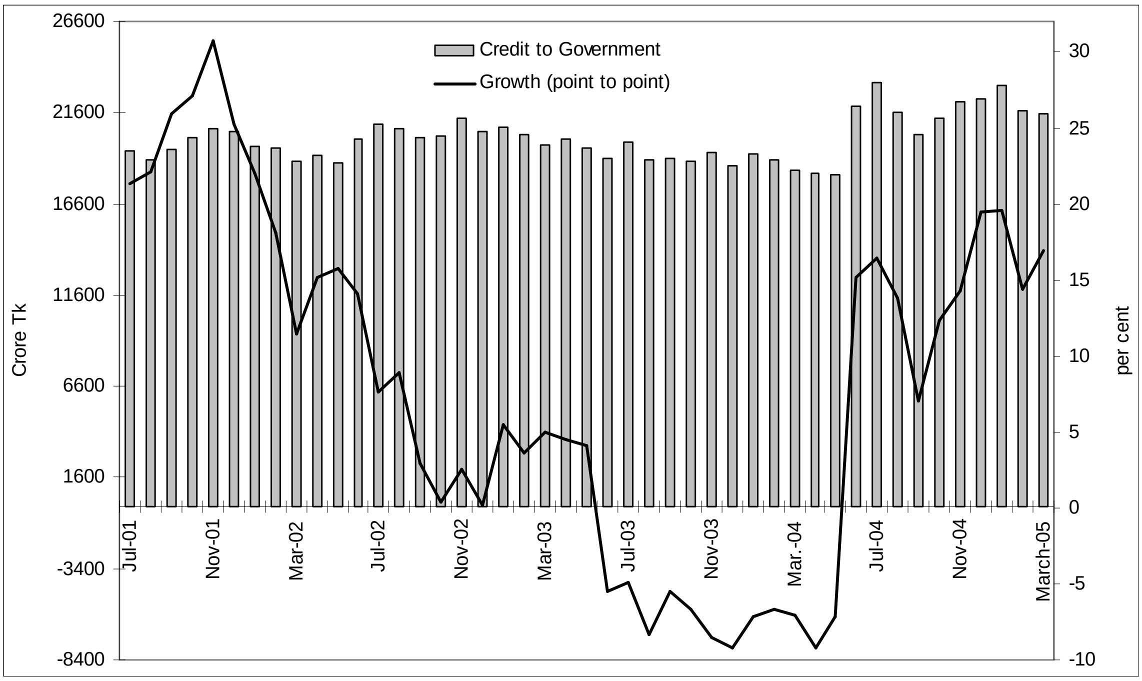
However, one may explain this upward trend in domestic credit expansion by the government's expansionary approach following the floods of July-August 2004. Curiously, high growth of credit was also observed before the flood in the government sector, as it increased its share in total domestic credit from 15.28 per cent in May 2004 to 18.32 per cent in July 2004, squeezing out the share of private sector from 77.8 per cent to 74.6 per cent between the same periods. However, soon after the flood during July-August period, the government restrained its borrowing to give more room to the private sector. From July 2004 onward, the share of private sector in total domestic credit started to rise, and by March 2005 it stood at 77.7 per cent, while the share of government sector declined to 15.73 per cent.

Thus, the growth of domestic credit during FY05 is mostly private sector driven. However, it is to be seen how the behaviour of monetary expansion changes following the cautions exercised by the government during the fourth quarter of FY05 (i.e. increase of CRR and lending rates).

Between July and March, government repaid a net amount of Tk 1622 crore from its outstanding credit, registering a (-) 7.21 per cent negative growth[8] over the first month of FY05 (i.e. July 2004). Notwithstanding, by the end of March 2005, the outstanding amount of government borrowing registered a significant 16.9 per cent growth on a point-to-point basis. This is because of the fact that the government is carrying a backlog of high borrowing in June 2004, when credit to government registered 20.4 per cent growth over the previous month, and 15.2 per cent growth on a point-to-point basis. This means, the government is still holding a large amount of credit, as the borrowing of June-July 2004 is much higher than the net repayment of subsequent months.[9]

[8] It can be noted that the average growth of monthly government credit during August 2004 to March 2005 was negative (-) 0.8 per cent (month over month).
[9] When compared with the outstanding figure of May 2004, the existing outstanding credit (as on March 2005) to government is still Tk 3351.90 crore or 18.39 per cent higher.

Figure 4.1: Monthly Trend in Credit to Government



Source: CPD-IRBD Database, 2005.

During the July-March period, outstanding credit to "other public sector" has increased by 10.1 per cent, while the private sector experienced a substantial 19.5 per cent growth over the matching figure of the previous year.

It may be noted here that the correlation of credit growths between public and private sectors often appears to be negative. When government borrows excessively from the banking sector, it usually squeezes banks' private sector lending capacity. However, excess liquidity in the banks provides enough room for government sector borrowing to expand without *crowding out* the share of the private sector. As seen during the first nine months of FY05, credit to the private sector increased both in terms of absolute volume and in terms of share, corroborating the expansionary approach of the government after the post-flood situation.

4.2 Government Borrowing and Public Debt

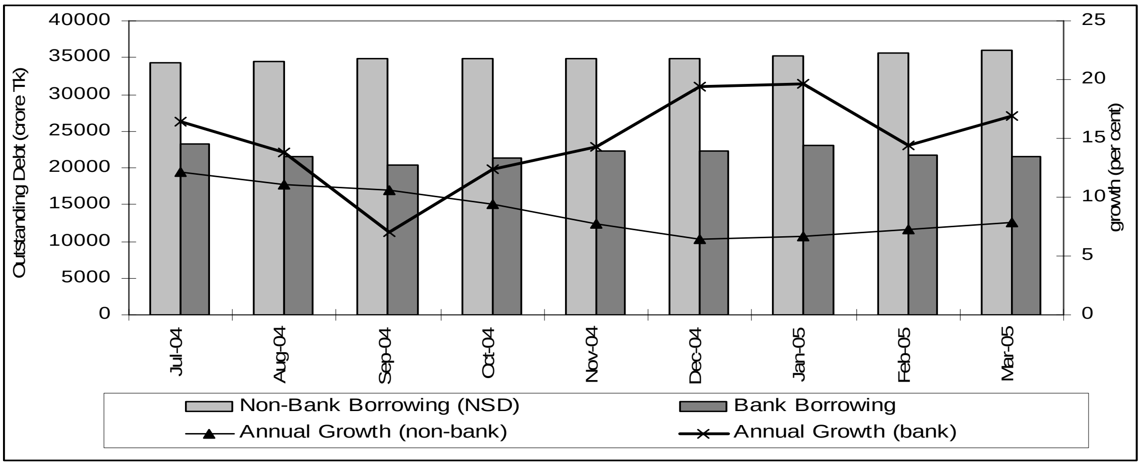
During the first nine months of FY05, government borrowing experienced a major shift as regards its source by way of moving away from non-bank sources to banking sources.

This process has been underpinned by a drastic fall in the net sale of National Savings Deposits (NSD). Share of bank borrowing in total outstanding public debt increased from 35.6 per cent in March 2004 to 37.5 per cent in March 2005.

Outstanding public borrowing at the end of March 2005 stood at Tk 57500.23 crore, registering an 11.1 per cent growth rate over the corresponding period of the previous fiscal year. While borrowing from Bank increased by 16.9 per cent, borrowing through non-bank instruments increased by 7.8 per cent.

Outstanding public debt (domestic) as per cent of GDP remained stable in FY05 as it increased to 15.6 per cent from 15.5 per cent at the end of FY04. While borrowing from non-bank as per cent of GDP reduced from 10.01 per cent to 9.75 per cent, borrowing from bank as per cent of GDP increased from 5.5 per cent to 5.9 per cent between March 2004 and March 2005. In other words, two-thirds of the domestic public debt is attributable to non-bank sector, while the rest one-third to the banking system.

Figure 4.2: Public Debt (domestic) in FY05: Changes in Outstanding Stock



Source: CPD-IRBD Database, 2005.

Sale of NSD certificates during the first nine months of FY05 stood at Tk 7634.0 crore registering a (-) 2.35 per cent negative growth, while the repayment of principal increased by 34.85 per cent, registering a (-) 40.37 per cent negative growth in the net sale including the capital market.

This decline in the sale of savings certificate is a response to the government’s decision of lowering the interest rate of NSD certificates to reduce the cost of borrowing and encouraging people to invest in the economy.

The recent upward movements in the capital market can be correlated with the declining trend of NSD sale. Though the second aim of the government, i.e. to encourage private investment, was somewhat achieved, the lowering of interest rate, however, backfired with a sharp decline in NSD sale, putting the government at a risk of financial inadequacy in the face of budget deficit.

In that case, the government will have to increase its borrowing from the banking sector, which will then create a negative impact on the private sector investment by squeezing the private sector's share of borrowing from the bank.

In the context of this dilemma, the government has taken some decisions to increase the sale of NSD certificates with the same lowered interest rate. The government has increased the limit of investment in NSD certificates, for single owner from Tk 20 lakh to Tk 25 lakh and in dual name from Tk 40 lakh to Tk 50 lakh, which is equally applicable for re-investment. Besides, one can also reinvest his/her interest with the principal. The commission of banks and post-offices has also been changed from the fixed rate of Tk 20 for each transaction to "5 per cent for each transaction" to encourage their selling effort.

It may be noted that bank borrowing target in FY05 was set at Tk 2599 crore. On the other hand, target for non-bank borrowing was set at Tk 4500 crore.

4.3 Agricultural Credit

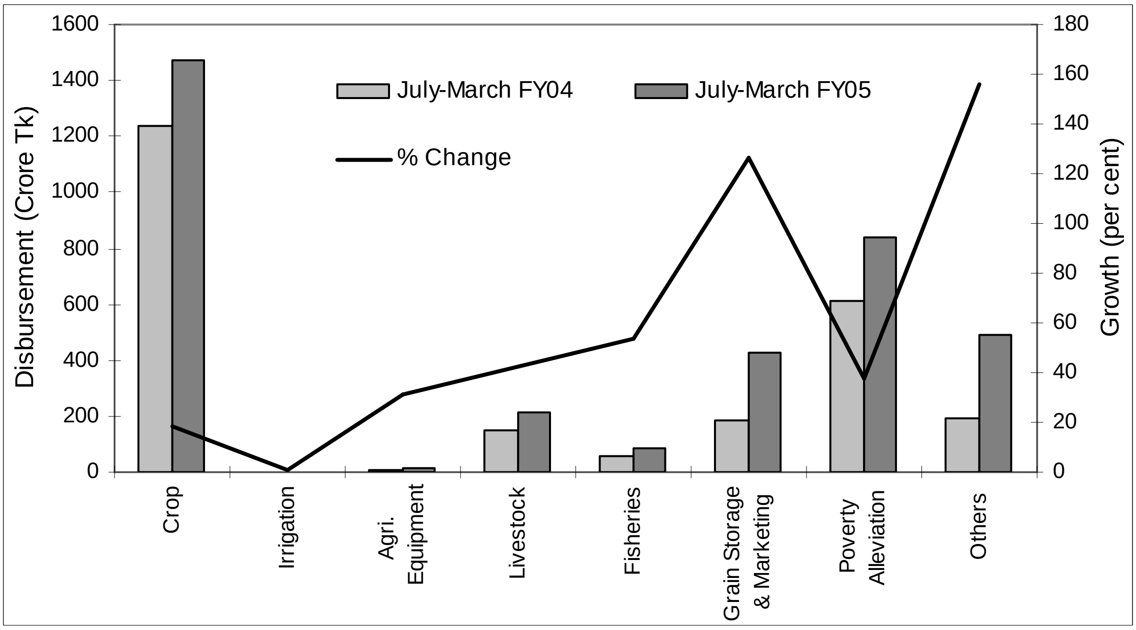
It was expected that the post-flood rehabilitation programmes of the government will be reflected by an increase in the agricultural credit. However, agricultural credit expansion during the first nine months of FY05 shows a mixed picture. Though disbursement has increased, the target has not been achieved.

Credit disbursement to the agricultural sector stood at Tk 3540.84 crore at the end of March 2005 which is 44.6 per cent higher than the disbursement of the matching period of the previous year. However, this extraordinarily high growth rate can be explained mostly by the expansionary approach of the government in the post flood months by its lower benchmark during the previous year.

While during the first nine months of FY04 only Tk 268.4 crore was disbursed for the rural economy, total net flow during the same period of FY05 stood at Tk 1595.53 crore, almost five times compared to the matching figure of the previous year.

However, it can be mentioned that the disbursement during this period is 63.9 per cent of the total fiscal target. A higher target achievement was desirable during this period because of the *Boro* production.

Figure 4.3: Agricultural Credit Expansion by Sector



Source: CPD-IRBD Database, 2005.

Crop loan followed by "Poverty Alleviation" received the highest amount of credit, while "Grain Storage & Marketing" registered the highest sectoral growth during the period under consideration. Interestingly, due to a low disbursement in FY04 and a moderate recovery in FY05, the overdue agricultural credit as per cent of outstanding credit has decreased significantly by 21.2 per cent during the first nine months of FY05. Classified loan as per cent of outstanding loan declined at the same time by an impressive 23.0 per cent rate.

It may be recalled here that the high growth of agricultural credit (11.03 per cent) during the flood year 1999 declined during the subsequent years, as lower disbursement (-5.56 per cent) and higher recovery (56.37 per cent) rate in FY00 led to an outflow of Tk 1.45 billion from the rural economy. The economy might observe a similar trend during the next fiscal year.

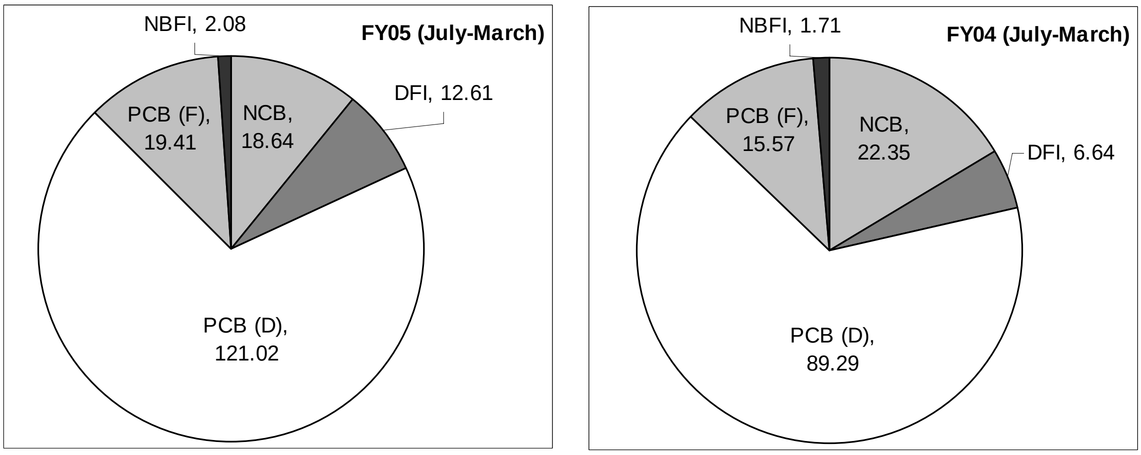
4.4 Industrial Credit

Term Loan

In the backdrop of the slowdown in growth of industrial term loans in the recent years (since FY01), the disbursement record for FY04 was quite impressive - Tk 6619.60 crore, i.e. a 67.08 per cent growth. After a recovery of Tk 4954.24 crore in FY04, the net flow to the sector was Tk 1304.97 crore which compares favourably with the outflow of (-) Tk 40.90 crore during the comparable period in FY03.

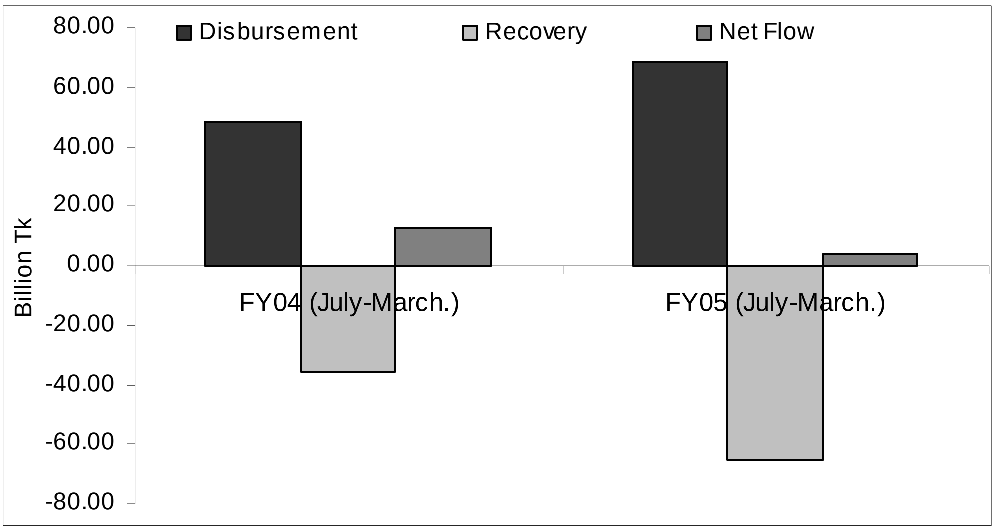
During the first three quarters of FY05, as against the sanction of Tk 8169.87 crore, an amount of Tk 6890.48 crore was disbursed as term loan, registering a 42.5 per cent growth over the corresponding periods of the previous year. The high growth in import of capital machineries and industrial raw materials (discussed afterwards) can be linked with this high rate of credit disbursement.

Figure 4.4: Disbursement of Term Loan FY04-05 (July-March)



Source: CPD-IRBD Database, 2005.

Figure 4.5: Net Flow of Term Loan FY04-05 (July-March)



Source: CPD-IRBD Database, 2005.

However, net disbursement during the first nine months of FY05 was (-) 77.1 per cent less than the equivalent figure of previous year. As against the disbursement of Tk 6890.48 crore, recovery of term loan during the same period of FY05 was Tk 6513.00 crore. Thus, the net flow of term loan stood at Tk 377.00 crore, which was Tk 1305.00 crore during the corresponding period of FY04.

