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State of the Bangladesh Economy in FY2010-11

(First Reading)

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

Expert Group Meeting on CPD-IRBD 2011 (First Reading)

As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation on 23 December 2010 at the CPD Dialogue Room. The working document of the First Reading of *State of the Bangladesh Economy FY2010-11* prepared by the CPD-IRBD team was shared at this in-house meeting with a distinguished group of policymakers and professionals. The CPD team is grateful to all those present at the consultation for sharing their views, insights and comments on the draft report. It needs to be mentioned, however, that the expert group members do not carry any responsibility for the contents of this report.

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

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STATE OF THE BANGLADESH ECONOMY IN FY2010-11

(First Reading)

1. INTRODUCTION

In the backdrop of the dual track recovery of the global economic environment, Bangladesh economy in the early months of fiscal year 2010-11 demonstrated mixed signals. These emerging signals portend new tensions in the fiscal, monetary and balance of payment (BoP) situation.

In the domestic sector, there are indications of strong production performance in the crop sector as well as positive turnaround in industrial investment. These trends were underpinned by higher credit flow and enhanced imports. However, the apparently buoyant state of the capital market appears to have more to do with lack of adequate investment opportunities in the country rather than an upsurge of investor interest in the equity market of the country *per se*.

The relatively encouraging performance of a number of key real sectors was not adequately matched by public investment behaviour. Implementation of the annual development programme (ADP) could not make a tangible departure (if not deteriorated) from the traditional stagnating trend. Indeed, the most critical sectors, particularly energy and power, seem to be the most laggard in this regard. However, given the rising commodity prices in the global market and recent developments in the power sector, size of government subsidies is set to increase substantially in the coming months. The rare silver lining in the fiscal sector is the upbeat revenue intake performance of the National Board of Revenue (NBR).

The aforesaid diverging trends in the economy may not in the final analysis result in a widening fiscal deficit; but these could give rise to new challenges for monetary policy from the perspective of financing the deficit, particularly when the consumer price index is moving upward.

With the lagged response of the global economic crisis fading away, export growth picked up significantly in early FY11, only to be met with significant decline in remittance income flow. The external income side also experienced a setback in the early months of FY2011 as disbursement of foreign aid remained subdued and inflow of foreign direct investment (FDI) continued to be stagnant. Consequently, one observes a growing pressure on both the current account balance as well as the balance of payment. The government is actively considering accessing quick disbursing foreign aid (which, however, may be fraught with policy conditionalities) from the international financial institutions.

In the above context, the analyses presented in this volume under CPD's *Independent Review of Bangladesh's Development* (IRBD) seek to capture the early signals of the current fiscal year and provide some indications about the trends in the near-term future. In doing so, it has drawn upon the latest available information and data from concerned government bodies, complementing these with interviews of knowledgeable informants and consultation with thematic experts.

The contents of the report comprise of two core components. The *first component* reviews the current macro-economic situation and focuses on a number of emerging trends having significance for macro-economic management.

The *second component* is dedicated to the scrutiny of five critical sectors of the economy, of contemporary importance. These are: (i) Investment Scenario; (ii) Inflation, Prices and Food Security;

(iii) Energy and Power; (iv) Trends in the Capital Market; and (v) Overseas Employment & Remittances.

The report concludes with short term outlook of the economy with special focus on growth prospect in FY2010-11.

2. STATE OF MACROECONOMY

2.1 Overview

In line with global economic trends, Bangladesh has experienced two volatile years (FY2008-09 and FY2009-10) when its economic growth was restrained below 6.0 per cent level (see Table 1). The first one, FY2008-09, was the year of global financial and economic crisis. In the face of fall in global demand commodity prices as well as domestic inflationary trend declined considerably. Incidentally, during this period, Bangladesh economy not only benefited from low prices of importables but was also able to avoid negative pressure on its export of goods and services.

On the other hand, in the next year (FY2009-10), the impacts of the global economic and financial crises started to have important consequences for the Bangladesh economy. Export revenues and remittance income growth started to decelerate, while the domestic inflationary trend took an upturn in consonance with the international market. A visible improvement in public investment (in terms of ADP implementation as per cent of GDP) has also been a promising feature of the last fiscal.

However, over these two years Bangladesh remained an underinvested country. The investable surplus (reflected by the gap between national savings and total investment) could not be made use

of due to the lack of domestic infrastructure. Growth in manufacturing sector (and hence in industry sector) remained modest. On the other hand, strong growth in agriculture sector helped maintain the GDP growth at respectable level and expansion of safety net programmes provided some protection to the living standard of the marginalised groups.

Macroeconomic management in FY2010-11 thus had to confront the twin tasks of (i) accelerating the GDP growth by energising domestic investment and responding to the lagged impact of the global financial crisis with its demonstrated adverse consequences for Bangladesh's increasingly globalising economy and (ii) maintaining macroeconomic stability to aid a broad-based and inclusive economic growth.

Table 1: Medium Term Macroeconomic Framework 2008-09 to 2010-11

Indicator	Actual		Planned
	FY09	FY10	FY11
Real Growth (%)	5.7	5.8	6.7
Agriculture Sector	4.1	4.7	NA
<i>Of which</i>			
Crop Sector	4.0	5.1	NA
Industry Sector	6.5	6.0	NA
<i>Of which</i>			
Manufacturing	6.7	5.7	NA
National Savings (% of GDP)	29.6	28.8	NA
Gross Investment (% of GDP)	24.4	25.0	26.4
ICOR	4.3	4.3	3.9
Total govt. outlay (% of GDP)	14.3	13.8	16.9
ADP (% of GDP)	3.1	3.7	4.9
ADP as % of total govt. outlay	21.7	27.2	29.0
Inflation (12 month annual average %)	6.7	7.3	6.5
Export (% change)	10.1	4.1	15.0
Import (% change)	4.2	4.1	16.0
Remittances (billion USD)	9.7	11.0	14.0

Source: Estimated from MoF (2010 and 2010a) and Bangladesh Bank (2010).

2.2 Emerging Situations in Macroeconomic Framework

The present section is organised around four emerging challenges of macroeconomic management¹: (a) maintaining fiscal balance; (b) designing a prudent monetary policy in view of the core macroeconomic challenges; (c) utilising the evolving opportunities and addressing the concerns in promoting export; (d) strengthening the balance of payment situation in view of the emerging strains it is likely to face. The section then attempts to connect the dots to sketch the implications of macroeconomic management in view of growth prospect for FY2010-11.

Fiscal Deficit: It is not the Size, but the Mode of Financing that matters

The budget for FY2010-11 envisaged a sizeable public expenditure target of Tk. 132,170 crore which is 31.4 per cent or Tk. 31,548 crore higher than the actual expenditure in FY2009-10. The resource balance indicated a fiscal deficit to the tune of 5.0 per cent of GDP for FY2010-11.

The budget envisaged a challenging revenue mobilisation target. The National Board of Revenue (NBR), the major and single-largest contributor of revenue (80 per cent of total), achieved a robust growth of 24.8 per cent during the first five months (July-November) against an annual target of 16.8 per cent; it will now need to attain 12.5 per cent growth during the rest of the period to achieve the annual target. Other than customs duty, NBR's tax collection from all other sources has been above their respective targets. More importantly, the robust collection of direct tax and indirect tax at domestic level has strengthened the composition of revenue mobilisation. This positive trend owes to the various new measures adopted in the budget for FY2010-11 to broaden the net of both direct

¹The issues are put according to a logical sequence but do not necessarily reflect priorities.

and indirect taxes.² Based on available evidence, it is difficult to conclude to what extent the increasing intake had been due to intensification of tax collection from the existing base as against inclusion of new tax measures!³

It may be noted here that the tax buoyancy for Bangladesh is estimated to be about 1.16, which would mean that a one per cent change in GDP influences a 1.16 per cent change in tax revenue collection (CPD 2010a). Thus, if programmed GDP growth rate is achieved under a business as usual scenario, the growth of tax revenue may be limited to 15.1 per cent for FY2010-11 (i.e. less than the target). This implies that tax collection efforts need to be sustained for achieving the aggregate tax collection targets.

The above mentioned issue becomes more pertinent as, in contrast to the NBR, non-NBR tax⁴ and non-tax revenue⁵ records portray a rather disappointing performance. These two heads are not likely to achieve the target for FY2010-11.⁶ Consequently, aggregate revenue mobilisation target may fall short, unless NBR manages to surpass its target substantially to offset the likely underperformance of the non-NBR sources. Under this most likely scenario, a mid-term upward

²Including introduction of more sectors and higher proportion of tax collection at source, raising VAT rate from truncated to actual (15 per cent) on services provided by dockyards, advertising agencies, printing presses, courier services, consultancy and supervisory firms, audit and accounting firms will raise companies' cost of doing business, introduction of tax on income from trading of shares in the stock exchange, raising tax at source from real estate developers and car purchase at the time of registration, etc.

³However, the measures taken to popularise income tax payment by NBR, including arranging 'Income Tax Fairs' in Dhaka and Chittagong, introducing submission of online income tax return on a pilot basis, developing income tax calculator for individual income tax payers, etc. are commendable.

⁴Includes taxes on narcotics & liquor, vehicles, land and stamp.

⁵Includes dividend & profit, post office & railway, interest/fees/tolls and other receipts.

⁶The growth for non-NBR tax was targeted at 25.8 per cent; however, only an 8.3 per cent has been achieved up to the first quarter compared to the matched period of the last fiscal year. Non-tax revenue collection has fared even worse, declined by (-) 26.3 per cent against the formidable growth target of 27.4 per cent that was set out for. Considerable fall in profit earnings from Bangladesh Bank and lower revenue collection by BTRC have been mentioned as the reasons for such disappointing performance by the Finance Minister (MoF 2010). Ensuring SoE's efficiency is also important to augment revenue from non-tax sources.

revision may be required with regard to the NBR targets.⁷ Concurrently, improved performance of the non-NBR revenue sources are also warranted (e.g. state-owned entities contributing more to public exchequer and upward revision of fees and charges of these entities).

On the expenditure front, in the early months of the fiscal year the ADP implementation could not make any breakthrough from the habit of being underspent. ADP utilisation rate during the first five months of FY2010-11 was 20.0 per cent compared to the 23.0 per cent for the similar period of last fiscal year, depicting a declining trend. However, since the size of the ADP in FY2010-11 was significantly higher, in monetary terms, the implementation was larger than the comparable period of the previous fiscal. Concurrently, 'non-ADP' expenditures during the first quarter remained within the target set for the period; during the first quarter of the fiscal year, 21.9 per cent of non-ADP expenditure was spent. As a result the budget deficit during the first three months remained well within the programmed limit, even though it increased somewhat compared to the corresponding period of FY2009-10. The overall budget deficit (excluding foreign grants) was 1.5 per cent of GDP at the end of first quarter of FY2010-11 (Table 2).

The budget deficit is most likely to increase in the coming months mainly due to higher public expenditure requirements. The Finance Division has already estimated a higher demand for subsidy (an additional Tk. 3,200 crore) for energy, power and agriculture in view of escalating global commodity prices.⁸ Given the present inflationary pressure, higher subsidy as a source of budget deficit appears to be well justified; this is also non-inflationary. However, a possibility of some shortfall in aggregate revenue outcome coupled with higher subsidy requirement may not result in

⁷It is perceived that in recent years the end-year revenue outcome of NBR has often been constrained by the targets set for various departments. If this is the actual case, a mid-term correction may help higher revenue mobilisation.

⁸Between June 2010 and November 2010, the international prices of oil (crude oil Brent), rice (Thailand 25 per cent), wheat (HRW) and urea increased by 12.6 per cent, 17.9 per cent, 42.5 per cent and 37.4 per cent respectively. It is also more likely that towards the end of the fiscal year more electricity will be added to the national grid from the ongoing quick rental power plants which are likely to result in additional fiscal burden.

any 'out-of-control' government expenditure, particularly because of underperformance of the ADP. Indeed, without a spectacular breakthrough in ADP disbursement, the budget deficit figure may remain well below 5 per cent of GDP. Thus, notwithstanding various developments in fiscal side, the size of budget deficit will not be a matter of concern for FY2010-11; rather it is argued that the composition of deficit financing may become a matter of judicious choice.

Table 2: Financing of Budget Deficit in FY2009-10 and FY2010-11 (as Per cent of Total Deficit)

Sector	FY10	FY11B	FY10 (Q1)	FY11 (Q1)
Net Foreign financing	47.5	39.8	92.6	31.8
Grant	19.0	12.2	80.8	27.0
Loan	49.8	40.6	73.5	40.5
Amortisation	21.3	13.1	61.7	35.7
Domestic Financing	52.5	60.2	7.4	68.2
Non-Bank Borrowing (net)	61.8	20.3	173.5	41.4
Bank Borrowing (net)	-9.3	39.9	-166.1	26.8
Total Financing as % GDP	3.3	5.0	0.9	1.5

Source: Calculated from MoF (2010).

As may be observed from Table 2, in financing the budget deficit during the first quarter of FY2010-11, contribution of foreign sources was lower than the comparable figure for last fiscal year as well as that of the matching domestic component of the current fiscal year. This is mainly due to the dismal performance record in implementing foreign aided projects in the ADP.

In contrast, fiscal deficit financing through bank borrowing had a greater role to play during the early months of the fiscal year. With non-bank intake by the government taking a setback as a result of the diminished incentive to invest in National Savings Directorate (NSD) certificates by the small savers, financing requirements from banking sources are expected to increase further in the later

months of the current fiscal year.⁹ The above mentioned developments suggest that the monetary policy may require playing, over the remaining part of FY2010-11, a more active role to accommodate the envisaged fiscal expansion and to service the additional private investment demands. The best possible option to finance government expenditure lies in augmenting domestic revenue mobilisation. Efforts need to be focused on accessing the foreign aid in the pipeline. It may also be the right time to reconsider effective yield rates of the savings in NSD tools.¹⁰

Maintaining the balance between domestic and foreign financing is also critical from macroeconomic stability perspective. Curiously, the government is already considering new sources of foreign financing even at the expense of higher financial costs and stricter policy conditionalities in the form of several Suppliers' Credit and IMF loan. It is surprising to note that the government considered these expensive options before trying to access quick disbursing budgetary support at a concessional rate from the World Bank.¹¹

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⁹Net sale of NSD certificates declined by 51.1 per cent during the first four months of the fiscal year. It may be recalled the government introduced a deduction of income tax at source for most NSD tools, while the interest rates for these certificates were also slashed in FY2010-11.