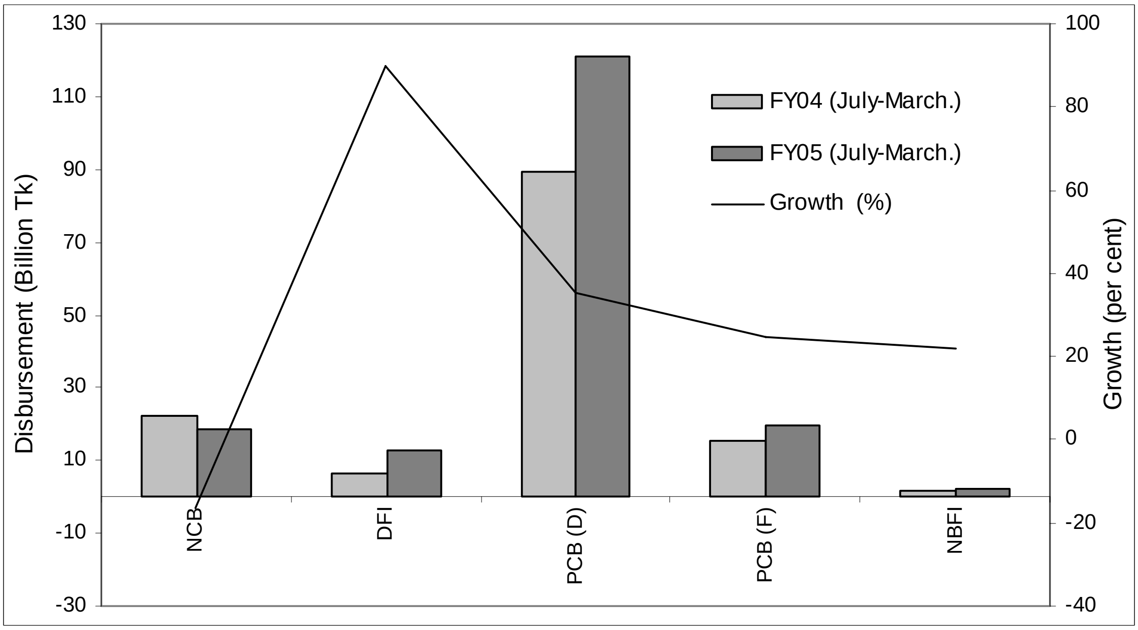
One interesting feature is that loan disbursement by NCBs during this period declined by (-) 50.0 per cent, though the loan sanctioned was 24.3 per cent higher than the July-March period of FY04. However, this low disbursement does not mean that there is a decline in consumer demand; rather this decline in loan disbursement is by government decision as part of NCB reforms.

Loan disbursement from PCB (domestic) shows a growth rate of 86.53 per cent, which has also emerged decisively as the largest contributor (little above 61 per cent) to total industrial loan disbursement. NCBs accounted for 4.91 per cent of the total term loan disbursement while DFI and PCB (F) contributed 2.96 per cent and 12.03 per cent to the total respectively. The rest 18.65 per cent of the term loan was contributed by NBFIs during the first nine months of FY05.

Working Capital

The flow of working capital also showed a noteworthy increase during the first nine months of FY05, both in terms of sanction and disbursement. During this period an amount of Tk 17376.03 crore was disbursed against the sanctioned amount of Tk 14505.78 crore for the same period. During the July-March period of FY05, the sanctioned amount increased by 28.78 per cent, while the disbursement grew by 28.19 per cent over the corresponding period of the previous fiscal year.

Figure 4.6: Disbursement of Working Capital FY04-05 (July-March)



Source: CPD-IRBD Database, 2005.

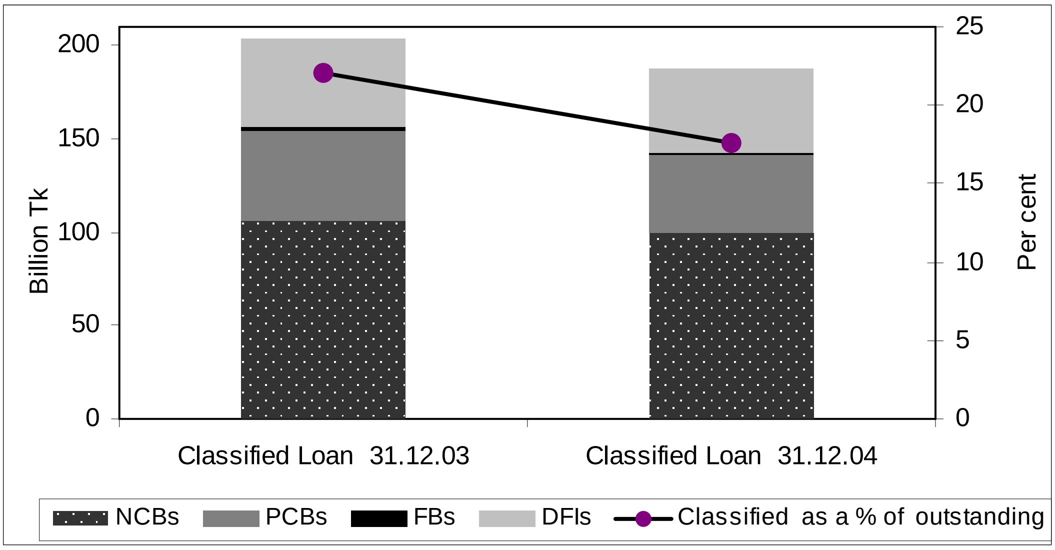
As in the case of the term loan, PCBs (domestic), which has the highest 70 per cent share in total disbursement of working capital, registered an expansionary 35.54 per cent growth rate. While the disbursement of DFIs increased by almost 90 per cent, NCBs registered a negative (-) 16.6 per cent growth during the first three quarters of FY05 over the corresponding period of the preceding fiscal year.

Relative contributions of working capital during the July-March FY05 period reveal that NCBs accounted for 10.73 per cent of the total working capital disbursement as DFI and PCB (F) contributed 7.25 per cent and 11.17 per cent share, respectively. The rest 1.20 per cent of the working capital was contributed by NBFIs during the period under report.

Loan Default Scenario

As of 31 December 2004, total classified loan stood at Tk 18726.42 crore, registering a (-) 7.84 per cent negative growth over the matched period (December 31, 2003) of the previous year, when the total classified loan stood at Tk 20319.53 crore. Consequently, the share of classified loans in total outstanding loans decreased from 22.13 per cent to 17.63 per cent between the same time intervals.

Figure 4.7: Classified Loan by Banks



Source: CPD-IRBD Database, 2005.

All the banks made significant progress during the reporting period of FY05 in reducing the total classified loan. NCBs, PCBs, FBs and DFIs recorded negative growth rates of (-) 5.80 per cent, (-) 13.54 per cent, (-) 36.62 per cent, and (-) 5.51 per cent respectively over the matched period of the preceding year (FY04). For all banks, the share of classified loans in total outstanding loans also decreased significantly.

4.5 Inflation

Consumer Price Inflation

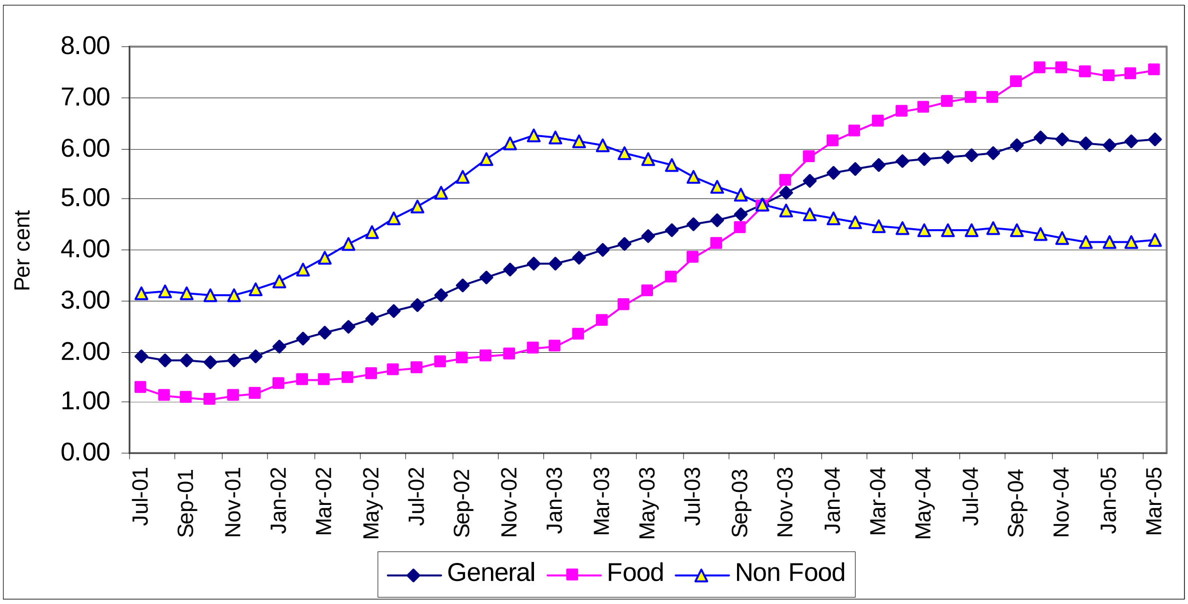
The rising trend in inflation has been a major concern in FY05. The national overall inflation on point-to-point basis at the beginning of FY05 (July 2004) was 5.65 per cent which gradually increased to 7.92 per cent in October 2004. The inflation rate gradually came down to 5.50 per cent by December 2004, but in the subsequent months it started to move up again and increased to 6.72 per cent in March 2005.

The 12-month moving average inflation rate also shows an increasing trend, reaching as high as 6.18 per cent in March 2005.

Three major features were observed in the price level: (i) inflation is higher in rural areas; (ii) food inflation is higher in both rural and urban areas; and (iii) non-food inflation is showing a moderate and stable trend since October 2002.

The underlying reasons for high inflation in FY05 are: (i) supply shortage due to flood in July-August 2004, and excessive rainfall and flash flood in September 2004; (ii) global price hike of food, oil, fertiliser and steel; (iii) increase in price of public utilities such as gas, and water; (iv) weakening of Taka against dollar that made imports costly; and (v) expansionary monetary policy.

Figure 4.8: Inflation (Moving Average)



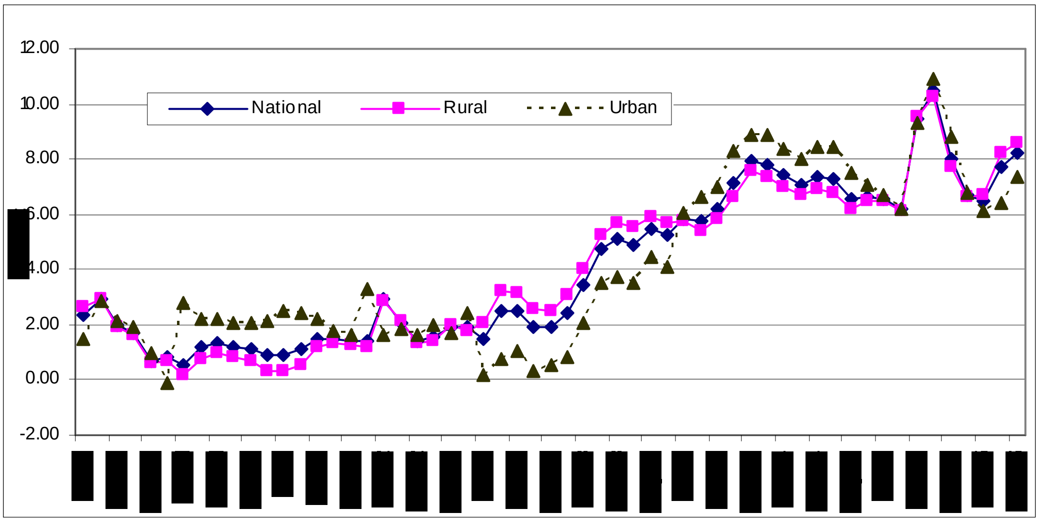
Source: CPD-IRBD Database, 2005.

Food Inflation

The 2004 flood appears to be the most influential factor in the rise in the food price, although the upturn started back in January 2003. The food inflation in FY04 was 6.64 per cent (on point to point basis), which then started to accelerate and in October 2004 it reached 10.46 per cent (on point to point basis), a record high since FY99. After October 2004, food inflation gradually declined to 6.52 per cent in January 2005, and then gradually increased to 8.22 per cent in March 2005.

Rising inflation is a matter of concern but not a threat as yet. However, this is one of the major challenges for FY05 and in the months to come the government will need to keep a watchful eye on the inflation curve.

Figure 4.9: Food Inflation (Point to Point)



Source: CPD-IRBD Database, 2005.

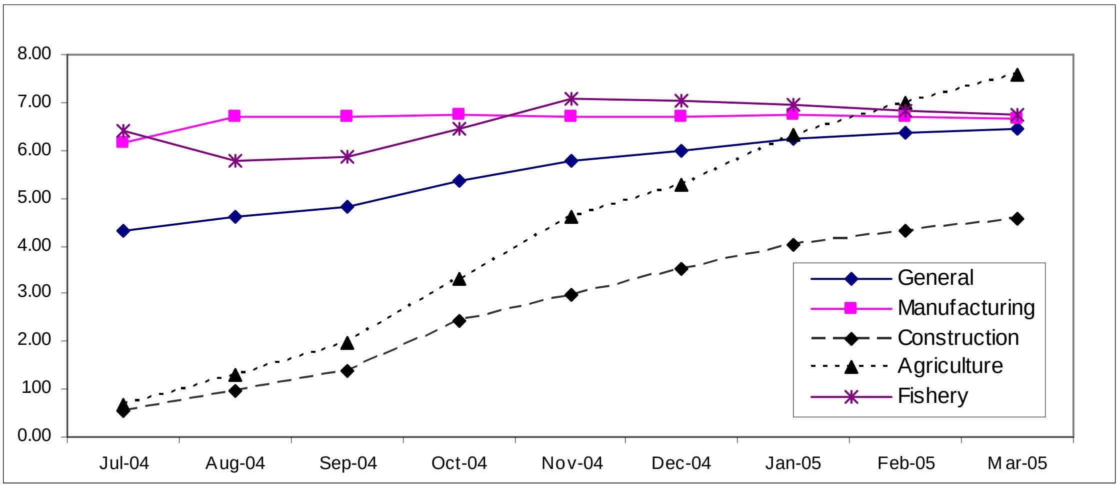
Wage Inflation

The general wage inflation grew marginally by 0.45 per cent in March 2005 on a point-to-point basis. The general wage inflation in 2002 and 2003 were 10.96 and 6.31 per cent respectively. Wage index for manufacturing industries, construction, agriculture and fishery also remained stagnant with marginal increase of 0.48 per cent, 0.26 per cent, 0.53 per cent and 0.43 per cent, respectively.

Wage inflation in manufacturing and fishery sectors is declining. This declining trend is probably an indicator of tightness in the labour market. Agricultural wage inflation has been rising since the beginning of this year. It may be recalled that agriculture wage index experienced a declining trend in FY04. Considering the high CPI inflation and food inflation in rural areas it seems that agricultural wage inflation has, to some extent, helped to keep the real income at a constant level. Wage inflation in the construction sector is low probably because the sector can easily get access to unskilled labour to satisfy its demand. It is pertinent to ask, why the wage inflation rate is slowing down. It may be an indicator of lack of employment opportunities and existence of unemployed workforce in the economy.

The crucial point here was that CPI inflation is increasing at higher rate than wage inflation. Thus, real income of average wage earners has been falling in FY05.

Figure 4.10: Wage Inflation



Source: CPD-IRBD Database, 2005.

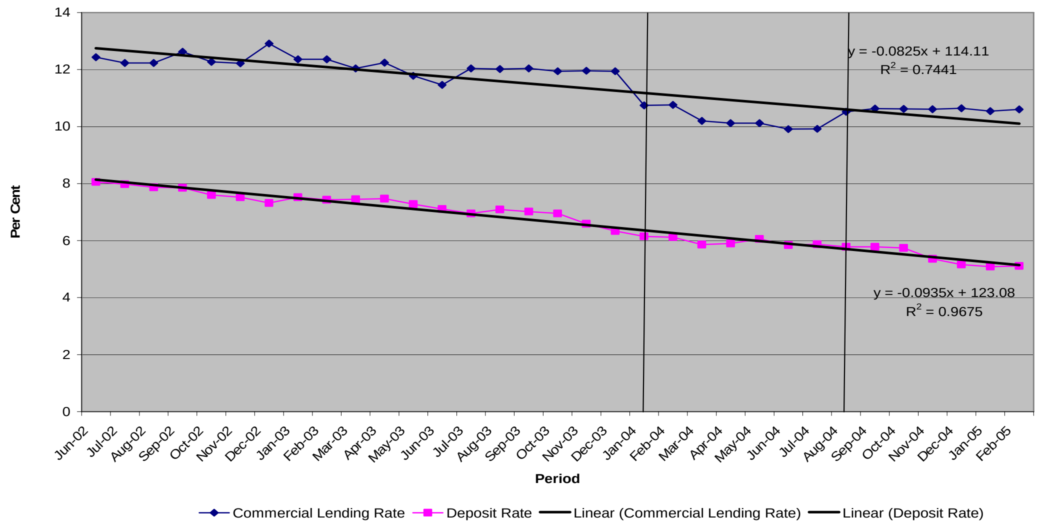
Box 4.2: Interest Rate Cut: At Who's Cost?

Several financial sector reform programmes since the mid-eighties attempted to bring in competition in the financial market through interest rate deregulation. Most of those reforms failed because they ignored market structure. For creating more vibrant private sector participation a liberal licensing policy was pursued by two governments since the 1990s. However, the interest rate rather rose as a result of wild hunt after the depositors' money by newly formed private commercial banks. The fundamental bottleneck in operationalsing a market based interest rate was high interest rate in government bonds. The government finally decided to cut the interest rate on government bonds with effect from January 2004.

Lending Interest Rate

Concurrently, with the reduction of interest on the government bonds the lending rate of NCB was also autonomously reduced. As a result of these two measures, the overall lending rate started to fall immediately [see Figure]. In case of weighted average lending rate, the interest rate fell from 11.94 per cent to 10.74 per cent in January 2004, compared to December 2003.

Figure Q. Trends in Commercial Interest Rate



Data Source: Economic Trends, Bangladesh Bank, Various Issues.

Since January 2004 up till February 2005, the weighted average commercial lending rate fell by 1.44 per cent in absolute term. The rate of the fall was 13.59 per cent. It should be noted that parallel pressure of the Bangladesh Bank and the Finance Minister himself also contributed to the reduction in interest rate.

Deposit Interest Rate

The reduction of the lending rate was achieved mainly through reduction of cost of fund, not through improvement of quality of lending. If we observe the trend of commercial deposit rate, the decline of the deposit rate was steady unlike the lending rate, which has an erratic pattern, and the weighted average fall in deposit rate in absolute term was 1.84 per cent (compared to the lending rate fall of 1.44 per cent). The rate of the fall was 36.01 per cent. The higher rate of decline in deposit interest rate shows that the entire exercise of interest rate liberalisation during the last 20 months (July 2003-February 2005) benefited the commercial banks more by having average premium from depositors of 0.4 per cent. Based on the total deposit for the period as Tk 2959.83 billion, the loss of depositors as interest income comes to about Tk 1183.93 billion annually. It is also to be noted that due to reduction of deposit interest rate the growth of time deposit slowed down [see the following table]. The time deposit growth rate for demand deposit was 0.57 per cent below, on the other hand, for time deposit it was 0.28 per cent. For March 2004 to March 2005, the respective growth rates are 16.35 per cent and 15.19 per cent.

Growth of Time and Demand Deposit, March 2004 and March 2005

Items	March, 2005	February, 2005	March, 2004	Percentage Changes March 2005 Over	
				February 2005	March 2004
1	2	3	4	5	6
1. Demand Deposits*	148410	147573	127551	0.57	16.35
2. Time Deposits*	1086014	1082999	942779	0.28	15.19
Total	**1234424**	**1230572**	**1070330**	**0.31**	**15.33**

Source: Bangladesh Bank.

As a whole, the commercial interest rate both for lending and deposit fell during the last fiscal year; however, it happened at the cost of depositors with two components: one, proportionate decline and second, extra reduction of deposit interest rate.

Interest rate and Inflation

Taming inflation only through increase of interest rate seems to be an inappropriate policy proposition. This policy will facilitate rise of lending interest rate but not the deposit interest rate. The positive gain of lending interest rate reduction will be lost because of such move. If one correlates the reduction of lending interest rate and growth of industrial credit, there is a positive relationship. In an environment of stagnant investment this trend became positive in recent past. The predictability of investment environment will be destroyed. The automatic controller of interest rate as a leverage for controlling inflation is not workable in Bangladeshi fragmented financial system. Lack of relationship between the bank rate (which is now 5 per cent) and the interest rate shows that the financial market is still fragmented. It is not that the government will be able to reduce interest rate immediately after inflation gets under control.

Alternatively, it was possible to increase the CRR and SLR, which could reduce the lendable money from the bank immediately and control the lending factor of inflation. After the normalisation of the inflation rate the CRR could be reduced. Furthermore, reduction of deposit rate contributes more to the inflation pressure than the reduction of lending rate, through increase of consumption by the potential depositors. The reasons of recent inflationary pressure lie elsewhere, not in the financial market. Those factors should be addressed; however, some of them are out of the government's control like rise in global fuel price and food price.

4.6 Exchange Rate Situation

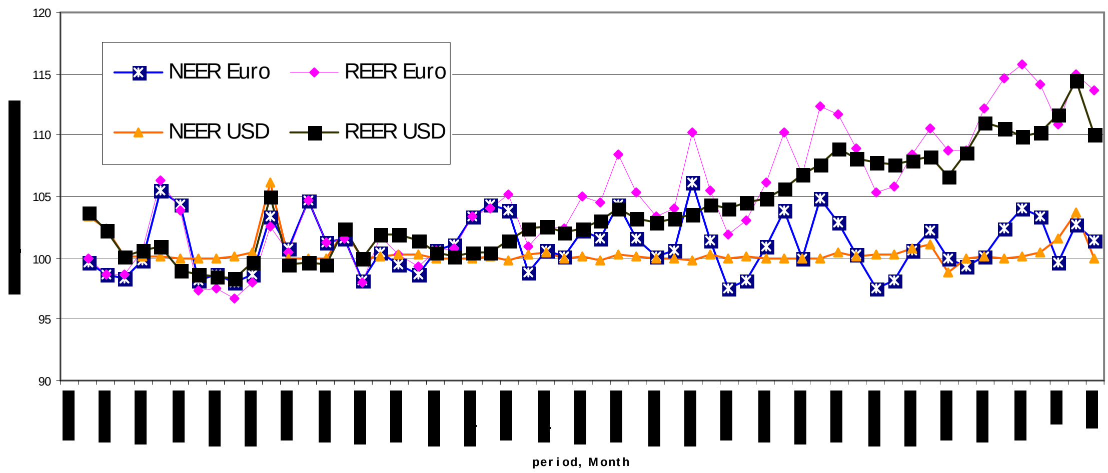
Current Situation of Taka

In May 2003 the government announced the full free floating of exchange rate in Bangladesh. It was a historic move towards application of market mechanism in macroeconomic management. It was expected that free floating of exchange rate will remove market distortion prevailing in the foreign exchange market. Earlier Bangladesh Bank used a buying and a selling rate for foreign exchange dealers based on Real Effective Exchange Rate (REER).

The trend of market exchange rate analysis does not evince any market correction which ought to take place after May 2003. Figure 4.11 shows the Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER). These estimates are based on the monthly average exchange rate data in Bangladesh and Reuter's system and Consumer Price Index (CPI) data from International Financial Statistics (IFS). Figure 4.11 reveals that after the adoption of free floating exchange rate, Taka remained overvalued against both USD and Euro during the entire period. (Note that the value of REER exceeding 100 implies overvaluation of Taka). In March 2005 Taka was overvalued by 13.58 per cent against Euro and 10 per cent against USD. This was 15 per cent and 14 per cent respectively in February 2005. Figure 4.12 depicts Euro-USD global rate and Euro-USD cross rate in Bangladesh. It shows that the movement of Taka against USD and Euro depends on the movement of Euro-USD in the international market.

This trend of overvaluation of domestic currency may encourage imports, and discourage exports and remittance flows. Deterioration in balance of trade as well as balance of payments situation in Bangladesh may be a result of such overvaluation of the domestic currency.

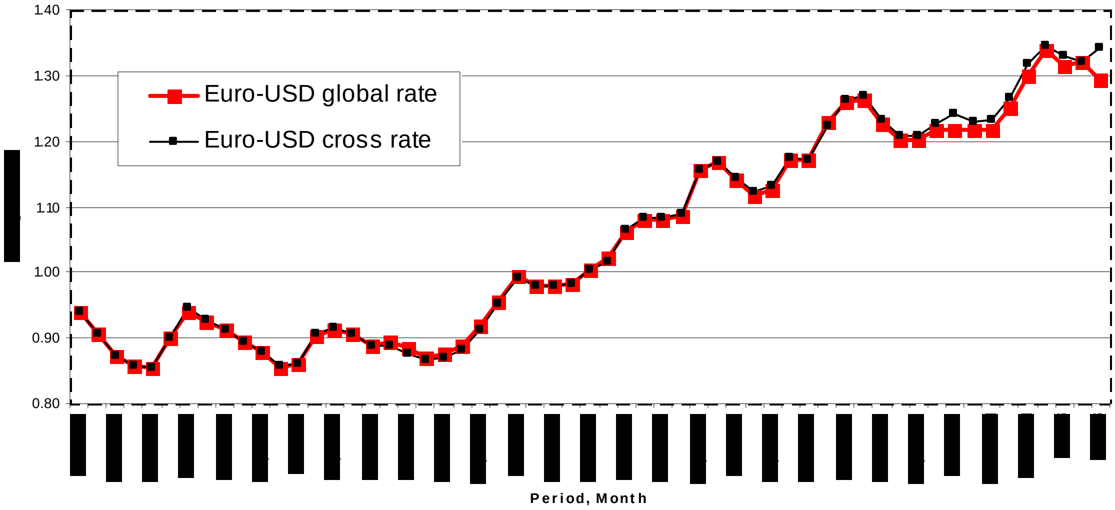
Figure 4.11: Movement of NEER and REER for USD and Euro



Source: CPD-IRBD Database, 2005.

According to the Commerzbank Research (2004), the Euro-USD rate will start to reverse in May-June 2005 and will reach 1.28 or less. Having a positive forecast of the economic growth in the Europe, the rate might improve in favour of USD further. One can observe that such trend is already on the ground. The Euro-USD exchange rate in the international market remained around 1.28 throughout 2005. During these months, exchange rate of Euro-USD in terms of Taka significantly increased both in real and nominal terms, and Euro-USD global rate and Euro-USD cross rate remained about the same.

Figure 4.12: Comparative Movement of Euro-USD Cross Rate in Bangladesh and Global Euro-USD Rates, Monthly Average



Source: CPD-IRBD Database, 2005.

External Sector Performance of Bangladesh: Does Exchange Rate Matter?

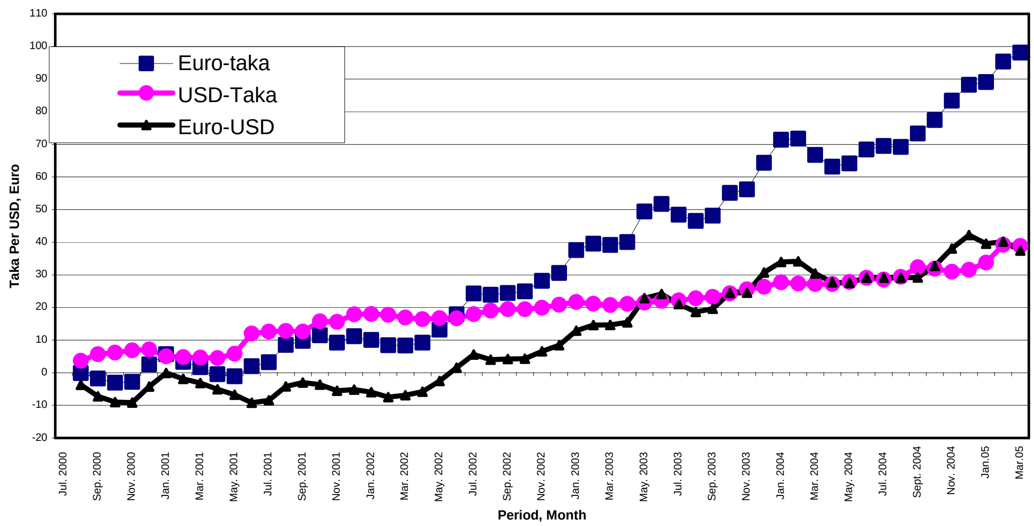
A major share of Bangladesh's import payment constitutes capital and intermediate goods. According to the import statistics, during July-March in FY05 the share of consumer goods in total import payments was only about 10 per cent, while the share of intermediate goods, industrial raw materials, petroleum and petroleum products, capital machinery and machinery for miscellaneous products was 74 per cent. In such a situation undervaluation of domestic currency will raise import costs of intermediate goods and raw materials, and in the ultimate analysis this may not encourage exports. However, there arises another issue. Bangladesh is beset with substantial trade deficit. Bangladesh's trade deficit stood at $2878 million (37 per cent of total import bill) during the period of July-February in FY05. One of the major sources of financing this trade deficit is remittance flow to the country. During July-April in FY05 total remittance flow to Bangladesh was $3196 million.

An econometric exercise was carried out at the CPD to capture the impact of exchange rate change and volatility on export performance of Bangladesh. The model was run through unit-root test of the variables, co-integration and error correction process (Raihan 2005). The exercise shows that undervaluation of Taka against Euro played a clear positive role in terms of export gain in the EU. During the period in question, one per cent undervaluation generated 1.25 per cent growth in export in the EU market.

Figure 4.13 shows the undervaluation of Taka against Dollar and Euro taking July 2000 as the base year. Taka has been undervalued more against Euro than against USD. Bangladesh's total export to the EU market increased at a faster rate during the last four years but at a slower rate in the US market. During July-March in FY05 total export to the EU market increased by 54 per cent compared to that of July-March period in FY02. During the same period total export to the USA increased by only 3.21 per cent.

However, there are two views as regards increase in export to the EU at a faster rate and to the USA at slower rate. One opinion suggests that significant undervaluation of Taka against Euro has made Bangladeshi exports more competitive in the Euro-denominated market. On the other hand, due to linear undervaluation of Taka against USD, export has not benefited much. Another opinion suggests that it was not because of the policy of conscious deeper undervaluation of Taka against Euro, rather global undervaluation of USD has added extra premium in the competitiveness of Bangladeshi products to the EU market.

Figure 4.13: Depreciation of Some Selected Currencies, Base Period July 2000



Source: CPD-IRBD Database, 2005.

In conclusion, two important findings may be identified. First, Taka remains appreciated against USD and Euro, and the movement of Taka against USD and Euro is determined mainly by the Euro-USD global exchange rate. Second, the exchange rate of Euro and USD in terms of Taka should be undervalued to stem the pressure on balance of payments brought by high import growth. This will also encourage exports and remittance flows, and improve balance of payments situation.

5 PERFORMANCE OF THE REAL SECTOR

5.1 Agricultural Production

Foodgrains

Foodgrains sector in FY04 recorded the highest production since the independence of Bangladesh. According to the final estimates of the BBS, actual foodgrain production in FY04 was: *Aus*: 1.83 million metric tonnes; *Aman*: 11.52 million metric tonnes; *Boro*: 12.84 million metric tonnes; and Wheat: 1.25 million metric tonnes.

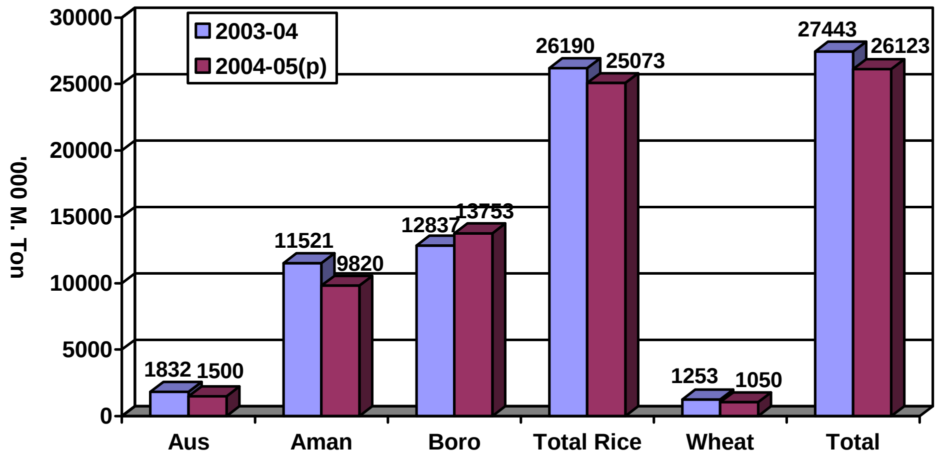
Thus, total production of foodgrains (rice and wheat) was 27.44 million metric tonnes (MT) which was 2.80 per cent higher than that of FY03. In FY04, total rice production increased by 3.98 per cent (compared to FY03), while wheat production decreased by 16.85 per cent. It may be mentioned here that wheat production has been gradually decreasing since 1999/00. Thus, it appears that increase in total foodgrain production in recent years is mainly due to the increase in rice production (mostly *Boro*).

The operational target for foodgrain production in FY05 has been set at 30 million MT which is 9.32 per cent higher than the actual production in FY04. According to the BBS, production of *Aus* rice has declined from 1.83 million tonnes to 1.50 million tonnes and *Aman* production has declined from 11.52 million tonnes to 9.82 million tonnes. In other words, *Aus* and *Aman* rice production in FY05 is respectively 18.1 per cent and 14.8 per cent lower than that of FY04. Decrease in *Aus* and *Aman* production was mainly due to the damage by the July-August flood (which affected 46 districts), and excessive rain and flash flood in September (which affected 24 districts).

Farmers tried to offset this loss by producing more *Boro* rice. Most of the Boro area has already been harvested, and is expected to be completed by mid-June 2005. *Boro* production situation of this year is good, and yield is likely to be higher than the last year. Bumper production of *Boro* is the result of the following factors: (i) farmers' special effort to compensate for the loss occurred by flood 2004; (ii) distribution of seed and balanced fertiliser, and modern seeds under post-flood agricultural rehabilitation programme of the government; (iii) good weather condition, particularly rain in March before the flowering stage of *Boro* plants. Neither the Directorate of Agricultural Extension (DAE) nor the BBS has released any provisional estimates yet. There seems to be some confusion about the likely production level of *Boro*. Experts are projecting that the actual *Boro* production might be more than the targeted *Boro* production in FY05. According to the DAE, *Boro* production target in FY05 is 13.75 million tonnes (i.e. 7.1 per cent higher than last year's production of

Boro rice). As mentioned earlier, wheat production has been gradually declining since FY00. Wheat production in FY05 is estimated to be 1.05 million MT (i.e. 16.2 per cent lower than that of FY04). Thus, if *Boro* production is up to the target level then total rice production in FY05 would be 25.07 million MT, i.e. 4.3 per cent less than that of FY04 (26.19 million MT), and total foodgrain production in FY05, estimated to be 26.08 million tonnes, is likely to be 5.0 per cent less than that of FY04 (Figure 5.1).

Figure 5.1: Production of Foodgrains in Bangladesh: 2003-04 and 2004-05



Source: CPD-IRBD Database, 2005.

Other Crops

During FY05 farmers have taken extra effort to increase winter vegetable production after their experience of high prices of vegetables during August-October 2004. Increased effort of farmers had led to an increased production and supply of vegetables since November 2004 which helped to reduce the price. However, farmers' success in increased vegetables production had been penalised through drastic fall in winter vegetable prices. In some areas farmers were not able to sell their winter vegetables even at producer's cost.

Livestock

The Directorate of Livestock Services (DLS) projected that milk production in FY05 is likely to be 2.03 million tonnes against 1.99 million tonnes in FY04, while meat production in FY05 would be 0.96 million tonnes against 0.91 million tonnes in FY04. On the other hand, number of eggs produced in FY05 is expected to be 5161 million against 4780 million in FY04. In FY05, growth in milk, meat and egg production is likely to be 2.01 per cent, 5.49 per cent and 7.97 per cent respectively. It may be noted that growth in milk, meat and egg production in FY04 was 9.34 per cent, 9.64 per cent and 0.06 per cent respectively. Slow growth of these products in FY05 owes largely to the flood of 2004.

Fisheries

According to the Directorate of Fisheries (DoF), fisheries production may experience a 5.50 per cent growth in FY05 against a 5.20 per cent growth in FY04. Though culture fisheries were negatively affected by the flood of 2004, there was same positive impact of this on open water fisheries since fish from ponds and other reservoirs had migrated to open water as a result of the flood.