¹⁰Albeit borrowed at a higher interest rate, in addition to put a balance between domestic sources of financing deficit, NSD certificates also possesses a number of advantages under the current economic condition including its non-inflationary nature, indirect role to provide an alternative lucrative sector for small investors outside the volatile capital market.

¹¹The Finance Division is currently negotiating a budgetary support scheme of USD 1 billion with the World Bank which is expected to be finalised in March 2011.

Box 1: The Upcoming IMF Loan for Bangladesh

Bangladesh is currently negotiating a credit deal with IMF equivalent to around USD 1 billion under its Extended Credit Facility (ECF) arrangement for three years (FY2011-14). It is expected that the loan package will receive IMF Board's clearance in February next year.¹² This would be for the first time in three years (following the termination of the PRGF arrangement in 2007) that Bangladesh is opting for an IMF programme. The ECF is set to replace the Poverty Reduction and Growth Facility (PRGF) under which medium-term financial support is provided to countries with *persistent* balance of payments problems. All countries that are currently eligible for aid from the PRGF can access the ECF and financing is decided, as may be the case, by using the same criteria as the PRGF.¹³ As per the IMF statement, ECF as a credit facility can be considered very flexible with structural conditionalities focused on long-term goals and provision for extension of the facility up to five years per arrangement.¹⁴ However, in reality, the ECF has not changed any of the substantive policies of the PRGF, continuing with the so-called upper credit tranche conditionality and the same terms, maturities, and recently raised access limits. This comes as a surprise in the context of the melancholic experience of the IMF-supported structural adjustment programmes (including those under PRGF) and the lessons drawn from the recent global financial and economic crises.

The last agreement for PRGF for Bangladesh was signed in June 2003 and in six instalments the IMF lent around USD 467 million. In September 2007, the IMF set 20 conditions under a package of reforms for the government under a new Poverty Reduction Growth Facilities (PRGF) arrangement. However, Bangladesh government decided not to go for negotiation of the seventh and last instalment of USD 123 million. In fact, Bangladesh Bank rejected at least four IMF recommendations over a four years period (FY2006-07 to FY2009-10) which included the adoption of Policy Support Instrument (PSI), introduction of a tight monetary policy, raising Cash Reserve Requirement (CRR) for the scheduled banks, and opening of the capital account.

¹²The loans will be given to the central bank. Later, the government will have to sign a deal with the BB for utilisation of the fund.

¹³Countries such as Zambia, Burundi, Armenia, Tajikistan, Togo, Liberia, Sierra Leone, Yemen, Gambia, Burkina Faso, and Kenya are currently receiving assistance under the ECF.

¹⁴Financing under the ECF carries a zero interest rate, with a grace period of five and half years, and a final maturity of ten years.

In order for the loan under ECF to Bangladesh to be disbursed, 11 steps will have to be taken by the country as per agreed conditions. Some of which are quite specific. They include raising CNG and furnace oil prices (to cut back on energy subsidy), establishing a framework to monitor losses of SOEs like the BPC, BCIC and PDB, and phasing-out of bank lending rate ceilings (for bringing in greater flexibility in the lending regime). The IMF also expects placement of the new VAT and income tax laws before the parliament and separation of policy and tax administration functions of the NBR along with taking measures to achieve revenue targets, and pursuing of demand-side management in the form of contractionary monetary policy (to check inflationary pressure).

In fact, a number of these conditions are almost analogous to those under the PRGF, which included adjustment of fuel prices, development of a new strategy for sale of Rupali Bank, formation of a tax policy unit under the ministry of finance, introduction of a quarterly flash reporting system for five SoEs that account for the bulk of SoE losses (i.e. Bangladesh Petroleum Corporation, Bangladesh Jute Mills Corporation, Bangladesh Power Development Board, Bangladesh Chemical Industries Corporation and Biman Bangladesh Airlines), and finalisation of a new foreign exchange law as well as new foreign exchange guidelines.

Although the Finance Minister has ruled out any conditionalities from the IMF side for securing the credit, and stated that the reforms agenda has been prepared locally, the IMF press release affirmed that it is under the ECF that the Bangladesh government has planned to raise tax revenue by about three percentage points of the GDP and pass and implement new VAT and income tax laws. VAT laws will be finalised in January, 2011 while new income tax law will come in June, 2011 with a view to strengthen to mobilisation of more domestic resources. A rise in CNG prices has also been hinted by the Finance minister, and it has already been announced that furnace oil price will be adjusted to the international prices. Among other issues, the IMF press release also stated the government's commitment to "improving monetary and exchange rate operations, and enhancing Bangladesh's integration into the regional and global economy through a more open trade and investment regime." As it would appear, many of the IMF inspired policy propositions including quantitative conditions, structural benchmarks and program reviews are being put into action even before the loan package has been sanctioned.

Thus, after IMF's PRGF scheme in FY2003-04, Bangladesh is again seeking funds to bolster its balance of payment (BoP), which is expected to take a further hit in the coming months due to rising global commodity prices (e.g. food, fuel and cotton prices) and growing import demand¹⁵ and the country's falling remittance income. While the need for safeguarding the BoP is well acknowledged, one wonders how rationale the proposition could be considering other possible options available (e.g. budgetary support from the World Bank). More importantly, the issue is whether the upcoming IMF loan will constrain the policy space of the government in undertaking the supply-side measures for sustained high growth. If that is the case (and this is a likely outcome), the government may consider, at the least, to make a public disclosure of the policy conditionalities and macro-economic targets agreed under the forthcoming IMF loan.

Need to revisit the Monetary Aggregates

The monetary policy for the first half of FY2010-11 was essentially geared to accommodate the projected fiscal expansion. However, a considerable deceleration of growth for private sector credit was planned, while a sharp fall in growth of net foreign assets was also projected in the backdrop of conservative outlook for remittance inflow.¹⁶ The target growth for money supply was kept at lower level of 15.2 per cent (Table 3). This again brought to question the selection of anchor variable (i.e. Broad Money growth) by the Bangladesh Bank.¹⁷ However, credit flow to private sector has remained on the high side and as a result money supply was higher compared to its projected level.¹⁸ Rebound of export-oriented industrial production coupled with anticipated improvement of

¹⁵The Finance Minister defended the planned credit loan deal by saying that Bangladesh could not avail IMF credit last year, because the BoP had been on sound footing for the last three years.

¹⁶The apprehension of decelerated remittances inflow to Bangladesh was somewhat contradictory to the optimistic anticipation in the MTMF. A 27.3 per cent growth of remittances in FY2010-11 was targeted in MTMF. The data for early months of FY2010-11 suggested that the Bangladesh Bank's expectation was closer to reality.

¹⁷Broad money perhaps is the most dependable and common anchor variable for formulating monetary policy in an 'inflation targeting' regime. Bhattacharya and Khan (2010) argued that the monetary policy in Bangladesh targets the aggregate money supply whilst the shares are distributed accordingly. The authors suggested that under present circumstances, monetary policy should use domestic credit as the anchor variable in view of the government's and private sector's credit requirement.

¹⁸Taslim (2010) argued that failure of central banks to contain the monetary aggregates within their target bands is not unusual. And hence, many of the central banks in developed countries abandoned the policy of monetary aggregates targeting.

domestic infrastructure services is expected to hold high level of private sector credit demand in the course of the current fiscal year. A surge of government sector credit is also expected towards the later half of FY2010-11 in line with the practice of end-loading of government expenditure. Combining these two factors, overall money supply is likely to surpass the target set for the end of the current fiscal year. A revision of the monetary targets thus may become pertinent in the coming Monetary Policy Statement (MPS) in January 2011. It will be interesting to observe whether the central bank feel constrained to rationalise the growth target for private sector credit flow, given the conventional approach of the IMF programme.

Table 3: Growth of Monetary Aggregates (in Per cent)

Monetary Aggregates	FY10	FY11 (Target)	FY11 (September)
Net Foreign Assets	41.3	4.2	27.3
Net Domestic Assets	18.8	17.6	20.2
Domestic Credit	17.9	17.9	20.3
Credit to Public Sector	-1.7	25.3	-0.3
Credit to Private Sector	24.2	16.0	26.7
Broad Money	22.4	15.2	21.5

Source: Bangladesh Bank (2010).

Inflation and Monetary Policy: In recent years, successive monetary policies in Bangladesh have tried to facilitate growth acceleration with an accommodative monetary policy without losing the focus on inflationary expectations. No wonder, the emerging inflationary pressure has drawn considerable attention from the monetary authority. In this connection, one may point out that the current inflationary phenomenon is very similar to the one experienced by Bangladesh during 2007 and 2008, when inflationary trends were driven by the upturn in international commodity prices in

addition to supply-side constraints and distortions in the domestic supply chain (Rahman *et al.* 2008).¹⁹ One can readily observe that the current inflationary trend is predicted by three factors.

(a) The overall inflation is driven by food inflation.²⁰ Given this, demand side management can hardly work given the inelastic nature of demand for food items. Thus it would be advisable to use apart from strengthening public safety net programmes to protect the income disadvantaged groups and ensure incentives to boost domestic food supply.²¹

(b) International price hike – as a small open economy, Bangladesh cannot influence the global price level, and hence, providing strategic and effectively delivered subsidy remains one of the few viable choices to protect competitiveness of the economy.

(c) Information asymmetry, lack of infrastructure and weak institutional capacity – there is no short-cut solution to these issues other than facilitating information flows, strategic market interventions and effective market (global and domestic) monitoring.

In recent months, the central bank is discretely moving towards demand side management with a soft contractionary stance. For example, for the second time over the last six months Bangladesh Bank has adjusted its policy rates to squeeze credit expansion ability of the commercial banks. The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) have been increased by 0.5 percentage point (to 6.0 per cent and 19.0 per cent respectively), whilst SLR for Islami banks has also been raised by 1 percentage point to 11.5 per cent, applicable from 15 December 2010.²² CPD estimate suggests

¹⁹Global commodity price index from IMF indicates a steady rise in global prices. The year-on-year growth in IMF's commodity price index and commodity food price index in November 2010 stood at 16.3 per cent and 21.0 per cent respectively.

²⁰In October 2010, the food inflation was 8.43 per cent whereas the food inflation was 3.82 per cent. In fact the present non-food inflation is one of the all-time-lows!

²¹On the contrary, the growth of agriculture credit disbursement decelerated considerably. Between July-November FY2010-11 agriculture credit disbursement growth was 11.1 per cent; the benchmark growth figure was 25.8 per cent.

²²Earlier in May 2010 the CRR and SLR have been also revised upward by raising by 0.5 percentage points (to 5.5 per cent and 18.5 per cent respectively) applicable from 15 May 2010. SLR for Islami banks was raised to 10.5 per cent at the same time.

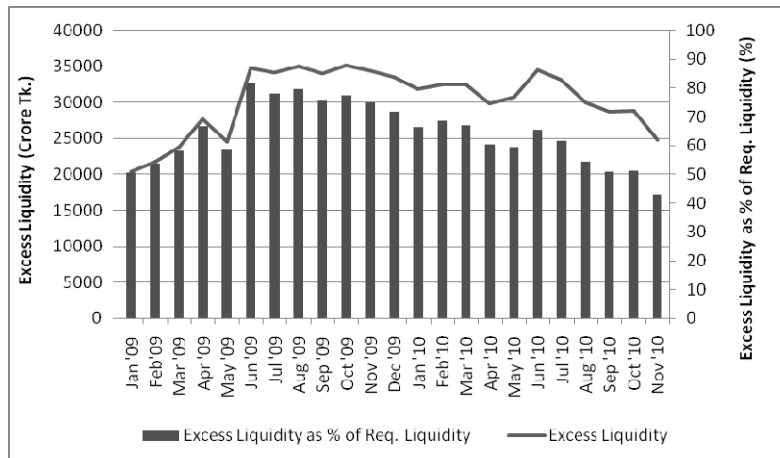
these revised rates may result in a withdrawal of about Tk. 2,000 crore from the market (8.0 per cent of the prevailing excess liquidity). Given the recent signals alluding to some turnaround in the investment, one wonders what these measures will mean regarding credit availability for servicing private sector demand.

High level of excess liquidity in the banking sector while being on the slide also indicates space for credit expansion. Over the first five months of FY2010-11 the level of excess liquidity has declined steadily (see Figure 1). Excess liquidity of the scheduled banks stood lower at Tk. 24,757 crore as of end November 2010 as against Tk. 34,500 crore as of end June 2010, i.e. a decline by 28.0 per cent. This consistent fall of excess liquidity may have been compounded by several factors. *First*, the industrial credit demand experienced acceleration.²³ *Second*, soaring global commodity prices coupled with higher demand for import of capital machineries and intermediate goods, resulted in higher money demand for financing of the imports. *Third*, a significant part of the money supply has also been diverted to the capital market for more lucrative returns.

While the first two factors mentioned above are creating legitimate demand, the third factor reflects operational failure on the part of concerned banks. Under such circumstances, the increase in policy rates put severe pressure in the call money market. The call money interest rate shot up to as high as 175- 180 per cent as the contractionary stance came into effect. The central bank also had to act immediately by injecting additional money in the market through repo.

²³Growth of industrial term loan disbursement was 38.3 per cent during the first quarter of FY2010-11. For the same period the growth of working capital was 32.1 per cent.

Figure 1: Excess Liquidity at the end period



Source: Bangladesh Bank (2010).