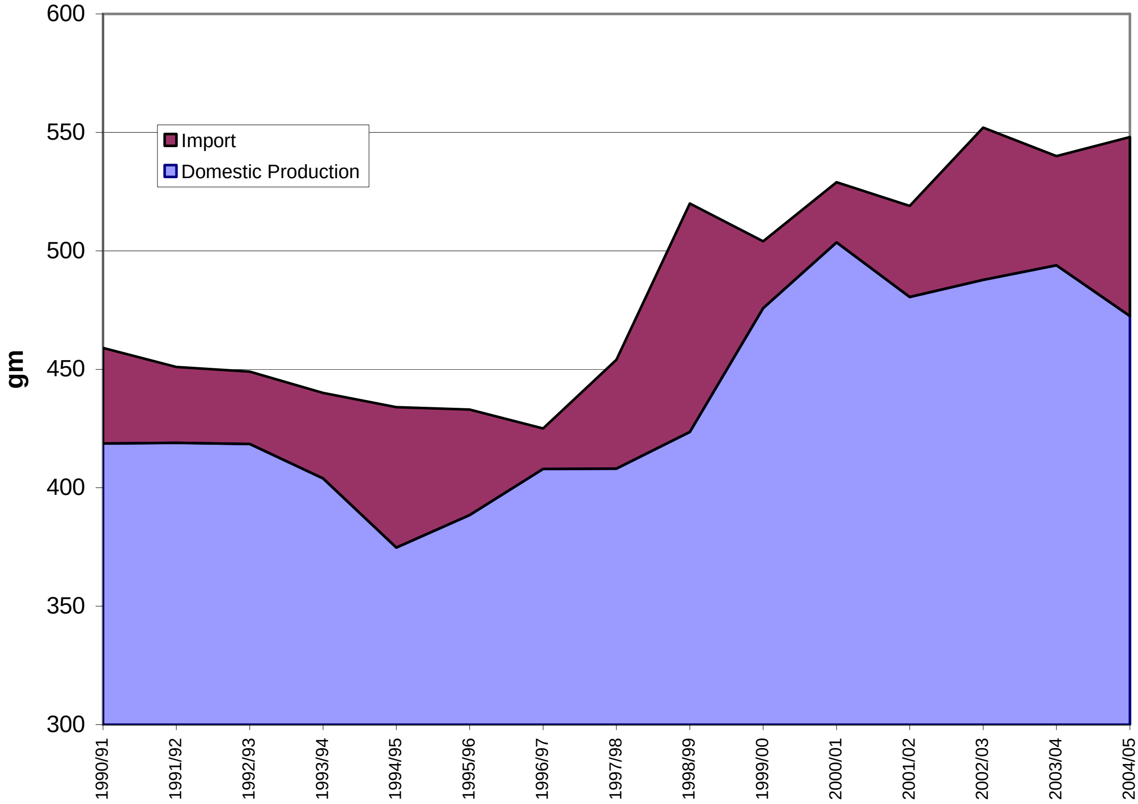
Food Aid, Commercial Import and Food Availability

Imports of foodgrains into Bangladesh are sustained from two sources: food aid and commercial imports. The later comes both through government and private channels.

During July-April of FY05, total rice import (public and private sector) was 1225 thousand tonnes against an import of 779 thousand tonnes during the comparable months of FY04 (i.e. 57.3 per cent higher). On the other hand, wheat import (by public and private sector) during July-April of FY05 was 1791 thousand MT against 1782 thousand MT during the comparable months of FY04 (i.e. 0.5 per cent higher). Thus, total foodgrain import (3016 thousand tonnes) in Bangladesh during the first 10 months (July-April) of FY05 was 17.8 per cent higher than that of FY04. Though a higher level of import was expected in view of the damage due to flood, high price in the international market had perhaps had a constraining impact on the import of food items.

Projected per capita food availability in FY05 is going to be 548 gram (gm) per day against 552 gm in FY03 and 540 gm in FY04 (Figure 5.2).

Figure 5.2: Per Capita Daily Foodgrain Availability



Source: Bangladesh Foodgrain Digest.

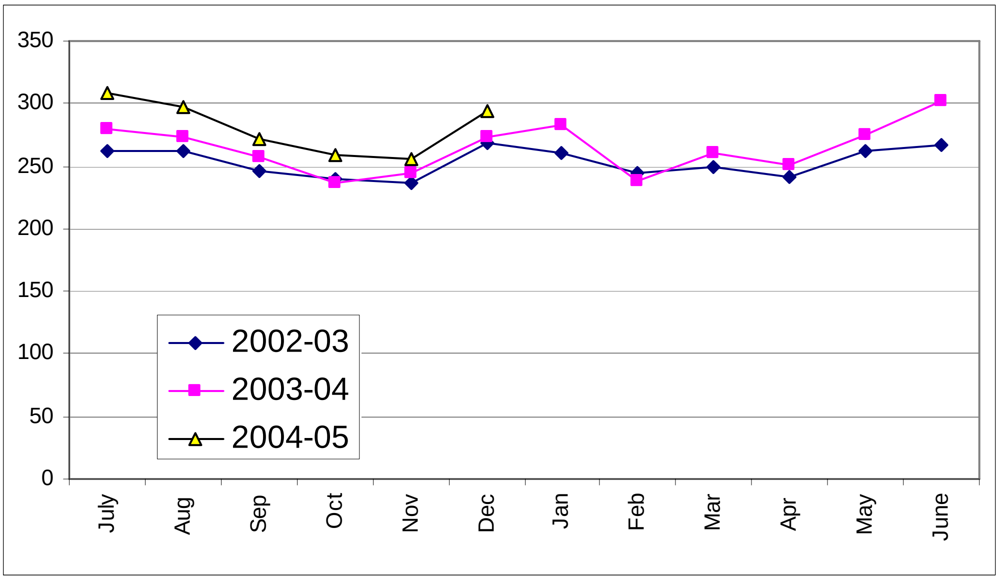
5.2 Production and Investment in Manufacturing and Service Sector

Production of Manufacturing and Service Sectors

The country observed an encouraging recovery in the industrial sector during the first half of FY05 after the devastating flood that the economy experienced at the beginning of the current fiscal. Quantum Index of Production (QIP) of medium and large scale manufacturing industries showed a considerable improvement, (QIP)-jumped to 281.13 during July-December 2004 against that of 260.52 during the comparable period of 2003 which indicates a 7.9 per cent growth in industrial production in the current fiscal. However, weighted average growth of production based on industrial production in 1988-89 shows a growth of 4.73 per cent, which would jump up to 10.86 per cent if the base changes to industrial production in 2000-01. This indicates that there is a need for substantive revision in the weight of industries if the estimates are to reflect the ground reality.

Starting with a very high level of production this year (QIP in July 2004 was 308.18); major manufacturing industries could not maintain it in the following months mainly because of the flood 2004. However, industries have quickly recovered their production level in December jumping by 38 points, from 256.48 to 294.80.

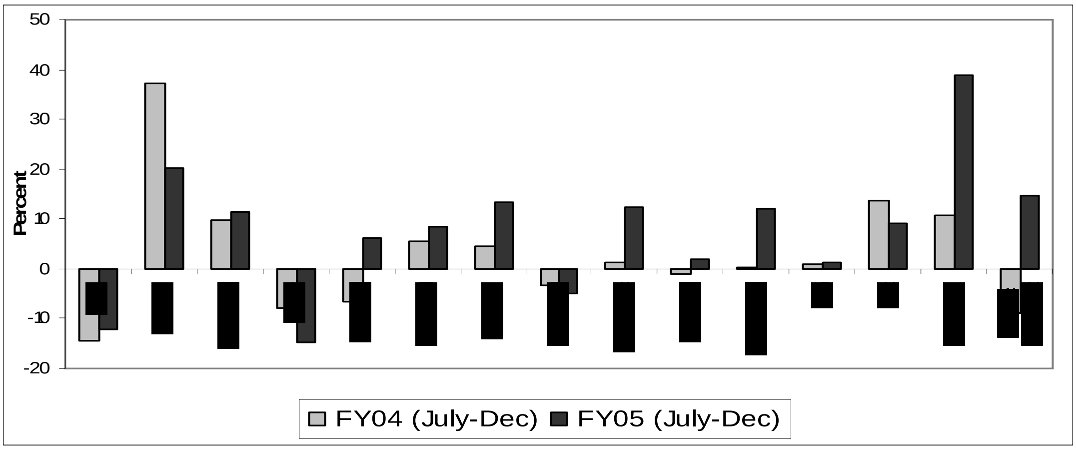
Figure 5.3: Quantum Index of Industrial Production during FY03-05



Source: CPD-IRBD Database, 2005.

Manufacturing of cotton and garments showed 20.35 per cent and 11.47 per cent growth respectively supporting the high growth performance of export by these sectors. Other sectors which showed modest to high growth during this period include: fertiliser (6.10 per cent), MS rod (8.34 per cent), cement (13.33 per cent) and drugs and pharmaceuticals (12.18 per cent). This increase was mainly because of increasing domestic and international demand. However, jute textile, paper and petroleum products showed negative growth during this period, registering (-) 12.29 per cent, (-) 14.70 per cent and (-) 4.90 per cent negative growth respectively, mainly because of declining local and international demand (in case of jute) or increasing import (in case of paper and petroleum products).

Figure 5.4: Growth in Major Industries during Jul-Dec of FY04 and FY05

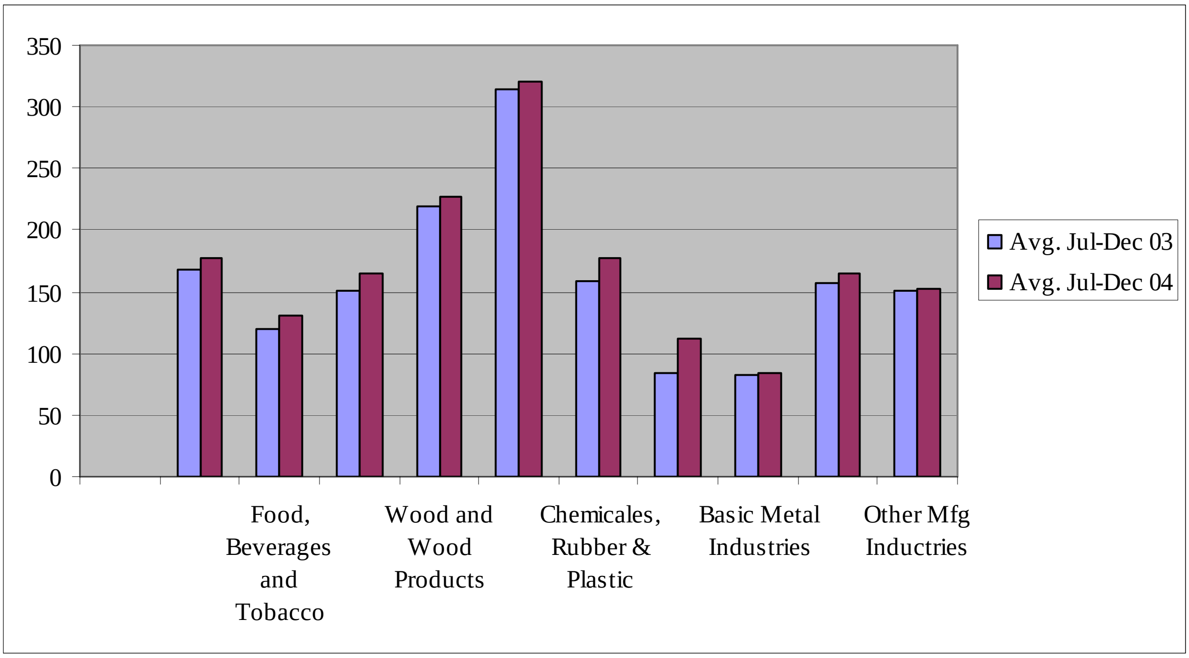


Source: CPD-IRBD Database, 2005.

On the other hand, production of small scale manufacturing industries has increased by 5.4 per cent during July-December of FY05 compared to the matching period of the previous year. This increase is slightly lower than the growth in large-scale industries. All small-scale industries have experienced growth in the current fiscal year at varying degrees. Small industries that achieved relatively moderate and high growth level are: non-metallic mineral products (33 per cent), chemicals, rubber and plastic (11.7 per cent), food, beverages and tobacco (8.7 per cent), textiles, leathers & apparel (8.6 per cent), and metal products machinery (5.12 per cent). On the other hand, industries that experienced relatively less growth are: wood and wood products (3.34 per cent), paper, printing and publishing (1.78 per cent), basic metal industries (1.01 per cent).

Growth of industrial production in different small-scale industries therefore indicates a close association with the growth of different large-scale industries. However, growth in production in the second quarter of the current fiscal year compared to that in the first quarter is very low (less than 1 per cent), mainly because of damages incurred due to the flood.

Figure 5.5: QIP of Small Scale Manufacturing Industries



Source: CPD-IRBD Database, 2005.

Box 5.1: CPD's Forthcoming Study on "Crisis of Power Supply and Its Economic Cost"

Power supply situation in Bangladesh is experiencing a serious crisis over the last few years. This worsening trend is afflicting huge loss to the economy. What is the economic cost of this power crisis to the nation? CPD carried out an analysis of the power crisis and has estimated the possible loss incurred by the economy in FY04 on this count. CPD's estimate also provides for sectoral decomposition of the loss.

According to the findings of the aforesaid study, the economy of Bangladesh has suffered a total loss of Tk 6,850 crore in FY04 due to power supply shortage. This figure is equivalent to about 2 per cent of the GDP. The commercial sector accounts for maximum share of the loss (58 per cent) followed by industry (34 per cent) and agriculture (8 per cent).

- Commercial sector is most affected due to the power crisis and its total loss is about Tk 4000 crore annually. Without an improvement in the power supply, growing electricity use in commercial activities would have negative incremental effect on the economy in future.
- Industrial sector is bearing a loss of about Tk 2,000 crore-Tk 2,500 crore, which is equivalent about 5 per cent of its sectoral contribution to the GDP. Over time this loss has increased. Small and medium size units are the major sufferers in this sector.
- Agriculture (including forestry and fisheries) is found to be least affected with a sectoral loss figure of Tk 518 crore. The burden could have been much higher if irrigation, the major electricity based agricultural activity, did not undertake load management by way of use of power mainly during off-peak hours.

Merchandise imports of non-foodgrain commodities have increased considerably (26.7 per cent) during July-February of FY05 compared to that of during the same period in FY04. Import of both consumer and non-consumer goods, especially industrial raw materials, intermediate products and capital machineries has increased. Major industrial products imported are: fertiliser (134 per cent), POL (72 per cent), plastic products (33 per cent), dyeing, tanning (26 per cent), clinker (13 per cent), iron, steel (31 per cent), capital goods (22 per cent), yarn (22 per cent), textile (23 per cent), staple fibre (35 per cent) etc. This indicates that large and medium industries could not yet develop linkage industries on a large scale within the country, and therefore, have to depend on imported raw materials, machineries and others. However, there is some indication of import substitution in case of pharmaceutical products and edible oil. Changes in imports of these products are (–) 10 per cent and 1.3 per cent respectively.

Table 5.1: Merchandise Import of Selected Commodities

(In Million US$)

Major Commodities	2003-04 (Jul-Feb)	2004-05 (Jul-Feb)	% of Change (Jul-Feb 04-05 over Jul-Feb 03-04)
1. Edible oil	310	314	1.29
2. Clinker	89	101	13.48
3. Crude petroleum	180	208	15.56
4. POL	420	723	72.14
5. Chemicals	264	308	16.67
6. Pharmaceutical products	30	27	-10.00
7. Fertiliser	118	276	133.90
8. Dyeing, tanning etc. materials	68	86	26.47
9. Plastics and Rubber articles thereof	228	303	32.89
10. Raw cotton	369	419	13.55
11. Yarn	213	259	21.60
12. Textile and article thereof	845	1043	23.43
13. Staple fibre	37	50	35.14
14. Iron, steel and other base metals	297	389	30.98
15. Capital goods	1452	1771	21.97
16. Others	642	766	19.31
17. Imports of EPZs	491	486	-1.02
TOTAL	**6631**	**8294**	**25.08**

Source: Statistics Department, Bangladesh Bank.

Historically, it has been observed that the growth of industries is closely associated with the growth of private investment in the country (Rahman, 2005) which is seen in case of investment in large, medium and small-scale industries in the current fiscal year.

Box 5.2: Political Economy of Petroleum Product Pricing

The government for the second time in FY05 resorted to price increase of petroleum products. This was done in order to reduce the loss incurred by the government due to the large price differentials between subsidized local and international markets. It is important to point out that import duty on petroleum products in Bangladesh is very high (import duty: 25 per cent, supplementary duty: 15 per cent, VAT: 15 per cent, and surcharge: 4 per cent) and constitute one of the major sources of revenue of the government.

In May 2005, petroleum product prices were increased: kerosene and diesel by Tk 3 (from Tk 23 to Tk 26) and petrol by Tk 2 (from Tk 33 to Tk 35). Price of octane remained unchanged at Tk 35. This price increase was to reduce losses of Bangladesh Petroleum Corporation (BPC) by about Tk 9 billion as against its current total loss of Tk 20.75 billion. One recognises the rationale for such rationalisation of prices, particularly in the backdrop of escalating global price of petroleum products. However, it is difficult to miss the distributive implications of this particular government measure.

Bangladesh’s annual demand for petroleum products is 3.8 million tonnes, of which 50 per cent demand is for diesel and kerosene, 1 per cent for petrol, 3 per cent for octane and rest for others. Diverse consumer groups, from rural and urban areas, demand different kinds of petroleum products for irrigation, operation of power tiller, inter-district transportation, urban transportation, manufacturing, and domestic activities including looking and illumination. This indicates that any readjustment in the fuel price by the government needs to consider its multidimensional impact without leaving one consumer group (particularly the disadvantaged ones) worse off as against others.

Readjustments of Fuel Price in Bangladesh (Tk/litre)

<table>
<tr><td>Year</td><td colspan="2">Kerosene</td><td colspan="2">Diesel</td><td colspan="2">Petrol</td><td colspan="2">Octane</td></tr>
<tr><td>Oct. 2001</td><td colspan="2">15.5</td><td colspan="2">15.5</td><td colspan="2">23</td><td colspan="2">25</td></tr>
<tr><td>27 Dec. 2001</td><td colspan="2">17</td><td colspan="2">17</td><td colspan="2">28</td><td colspan="2">30</td></tr>
<tr><td>06 Jan. 2003</td><td colspan="2">17</td><td colspan="2">20</td><td colspan="2">33</td><td colspan="2">35</td></tr>
<tr><td>01 May 2004</td><td colspan="2">20</td><td colspan="2">20</td><td colspan="2">33</td><td colspan="2">35</td></tr>
<tr><td>23 Dec. 2004</td><td>23</td><td rowspan="2">13.1 per cent ↑</td><td>23</td><td rowspan="2">13.1 per cent ↑</td><td>33</td><td rowspan="2">6.1 per cent ↑</td><td>35</td><td rowspan="2">0 per cent</td></tr>
<tr><td>24 May 2005</td><td>26</td><td>26</td><td>35</td><td>35</td></tr>
<tr><td>West Bengal, India (November 2004)</td><td colspan="2">13.6 (Rs.9.01)</td><td colspan="2">33.4 (Rs.22.7)</td><td colspan="2">52 (Rs.35.4)</td><td colspan="2">56.2 (Rs.38.2)</td></tr>
<tr><td>Difference with India</td><td colspan="2">12.4</td><td colspan="2">7.4</td><td colspan="2">17</td><td colspan="2">21.2</td></tr>
</table>

Source: Prepared by CPD based on Financial Express, Bangladesh and www.bharatpetroleum.com

It can be deduced from the table that diesel and kerosene price has been increased by 13 per cent, while petrol price was raised by 6 per cent a rate less than half of the former. A substantial increase in diesel price will raise cost of irrigation, as well as cost of transportation of agricultural commodities along with other effects. At the same time, enhanced kerosene price will put pressure on cost of living of rural people who use it substantially. Therefore, rural poor, i.e. the largest social strata of the population will be directly and adversely affected because of higher cost of diesel and kerosene.

Conversely, comparatively low rise in petrol price will affect urban dwellers having cars and other transports only insignificantly. Indeed, price of octane, which is largely used in the cars of affluent people, did not undergo any change. One of the major reasons cited by the government in favour of this petroleum products price hike was to deter the possibility of the items being smuggled out to the neighbouring country. The table will further indicate that the price differential with West Bengal, India is highest in case of Octane (Tk 21.2), followed by Petrol (Tk17), Kerosene (Tk 12.4) and Diesel (Tk 7.4). If diesel can be carried as head load, cannot petrol and octane be carried as well? One would be rather tempted to suggest that the revealed fuel price adjustments have been thoroughly biased in favour of urban well-off people without due consideration to the interests of the rural poor.

Investment in Manufacturing and Service Sectors

During the second quarter of FY05 (Sept-Dec) investment in manufacturing and service sectors has been increasing. Investment as identified from outstanding bank-advances has reached Tk 812.9 billion, with a growth of 4.1 per cent. Large and medium scale industries have accounted for more than 35 per cent of total advances, while service sector has a share of 42.7 per cent. This implies that more than three-fourth of total advances has been concentrated to large and medium-scale based industrial activities. On the other hand, advances to small and cottage industries have fallen sharply (-13 per cent) during the last quarter, and their share in total advances has declined to less than 2 per cent (as against 2.32 per cent in September 2004). Industrial sector, therefore, has undergone a structural transformation as traditional small and cottage industries could not maintain their share in total industrial production.

Investment in large and medium scale industries has concentrated some major industries. Relatively high growth in investment has been observed in the following sectors: non-metallic products (16.67 per cent), beverage and tobacco (16.15 per cent), and chemical and chemical products (10.33 per cent), while moderate growth level is observed in engineering, basic metal and metal products (8.43 per cent), jute, cotton and wearing apparel (8.38 per cent). Besides, investment in some industries has declined in the first quarter: food stuff (-1.33 per cent), paper and paper products (-11.91 per cent), power and fuel (-17.87 per cent), and leather and leather products (-18.54 per cent). Therefore, growth in large, medium and small scale industries is primarily based on the substantial borrowing from the financial institutions. It appears that the contribution of the capital market to this growth is either absent or negligible. This is almost non-existent in the case of growth of small scale industries.

Table 5.2: Advances Classified by Economic Purposes (Selected Manufacturing and Service Sectors)

(in Crore Taka)

	As of 30 June, 2004	As of 31 Dec., 2004	per cent Change	Note
1. Large and Medium Industries				
Other Than Working Capital Financing	16752.82 (17.6)	17782.01 (17.4)	6.14	
Food stuff	2054.99	2027.61	-1.33	Decrease investment in rice, flour & dal mills
Beverage & Tobacco	451.25	524.16	16.15	
Jute, Cotton and Wearing Apparel	8249.8	8940.86	8.38	Decrease investment in cotton & jute mills, Increase investment in textiles
Leather & Leather Products	634.47	516.84	-18.54	Decrease investment in leather processing, but increase in manufacturing
Paper and Paper Products	608.38	535.91	-11.91	Decrease investment in all kinds of paper except newspaper
Chemical & Chemical Products	1518.24	1675.08	10.33	Substantial investment in drugs & pharmaceuticals; decrease in heavy industrial chemicals
Non-Metallic Products	1005.61	1173.23	16.67	Slightly decrease investment in cement & asbestos
Engineering, Basic Metal & Metal Products	1904.34	2064.97	8.43	Substantial investment in electrical equipment
Power and Fuel Industries	122.23	151.14	23.65	Decrease investment in power, petroleum
Working Capital Financing	16085.36 (16.9)	18549.93 (18.1)	15.32	
2. Service Industries (Selected)				
Other Than Working Capital Financing				
Construction	6426.28 (6.8)	6942.48 (6.8)	8.03	Slight increase in urban & other housing
Transport & Communications	1164.62 (1.2)	1268.62 (1.2)	8.93	Increase investment in road transport
Storage	843.81 (0. 9)	758.14 (0.7)	-10.15	Decrease investment in cold storage
Trade	32026.1 (33.7)	34567.93 (33.8)	7.94	Increase investment in wholesale & retail trade
Working Capital Financing	126.82 (0.13)	156.82 (0.15)	23.66	
3. Small Scale & Cottage Industries				
Other Than Working Capital Financing	944.34 (0.99)	670.56 (0.65)	-28.99	
Working Capital Financing	1283.85 (1.35)	1266.15 (1.24)	-1.38	

Source: Bangladesh Bank.

There are some indications of structural readjustment within manufacturing activities. Growth of investment (either increase or decrease) in particular categories is not observed in all activities. For example, under chemical and chemical products category, drugs and pharmaceutical industries received substantial investment, while heavy industrial chemical industries received relatively low level investment compared to the previous period. This is also found in the case of non-metallic products category, leather and leather products category. It may be indicated that there is a tendency for the industrial sector to concentrate on local and international demand-oriented specialised production.

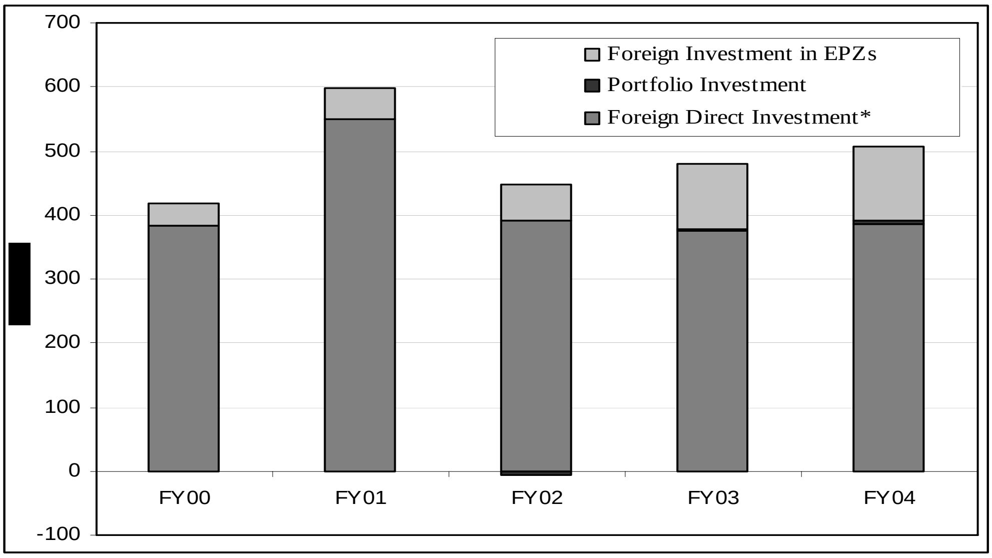
In the case of service related activities, investment has sharply increased in working capital financing, mainly in trade related activities. Investment in construction and transport and communication activities also shows a moderately high growth in the first half of FY05. Interestingly, investment in storage service especially in cold storage service has declined (-10.15 per cent). With the growth of vegetable production in recent years, investment in cold storage, especially designed for storing vegetables, should be given high priority.

Investment in small scale and cottage industries, on the other hand, shows a significant fall in the first half of the current fiscal year, especially in project financing (-29 per cent) than working capital financing (-1.4 per cent), indicating that banking finance in cottage type economic activity has dried up. This also indicates that small and cottage industries have now undergone a structural transformation as formal financing is mainly targeting the urban based activities.

5.3 Foreign Investment

After the decline in FY02, the flow of foreign investment is gradually picking up, but it is yet to recapture the recent peak of FY01, when Bangladesh received almost $550 million as foreign investment. During FY04 the country received a net amount of $391 million as foreign investment, registering a marginal 3.6 per cent annual growth over the previous year.

Figure 5.6: Foreign Investment during FY00-FY04

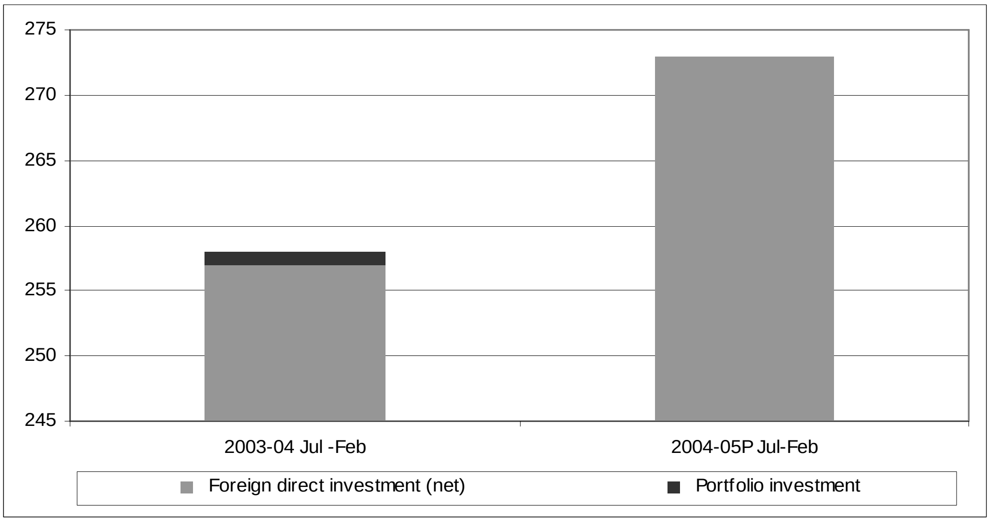


Source: Bangladesh Bank Report, 2004.

It may be recalled that BOI has targeted foreign investment to grow from $400 million in 2003 to $1 billion by 2006. According to BOI estimate, FDI inflow during January-December 2004 is slightly lower ($550) than the targeted $600 million. But that positive scenario would get reversed if the target is compared with Bangladesh Bank survey data. During January-December 2004, according to Bangladesh Bank, FDI inflow was only about $370 million. The large discrepancy between BOI and Bangladesh Bank FDI data is a matter of concern (see Box 5.3).

Latest available figures show that during July-February period of FY05, the country received a net amount of $237 million as foreign investment. There was no new portfolio investment during this period. Although total flow of foreign investment is 6.23 per cent higher in FY05 than the corresponding figure of the previous year (FY04), this would not be sufficient to achieve the target. In this backdrop, it will be a challenge to achieve the target of $800 million set for 2005. Of course, if and when Tata's investment gets on track, the position of FDI inflow will hopefully improve significantly.

Figure 5.7: Foreign Investment during July-February of FY04-FY05

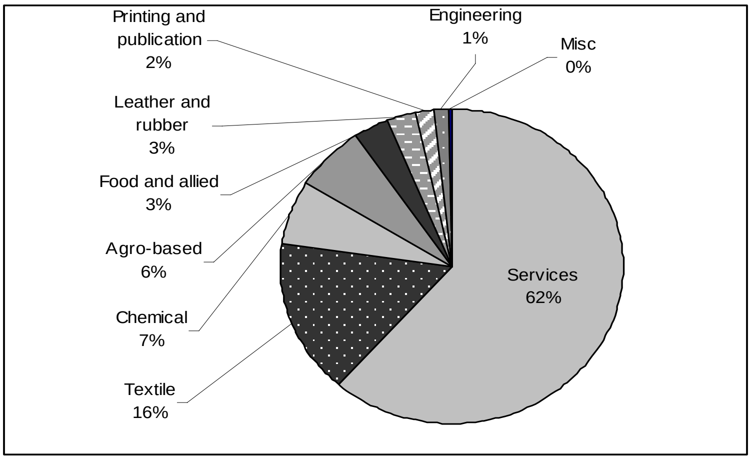


Source: Bangladesh Bank.

FDI inflow in EPZ shows a deceleration in the current fiscal year. According to BEPZA, up to April 2005 total FDI inflow was $71.82 million, which was about 15.5 per cent lower than the comparable period of the previous year. It may be noted that total FDI in EPZs in FY2004 was $115.04 million. Although government has established six EPZs in different parts of the country, viz. Dhaka, Chittagong, Mongla, Comilla, Ishwardi and Natore, almost all investment (99.5 per cent) took place either in Dhaka or Chittagong EPZ. This raises question regarding selection of areas for EPZ. Although there is more demand to invest in suitable areas, such as Dhaka and Chittagong, government's restrictive policy to establish private EPZs has resulted in low level of FDI inflow. For example, government's opposition for unknown reasons is delaying the operationalisation of Korean EPZ established in Chittagong.

The sectoral decomposition of FDI flow in FY04 reveals that the majority of the FDI in Bangladesh has targeted the service sector (such as telecommunication, energy and power and mining and quarrying), accounting for about 62 per cent of the total FDI flow. In the manufacturing sector, the major industries are: textile (16 per cent), chemical (7 per cent) and agro-based industries (6 per cent) sector. However, some of the critically important sectors such as infrastructure, engineering and leather remain under-invested.

Figure 5.8: Sectoral Composition of Registered FDI, FY04



Source: Board of Investment.

Recent FDIs are targeting the country's prospective opportunities in energy and textile industries, along with chemical and fertiliser, pharmaceuticals, infrastructure, financial sector and telecommunication, which may partially meet the required investments in some demanding sectors where local investors are not ready to invest. It indicates that foreign investors are targeting those industries which have either large domestic or foreign markets. Prospective FDIs in RMG, textiles by Taiwan, France, Pakistan and Malaysia are mainly targeting the duty-free market access facility enjoyed by Bangladesh in most of the developed countries. FDIs in fertiliser, steel, and energy by countries like India, France, Turkey and USA are targeting mainly the domestic market.

Table 5.3: FDI Flow to Prospective Sectors in Bangladesh from Selected Countries

Country	Chemical and fertiliser	Pharma-ceutical	Steel	Finan-cial	Energy	Infras-tructure	RMG	Textile	Leather	Cera-mics	ICT	Agro Proce-ssing	Others
France	√	√						√	√	√	√		
Pakistan							√	√					√
Turkey					√	√						√	√
UAE				√									√
Malaysia		√	√	√	√	√		√	√	√	√	√	√
USA	√				√								

Note: Others include sectors in which only one country promises to invest, these are telecom, jute, tea, transport and hotel and tourism.
Source: BOI, various issues of daily newspapers.

Box 5.3: FDI Inflow: Discrepancy Between BOI and Bangladesh Bank Data Continues

In the backdrop of significant divergence between the Bangladesh Bank (BB) and the Board of Investment (BOI) regarding estimates of FDI inflow to Bangladesh, both the institutions have been publishing FDI data since 2002 based on their respective surveys of foreign enterprises. Both institutions undertook the surveys because of substantial underreporting in the banking data compounded by definitional problems. Following publication of their first reports (2002), it was found that while BB estimated an inflow of $328.3 million in January-December 2002, BOI put forward a figure of $328.1 million, indicating an insignificant difference between the two. Curiously, in the following years (2003, 2004 and 2005), survey data of both institutions on FDI flow gradually diverged as can be seen from the table below.

($ Million)

Source	FDI Inflow (January - December)		
	2002	2003	2004
BB	328.3	350.2	370
BOI	328.2	441	550
Difference	0.1	90.8	180

Source: Compiled by CPD based on data from BB and BOI.

Data collected under Bangladesh Bank survey appear to be methodologically more robust than that of BOI. Examining questionnaires of both institutions, it is found that BOI collects FDI inflow data only, while BB's is a rigorous attempt to collect, along with the inflow figure, information on the companies' paid up capital, claims and liabilities, operating profit and net income, and stock of FDI etc. Such information, available from BB survey, allows us to cross-check the authenticity of the inflow data. Besides, different monetary units used in the two surveys, 'thousand taka' by BB and 'US $ Million' by BOI, may create discrepancies during currency conversion. The two institutions also use different reference periods for reporting of data: BB uses fiscal year (July-June), while BOI uses calendar year (January –December).

It is not obvious which of the institutions have the mandate to collect FDI related data. As such, the foreign companies may not feel obliged to provide the solicited information to BOI. Bangladesh Bank also has no direct authority over foreign enterprises other than to make request under Article 69 (Bangladesh Bank Order, 1972).

Whatsoever, it seems some progress has been made in reporting ad reconciling the information on FDI in Bangladesh since CPD first pointed out the discrepancy in this regard in 2002. This process may be further improved if BB is made the sole focal point for collection of FDI related information, while BOI may provide logistic support in conducting the survey.

5.4 Capital Market

During the first eleven months of FY05 both Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) observed an increase in share price index. The general index of DSE increased from 1319 in June 2004 to 1654.22 in 2 June 2005, registering about 25.4 per cent increase in eleven months. CSE followed the same trend when all share price index increased by 41.2 per cent, from 2292 in FY04 to 3235.62 in 2 June 2005. For the first time since 28 July 1997 all share price index crossed 1000 mark on 4 April, and then 1200 on 3 June 2004 which is now hovering around 1650.

Market capitalisation of the DSE during FY04 and 2 June 2005 has increased by 40 per cent from Tk 142.4 billion in FY04 to Tk 2001 billion ($3176.22 million) in FY05 (on 2 June 2005). The CSE experienced a higher increase (53.3 per cent) during the above period. During FY04 market capitalisation of the CSE was Tk 127.2 billion which has gone up to Tk 195 billion ($3096.14 million) on 2 June 2005.

On the contrary, the issuance of Initial Public Offerings (IPOs) has gone down during FY05 compared to FY04 as only 8 new IPOs entered into the market between FY04 and FY05. The new entrants are only from the banking and financial sectors. This is a worrying concern, as following the simple law of demand-supply the rate of over subscription has gone up. During the FY04 public subscription was 2106 per cent of the public offers. For FY05, information is available for only 4 out of 8 newly entered IPOs. The share of public subscription in the public offers during FY05 was 889.78 per cent.

There is a substantial amount of liquid money in the hands of common people and at the household level other than that of in the banking system of Bangladesh. In view of the fact that the income potentials from sources like banks and NSD certificates have gone down due to lowering of the interest rates, a number of small and medium investors are now coming into the capital market with their investible surplus. Following the boom and bust in the Capital market in 1996, several initiatives taken by the Securities and Exchange Commission[10] (SEC) have also contributed to the over subscription of IPOs.

Notwithstanding the oversubscription, the capital market continues to remain both shallow and skewed in Bangladesh. Current market capitalisation in DSE (2 June 2005) is only 5.4 per cent of GDP which was even lower at 3.2 per cent in June 2004. Three groups of listed companies, *viz.* (i) Banks, (ii) Pharmaceuticals and Chemicals, and (iii) Food and Allied Products together controlled about 60 per cent of the market capitalisation.

Banks, insurance and investment activities attracted most of the investors' interest. After the Lafarge Shurma Cement's enlistment in the share market in November 2003, no IPOs have come from the real sector. No IPOs from telecommunication services were observed as yet though the sector is picking up recently. In general, banking and financial institutions performed better in the security market. Out of 29 enlisted banking and non-banking financial institutions, 21 are of 'A' category, whose price earning ratios are mostly about 10. It seems

[10] Such initiatives include abolition of curb market, introduction of Automated Trading System, Central Depository System (CDS), and overall technological changes.

that private commercial banks have performed well under prudent law and regulation, and better supervision by the Bangladesh Bank, introducing new products such as government treasury bills, prize bonds, shares of public limited companies, treasury dealings both in local and foreign currency, automation tools such as ATM, SWIFT, extended consumer credit scheme, merchant banking, credit card operation and Islamic banking.