In order to bring the investment situation of the country out of its current sluggish state it is important to secure a greater volume of private investment – both through higher availability of credit as well as by reducing the borrowing cost. In the recent years, the central bank is under pressure from the private sector to reduce the lending rate to perk up investment. It is well recognized that lowering of effective lending rate needs to be effected by reducing the interest rate spread. Interest rate spread has come down to 4.6 per cent in October 2010 from 5.0 per cent in June 2010 – mainly due to lower lending rate. However, on this issue, Bangladesh Bank in its last MPS (July 2010) has gone for keeping its regulatory interventions limited to “those justifiable on consumer protection grounds; interventions beyond these will impair effectiveness of monetary policies, obstructing normal transmission channels of the policies.” The current tightening of the monetary aggregates could raise the interest rate. The increasing inflationary trend will also warrant increase of interest rates across the board to keep the real value positive. It appears that the central bank is going to confront the dilemma underpinned by namely two conflicting objectives, namely, promoting private investment by improving accessibility to credit and controlling inflation with demand-side management. In view of the inflation in economies such as Bangladesh being more of a structural nature (as against being a purely monetary phenomenon), one would expect that the

central bank will continue its accommodative and moderately expansionary monetary stance in the coming months of FY2010-11.

Taking advantage of global export recovery

In the backdrop of the low export growth of FY2009-10 (-7.0 per cent), the robust performance during the first five months of FY2010-11 is indeed encouraging. Export registered a 35.8 per cent growth in this period. This growth in export was shared by both RMG and non-RMG sectors such as, raw jute, frozen food and leather products (see Table 4). However, it is to be noted that this high growth was against the low benchmark of the comparable period of the previous fiscal year. During December-June FY2009-10 export posted a 12.1 per cent growth which implies that subsequent growth over the next few months of FY2010-11 will need to be estimated over higher benchmark figures.²⁴

RMG export growth during the first five months of FY2010-11 was an impressive 36.4 per cent while non-RMG posted a 33.7 per cent growth.²⁵ Over this period, export has been able to pace ahead of the target set for the current fiscal year.²⁶ Achieving export targets has acquired enhanced importance given the deceleration in the trade balance of the country (more details later).

²⁴During the latter half of FY2009-10, export started to pick-up while the global economy began to recover and avoided a double-dip recession.

²⁵Whilst RMG export is well ahead of the target, non-RMG lags behind somewhat - to reach the target this will require 24.9 per cent growth over the remaining seven months of FY2010-11.

²⁶However, given the slow pace of global recovery coupled with the lagged impact of the global economic crisis, the targets for RMG (both knit and woven) were set on a conservative mode.

Table 4: Export Growth Rates: Comparative Picture

Product	Growth Target for FY2010-11	Growth Jul-Nov FY11	Growth Jul-Nov FY10	Required growth for Dec-Jun FY11
RMG	10.0	36.4	-6.7	-5.9
Knit	10.0	36.9	-5.7	-7.8
Woven	10.0	35.8	-7.8	-4.1
Non RMG	28.2	33.7	-8.1	24.9
Raw Jute	30.0	68.7	34.7	-0.2
Total	14.2	35.8	-7.0	1.1

Source: Estimated from EPB (2010).

The observed robust growth of RMG export during the early months of FY2010-11 continued to remain volume-driven in view of heightened demand in major importing countries. However, in view of the significant rise in cotton price since the end of FY2009-10, there has been a hike in production cost of RMG items. This is perhaps yet to be reflected in the current export figures since most of the export orders predate this rise.²⁷ It is conceivable that future prices will reflect this and future growth of RMG will, at least in part, be value-driven. Non-RMG export growth was mainly volume driven (except for leather). High price of raw jute in the domestic market should have led to a value-driven growth in the jute export, but a closer scrutiny revealed a decline in unit price of exported raw jute.

A number of recent events allude to further opportunities to boost the export sector. *First*, the European Union (EU) has revised the Rules of Origin (RoO)²⁸ under generalised system of preference

²⁷Indeed, FY2010-11 as compared to the corresponding period of the previous fiscal year.

²⁸EU's existing RoO allows two-stage processing which permits RMG manufacturing from imported yarn to avail the duty-free export under GSP. This implies that, in practice, only knitted RMG items from Bangladesh were able to utilise the GSP scheme. Presently GSP utilisation rate of Bangladeshi textile products in the EU market is 78 per cent. The rest 22 percent, which enters the EU market paying (on an average) 12 per cent

(GSP) for LDCs allowing single-stage processing for manufacturing RMG products. This will allow duty-free export of RMG even when the fabric is imported. Exporters of woven RMG will be the major beneficiaries of this change in the RoO. This will help continue Bangladesh's current good performance in the EU apparels market and will likely lead to a shift in the composition of apparels in favour of woven-wear. The amended RoO will also have positive impact on production of higher value-added items. The changed RoO for non-RMG items (a 30 per cent domestic value addition in most cases) will also hopefully play a conducive role in promoting export of non-RMG items to the EU. *Second*, Bangladesh's export of apparels to Japan has seen significant growth in recent times. The envisaged change in the RoO for knitwear (from three to one stage conversion) should allow Bangladesh to further strengthen her position in the Japanese market.²⁹ *Third*, it has recently been agreed, on principle, that India will remove 61 items from its existing sensitive list for Bangladesh, of which 47 are RMG items (both knit and woven). This, when implemented, will help Bangladesh to increase her export to the Indian market.³⁰ *Fourth*, duty-free cotton imports from India through Benapole port has resumed recently (after six months of suspension) which is expected to allow weavers to access yarn at competitive price. *Fifth*, as global recovery from the financial crisis gain pace, global demand of Bangladesh's exportable goods has also been on the rise. During July-October FY2010-11, Bangladesh's RMG export to US market registered a 21.6 per cent growth which

duty, are mainly woven products. Moreover, as high quality fabric is not manufactured locally to the quantity needed, Bangladesh was not being able to avail GSP for high-end products in the EU under the existing rules. The new RoO will provide opportunities for the local exporters to expand their share in the higher end of the EU market.

²⁹Currently, while Bangladeshi woven products enjoy duty-free treatment in Japan, many knitwear items have to undergo a three-stage processing (which implies yarn must be produced locally) to be eligible for Japanese GSP. However, due to not being able to fulfil the RoO criteria, knitwear export from Bangladesh, on an average, has to face a duty of 17 per cent in Japan.

³⁰Anecdotal information hints that duty-free access to more Bangladeshi products which is likely to be announced when Indian premier Manmohan Singh visits Dhaka possibly in February this year. It is to be noted here that India has offered to provide zero duty market access for up to eight million pieces of garments from Bangladesh (Tariff Rate Quota (TRQ)) without any sourcing conditionality as per a memorandum of understanding (MoU) between the two countries in 2008. However, only 44 per cent and 52 per cent of the TRQ could be utilized in 2008 (April-December) and 2009 respectively. It is an encouraging sign that exports of RMG products to India under the TRQ has risen significantly in recent times – about 20 per cent of the TRQ could be utilised during the first two months of 2010 in contrast to the very low figure of utilisation during the matched period of earlier two years.

was (-) 9.8 per cent over the comparable months of FY2009-10. Other competitors of Bangladeshi RMG exporters such as Cambodia, Vietnam and China also were able to post high growth rates for exports to the US market. In the EU market, Bangladesh posted a 20.2 percent growth in RMG export during July-September FY2010-11.³¹ China and Vietnam posted similar growth while Cambodia's growth was relatively low at 10.4 per cent. It needs to be mentioned here that, unlike the other three competitors for which this growth was achieved over a rather low benchmark, Bangladesh posted such high growth over the 7.6 per cent growth registered during the comparable months of the previous fiscal.

To maintain the current robust export growth Bangladesh will need to address a number of issues. *First*, exporters have to incur higher cost due to lack of regular power supply from the national grid, weak infrastructure and longer lead time. The government has provided some support to mitigate the adverse impact, but more will need to be done, also in view of the fact that the minimum wage in the RMG has started to be implemented as of November, 2010. *Second*, the frequency of labour unrest has increased in the RMG sector which could lead to serious disruption in the production performance. Whilst the government has taken an initiative to set up an 'Industrial Policy', more will need to be done to ensure industrial peace. *Third*, recent international campaign by rights groups with regard to the core labour standards and living wages for RMG workers in Asia, including Bangladesh, there is a pressure to ensure further rise in the wages of RMG workers towards 'living wages'. In view of this, renewed attention should be given to raising productivity in the RMG and other export-oriented sectors to enable entrepreneurs to give higher wages to workers. *Fourth*, the SFYP should come up with a comprehensive plan for export and market diversification and make necessary financial resources available towards this. There is a possibility that India will further raise the duty-free quota for RMG; Bangladesh should take appropriate steps to take advantage of the

³¹This upward trend is likely to climb further under the new RoO scheme by the EU which will be in place from January 2011.

growing regional market (including that of China). *Fifth*, emphasis should be put on addressing the non-tariff barriers to trade which are perceived to be crucial to expanding export of non-RMG goods, particularly agricultural and other non-traditional items. Towards this, strengthening of the BSTI and signing of mutual recognition agreements with standardisation/certification institutions of neighbouring countries (mainly India) ought to be given high priority. Bangladesh should also see to it that the proposed SARSO (South Asia Regional Standardisation Office, to be set up in Dhaka) takes off the ground at an early date. Addressing these concerns will help Bangladesh to take advantage of the global agri-export market, which she has not been able to do till now in spite of the duty-free preferential treatment, which she receives for almost all products in most of the developed country markets.

Balance of Payment (BoP): under pressure?

Bangladesh has been enjoying a current account surplus over the last five years. Current account surplus stood at USD 834 million during the first four months of FY2010-11³² (Table 5). However, indications suggest that it could come under some pressure in the coming months. The encouraging export growth performance has not been able to arrest the deteriorating trade balance; deficit in trade balance increased to USD (-) 1,876 million over the same period which was USD (-) 1,540 million during the comparable months of FY2009-10. A slow down in the remittance flow and swelling import payment³³ has largely attributed to the contracting current account surplus. Lack of FDI and low level of foreign aid inflow could only create additional burden for the balance of payment situation. An expanding balance of payment deficit may become evident by the end of the fiscal year if the current trends continue.

³²This was USD 1292 million during the same months of the previous fiscal year.

³³Foodgrains import increased drastically during this period (92.9 per cent) owing to soaring global prices for foodgrains and higher volume demand while import of capital machinery increased by 35.7 per cent. In addition to this, high growth attained for import of RMG industry inputs (raw cotton, yarn, dyeing and tanning materials), crude petroleum and fertiliser resulted in 43.1 per cent growth for import of consumer and intermediate goods.

Table 5: Balance of Payment (USD million)

Items	FY2009-10 (July-Oct)	FY2010-11 (July-Oct)
Trade balance	-1540	-1876
Export f.o.b.(including EPZ)	4904	6741
Import f.o.b (including EPZ)	-6444	-8617
Services	-533	-683
Receipts	611	786
Payments	-1144	-1469
Income	-479	-406
Receipts	13	30
Payments	-492	-436
Of which : Official interest payments	-70	-70
Current transfers	3844	3799
Official transfers	45	43
Private transfers	3799	3756
Of which : Workers' remittances	3610	3583
Current Account Balance	1292	834
Capital account	128	111
Financial account	255	-1021
Foreign direct investment (net)	207	258
Portfolio investment	-29	50
Other investment	77	-1329
Errors and omissions	-481	-439
Overall Balance	1194	-515

Source: Bangladesh Bank (2010).

The BoP situation is emerging as an important macroeconomic concern which would require close attention in the current context. In this backdrop, BoP situation is likely to hinge on trade balance and remittance flow. Policy support has not been very effective to propel remittance and FDI in short-term, leaving export to be the major tool to balance the situation. Efforts to release foreign aid in the pipeline may be also intensified. Foreign exchange reserves stood at USD 10.7 billion by the

end of November of FY2010-11 which is equivalent to 4.4 months of import. This could provide some cushion against any sudden fall in forex earnings or rise in forex demand. This leaves some room to use current foreign exchange reserves all Bangladesh to maintain stability of the exchange rate and to cope with larger trade deficit.

The exchange rate of Taka against USD has been more or less stable in recent years showing some tendency towards depreciation in recent times. The stability of exchange rate is also important from the perspective of balancing the tension between inflation any targets and export competitiveness. The apprehension of a multi-way global currency war has been avoided for the moment. However, it may be mentioned here that USD has depreciated against CNY and INR by 2.5 per cent and 1.1 per cent respectively over the last six months. This could help export competitiveness of Bangladesh vis-à-vis Chinese counterparts. On the other hand, this would also put some pressure on prices of imported consumer goods as well as intermediate and capital goods. In view of ongoing global developments, there is a need to remain constantly vigilant regarding the exchange rates movement.

Macroeconomic Management in FY2010-11

Because of various developments experienced in the global, regional and national arena, macro-economic management is set to become more challenging in FY2010-11. Besides, the rising inflationary trend (separately dealt with in a later section), new tensions, if not strains, are emerging in the areas of fiscal performance, monetary policy and balance of payments.

Fiscal Performance

On the revenue side, robust performance of the NBR has created some fiscal space (see Figure 2). However, less than necessary revenue intake by non-NBR sources may result in aggregate shortfall.

To offset the likely shortage of revenue earnings originating from non-NBR sources, NBR should not leave any stone unturned in mobilising all potential resources to beef up the national exchequer.