The major reason behind profit making companies for not entering into the capital market could be the absence of managerial expertise to expand their business further. Some also fear to lose their family ownership in the company if they go to the share market. Besides, this also would have called for more accountability and transparency in terms of profit making. The presence of "professional" shareholders which creates nuisance in the AGMs with a nominal share also distorts the market.

The dividend and profit provided to the investors for their hard earned shares are not adequate, and thus everyone is buying and offloading their shares at a higher price to make profit, which is causing this phoney increase in share price index. It does not relate to the performance of the share offering companies nor does it show the overall macroeconomic trend of the country.[11] The recent attempt by one of the local private banks to offload shares in the capital market by opening 15,000 fake beneficiary owners' (BO) account is a case in point.

IPOs from the real sectors also need to be encouraged. If new IPOs do not come in the market to absorb this high demand and necessary market corrections are not seen, this spurious surge in the capital market will soon fall down as only buying and selling of share certificate cannot sustain this bullish trend. Therefore, along with the telecommunications and other private sector companies, government blue chips should also be encouraged to come into the market. Share of the profitable multinational companies and of other local companies owned by the government may be floated. Enlistment with the share market could be the part of the conditionality for setting up new business in Bangladesh by the foreign companies, such as banking and telecommunications sectors. Indian business giant Tata, which is going to make huge investment, could also be asked to float its share in the market. IPOs may also be encouraged through tax benefit.

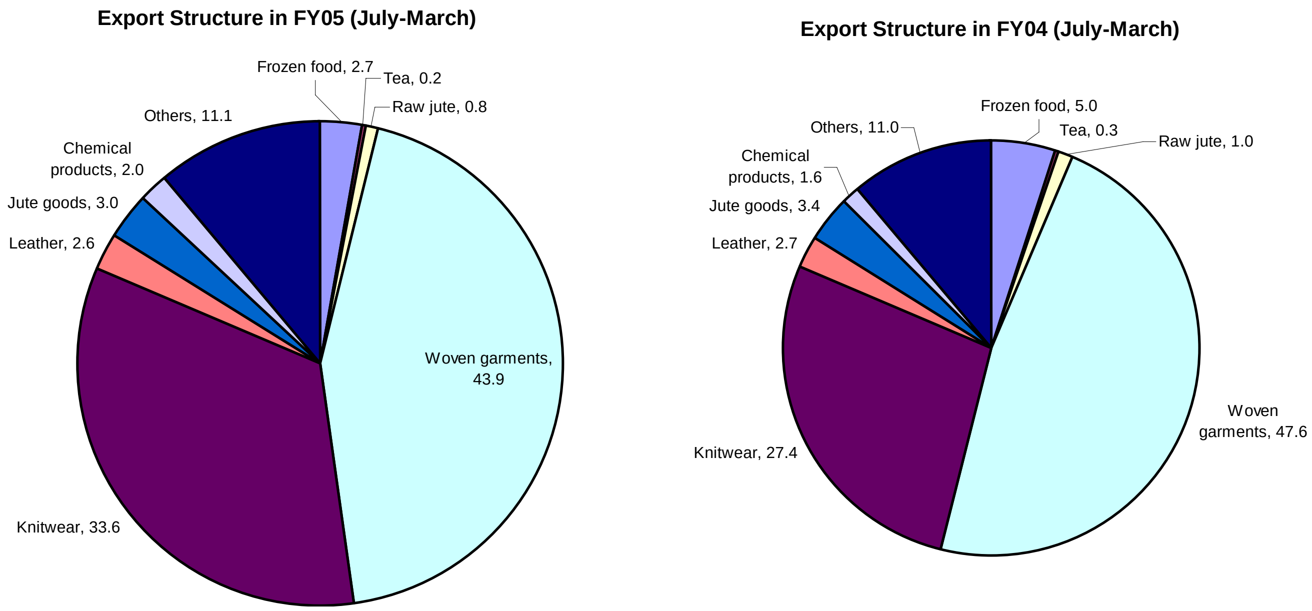
[11] However, since the new IPOs are coming from the CDBL system and there is no curb market, at least this increase is not coming from any fake share certificates as it was observed in 1996. Besides, the major increase in share price index is seen mainly on high value companies (DSE 20 and CSE 30) who are giving 10 per cent dividend to their share holders.

6 BEHAVIOUR OF THE EXTERNAL SECTOR

6.1 Export Sector

Export earnings for the period July-March FY05 stood at $6097 million, showing a highly encouraging growth of 12.5 per cent, as compared to $5421 million of the corresponding period of FY04. Despite the negative growth of primary commodities (-18.7 per cent) during the matched period, export earnings were near to attaining the strategic export target (which was $6210 million for this period) thanks to the robust performance of the manufacturing sector with a growth of 14.8 per cent.

Figure 6.1: Export Structure for July-March (FY04 and FY05)



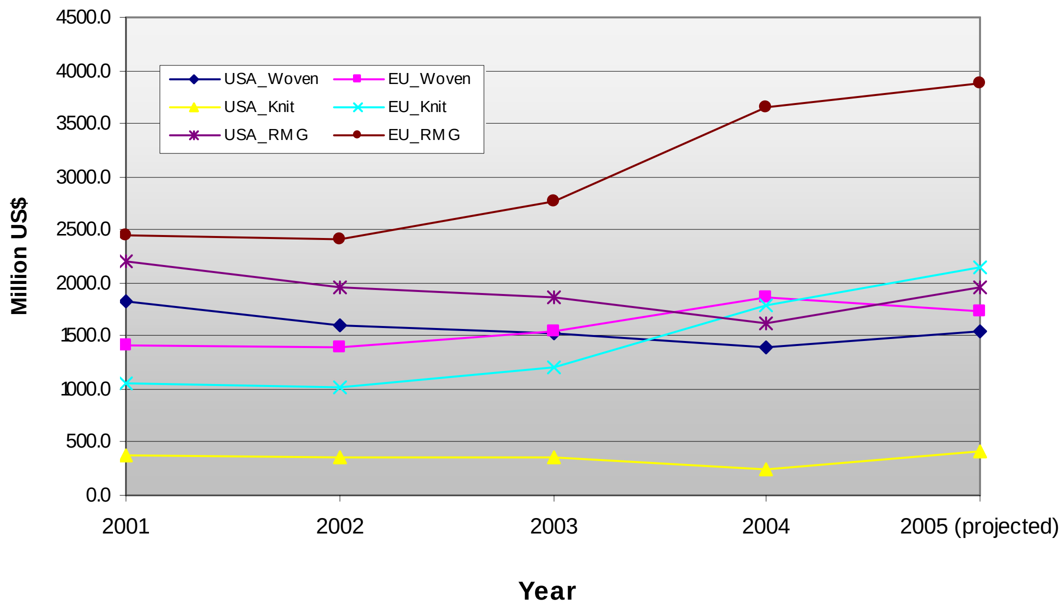
Source: CPD-IRBD Database, 2005.

Export sector's good performance in FY05 is especially significant since this particular year coincides with the full and final phase-out of the MFA quotas. Export earnings from woven garments have increased by 3.8 per cent, from $2579.7 million to $2676.8 million during the first nine months of FY05, whilst knitwear showed a robust and significant growth of 38.1 per cent. Export of knitwear increased from $1485.2 million to $2051.3 million during this period.

It is intriguing to observe the export performance of RMG during the first few months of the Post-MFA period. During January – March 2005 (for which data is available) for the first time in a decade (barring FY02), the RMG export has failed to achieve a double digit growth rate, recording a growth rate of 9.5 per cent compared to the same period of 2004. During this period, knit items experienced 38.6 per cent growth, however, woven items registered a negative growth (-5.6 per cent). It may be noted that the share of Woven items is usually two-thirds of the total RMG export. A CPD analysis of Bangladesh's garments export performance in the various markets reveals that woven items were experiencing a negative growth in the EU (-19.1 per cent), Canada (-10.2 per cent) and Japan (-58.0 per cent), but had positive growth in USA and Australia. On the other hand, Knit items experienced a positive growth in all major markets: EU (59.8 per cent), USA (201.7 per cent), Canada (142.2 per cent), Australia (203.1 per cent) and Japan (49.1 per cent).

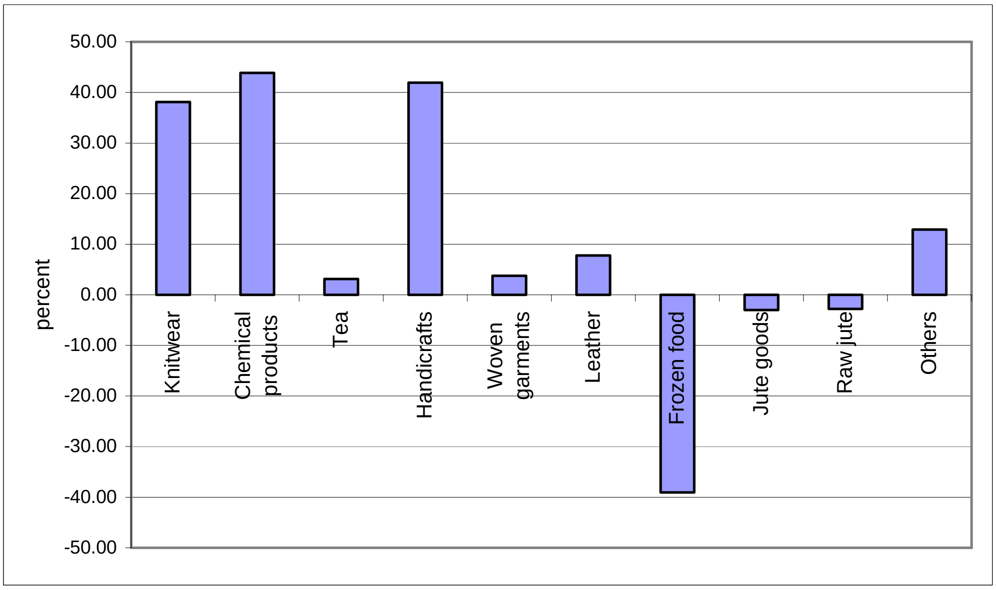
It was feared that Bangladesh might lose its market share in the USA after the phase out of the quota restrictions; the signal for the month of January was very disquieting indeed. However, export picked up in February and showed some increase in March. It is still too early to predict the prospects of the garments industry in the post-MFA era though it appears that export during FY05 will be near 10 per cent. Also, considerations should be given to the fact that the USA has put s*afeguard measures* on import of certain Chinese textile and apparel items, and EU is also thinking very much along the line. These measures might bring some respite to Bangladesh in these markets.

Figure 6.2: Trends in RMG Exports by Markets: FY01 to FY05



Source: CPD-IRBD Database, 2005.

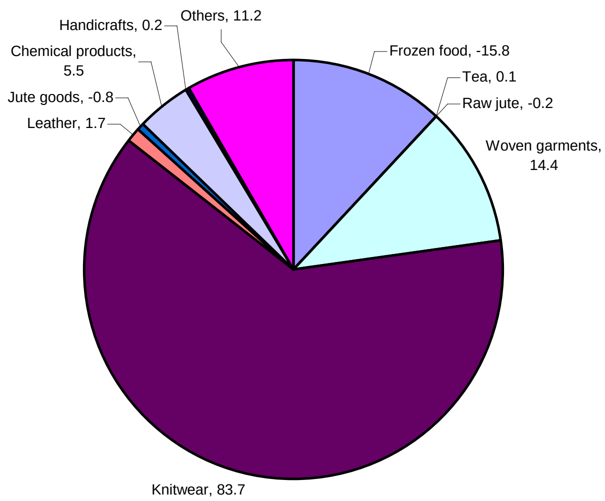
Figure 6.3: Commodity-wise Growth of Exports During FY05 (July-March)



Source: CPD-IRBD Database, 2005.

Export earnings from some of the other manufactured goods such as leather (7.8 per cent), chemical products (43.9 per cent) and handicrafts (41.9 per cent) also experienced moderate to high growth rates. The downward spiral of jute goods could not be halted, and export of jute goods registered a negative growth of (-) 3.0 per cent during this period. However, other than tea, which posted a modest 3.1 per cent growth, export earnings from all other principal primary commodities including raw jute and frozen foods have declined sharply by (-) 2.8 per cent and (-) 39.1 per cent respectively during the period under analysis.

Figure 6.4: Contribution in Incremental Exports During FY05 (July-March)



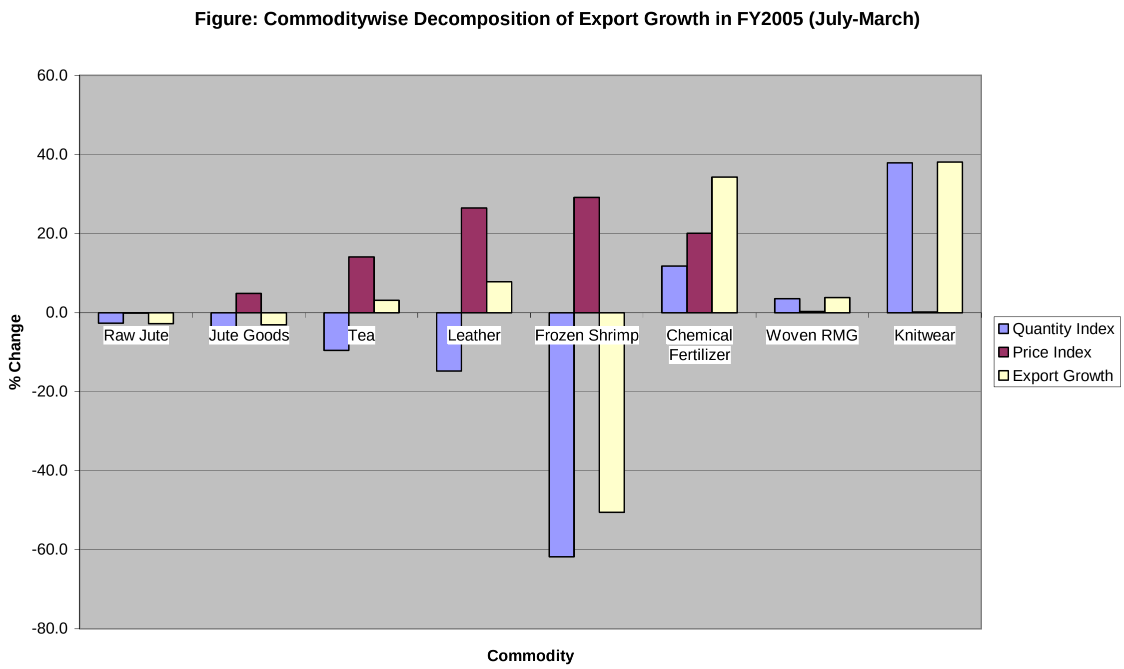
Source: CPD-IRBD Database, 2005.

However, the continued dominance of RMG in the export basket of the country has hardly undergone any change- about 98 per cent of the incremental export was accounted for by the growth of RMG exports. This is clearly evident from the data on incremental export of primary commodities which registered downward trend (-10.5 per cent), specially with the frozen food's negative share (-16 per cent) in incremental export. Export diversification must be given due importance to minimise Bangladesh's risks in the volatile global market of Bangladesh's exports. This emerging declining trend of frozen food export reamphasises the need for taking active initiative to diversifying its export destination. However, quality control is important to get greater access to the developed world.

Sources of Export Growth

Decomposition of export growth presents a mixed picture. Most of the growth in export earnings has been sustained through increase in volume. On the other hand, the export price index shows no significant rise in the average prices of Bangladesh's export goods in the global market.

Figure 6.5: Commodity Wise Decomposition of Export Growth in FY05 (July-March)



Source: CPD-IRBD Database, 2005.

In the case of country's major export item, the volume of exports in woven-RMG registered a moderate growth (about 4 per cent) whereas average price has indeed remained stagnant (0.3 per cent). Though the average price of knit-RMG somewhat remained the same, the enormous very high rise in quantity index for knit-RMG items clearly shows that most of the increase in export earning from this item is coming only thanks to substantial increase in volume. Alarmingly, another important export item of the country, the frozen shrimp, registered a hefty negative growth (-62 per cent) in quantity index and the sector has not been able to take advantage of the significant rise in the price index (29 per cent). Ensuring good prices of her export items through product diversification, identification of new export destinations and quality improvements remains major challenges for Bangladesh's export sector. Putting special emphasis on increased local value addition and movement of the value chain to counter the challenge of deteriorating terms of trade is becoming increasingly important factors of competitiveness for Bangladesh.

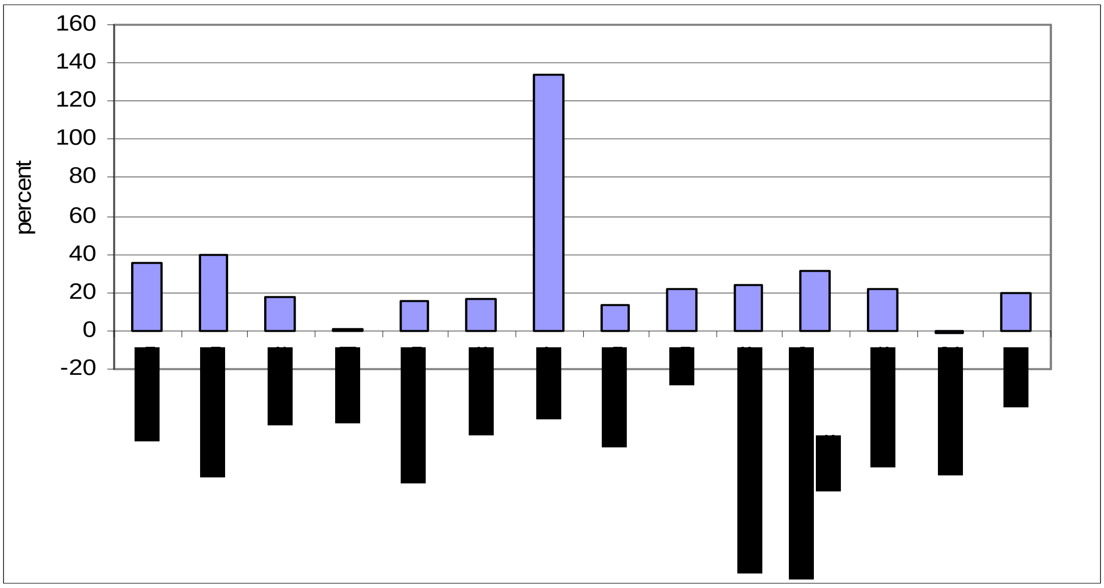
6.2 Import

Bangladesh's total import during the period July-February of FY05 was $8294 million which is 25.1 per cent higher than the matched period of the previous fiscal year. Major contribution to this growth came from capital goods, POL, textiles and articles, fertiliser and foodgrain. In terms of share in total imports, capital goods contributed the highest and it also registered a robust growth of 22.0 per cent. The import payments for POL products rose due to the recent hike in world oil price. If this trend continues and which apparently is likely to continue for some time to come, this could put the BOP situation under significant pressure in the coming days.

- Among the growth of commodities (other than foodgrains), fertiliser accounted for the highest import growth of 133.9 per cent.
- Imports of EPZ registered a marginal negative growth of 1.0 per cent.
- The downward trends (-10.0 per cent) of import of pharmaceuticals products indicated growing domestic capacity in this sector which was a good signs.

Import of foodgrains increased significantly by 35.9 per cent during this period to cope with damages due to the flood 2004. Import of textile and garments related inputs such as raw cotton (13.5 per cent), yarn (21.6 per cent) and textile and related articles (23.4 per cent) registered a remarkable growth during the July-February period of FY05, compared to the corresponding period of FY04, supporting the robust export performance of apparel sector in recent months.

Figure 6.6: Sectoral Growth of Imports During Jul-Feb FY05



Source: CPD-IRBD Database, 2005.

Notwithstanding some concern that Bangladesh's development is largely dominated by the service sector, and the contribution of the real sector is declining, the high growth in imports of raw materials and capital machineries is a positive development which is expected to have favourable impact on investment and growth in the real economy.

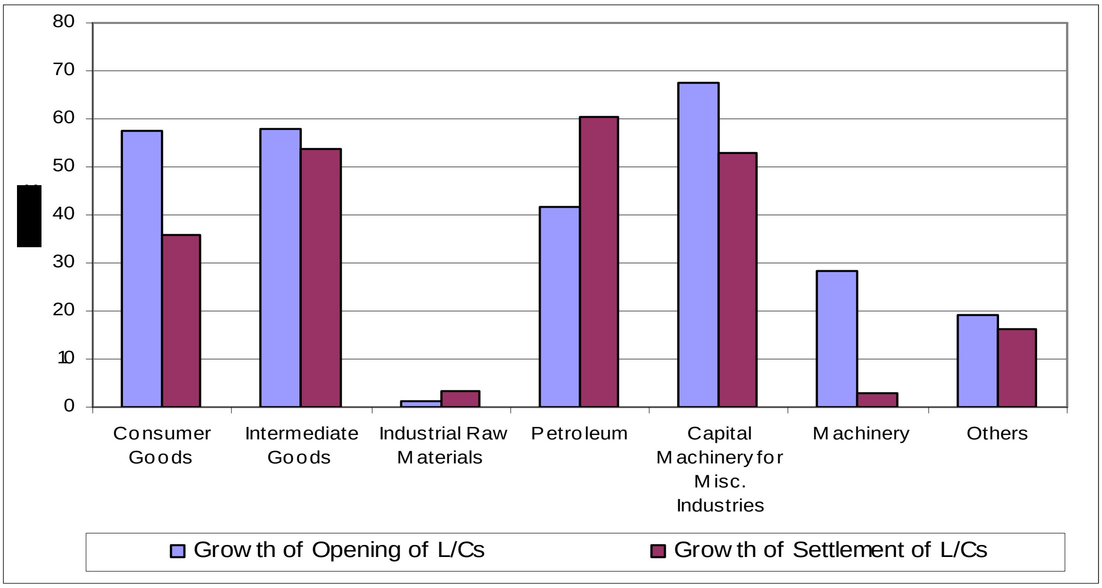
Opening and Settlement of Import LCs

Import growth during the first nine months of FY05 is also substantiated by the data on fresh opening and settlements of import letter of credits (LCs). During this period (July- March, FY05) LCs worth around $9448.9 million were settled, and around $10807 million has been opened, registering a growth of 19.6 per cent and 24.1 per cent respectively over the corresponding period of the last year.

- Settlement and opening of LCs for foodgrains increased by 46.4 per cent and 107.4 per cent respectively. However, for consumer goods these figures stood at 35.9 per cent and 57.7 per cent respectively.
- In the case of capital machineries, LCs settlement registered a growth of 53.1 per cent followed by a growth of 67.4 per cent in the case of fresh LCs opening. Major sectors of enjoying this growth were textile, garments, pharmaceuticals and jute.
- Price hike in international oil market is the main cause for the growth in LCs opening and settlement for petroleum and petroleum products.
- Both settlement and opening of LCs for textile fabrics and accessories for garments experienced a negative growth of (-) 11.7 per cent and (-) 17.7 per cent respectively,

which is obviously a cause for concern as far as the expected performance of particularly the woven RMG was concerned.

Figure 6.7: Growth Rates of Opening and Settlement of LCs of FY05 Over FY04 (July-March)



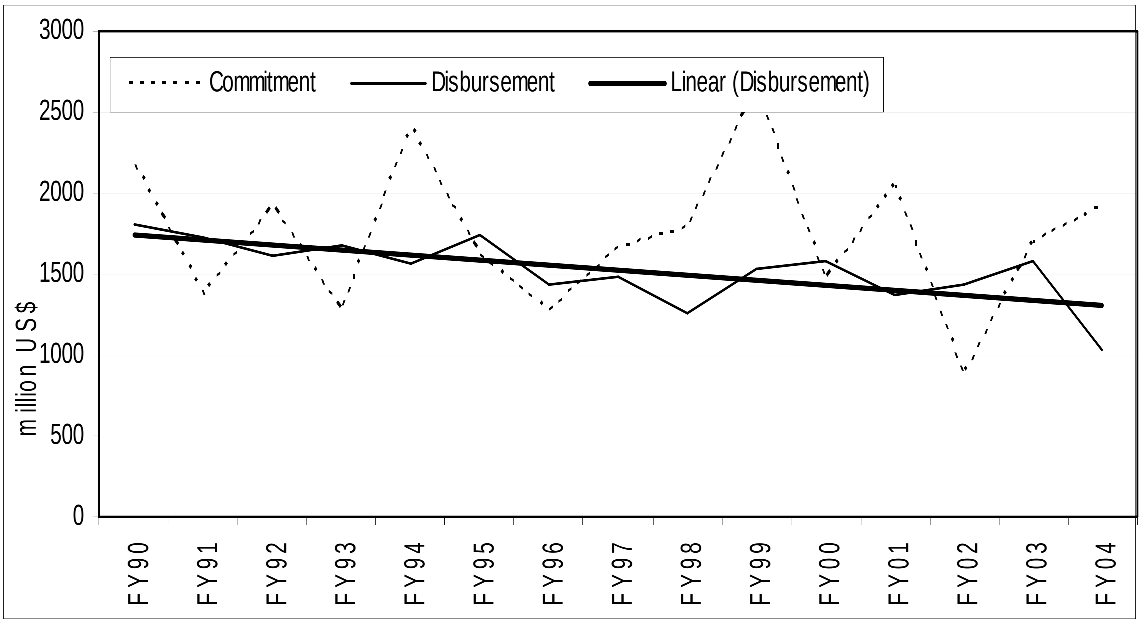
Source: CPD-IRBD Database, 2005.

6.3 Foreign Aid

The declining trend of foreign aid disbursement (both in absolute and relative terms) deteriorated further in FY04 when it came down to $1033.4 million (1.9 per cent of GDP) from that of $1585 million (3.1 per cent of GDP) in FY03, registering a (-) 34.8 per cent negative growth. During FY04, only 82 per cent of the allocated project aid was utilised in the ADP, while for the period July-March, FY05, this ratio is only 47 per cent. Besides, the discrepancy between the commitment and disbursement is increasing systematically.

Commitment of foreign aid during the July-January period of FY05 stood at $715.2 million (12 per cent of it being flood related commitment). During the comparable period of FY04 it was $913.2 million that is 21.7 per cent more than that of FY05.

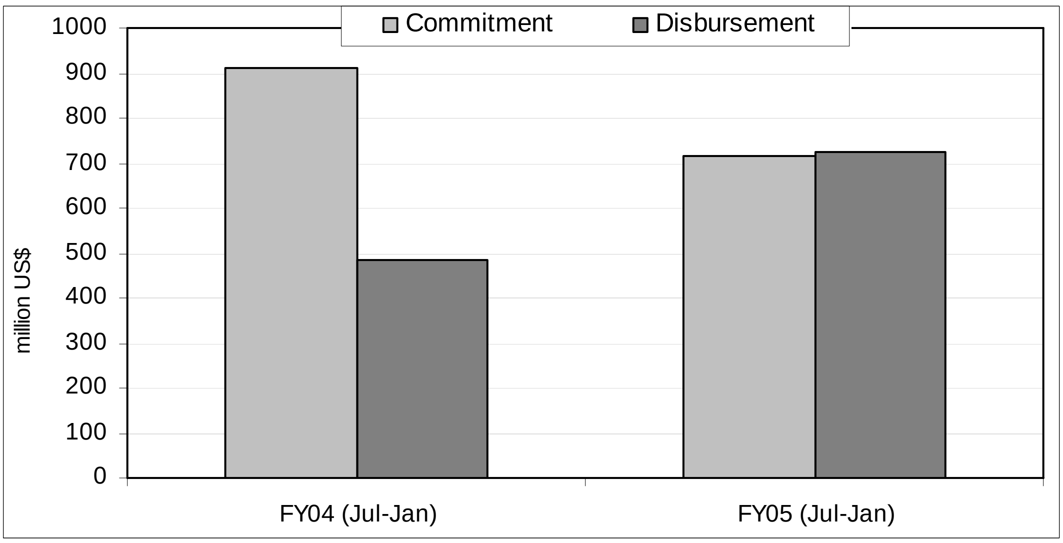
Figure 6.8: Flow of Foreign Aid in Bangladesh During FY90-04



Source: CPD-IRBD Database.

However, flow of foreign aid has increased in terms of disbursement during the first seven months of FY05. Disbursement of foreign aid during the period of July-January FY04 was $ 483.6 million; the matched figure for the current fiscal year stands higher at $726.2 million. This indicates that the disbursement of foreign aid was about 1.5 times more compared to the corresponding figure of the previous fiscal year.

Figure 6.9: Flow of Foreign Aid During July - January of FY04-05

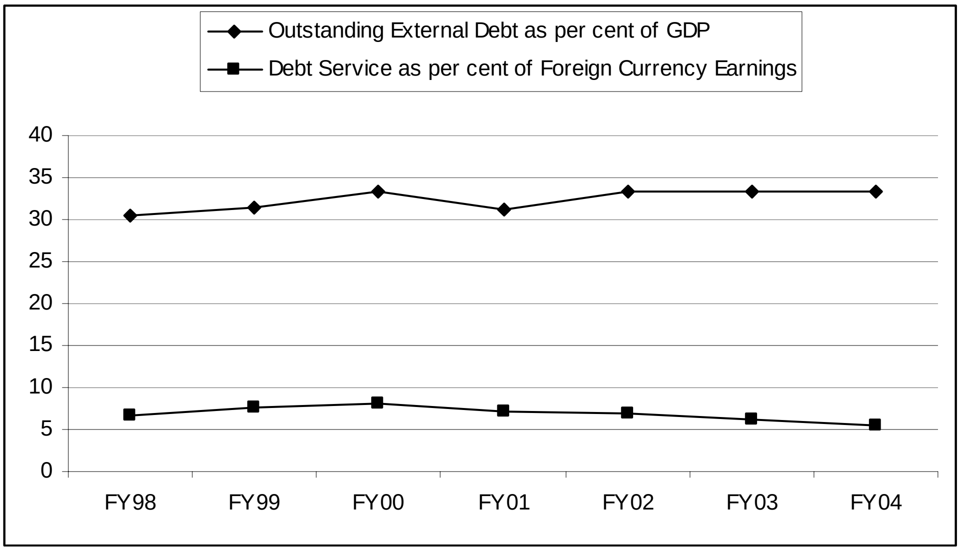


Source: CPD-IRBD Database.

However, the composition of aid disbursement during the first seven months of FY05 tends to be rather disturbing because of the absence of food and commodity aid. A nominal amount of $5.8 million was committed as food aid in FY05. On the other hand, the share of ever increasing loan in aid commitment was even higher during the July-January period of FY05; about 80 per cent as against 45 per cent during the same period in FY04. As regards disbursement, the shares of loan during the two comparable periods were 95 per cent and 71 per cent respectively.

There is no denying that Bangladesh has been experiencing a ballooning aid pipeline in recent years. This is corroborated by the fact that while this pipeline was $5450 million in FY03, the matching figure for FY04 was $5738 million. Based on the recent available data (July-January of FY05), aid pipeline is estimated to be $5727 million. However, the growing trend of loan in aid commitment has resulted in an increased outstanding debt (33 per cent of GDP in FY04), which, in turn, ends up in more per capita external debt ($132.79 for FY04). On the other hand, debt servicing as percentage of foreign currency earnings has continued to remain comfortable in recent years (Figure below). While this share was 6.9 per cent in FY02, it was 6.3 per cent in FY03 and 5.4 per cent in FY04.

Figure 6.10: Trend in Outstanding Debt and Debt Servicing



Source: CPD-IRBD Database.

Suppliers' Credit

A period wise comparison of flow of hard term loans extended to the Bangladesh Government by external agencies reveals that net contract of suppliers' credit has continued to remain high. Although the average annual net contract amount during 1991-95 and 1996-2000 was $98 million and $89 million respectively, the same is found to be only $87 million during the 2001-04 periods. If one predicts that another $100 million will be added during the remaining period of FY05, it might surpass the matched figure for the period 1996-2000.

However, as for disbursement, the lowest annual average is found to be during 2000-05 period ($24 million). This, during the 1991-95 and 1996-2000 periods, was $78 million (total disbursement $389.53 million) and $69 million (total $347.41 million) respectively.

Table 6.1: Flow of Suppliers' Credit (1991-2005)

Period	Nos.	Sources	Sectors	Amount net of Cancellation (million $)		Disbursement (million $)	
				Total	Annual Average	Total	Annual Average
1991-1995	07	China, North Korea, NDF, Pakistan, Russia	Power, Industry, Agriculture, Mining	491.69	98	389.53	78
1996-2000	11	Russia, Sweden, UK, China, India	Power, Infrastructure, Telecom	425.10	89	347.41	69
2001-2005	06	China, Japan, Spain	Industry, Power, Infrastructure, Telecom	347.15 (upto June 2004)	87	119.5 (upto June 2005)	24

Source: CPD-IRBD Database, 2005.

Grace period for suppliers' credit has been squeezed during the last decade. While the average grace period for the projects covered under the period 1991-95 was 4 years, the same was 2 years and 3 years respectively for the periods 1996-2000 and 2001-05. This, indeed, is a major concern as it creates immediate pressure to go for repayment. However, the average amount of down payment of project loans during the three periods under review is somewhat similar ($9 million or about 16 per cent of the total commitment for the three periods). A similar trend is also witnessed in the context of international service charge with $5 million being the average for all the three periods. As regards the length of repayment period, the minimum was 7 years with 30 years being the maximum. This may be a matter of relief in some cases, but not so encouraging in other areas.

The foregoing discussion supports that suppliers' credit continues to play a significant role in accessing external resources and that the performance of the present regime is no less active in comparison to the previous one. It is to be seen to what extent the government contracts further suppliers' credit during the last year of its tenure.

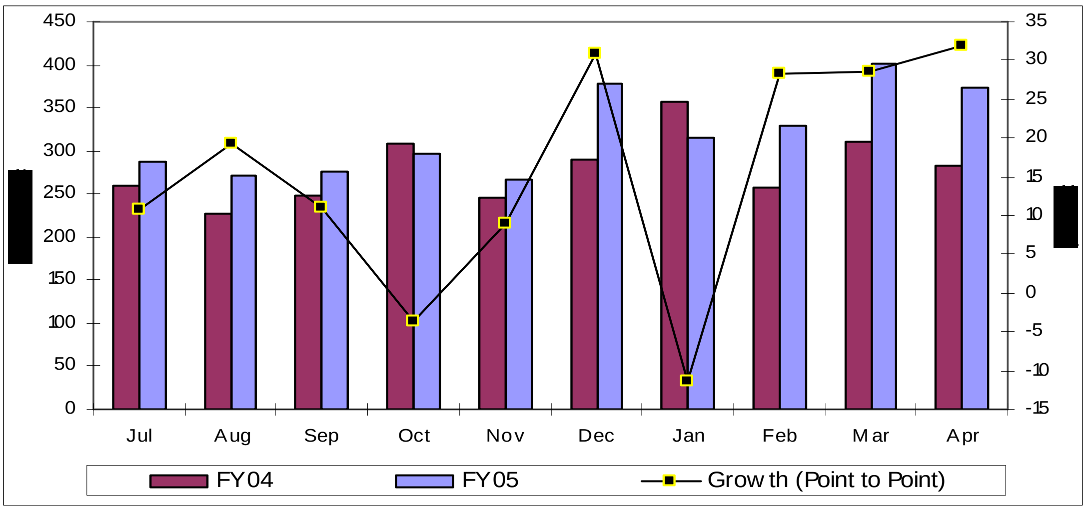
6.4 Remittances

The flow of worker's remittance sent by the expatriate Bangladeshis has now become a significant contributor to the total forex earnings and current account balance of the country.

During the July-April period of FY05, remittances have registered an impressive 14.7 per cent growth over the corresponding period of the previous fiscal to stand at $3196.8 million.

After the moderate growth rates visible in the 1990s, remittances experienced phenomenal growth from FY02 and continued to register this during the July-April period of FY05. The relatively moderate growth of remittance during the first ten months of FY05 is remarkable particularly in view of the high benchmark posted during the previous years. In total expatriate labour force, share of low paid labour (unskilled and semi-skilled) is quite high. Illegal and inhuman transportation of labour is also becoming a major concern. This sector should be given high priority by Bangladesh's policymakers in view of the emerging and possible opportunities in the global labour market.

Figure 6.11: Monthly Trend in the Flow of Remittances during FY04-FY05

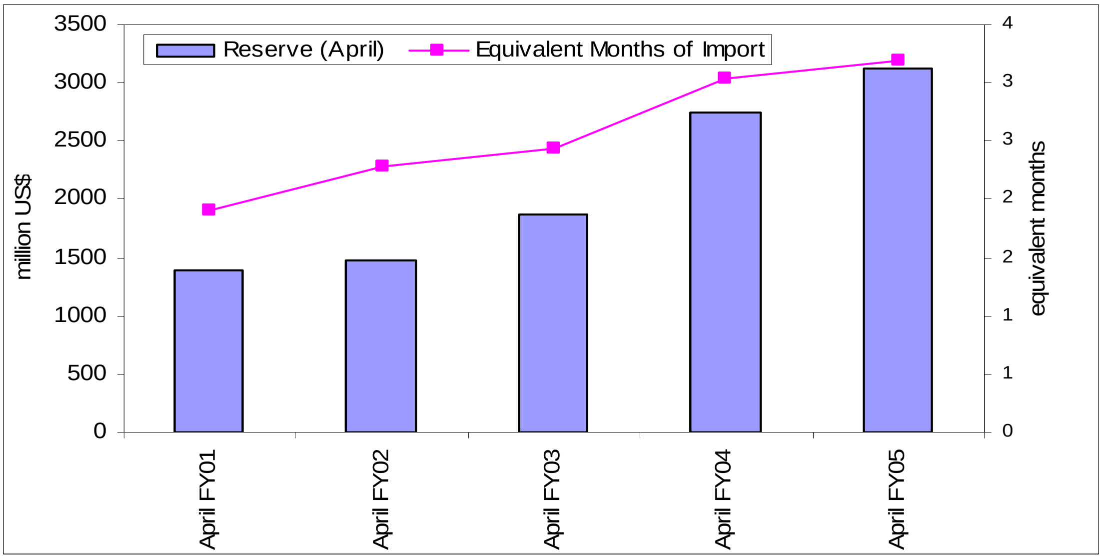


Source: CPD-IRBD Database, 2005.