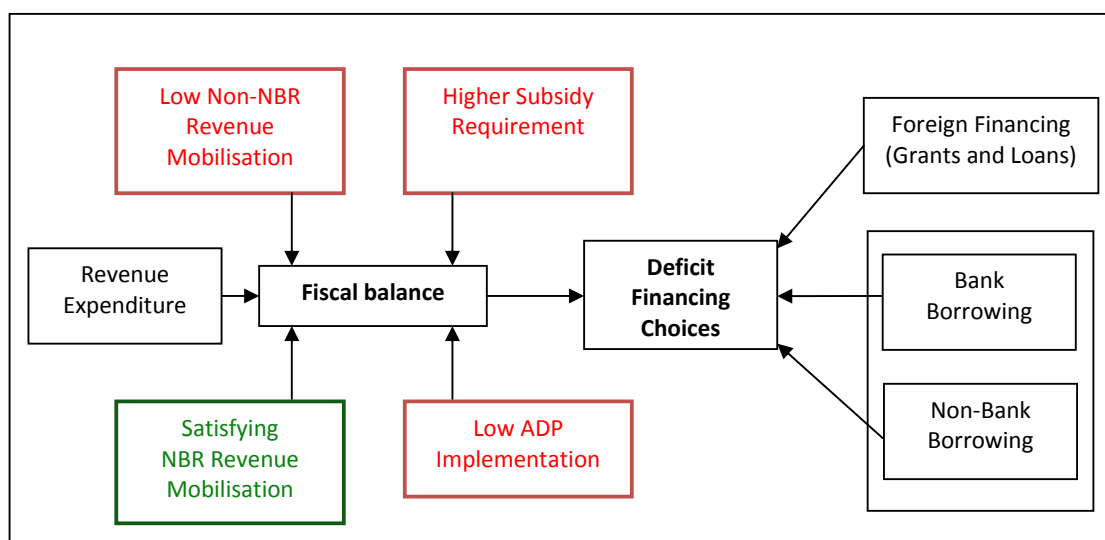
Over the past several years, budget deficits remained below the programmed level as a consequence of the underspending of the ADP, i.e. for the wrong reason. If early signals are anything to go by, once again delivery of actual ADP for FY2010-11 will be substantially lower than its original size. This may help to keep the fiscal deficit, at the end of FY2010-11, under control, but for the wrong reasons.

In the backdrop of the rise in global commodity prices, and obligations under various power deals, government expenditures, particularly subsidy requirements may surpass the programmed level. On this issue, the government should not be hesitant to accommodate any rational demand for additional subsidy requirement for critical sectors, although it may lead to higher non-development expenditure. Thus, the size of the budget deficit should not become a policy preoccupation and should be allowed to increase so as to accommodate growth oriented supply-side interventions as well as provisions for expanded safety nets.

At this point it is important to stress that, in the current context, it is not the size of budget deficit rather its financing mode which will assume greater importance.

In order to have a balanced mix of sources for deficit financing, efforts should be intensified for enhancing revenue surplus for underwriting development expenditure, accessing foreign aid in the pipeline, enhancing sale of NSD certificates and mobilisation of bank deposits by way of interest rate and income tax provision rationalisation, and limiting bank borrowing so as to accommodate private sector's demand for investment.

Figure 2: Fiscal Management in FY2010-11



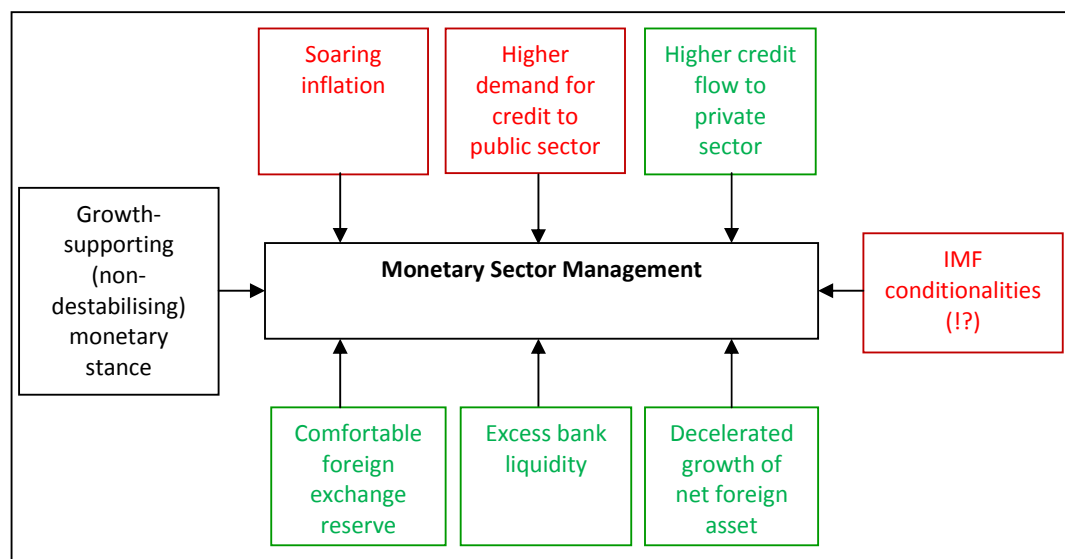
Monetary Policy

Contraction can hardly subdue price hike which is often linked to global phenomenon or various types of supply shocks (Figure 3). Thus, monetary policy in the coming months should continue to accommodate the growing public and private investment demand. However, given the inflation rate, it is felt that interest rates may experience an upward trend to keep the deposit rates positive.

In the backdrop of rising inflationary trend, there will be strong pressure to adapt contractionary monetary policy stance in the coming days. However, a number of studies systematically show that given the nature of inflation in an economy such as that of Bangladesh, money supply is not likely to have significant impact on inflation.

It is seen that in recent months BDT has experienced, albeit very low, depreciation against the USD. However, many other major currencies have appreciated during the early months of FY2010-11. This perhaps reflects a response to the growing balance of payment pressure. A vigilant exchange rate management would be called for in order to maintain a balance between the conflicting interests of the exporters and consumers.

Figure 3: Monetary Sector Management in FY2010-11



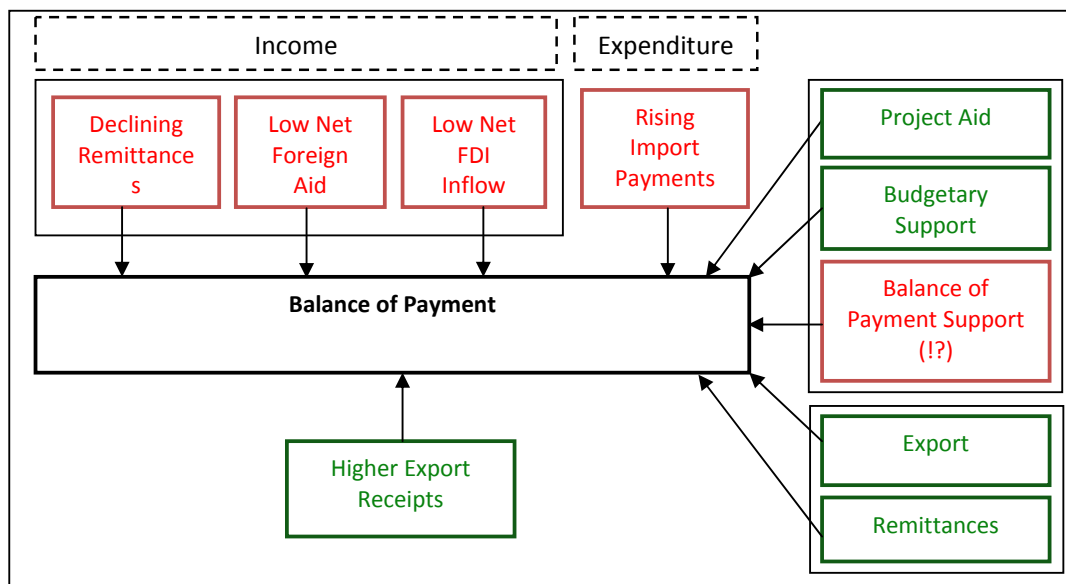
Balance of Payment

A relatively broad-based export growth has boosted foreign exchange earnings of Bangladesh (Figure 4); however, decelerated remittance receipts and swelling import payments have put pressure on the balance of payment. Stagnating FDI and low inflow of foreign aid are putting further strains on the BoP.

Due attention will need to be given to tap higher foreign aid which will enable to undertake an enlarged ADP and also secure some respite from the emerging pressures on BoP. A special effort is needed to fast-track the ongoing negotiations for large project aids (e.g. for Padma Bridge) and quick disbursing concessional budgetary support from the World Bank. The government will be well advised not to act in haste in finalising the deal with the IMF and must ensure in the process that it has the necessary policy space.

To sustain the export growth special emphasis has to be put on reaping the growing opportunities in the face of global economic recovery. Access to potential export markets such as Turkey and Japan ought to be given priority. In a similar vein, reviving the ongoing problems in the traditional manpower export markets, particularly in Saudi Arabia, will be of crucial importance. Taking advantage of new market opportunity for manpower export, particularly to Malaysia, should be seen as a priority.

Figure 4: Balance of Payment Management in FY2010-11



One, however, should not ignore the need to revitalise domestic investment scenario through implementation of the required infrastructure projects (services including energy and power). Restoring stability in the volatile capital market of the country must be seen as a priority.

3. REVIEW OF A SET OF CRITICAL ISSUES

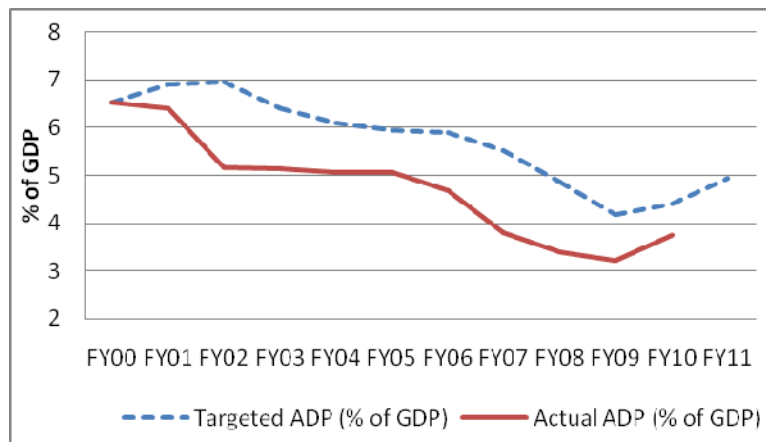
3.1. INVESTMENT SCENARIO

Implementation of Annual Development Programme Remains Lacklustre

After declining for four consecutive years, implemented Annual Development Programme (ADP) as a percentage of GDP demonstrated improvement, albeit marginal, in FY2009-10 and stood at 3.7 per cent (as against 3.2 per cent in FY2008-09). This was underpinned by the ADP expenditure, showing an impressive growth of 31.8 per cent over the actual ADP expenditure in FY2008-09. However, the level of ADP delivery in general remains far from adequate given the overall low level of investment in Bangladesh (24.3 per cent of GDP), apart from the longstanding doubts with regard to its quality.

For FY2010-11, an ADP of Tk. 38,500 crore has been adopted, which would be 4.9 per cent of the targeted GDP for the fiscal year (Figure 5). It may be recalled here that the ADP-GDP ratio has steadily declined from the peak of 6.5 per cent of GDP in FY1999-00. The programmed ADP of FY2010-11 is 26.2 per cent larger than the original ADP of FY2009-10 and 48.5 per cent larger than the actual ADP of FY2009-10. Thus, full delivery of the current ADP constitutes a critical challenge for the government.

Figure 5: Targeted and Actual Public Investment (ADP) as % of GDP



Source: Calculated from IMED (2010); MoF (2010).

Implementation status observed during the first five months (July-November) of FY2010-11, however, does not depict encouraging trend. Compared to 22.6 per cent implementation level achieved during the July-November period in FY2009-10, a lower level of expenditure, i.e. 20.4 per cent, has been recorded during the corresponding period of the current fiscal year.³⁴ Lower budget deficit that has been experienced during the early months of the current fiscal year (see Section 2) reflects low expenditure on ADP. This also implies that a phenomenal improvement in expenditure trend (a growth requirement of 61.1 per cent) needs to be attained over the remaining seven months in order for the targeted ADP to be realised in full. The recorded slowdown is largely due to the comparatively lower utilisation of the project aid component of ADP financing. While utilisation of local currency improved by 1.4 percentage point to 24.1 per cent, offtake of aid component declined to 14.8 per cent during the first five months of FY2010-11 from 22.6 per cent in the previous year. Lower contribution of foreign financing that has been observed in financing the budget deficit bears the marks of such low utilisation of the project aid component in the ADP.

³⁴However, an increase of 13.8 per cent has been recorded in monetary terms during the observed period.

Among the top five ministries (in terms of allocations received) only two ministries, namely Local Government Division (23.0 per cent), and Ministry of Primary & Mass Education (37.0 per cent) managed to spend more than the average implementation rate of the first five months of the current fiscal year. On the other hand, Power Division, Ministry of Health & Family Welfare (15.0 per cent) and Roads & Rail Division – the three other top recipient of allocation demonstrated poor spending of only 16.0 per cent, 18.0 per cent and 13.0 per cent of their respective allocations. With 19.6 per cent average utilisation of allocated funds, all the 33 ministries under the Medium Term Budgetary Framework (MTBF) were also characterised by a below average performance.

The sources of low ADP implementation are quite well known. An earlier CPD analysis, drawing on the IMED (Implementation Monitoring and Evaluation Division) reports on ADP implementation, concluded that issues related to upstream stages of ADP implementation, such as “tender process” and “land acquisition,” have emerged as major bottlenecks in recent years (Bhattacharya, Iqbal and Khan 2010). In other words, at present launching of the ADP projects itself has become a critical concern of development administration. While update of these reports for FY2009-10 are unavailable, anecdotal information suggests that impediments of the abovementioned nature have continued to persist over the previous as well as the current fiscal year. It is also interesting to note the relative contribution of different ministries/divisions to the current rate of ADP implementation. Unfortunately, it is the inability of the Power Division to utilise the allocated resources that has been significantly holding the overall delivery of the ADP back (Table 6). Indeed, in the previous two years (FY2008-09 and FY2009-10), Power Division’s contribution to the overall growth in ADP expenditure was negative.