6.5 Forex Reserves

After the pinnacle attained in FY95 when the foreign exchange reserve of Bangladesh reached $3070 million, the country experienced a continued decline in the forex reserve till FY01 when it stood at $1307 million. Since then, the forex reserve has started to move up and in FY04 it stood at $2704 million. Since FY95, the forex reserves again crossed the $3 billion mark at the beginning of FY05.

Figure 6.13: Foreign Exchange Reserves and Equivalent Months of Import



Source: CPD-IRBD Database, 2005.

Forex reserve at the end of April 2005 stood at $3126.85 million, which is about 13.83 per cent higher than the corresponding year. It may be pointed out that Bangladesh, because of the conditionalities under the PRGF of IMF, is committed to ensure cumulative increase in net forex reserves on a quarterly basis. It seems highly improbable that in view of increasing import payments Bangladesh will be able to keep this commitment for June 2005 (under the PRGF, the incremental reserves for the March-June, 2005 quarter will need to be equivalent to $348.0 million). However, earlier, in end April 2005, Bangladesh Bank created some tension and contusion by delaying forex payment in order to keep the reserves at $3 billion level as required by IMFs' performance indicator.

In spite of the recent upturn in the reserves, given that the imports are rising, the current growth momentum in reserves may not be sustained in the coming months.

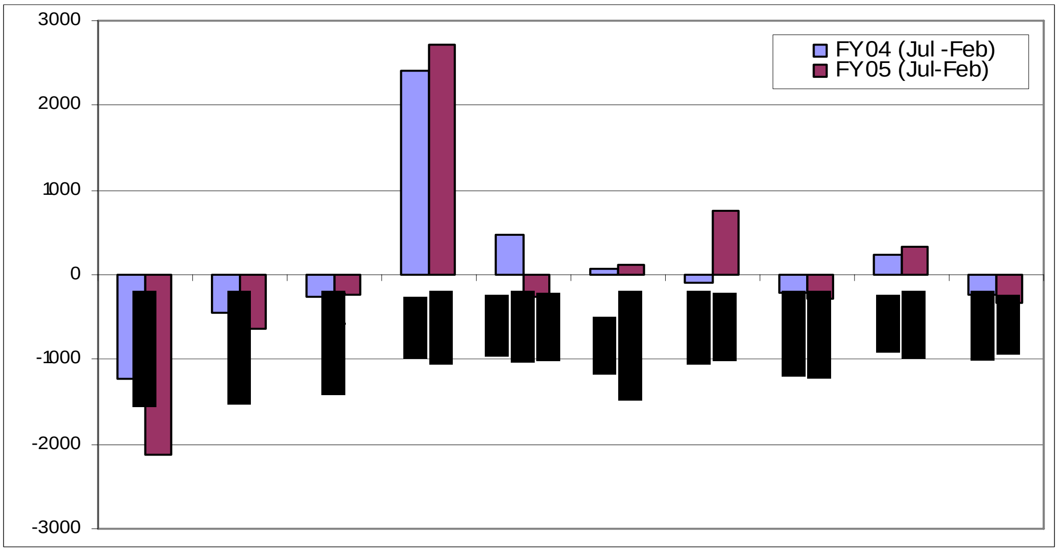
6.6 Balance of Payments

The overall balance stood at $325 million during the July-February period of FY05 compared to $247 million over the corresponding period of FY04 indicating some improvements in the BOP situation. However, higher import growth has offset the benefits of the robust export growth and high levels of remittance flow resulting in a deficit of (-) $268 million in current account balance during the July-February period of FY05; in contrast, during the July-February period of FY04 current account balance stood at $473 million. If remittance is excluded (which is about 45 per cent of the total export earnings), the current account balance during this period would further decline to a deficit figure of (-) $2154 million. Trade deficit has further deteriorated in FY05 to stand at (-) $2117 million compared to (-) $1236 million over the corresponding period of FY04.

Added to this deficit was the deficit in services (net) which increased from (-) $456 million to (-) $638 million. The deficit under the income category came down from (-) $253 million to (-) $238 million. The surplus in current transfer has increased from $2418 million to $2725 million. Thus, the positive movements in the balance in income (net) and current transfer (net) were not enough to offset the deficits in the balance in *trade and services* (net) which, in the end, led to the deficit in the current account posted in July-February period of FY05. The CPD analysis again reemphasises the crucial role that current transfers, mainly remittances, have come to play in terms of providing Bangladesh with a comfortable cushion with respect to the balance of payments position in the current account.

A few words need to be said as regards financial account situation in the BOP which stood at $749 million, registering an astonishing growth of 914 per cent. Financial account has three major components: net FDI, portfolio investment and other investment. While foreign direct investment experienced a marginal 6.2 per cent growth, no portfolio investment was observed during this period. On the other hand, other investment increased significantly from (-) $350 million in FY04 to $476 million in FY05. However, a nagging concern is that a substantial part of other investment came in the form of Medium and Long-Term (MLT) loans and not in the form of investment.

Figure 6.12: Balance of Payment Scenario during July-February in FY04-05



Source: CPD-IRBD Database, 2005.

7 CONCLUDING OBSERVATIONS

The foregoing analysis of major macroeconomic trends as well as developments in the real economy suggests that the overall state of the Bangladesh economy remained steady during the fiscal year 2004-05. Driven by both domestic and external demand, the economy may very well achieve the scaled downed GDP growth target of 5.5 per cent. However, Bangladesh's current growth performance continues to lag behind that of its South Asian neighbours.

During the first half of FY05, the economy was positioned between the twin shocks of Floods 2004 and total phase-out of the MFA. As of date, the economy has recovered reasonably well from the flood related devastations. Adverse consequences of full quota removal yet to show up in the export sector.

During the second half of FY05, strains have generated on the balance of payment situation due to high import growth fuelled by generous credit expansion in the private sector. Paradoxically, whenever private investment picks up in Bangladesh, it affects the external balance which in turn enfeebles the fiscal balance. The macroeconomic situation got further weakened due to crawling rise of consumer price index.

Notwithstanding the fact that the macroeconomic stability has improved during the last couple of years, the growth payoff in Bangladesh had not been adequate, particularly from the poverty alleviation perspective. It is now well established that macroeconomic stability is a necessary condition, but not a sufficient one for better economic growth and more so for a pro-poor growth.

It is in this context that one can readily identify the following six major sources of fragility and credibility gap which afflict the current apparent macroeconomic stability in Bangladesh.

- Systematic inability to implement public investment programme.
- Failure to undertake complementary reforms for improvement of the micro-conditions for private investment.
- Slow progress in domestic revenue mobilisation as dependence on international trade tax continues, and direct tax collection is increasing at a pace that is slower than domestic VAT.
- Upsurge in inflation rate underwritten by cost-push factors.
- Notwithstanding robust export and remittances growth, the balance of external payments remains delicate.

- Widening disparity in income distribution which is limiting the growth prospect including its sustainability.

The major source of the fragility emanates from the stagnating investment scenario of the country. The apparently buoyant proxy indictors of investment (e.g. term loan disbursement and import of capital machinery) take a new meaning when we observe the stagnating national investment rate. It is now being contended that the failure to deliver an augmented package of public investment projects is the root cause of the aggregate investment stagnation. The private investment rate continues to be subdued as it is deprived of the "crowding-in effect" of a vigorous public investment programme.

Systematic inability to implement an enlarged ADP is the primary cause of the prevailing investment deficit. One may identify a range of issues to explain the low implementation rate of ADP, but it seems that the major problem lies in contracting these usually lumpy and lucrative projects to suitable companies. This process has often been afflicted by uncertainty leading to long gestation period. This process has been also characterised by inadequate transparency resulting in cost escalation. One may cite in this regard a long list of big projects which did not get materialised during the recent past.

The lack of predictability and inadequate transparency in economic transactions in the public sector has had concomitant negative impact on the private sector investment. The second major source of weakness underlying the growth payoff situation comes from the credibility gap emanating from slow progress in market facilitating reforms. Lack of complementary reforms to improve the micro-conditions for economic growth further aggravated business environment. These reforms basically relate to improvement of governance in public infrastructural facilities and utilities, regulatory framework for capital and debt market, contract enforcement through judicial process, transparency in public expenditure, etc.

The third major source of macroeconomic vulnerability relates to the country's very low revenue effort. Such vulnerability gets accentuated in the face of low off-take of foreign aid. Notwithstanding deep trade liberalisation, international trade taxes still account for more than 37 per cent of total revenue collection in Bangladesh. More importantly, direct taxes (e.g. income tax), which are progressive in nature, have grown at less than 9 per cent between FY00 and FY04, while VAT (domestic), which is not mean tested, has grown at about 18 per cent per annum during the same period. Increasing tax base, plugging leakages, revamping tax administration, improving payee service, etc. are some of the measures which can improve the situation. One waits in anticipation to see the performance of the newly instituted office of the *Tax Ombudsman*.

Inflationary pressure (the fourth factor) on the macroeconomic situation has increased largely due to a number of cost push factors – some of which are beyond the control of the government. These include high global prices of food, fuel and fertiliser. Indeed, inflationary process in an economy like Bangladesh is usually structural in nature. It will be inappropriate to seek solution of the problem in contractionary monetary policy. Changes in consumption structure and productivity growth can provide some respite. But one need to see to it that increases in wage goods prices does affect competitiveness of the economy.

The fifth of the major fragilities of Bangladesh's macroeconomic situation is exposed by the thin elbow room which the balance of payment of the country enjoys. Import growth spurred by enhanced investment demand creates increased tension. It is an unfortunate coincidence that the investment growth in Bangladesh overlapped with spiking of global prices of certain critical commodities. While one needs to slow down the import growth along with export and remittance promotion, it is a question of finding the appropriate instrument for it.

The six aspect of the growth scenario in Bangladesh relates to its inequitable distribution. It is held that some of the current sources of growth are supposed to be pro-poor, e.g. crop sector and export-oriented manufacturing. However, some other sources of the current growth are more dominant and income in-equaliser, e.g. foreign remittances and rural non-farm activities. Widening income and asset disparity can not only decelerate the growth process, but can also undercut social cohesion. Growing regional disparity can also emerge as a political problem. Finding the right recipe for an inclusive growth track remains an intellectual and practical challenge.

Outlook for Budget FY06

Issues relating to Policy Framework will be the most interesting part of the forthcoming budget. Bangladesh, for the first time, is going to have a budget under the framework of its newly finalised *Poverty Reduction Strategy Paper* (PRSP) for FY05-FY07. In this sense the forthcoming budget will be more predictable than the previous ones as we already know its macroeconomic parameters from the *Medium Term Macroeconomic Framework* (MTMF) of the PRSP. It will be, however, a matter of special interest to observe whether the Finance Minister, in order to bring more predictability, accountability and transparency in the budgetary process, announces a *Medium Term Budgetary Framework*, a three-year rolling

Public Investment Programme and a *Medium Term Expenditure Framework* with expenditure ceiling. The Minister may also go ahead and propose an independent oversight *Financial Reporting Council*.

It will be also a matter of interest to observe whether the process of unification of revenue and development budget gets deepened further. Similarly, it is expected that the independent budget preparation by ministries will get a fresh boost by going beyond the present six (Agriculture, Health, Education, Livestock and Fisheries, Flood and Disaster Management, Social Welfare).

<u>The second dimension of the forthcoming national budget will be its macroeconomic stance</u>. Given the emerging tensions in the macroeconomic situations, suggestions have been put forward (by IMF) to increase the interest rate to slowdown the monetary growth. Some others (economists) have suggested "flexibility in exchange rate" (euphemism for devaluation) to stem the pressure on demand for foreign exchange. The major macroeconomic challenge for the next budget will be to sustain the investment demand without jeopardising the macroeconomic stability.

In this context it is maintained that no single policy instrument can fully diffuse the gathering clouds on the horizons of macroeconomic situation. Possibly, a combination of three major approaches will be necessary to adapt domestic demand, external demand and aggregate demand to their allowable maximum limits. These instruments are (i) adjustment of nominal interest rate in line with the inflation rate making the real rate marginally positive; (ii) downward revision of the exchange rate of Taka to attain its equilibrium value; and (iii) moratorium on governments recurrent expenditures and streamlining of ADP.

A judicious mix of these approaches may keep the growth process steady without fatiguing macroeconomic balances. Such a mix will also promote convergence between the fiscal and monetary policies. It will be a matter of great interest to observe to what extent the national budget for FY05 comes close to this approach.

<u>The third and most interesting aspect of the upcoming national budget will be its fiscal measures</u>. The allocative priorities for the ADP for FY05 are well known by now. The Ministry of Local Government got a resounding increase, followed by Health and Population, Education and Religion, Power and Transport. Agriculture is also going to get an added allocation, particularly on account of subsidies. Revenue expenditures may be projected with

10-12 per cent growth, taking into account the declared pay increase for the government employees.

On the revenue front, possibly no new taxes will be introduced although some revisions will be in order (e.g. increasing the taxable income limit and the minimum income tax payable). The provision for new enterprises tax holiday may be disciplined by provisioning it only for certain sectors. Tariff structure may move towards a three tier system with a maximum of 25 per cent. One may also see reduction of zero tariff items. It is to be seen whether streamlining of the para-tariffs e.g. Supplementary Duty, Infrastructure Development Surcharge, etc. are on the card.

The upcoming budget is definitely going to contain some measures broadening the safety net programmes either through expansion of the old ones or through introduction of new schemes.

Economic Policy-making During the Time of Political Transition

The upcoming fiscal year will be the last year of the present tenure of the government. All over the world, pre-election political correlates do influence the nature of economic decisions. However, in many countries, thanks to the presence of strong oversight institutions, the scope for expedient tampering with economic policies is greatly reduced. Regrettably, Bangladesh is not endowed with such institutions and regulatory frameworks. Thus, one observes that successive regimes in Bangladesh have manipulated public resources and overstretched their decision-making authority to improve their chance of electability, some time with ambiguous consequences. *It is in this context that we conclude our review by identifying eight hazards of policymaking during a period of political transition which Bangladesh is bracing for in 2006.*

(i) Bloated Public Investment Programme

Most outgoing governments seek to get access to maximum amount of public resource for placating the electoral constituencies. In the same tradition the ADP for FY06 has been fixed at Tk 24,500 crore, i.e. 19.5 per cent more than the revised figure for FY05. It has been mentioned earlier that in the recent past the government has failed to utilise, on average, 20 per cent of the original development allocations. Indeed, the present government is currently incapable to execute such a grandiose public investment programme. Thus, this raises an apprehension about misuse of the earmarked resources.

(ii) Adverse Selection of Projects and Programmes

A bloated public investment programme by definition cannot constitute only demand-driven projects. Not only these projects are included on political considerations, these are also included in sectors and programmes which allow unaccountable use of revenues. Thus, no wonder, in the ADP for FY06, the Ministry of Local Government was awarded the highest increase (28.4 per cent) – a large part of which will be used to "develop" rural infrastructure. On the other hand, more than 75 per cent increase in Block Allocation under the ADP for FY06 speaks volumes for itself.

(iii) Tendentious Award of Tax and Tariff Relief

In their pursuit to generate election finance, governments are often tempted to award tax relief or tariff rebate to their powerful elite supporters. This may take the form of targeted tax breaks in certain areas. Alternatively, it may look like a universal policy which ultimately benefits a chosen few. One such policy happens to be tax amnesty for undeclared income. The Finance Minister has repeatedly mentioned that he will not resort to such policy distortions any more, but one will have to wait till the budget day to watch him rise to his promise.

(iv) Contracting of Questionable Suppliers Credit

As has been depicted earlier, all political regimes in Bangladesh have accessed hard term foreign loans of questionable value. In fact, succeeding governments have routinely restored to various justifications to go for suppliers' credit. The present government in fact made a big issue about the suppliers' credits contracted by the earlier regime, only to revive most of them under conspicuous circumstances. The present government in four years has already signed up $347 million worth of hard term foreign loans as against a total of $425 million of the earlier regime. One wonders how much more is to come soon.

(v) Patronage Distribution through Public Procurement

In order to control rent seeking through projects involving public resources, the government has recently introduced, not without hiccups, the Public Procurement Policy. Notwithstanding that, apprehension remains real about the government bending the rules (if not violating them) to suit its favoured contractors. The state of affairs in the power sector gives credence to this concern. The ill fated *Sirajganj Power Project* has emerged as the best case study in this context. One needs to only observe how in the coming months various government sponsored contracts are dished out to the usual suspects.

(vi) Patronage Distribution through Privatisation of State-Owned Enterprises

The process of privatisation of state-owned enterprises has earned a bad name in Bangladesh. It has become co-terminus with unscrupulous transactions where public assets change hands for private benefits. This process may receive fresh impetus as the electoral frontier draws near. Presently the government has a substantial pipeline of financial and industrial enterprises earmarked for privatisation. The government will be under the dual pressure of improving its performance by clearing this pipeline and satisfying the prospective buyers of certain allegiance. The test case in this regard will be the *Rupali Bank* as the most prized giveaway in the current privatisation list.

(vii) Issuance of New Bank Licences

Regrettably, award of licences for setting up of new banks and non-banking financial institutions in Bangladesh till now has been more an issue of having the right contacts with power elites, rather than having the right professional and business credentials. During 1991-96, a total of 25 financial institutions (bank and non-banking) were awarded licenses, whereas during 1996-2001 the number was

29. The present government as of date has issued 9 licenses. While a couple of dozens of applications for opening new banks remain pending with the government, it is being speculated that a fortunate few may indeed become successful. Given the current need for consolidation of the financial sector, entry of new banks will only put new strains on the sector.

(viii) Issuance of New Insurance Licences

In the context of weak regulatory framework, setting up of insurance company has turned out to be a lucrative venture in Bangladesh. In fact, those who failed to get a bank licence ended up being a co-owner of an insurance company. Antecedents of these owners do project a certain profile. Between 1991 and 1996 a total number of 10 insurance companies were established, while during 1996-2001 the number increased to 29. Although no insurance licence has been issued during the last four years, but it is to be seen whether during the next fiscal year the government opens its account on this count.

The abovementioned list of eight hazards of economic policymaking of a pre-election government is not an exhaustive one. But this list may very well work as a select point of reference for establishing economic accountability during a period of heightened electoral politics. One is inclined to believe that the upcoming budget will assuage citizens' concerns in these areas.