Table 6: Incremental contribution of ministries/divisions in ADP allocation and expenditure

Ministries/divisions	Incremental Share in Allocation		Incremental Share in	
	Growth (Original ADP)		Expenditure Growth	
	FY09	FY10	FY09	FY10
Top 5 Ministries				
Local Government Division	36.3	26.6	35.0	30.0
Ministry of Communication	34.1	15.0	-9.7	18.7
Power Division	33.4	-7.0	-12.1	-5.1
Ministry of Health and Family Welfare	14.4	13.2	16.5	6.4
Ministry of Primary and Mass Education	-13.3	9.4	5.3	10.9
Other Ministries	-4.9	42.8	64.9	39.0

Source: Progress Review for Annual Development Programme, IMED (various issues).

Such sustained poor performance of the Power Division had multiple consequences which were of critical importance. First, failure to utilise the allocated public fund to improve power generation capacity is having economy-wide negative impact, particularly on investment and employment. Second, non-utilisation of allocation for Power Division might have forced the government to opt for rental power plants at high costs. Third, from a simple ADP implementation perspective, failure of the Power Division in utilising its allocation (which is one of the highest among all ministries/divisions) means inefficient distribution of allocation, assuming that the failure is associated with its implementation capacity. A redistribution of the allocation among better performing ministries could lead to higher overall ADP implementation which in turn could lead to higher public investment-GDP ratio – generating greater development impact. From a more pragmatic point of view, it is not enough to prioritise a sector with higher allocation; it is needed to

improve the leadership endowments, and implementation capacity of the concerned ministries along with reprioritisation of a reduced project basket.³⁵

Box 2: Data constraints

Improving ADP implementation has been placed high on agenda of the current government. Attaining this target would require constant monitoring of the relevant bottlenecks and constraints faced by the line ministries in implementing projects and addressing those issues by the Executive Committee of National Economic Council (ECNEC) through an effective feedback mechanism. However, in conducting CPD's present analysis on state of ADP implementation, lack of real-time and appropriate data was felt severely.

Project-wise implementation information is not available with the IMED. Even for the fifty priority projects that were to be selected for scrutiny (as mentioned by the Finance Minister in his speech delivered before the parliament), no information could be located. IMED's quarterly report on ADP implementation status usually identifies the constraints faced by the line ministries so that ECNEC can address the issues. However, the latest report was published only for FY2008-09 and no such report was available for the early months of the current year. In the absence of project-wise implementation information, it was also not possible to diagnose the status of comparative performance of projects implemented with foreign finance and those with local finance.

It is difficult to comprehend how top-level decision makers are monitoring ADP implementation in the absence of project-wise real-time data. It may be also pointed out that implementation of ADP is essentially an expenditure accounting exercise and does not provide information with regard to project performance and its impact.

³⁵In the current ADP of FY2010-11, Power Division has 40 projects.

Whither PPP projects?

The concept of collaboration between public and private sector to mobilise additional resources for investment, usually build as *Public Private Partnerships* (PPPs), is not a new one. An allocation of Tk. 2,500 crore was earmarked under PPP in the budget for FY2009-10, which however, remained unutilised. In the budget for FY2010-11, an allocation of Tk. 3,000 crore was proposed for the PPP component. In the recent past, there had been some developments in the policy areas related to PPP in the country. These include the following: (a) A PPP Policy and Strategy as well as three PPP Guidelines have been approved by the government; (b) 23 PPP projects relating to power, infrastructure and healthcare sectors have been included in the FY2010-11 ADP project list; (c) Provision for 'infrastructure depreciation allowance' for PPP Projects has been proposed; and (d) *Bangladesh Infrastructure Finance Fund* (BIFF) has been created to attract domestic and foreign investment for the PPP projects.

Box 3: PPP projects in the ADP of FY2010-11

Twenty three PPP projects were enlisted in the ADP for FY2010-11 which included two transport infrastructure development projects, five power plant projects, eight health service related projects. Rest of them included projects related to sewerage system improvement, construction of market, parks and residential areas, auditorium etc.

A few of those PPP projects have been initiated during this year. Construction of the Jatrabari-Gulistan flyover³⁶, the biggest project taken up so far under PPP, has been (re)inaugurated in June 2010 and construction started from December 2010. Tender for the Dhaka Elevated Expressway project³⁷ has been floated in November 2010 and construction is expected to start from March 2011.

³⁶The project will be implemented at a cost of Tk. 1,350 crore on Build-Own-Operate-Transfer (BOOT) basis by UAE based Belhasa Accom and Associates Ltd, an associate company of the Orion Group.

³⁷Estimated cost of the 32 km long elevated expressway is Tk. 8,617 crore. The project may now move forward; a constraining litigation has been disposed off recently.

MoU has been signed for the coal-fired power plant in Khulna, a joint venture between two state-owned power companies of Bangladesh and India, and tender is planned to be floated in March 2011.

However, none of these 23 projects, though enlisted, were mainstreamed within the ADP and no fund was allocated for them. Officials from the planning ministry informed that those projects will receive allocation later based on their progress. Besides, no implementation time-line has been set for these projects.

All the projects taken so far under PPP are large scale initiatives. On a different note, it can be mentioned here that a second international airport, though it was not included in the list of abovementioned 23 projects, has also been under government's active consideration. Indeed, land acquisition for this project has started from December 2010.

Success of the much hyped PPP hinges critically on a number of issues which needs immediate attention. *First*, there remains a serious lack in the preparatory works which includes enactment of an appropriate legislation. Land acquisition, a pre-project activity particularly important for large projects, needs legal backup while a guideline for determining the land price is also important. This has been a serious problem faced by the Dhaka Elevated Expressway project.³⁸ *Second*, Weak administrative set up may also undermine the success of PPP. The budget for FY2010-11 proposed setting up of a PPP office run by a group of suitable experts, which is still to be realised. *Third*, shortage of manpower and expertise in the area of administering, operating and harmonising PPP projects needs to be addressed on an immediate basis. Experts and the donors have raised concerns regarding timely execution of the Dhaka Elevated Expressway project because of lack of manpower.

³⁸Consultants, while submitting report on Dhaka elevated expressway, have mentioned that land acquisition in Dhaka or its suburbs is quite difficult because of scarcity of land and soaring land prices.

Fourth, bureaucratic procedures within the government is characterised by lengthy decision-making process which seriously inhibits the operationalisation of the envisaged public-private cooperation. Weak coordination among the government agencies and ministries, lengthy process of bidding and evaluation has delayed the Padma bridge project and a number of power plant projects.

A transparent procurement and selection method for the investors at both national and international levels are pre-requisites for the effective implementation of the PPP projects. Creating a centre of excellence to deal with various parties involved during PPP project implementation³⁹ has proved to be useful in Bangladesh and elsewhere. Financial return⁴⁰ would also enhance attractiveness of a project along with other government support in the form of foreign exchange rate protection and early completion incentives, etc. Quality of the project outcomes ought to be ensured and maintaining the time-line of the projects needs to be given highest priority. PPP also could potentially work as an incentive to attract FDI; however, this remains far from being realised.

Preparation of a set of policy guidelines for the PPPs is a good step; however, some experts have argued that rather than having a single set of generic guidelines, sector specific guidelines would have been more useful and of practical use. Notwithstanding some discrete and feeble signals, PPP initiatives are yet to gather momentum in the country.

Financing investment

Public investment in Bangladesh is generally underwritten by revenue surplus, concessional foreign aid, and borrowings from banking and non-banking sources. Private investment in the formal sector,

³⁹During the 1990s the *Power Cell*, a similar body, provided valuable service by becoming a single-point expert service provider to the government in selecting, negotiating and implementing PPP projects. This can also save the cost of hiring costly international consultants.

⁴⁰Direct financial support may include investment of capital, free use of project sites and facilities, and tax incentives. Financial support can also be indirect, for example, a loan repayment guarantee by the central government which assures that lenders will be fully repaid by the government if the project fails.

on the other hand, has been usually underwritten by sponsors' capital (both local and foreign), bank borrowing and equity finance received from the stock market. A number of private projects have received support from international development agencies and recently, the central bank has allowed overseas borrowing by private entities on a case by case basis.

Given the volatile (and often insignificant)⁴¹ revenue surplus available, the government has to opt for other available options in financing investment needs. With regard to the capital market, for the last couple of years there has been a high percentage of over-subscription for the Initial Public Offerings (IPOs). Although the number of IPOs increased by 50.0 per cent during the last fiscal year, the demand versus supply gap is yet to converge. Significant oversubscription validates the presence of excess liquidity in the capital market to cater to financing both private and public investments. However, this will require measures to stabilise the market to raise investors' confidence. It is important that more SoEs get listed in the capital market.

Foreign Direct Investments (FDIs), on the other hand, historically has not been able to play its role to the extent desired in Bangladesh. In fact FDI inflow exhibited a decrease since 2008 and stood at only USD 636 million in FY2009-10, with marginal improvement during the initial four months of FY2010-11⁴², despite the many advantages that the country offers. As reflected from this phenomenon, Bangladesh appears to be trapped in a low investment-low infrastructure-low investment vicious cycle. A breakthrough requires investments in both physical infrastructures, as well as in governance and business climate indicators. This could also encourage Non-Resident Bangladeshis (NRBs) to invest, a potential source of finance which has remained largely untapped till now.

⁴¹Revenue surplus in FY2008-09 and FY2009-10 was of Tk. 1,995 crore and Tk. 14,512 crore respectively against the targeted ADP of Tk. 25,600 crore and Tk. 30,500 crore.

⁴²During July-October of FY2010-11 USD 258 million FDI inflow has been recorded against USD 207 million during the corresponding period of FY2010.

More conventional sources of financing public investments have been non-bank and bank borrowing by the government. In the previous year (FY2009-10), non-bank borrowing has been a major source of finance for the government.⁴³ Given the contractionary monetary policy that the government is pursuing in view of getting hold of the rising inflation and with applied disincentives for investment in NSD certificates (see Section 2), the government in FY2010-11 has tended to be more inclined towards bank borrowing. Although bank-borrowing by the government could be more inflationary than non-bank borrowing, the former has the advantage of ready availability over the latter. However, as argued in the previous section of this report, demand side management might not do the needful in curbing the rising trend of inflation and non-bank borrowing may well be a more viable option for the government to finance investment requirements – through the support of an accommodative monetary policy stance.

The government also has the option of getting more foreign aid to finance investment. Typically over 40.0 per cent of the annual public investment program is targeted to be financed from donor support.⁴⁴ However, due to its low implementation capacity, Bangladesh has been regularly failing to avail of the committed foreign financing. Notwithstanding the fact that both the grant component within foreign financing⁴⁵ in particular and aid flow in general⁴⁶ have been on decline, donor support still remains an important option for bridging the resource gap for public development expenditure. To address this, improved capacity of utilising funds by the line ministries will be needed. Another constraint in this regard relates to Bangladesh's weak negotiating capacity for securing donor support on the best possible terms. Given the emerging trends in fiscal balance and balance of

⁴³In FY2009-10, 61.8 per cent of the total deficit financing came from non-bank borrowing.

⁴⁴Targeted foreign financing component constituted 42.0 per cent and 40.0 per cent respectively in the original ADPs of FY2009-10 and FY2010-11.

⁴⁵27.6 per cent of the gross foreign financing in FY2009-10 came as grants. Grants constitute 23.1 per cent of the gross foreign financing target for FY2011.

⁴⁶47.5 per cent of the total deficit financing came from foreign financing in FY2009-10. For FY2010-11, 39.8 per cent of the financing is targeted to be contributed by foreign financing.

payment in the current fiscal year, the government has decided to tap two foreign sources, namely, the IMF (see Section 2) and suppliers' credit (see Box 4). However, the rationale of accessing these sources is not quite clear.

Box 4: Suppliers' Credit

Historically Suppliers' Credit has been a small proportion in the foreign aid portfolio of Bangladesh. As of FY2008-09, only about USD 2 billion was disbursed under this hard term loan facility⁴⁷ in favour of projects in infrastructure, industry and power sectors. Suppliers' Credit as a lending window is often criticised for its discriminatory procurement conditions, higher rates of interest as well as for its shorter grace and tighter repayment period. As Bangladesh moved away from aid dependence, the scope of Suppliers' Credit became limited, and it has been considered only for priority projects for which easy soft loan was not readily available. However, cases of supply-driven non-priority projects being underwritten by Suppliers' Credit are also not rare in Bangladesh.

The Finance Division and ERD are currently examining the possibility of acquiring Suppliers' Credit for a wide range of projects including some power projects that are to be implemented under the PPP. The amount considered for suppliers' credit could be equivalent to USD 6.9 billion for 45 projects – three times higher than the all time disbursement. These projects are in the areas of physical infrastructure, power sectors, agriculture, water resource and rural institution.

Incidentally, the government has already signed a deal with Exim Bank of India for borrowing USD 1 billion bearing a fixed interest of 1.8 per cent plus a commitment fee at a rate of 0.5 per cent per year on unutilised credit which is repayable in 20 years with a grace period of 5 years. The credit is intended to underwrite the Indo-Bangladesh connectivity projects, the financial deal that has been

⁴⁷This is not a substantial portion of total foreign aids of USD 50.37 billion received as of the same period.

signed between GoB and the Exim Bank of India. It is to be noted that this credit is of a suppliers credit nature. The loan is tied to particular projects and the large share of porocurements under the credit line will have to be sourced in India.

It appears that the government is opting for more expensive and hard term financing options. Recent credit ratings by *Moody's Investors Service* and *Standard & Poor's* reflect Bangladesh's improved credit worthiness. However, one needs to exercise these borrowing options keeping in mind their macro-economic implications as well as their opportunity cost.

Thus, the binding constraint to investment is not the availability of funds, whether in terms of local or foreign resources, but rather the lack of adequate capacity of the government to spend or invest. More consideration also needs to be devoted on how to improve the investment climate. In this regard, the government can pursue the recommendations proposed by the RRC (Regulatory Reform Commission) and the BBBF (Bangladesh Better Business Forum) and may consider the option of reviving these platforms.

Investment Climate – Mixed Signals?

Private investment as a percentage of GDP remained stagnant at 19.7 per cent in FY2009-10. Although no information is available for the current fiscal year, certain discrete developments may be observed which allude to some improvement in the investment situation. *First*, the export growth has been very robust due to improvement in import demand in line with the global recovery. *Second*, term loan disbursement in the first quarter (Q1) increased by 38.3 per cent compared to 9.1 per cent during the Q1 of FY2009-10.⁴⁸ *Third*, overall import increased by 33.5 per cent during the first four months of FY2010-11; import of capital machinery increased by 35.7 per cent. *Further*, LC settlement for capital machinery also experienced a healthy growth of 36.0 per cent during July-

⁴⁸Sectoral distribution of disbursed term loan could have given more clear indication of its impact.

October of FY2010-11 (-19.9 per cent during July-October of FY2009-10); overall LC settlement increased by 39.3 per cent during this period.

However, disaggregated L/C settlement information prompts one to be rather cautious about investment prospects over the near term future. L/C settlement of capital machineries during July-October of FY2010-11 was higher by USD 161.6 million compared to the corresponding period of FY2009-10. Of this increase, large export-oriented industries (textile and garments, leather, jute, pharmaceuticals, packaging) accounted for only USD 29.3 million or about 18.1 per cent. Rest of the increase came from 'other industries', a breakdown of which is not available. Assuming that these L/Cs were opened by small scale industries, one may suspect that the new investment is going for machineries for captive power generation (in the form of generator imports), which cannot exactly be taken as expansion of productive capacity. Available HS code wise import data for July-September of the current fiscal year support such apprehension. Import of generators constituted 40.2 per cent of the incremental imports of capital machineries during this period when compared with the corresponding period of the previous fiscal year.

It is also to be borne in mind that these improvements in the proxy indicators of the investment scenario are driven by heightened demand in the global market. Recovery phase of the global financial crisis also created an opportunity to better posit the country in the global supply chain but this called for supply-side push through improvement of the investment climate. However, there is little evidence to indicate relaxation of the overall constraints characteristic of Bangladesh's investment climate including lack of adequate supply of energy - both electricity and gas. Bangladesh's position has remained almost unchanged in the recent years in the WB's *Cost of Doing Business* ranking as well as in the *Global Competitiveness Index* (GCI) of the World Economic Forum (prepared with CPD's input) and only some improvement in *Corruption Perception Index* (CPI) of the

Transparency International (TI). Not much improvement has been visible in this regard over the last couple of years.

Thus, while the public investment situation continues to remain lacklustre, private investment scenario do exhibit some encouraging signs associated with the external economy. It is now to be observed whether the emerging trends can catalyse a dynamic investment performance leading to a broad-based manufacturing growth.

3.2. INFLATION, PRICES AND FOOD SECURITY

Introduction

Increasing food prices is an issue of concern for Bangladesh as it affects not only food security and poverty reduction but also has important implications for macroeconomic management. It has been a difficult task for the policymakers to contain the rise in commodity prices and bring the inflation down in recent years. Though food inflation in Bangladesh moderated to some extent between October 2008 and September 2009 (after an accelerated growth throughout 2007 and most of 2008), this has gained momentum in recent times. Prices and inflation have emerged as major policy concerns in the current fiscal year.

This section looks at the inflationary trends and prices in relation to the food security situation in the country over the period of the first few months of FY2010-11. As rice constitutes a major component in the food basket of the people in Bangladesh, behaviour of global and domestic prices of rice have been examined with a view to assess the food inflation situation in the country.

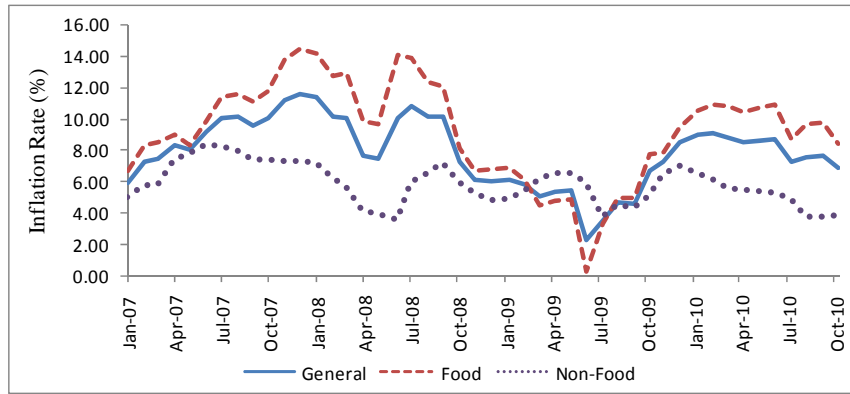
Recent inflationary trend is well above the target

General inflation: point-to-point vs 12-month average: Since the beginning of FY2010-11 national *point-to-point inflation* was on a rising curve. However, in October 2010, it declined to 6.9 per cent which was somewhat higher than that of in October 2009 which was 6.7 per cent (Figure 6). On the other hand, 12-month average inflation rate at the national level has reached as high as 8.1 per cent in October 2010 compared to 5.1 per cent in October 2009 (Figure 7).

Food vs non-food inflation: National P to P *non-food inflation* was consistently decreasing since the beginning of FY2010-11 though it has increased in October 2010. On the other hand, national P to P *food inflation* has decreased notably from 10.9 per cent in June 2010 to 8.4 per cent in October 2010. When compared to the 12-month average, *national food inflation* has reached as high as 9.8 per cent in October 2010 which is the highest ever since February 2009. However, 12-month average *national non-food inflation* is on the decline since July 2010; it has reached 5.3 per cent in October 2010 from 5.5 per cent in July 2010.

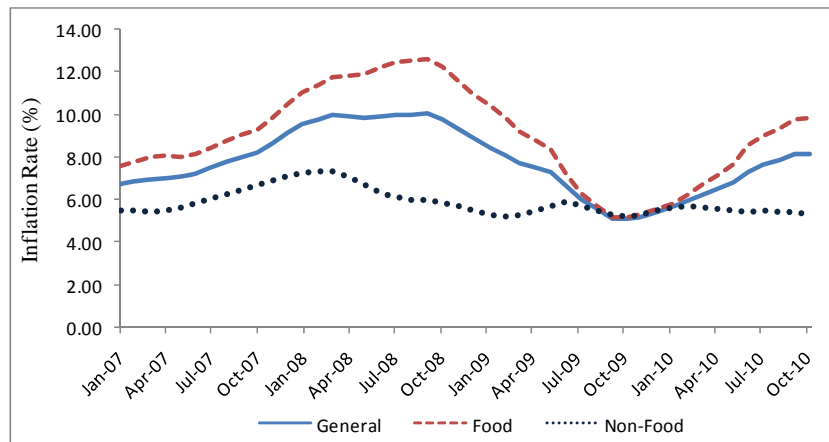
Urban and rural inflation: Rural food inflation has surpassed urban food inflation in August 2010. This atypical pattern has continued until recently. In October 2010, rural food inflation stood at 9.1 per cent which was higher than the urban food inflation rate of 6.8 per cent. However, non-food inflation in the rural areas was marginally lower than that in urban areas in October 2010 which were 3.8 and 4.0 per cent respectively (Figure 8).

Figure 6: Point-to-Point Inflation



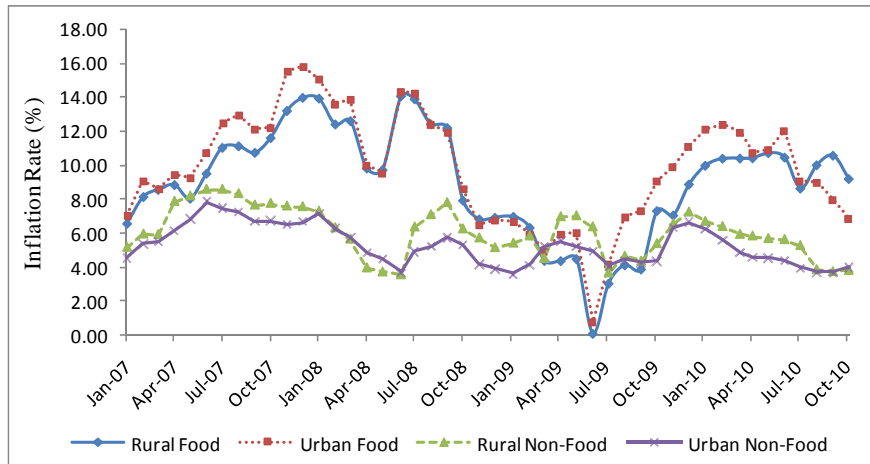
Source: BBS 2010.

Figure 7: Twelve Month Moving Average Inflation



Source: BBS 2010.

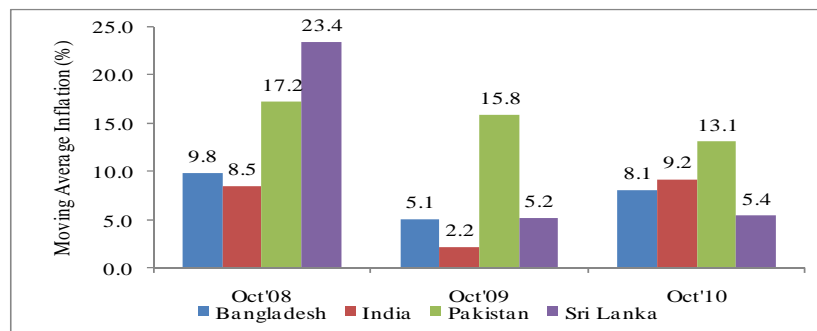
Figure 8: Food vs. Non-food Inflation in Rural and Urban Areas



Source: BBS 2010.

Inflation in South Asia: Except for Sri Lanka, Bangladesh has been experiencing a lower inflation rate compared to her other neighbours. One of the reasons for a higher inflation rate in India could be the high growth in the country compared to Bangladesh. The Indian economy has started to turn around with a growth rate of more than 7 per cent in FY2009-10 with high consumption and aggregate demand. Conversely, the Sri Lankan economy with only a growth rate of 3.5 per cent in FY2009-10 had experienced a low inflation rate. Pakistan epitomises the case of a conflict economy with a high inflation rate and a very low growth rate (Figure 9).

Figure 9: Inflation in Neighbouring Countries



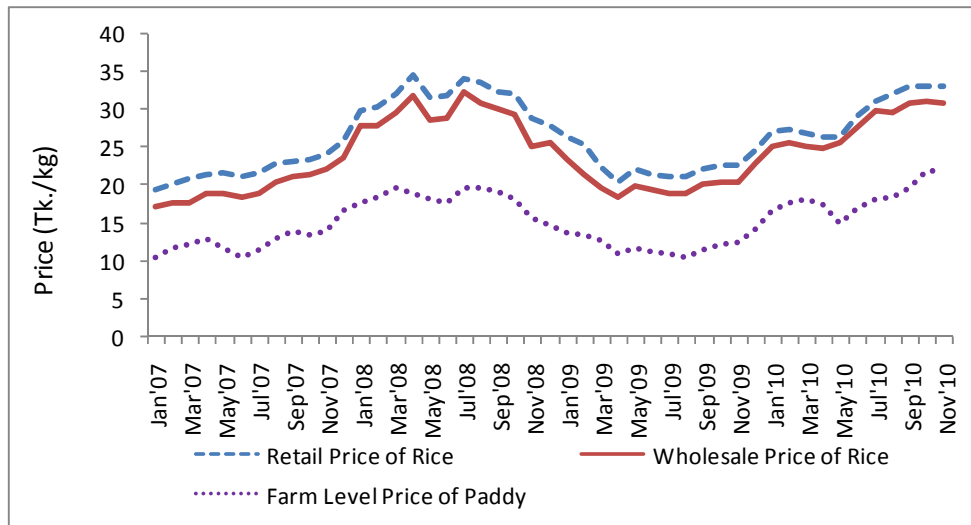
Source: Bangladesh Bank; Reserve Bank of India; State Bank of Pakistan; Department of Census and Statistics, Sri Lanka.

Food prices continue to contribute to high inflation rate

Rice: In the face of rising food prices in the domestic market inflation rate continues to remain high during the first few months of FY2010-11. In recent months, domestic rice prices have been on the rise (Figure 10). In November 2010, average wholesale price of coarse rice was Tk. 30.8 per kg. On the other hand, retail price of rice was Tk. 33.0 per kg. Farm level price of paddy was Tk. 21.8 per kg. Between November 2009 and November 2010, wholesale and retail price of coarse rice in local market has increased by 51.0 per cent and 47.0 per cent respectively, while the farm level price of paddy has increased by 78.0 per cent. However, the gap between the prices of retail and farm level continued to rise throughout November 2009 to November 2010. The difference between farm-gate and retail prices of paddy was 45.6 per cent of the retail price in November 2009 which rose to 64.4 per cent in 2010. This does not indicate enhanced farmers' share in the retail price, rather is suggestive of increased role of the market intermediaries. On the other hand, the coefficient of variation between the gap of farm level and retail level prices was 14.0 during November 2009 to November 2010, which was 11.4 during the comparable periods of 2008 and 2009. This is indicative of increased variability in the price of rice in the local markets.

To reduce the market power of rice millers, in late December 2010, Bangladesh Bank issued a circular to the commercial banks to adjust the loans given to rice mill owners and traders every 30 days; previously this was 45 days. It is to be seen whether this measure will be adequate enough to reduce the monopoly power of millers.

Figure 10: Monthly wholesale and retail price of rice (coarse) and paddy



Source: Department of Agricultural Marketing (DAM).

Wheat: The prices of wheat also experienced an increasing trend in Bangladesh due to the rising prices of wheat in the international market. This was attributed to drought in Russian Federation and Kazakhstan and unfavourable weather in Canada, the EU and Ukraine in FY2009-10. Additionally, Russia had imposed export restrictions on wheat since mid-August and extended the ban to 30 June 2011 to ensure domestic food security. During September 2009 and September 2010 international wheat price has increased by 51.0 per cent. This price hike has been transmitted immediately to Bangladesh where the price of *atta* in local market has increased by 74.0 per cent between November 2009 and November 2010.

Structural factors overrule monetary factors in explaining high inflation

Inflation in Bangladesh has been the result of a number of factors, of both domestic and international nature. Features of inflation in Bangladesh clearly indicate that high food price significantly enhances overall consumer prices. This is largely because food carries a significant

weight in the Consumer Price Index (CPI) of the country. The share of food, beverage and tobacco⁴⁹ is 58.8 per cent in the national CPI of Bangladesh; however, the weight of rice is only 20.1 per cent of total items (BBS 2009).

Over the years the average contribution of food prices to overall inflation has increased (Table 7). For example, in FY2000-01 the contribution of food and non-food inflation in overall inflation was 41.9 per cent and 58.1 per cent respectively. This has reversed in FY2009-10 when the contribution of food and non-food inflation stood at 68.7 per cent and 31.3 per cent respectively.

Table 7: Average contribution of food and non food categories to CPI inflation

Year	General Inflation	Contribution of food to Inflation (%)	Contribution of non-food to Inflation (%)
FY2000-01	1.94	41.86	58.14
FY2001-02	2.79	34.38	65.62
FY2002-03	4.38	46.48	53.52
FY2003-04	5.83	69.94	30.06
FY2004-05	6.49	71.62	28.38
FY2005-06	7.16	63.77	36.23
FY2006-07	7.20	66.28	33.72
FY2007-08	9.94	72.69	27.31
FY2008-09	6.66	63.52	36.48
FY2009-10	7.31	68.66	31.34

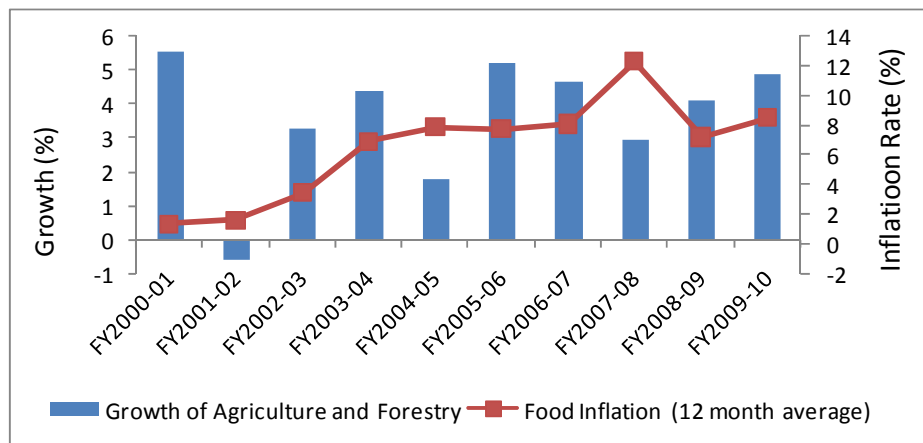
Note: Base: 1995-96=100. Weight: General =100; Food = 58.84; Non-food = 41.16. Contribution of food and non-food is calculated as the share (weight) of food/non-food in general CPI multiplied by food/non-food inflation divided by overall inflation rate.

Source: CPD calculation based BBS data.

As one would expect, growth in the agriculture sector was inversely related to food inflation. Figure 11 reveals that inflation rate (12 monthly moving averages) and growth of agricultural growth followed more or less a similar pattern, i.e. higher supply by the agriculture sector was accompanied by lower inflation rate.

⁴⁹BBS groups food, beverages and tobacco in the category of 'food.'

Figure 11: Growth of Agriculture Sector and Food Inflation



Source: BBS 2010.

However, the inflation dynamics in Bangladesh is probably somewhat more complicated than the abovementioned straightforward relationship. This has partly to do with the confusion related to supply and demand situation of food grains in the country. Available data and a closer look at the balance sheet of foodgrain availability indicate that during the last few years domestic food production exceeded the demand in the country. Consequently, the excess foodgrain supply should have had a positive impact on the country's import. However, in reality the country continued to import foodgrain from the international market at a high price at a time when there was supply-side disruption and increase in the global demand. This apparent paradoxical situation of demand and supply of foodgrain in the country and the food prices raises a number of questions as regards the veracity of the statistics relating to size of the population, per capita food intake and the accuracy in the estimation of domestic foodgrain production. Annex Table 1 presents an estimation of the net foodgrain production in Bangladesh and per capita food availability during the period 2001-2010. It is surprising to note that even after a comfortable level of per capita food availability the rice prices are constantly on the rise in the market. If official statistics are correct, then this situation calls for an investigation into the possible new dynamics emerging in the foodgrain market of the country.

Detailed studies with regard to the determinants of inflation in Bangladesh indicate that monetary and exchange rate policies have significant impact on inflation (Osmani 2007; Mortaza 2006; and Majumdar 2006). Whilst money supply and exchange rates tend to have a significant positive impact on inflationary trend, devaluation of currency was found to have insignificant influence on inflation in Bangladesh (Hossain 2007). Besides, inward remittance, government debt, inflation inertia and food and oil prices are also major determining factors of inflation in Bangladesh (Ahmed undated). Though the role of non-competitive market (syndicate) behaviour is a much-discussed topic which is perceived to have aggravated the inflationary situation in Bangladesh, empirical studies have found divergent results on this. For example, Osmani (2007) did not observe any significant role of non-competitive market behaviour in making commodity prices volatile. Ahmed (undated) and Majumdar (2006) had identified it as a major determining factor behind the high inflation in Bangladesh. In addition to these, it was also found that wage (labour) cost and import cost, along with global and supply shortage of agricultural commodities played an important role in the inflationary behaviour in Bangladesh (Majumdar 2006).

A recent study by CPD (2010) has found clear evidence of a positive relationship between inflation and a number of variables such as broad money supply, foreign reserve, and domestic petroleum price. The study also found that inflation is negatively related to domestic rice production.

Box 5: Findings of the CPD study on determinants of inflation in Bangladesh

This study uses OLS after exploring the time series properties of the model variables to explain the major influencing factors of inflation in Bangladesh and considers demand-pull and cost-push arguments. The study assumes that inflation (CPI, 12-month moving average) is the function of domestic rice production (RP), domestic petroleum price (PP), broad money supply (BM) and foreign reserve (FR) covering the period FY1980-81 to FY2008-09.

To test time series properties, the study uses step-by-step econometric techniques to test unit root (stationarity). Accordingly, DF, ADF, PP and KPSS unit root tests show that all series are integrated in order one. In addition, double-log specified nested regression result reveals the following that can be used to check the robustness of the specified model.

$$\Delta \ln.CPI = 0.005 - 5.46^a \Delta \ln.RP + 0.29^b \Delta \ln.PP + 0.44 \Delta \ln.BM + 0.56^c \Delta \ln.FR$$

$R^2 = 0.36$; Adj. $R^2 = 0.25$; Prob>F = 0.02; ARCH $\chi^2 = 2.90$.

Result shows that inflation in Bangladesh is negatively related to domestic rice production (RP), and positively related to domestic petroleum price (PP), broad money supply (BM) and foreign reserve (FR).

Note: a, b, c represents significance at 1 per cent, 5 per cent and 10 per cent, respectively.

Source: CPD (2010).

Policy responses

The government's policy response to soaring prices and high inflation aims mainly to ensure food availability and to protect the poor from hunger. With this end in view, the major policy initiatives undertaken recently by the government included: (i) enhanced rice and wheat imports from world market through bilateral agreements; (ii) decision not to go for public procurement of rice from the domestic market; (iii) improvement in access to food through expansion of social protection and social safety nets; (iv) improvement in the production situation through various fiscal incentives. Also there have been discrete attempts to control the overall credit flow.

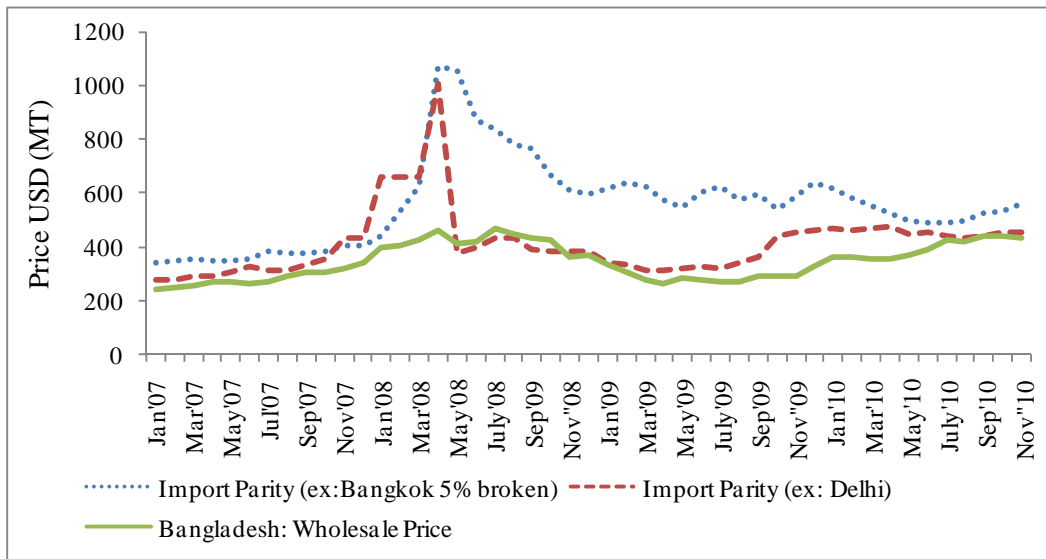
Stock and food procurement situation is not encouraging: As of mid-December 2010 the government had a stock of 7.6 lakh MT⁵⁰ which was 31.0 per cent (11.0 lakh MT) lower than the comparable period of previous year. During the last Boro season, the government procured only 5.6 lakh MT of rice which was lower than the previous season. The GoB has decided not to procure aman rice in the current season since the farmers were getting a good price for the item. Instead of domestic procurement the government plans to collect foodgrains from the international market. Till mid-December the government has imported 5.7 lakh MT foodgrains while the private sector imported another 15.4 lakh MT. Another 5.3 lakh MT foodgrains is in the process of being released from the Chittagong Port at the moment.

However, the present stock is still lower than the standard stock of 1.5 million MT to meet up the demand in the country. Whether the government will import from the international market or not is not clear as yet. Given the volatility of foodgrain production and prices, the government will have to prepare itself well in advance to avoid any disruption in the domestic supply situation.

A comparison of rice prices in Bangladesh, India, and Thailand since January 2007 to November 2010 reveals that rice price in Bangladesh is generally lower than Thailand and also lower than India, with some exceptions. During mid-2007 and mid-2008, rice price in international market was exorbitantly high; prices though started to decline since October 2009 (Figure 12). In November 2010, average wholesale price of coarse rice in Bangladesh was USD 437 per MT which was 22.0 per cent (USD 559 per MT) and 3.6 per cent (USD 453 per MT) lower than the import parity price of Thailand and Delhi. It may be noted here that the gap between local and international prices of rice started to decline since May 2010 as a result of price hike in the local market.

⁵⁰5.5 lakh MT of rice and 2.0 lakh MT of wheat.

Figure 12: Comparison of domestic rice prices in Bangladesh, India and Thailand



Source: Department of Agricultural Marketing (DAM) for Bangladesh; Thailand Rice Exporters Association for Bangkok; and Ministry of Consumer Affairs, Food and Public Distribution, Government of India.

It is thus clear that rice imported from the global market will have to be procured at higher prices. Domestic prices could go up further as inflationary trend is transmitted from the international market. The government may have to go back and review its decision of not procuring aman rice from the domestic market.

Public food distribution situation has eased the pressure on the low income households: In the first few months of current fiscal year, total distribution under the Public Food Distribution System (PFDS) has increased due to higher level of distribution under the priced channels, even though distribution under non-priced channels decreased sharply. During July-November of FY2010-11, the amount of foodgrains distributed under various PFDS channels was about 541 thousand MT against 497 thousand MT distributed during the comparable period of previous year (Annex Table 2). In other words, during the first five months of the current fiscal year total distribution under PFDS was 9.0 per cent higher than that of last year. Distribution through priced channel has observed a significant

rise of 165.0 per cent due to government's intensive open market sale (OMS) and Fair Price drive.⁵¹

In the current fiscal, the government has extended the OMS programme to upazila level at a price of Tk. 24 per kg of rice to enable the low-income group of people to address the hike in food prices.

However, the OMS initiative is facing a number of problems. It is often alleged that dealers are selling the rice in the black market since they could get a net profit of Tk. 5.5 per kg by doing so. The government is reportedly considering introduction of rationing for certain segments of people. It is pertinent to recall that the wide-ranging rationing may lead to widespread corruption and misappropriation. However, government may introduce a *targeted rationing system* for the particular areas such as *char* and *haor* areas, as well as for the industrial workers and low-paid government officials.

Monetary measures are less effective in the current context: Though the Bangladesh Bank has been pursuing an accommodative monetary policy over the recent past (Annex Table 3), it has recently adopted a number of measures to mop up excess liquidity (see Section 2a for details). It is felt that a tighter monetary policy will not be effective in reducing inflationary pressure significantly, given the domestic and international supply situation of foodgrains. However, the emphasis on expansion of agricultural credit to increase production is a welcome step. It is worrisome though to note that the disbursement of agricultural credit has declined during the first five months of FY2010-11. It has increased by only 11.1 per cent though the benchmark growth figure was 25.8 per cent.

Success of fiscal measures will depend on the proper implementation: The government has undertaken a number of fiscal measures in order to reduce the pressure of inflation on the poorer section of the population. Apart from reducing customs duty on commodities, in the budget of

⁵¹During July-November of FY2010-11, an amount of 31 thousand MT of rice has been sold under Fair Price programme. Moreover, 164 thousand MT rice has been distributed through OMS which was only about 1 thousand MT in the comparable months of previous year.

FY2010-11, an allocation of Tk. 4,000 crore has been proposed as subsidy to the agricultural sector. An allocation of Tk. 300 crore has been proposed to expand irrigation facilities in the southern part of Bangladesh by utilising surface water, mitigating water logging problems in the south-west region and widening the area of cultivable land and facilitating multi-crop production through draining out water in *haor* areas. Tk. 412 crore has been allocated as *Agricultural Research Fund* for encouraging agricultural research to enhance agricultural productivity through crop diversification. It is to be seen whether all these measures are going to have any stabilising impact on the market in the coming months.

3.3. POWER AND ENERGY

Addressing the power and energy sector problems remained the most challenging task confronting the present government since the time it assumed power in January 2009. At present, only 48.5 per cent of the total population in Bangladesh has access to electricity and per capita annual consumption rate is a mere 236 kwh, one of the lowest in the world. To mitigate the problem, the government has been taking a number of initiatives, on several fronts, with different degree of success. Whilst some new generation schemes have come on stream, it is worrying that a number of the quick rental and rental plants commissioned as part of the new power plan could not go into production on time. In view of the poor progress of construction works involving some of the other plants which are scheduled to go into production in the first half of FY2010-11, emerging fiscal burden from delay in supply by them also needs to be taken into cognisance. Reducing the power subsidy through adoption of appropriate tariff policy, increasing the level of efficiency in the existing plants, ensuring smooth fuel supply and more intensive exploration of gas and coal resources, are some key policy issues which will deserve attention of the policymakers over the second half of the current fiscal year.

State of Electricity Generation

A total of 1021 MW of electricity has been added to the national grid during the last two years of tenure of the present Awami League Government (Table 8). Out of this 1021 MW new addition, four plants with the total capacity of 300 MW were signed after the present government came to power, and rest were signed during the tenure of the previous caretaker government.

Table 8: List of Power Plants Started Operation since January 2009

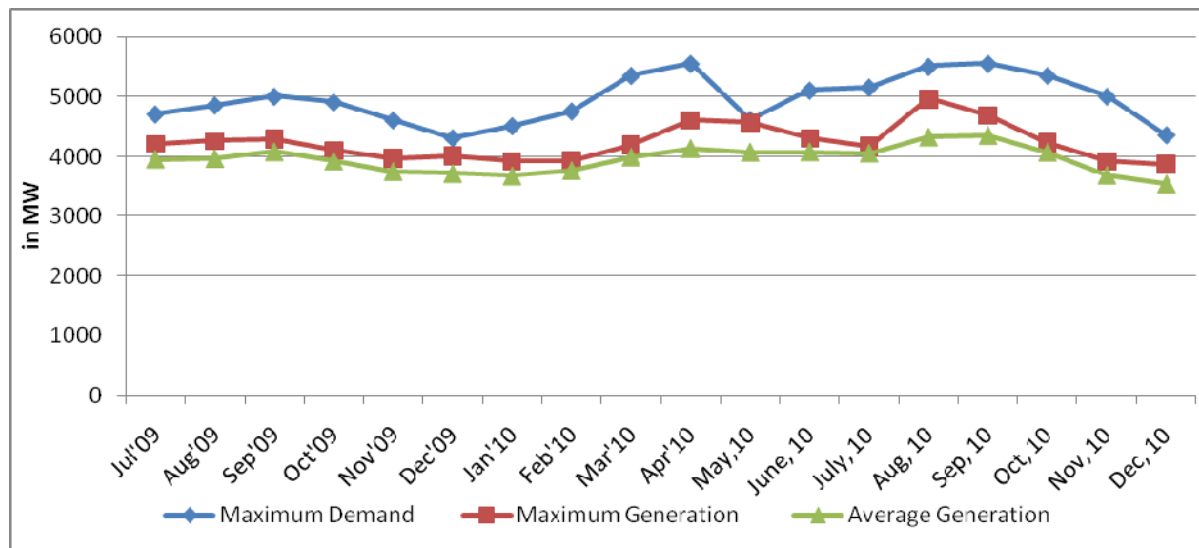
SI	Plants	Type and Company	Capacity (MW)	Contract Signed During	Date of Operation	Fuel Type
1	Habiganj	Small IPP	11	CG	10 Jan, 2009	Gas
2	Shajibazar	Rental (15 Years)	86	CG	9 Feb, 2009	Gas
3	Feni	Small IPP	22	CG	16 Feb, 2009	Gas
4	Ullapara	Small IPP	11	CG	2 Mar, 2009	Gas
5	Kumargaon	Rental (15 Years)	10	CG	15 Mar, 2009	Gas
6	Mahipal (Feni)	Small IPP	11	CG	22 April, 2009	Gas
7	Mou na, Gazipur	Small IPP	33	CG	12 May 2009	Gas
8	Madhavkunda	Small IPP	22	CG	23 May, 2009	Gas
9	Rupganj, N'ganj	Small IPP	33	CG	9 June, 2009	Gas
10	Jangalia (Comilla)	Small IPP	33	CG	25 June, 2009	Gas
11	Bhola	Rental (3 Years)	33	CG	12 July, 2009	Gas
12	Fenchuganj	Rental (15 Years)	51	CG	18 Oct, 2009	Gas
13	Ashuganj	Rental (3 Years)	55	CG	7 April, 2010	Gas
14	Shikalbaha	Rental (3 Years)	55	CG	6 May, 2010	F. Oil
15	Thakurgaon	Rental (3 Years)	50	AL	2 Aug, 2010	HSD
16	Khulna	Quick Rental (3 Years)	55	AL	10 Aug, 2010	HSD
17	Ghorashal	Quick Rental (3 Years)	145	AL	10 & 23 Aug, 2010	HSD
18	Shikalbaha	Peaking Plant	150	CG	8 Sept, 2010	Gas
19	Shiddhirganj	Peaking Plant	105	CG	15 Oct, 2010	Gas
20	Pagla, N'ganj	Quick Rental (3 Years)	50	AL	24 Nov 2010	HSD
Total			1021			

Source: BPDB, 2010.

CG= Last Caretaker Government, AL = Present Awami League Government

The average supply of electricity since July 2010 was low, 4008.56 MW⁵², against an estimated demand of 6000 MW with, and 7000 MW without, demand side management (DSM). Out of the reasons why the present average power generation remained lower since October 2010 than the first three months of FY2010-11 (Figure 13), frequent retrofitting and overhauling activities involving a number of aged plants and shortage and diversion of gas to resume fertilizer production for *Boro* season, are most important. It may be noted here that about 600 MW of electricity generation capacity could not be used due to shortage in gas supply.

Figure 13: Gaps between Maximum Demand, Maximum Generation and Average Generation



Source: BPDB, 2010.

Quick Rental: How Quick?

Under the newly unveiled power plan⁵³, a total of 32 plants with 12000 MW generation capacities by 2015 have been envisaged, out of which only 300 MW⁵⁴ is currently in operation and the rest are still in the generation phase. Under the plan, by April 2011 an additional 1350 MW of electricity is to be

⁵²Considering the average production for the period of 1 July 2010 to 31 December 2010.

⁵³"Towards Revamping Power and Energy Sector: A Road Map" unveiled in the conjunction with the FY2010-11 national budget.

⁵⁴Including 50 MW capacity quick rental plant at Pagla, Naryanganj.

added to the national grid from quick rental and rental plants. However, production schedule with regard to plants which were supposed to start their production by 2010 has been quite disappointing. Four plants (of 415 MW total capacities⁵⁵) have already failed to start their production by December 2010 as was planned earlier.

Table 9: Progress of quick rental and rental plants expected to start production within April 2011

Plants	Type and Company	Capacity (MW)	Contract Signed on	Date of Operation	% of works completed	% of works supposed to be completed
Bheramara*	Rental	110	4/2/2010	Nov, 2010	95	100
Noapara*	Rental	105	4/6/2010	Nov, 2010	49	100
Shiddirganj*	Q. R., Desh Energy	100	4/7/2010	Nov, 2010	70	100
Meghnaghat*	Q.R., HPGL	100	28/6/2010	Dec, 2010	35	100
Gorashal	Q.R., Max Power	78	27/10/2010	Feb, 2011
Barisal	Rental	50	15/2/2010	March, 2011	6	68.75
Madanganj	Q.R., Summit Power	102	23/6/2010	March, 2011	42	50
Meghnaghat	Q.R., IEL	100	30/6/2010	March, 2011	38	53.33
Khulna	Q.R., KPCL	115	23/6/2010	March, 2011	28	50
Keraniganj	Q.R., Power Pack	100	8/7/2010	March, 2011	15	47.06
Amnora	Q.R., Sinha Power	50	15/7/2010	April, 2011	23	41.67
Nowapara	Q.R., Khan Jahan Ali	40	25/7/2010	April, 2011	20	40.56
Julda	Q.R., Acorn Infra SL	100	6/7/2010	April, 2011	16	42.11
Shiddirganj	Q.R., Dutch-Bangla P	100	1/7/2010	April, 2011	25	47.22
Katakali	Q.R., NPSL	50	27/7/2010	April, 2011	30	37

Source: BPDB, 2010,

* indicates the plants which have failed to start production in due time (till December 2010)

In addition, overall work progress of a number of under-construction plants is also not very

encouraging⁵⁶. The progress of construction involving 12 quick rental plants of 1035 MW capacity and 3 rental plants of 265 MW capacities, which are supposed to start production by April, 2011 has been behind schedule (Table 9).

- For base case total fiscal burden between FY2011 to FY2015 is estimated to be Tk. 23,125 crore
- For an increase of tariff rate by 5.75 per cent per annum total fiscal burden is supposed to be to the tune of Tk. 19,115 crore
- For a per year increase of tariff rate by 12 per cent the fiscal burden is estimated to be about Tk. 15,375 crore

⁵⁵110 MW Bheramara Rental, 105 MW Jessore Rental and 100 MW Shiddirganj Quick Rental plants.

⁵⁶For many plants the progress is beyond satisfactory and just cannot start their operation by due date if they continue their normal construction process.

As is known, the government has already imposed a penalty of Tk. 57 crore on two rental power companies⁵⁷ for failure to meet contractual obligations on time. However, mere imposition of penalty cannot actually compensate for the actual economic loss and foregone opportunities.

Rationalisation of Power Tariff

An earlier CPD-IRBD exercise has attempted to estimate fiscal burden of the government arising from implementation of the new power plan, under various tariff scenario. These

Out of the 12 quick rental power plants currently under construction and that are supposed to start production by April 2011, one plant lagged behind the construction schedule by a reachable distance (0-25 per cent work left, considering equal rate of work completion per month), four within moderately high distance (26-50 per cent), two were significantly lagging behind (51-75 per cent) and two were lagging behind by a long distance (above 75 per cent).

ranged between Tk. 2,500 crore to over Tk. 5,000 crore per annum.⁵⁸

The bulk tariff rate charged by the government to power distribution companies was Tk. 2.37/kwh in June 2010. Ceteris paribus, increase of only the fuel cost for power generation is likely to push the per unit bulk rate to Tk.3.62 in FY2010-11, Tk.4.41 in FY2011-12 and Tk.4.98 in FY2012-13. Compared to the present bulk tariff rate, in FY2012-13, the rate will need to be increased by about 110.0 per cent to cut the subsidy burden. To check huge loss by the power distribution companies, there is a need to raise retail tariff rate by an equivalent amount within FY2012-13. The proposal of BPDB is to increase the bulk tariff rate by 12 per cent every six months till 2014. Whilst from medium term perspective power tariff will need to reflect market price, there ought to be some differentiation in the system to accommodate purchasing power concerns of the poor. Along with rationalisation of the tariff structure, it is also important to raise the efficacy of the tariff collection system. CPD believes that the proposal made by BPDB will minimise power subsidy significantly.

⁵⁷Tk. 51.7 crore on the Quantum Power Ltd. in failing to start 215 MW capacity plant at Bheramara and Tk. 5.25 crore on Desh Energy for its 100 MW plant at Shiddhirganj.

⁵⁸For details please refer CPD's IRBD Series for FY2010.

Fuel Supply and Management Issue

At present about 89 per cent of power generation in Bangladesh is based on natural gas. However, such dependence on gas for power generation is likely to decline gradually in the face of increasing emphasis on diesel and furnace oil-fired quick rental and rental plants during FY2010-11 and FY2011-12. At present, daily demand for gas for power generation is estimated to be 463.9 bcf for the year 2010 (including all dual-fuel plants and those which ceased operation due to technical faults and overhauling). Considering the average rate of gas consumption and to implement the target of producing additional 11,500 MW of electricity in the country within 2015, the government has made a conservative estimate of gas demand by different sectors in the country over the next five years (Table 10).

Table 10: Conservative Estimates of Sector-wise Demand of Gas b/t FY2010 to FY2015 (bcf)

Sector	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Power	278.2	300.5	324.5	50.5	378.5	415.8
Captive Power	120.9	142.6	164	188.6	216.9	238.6
Fertiliser	94	94	94	94	94	94
Industry	133.9	160.7	184.8	214.4	246.5	271.1
Household	88.9	99.5	111.4	124.8	139.8	153.8
CNG	37.2	44.7	51.4	56.5	113	124.3
Others	30	30.8	31.9	32.7	33.7	37.4
Total	783.1	872.8	962	1061.5	1222.4	1335

Source: Ministry of Finance, 2010.

Given the increasing demand of gas in the country, the overall supply situation has remained quite disappointing (*for detail see the later part of the section*). On an average 40 to 41 per cent⁵⁹ of the total gas produced in the country is supplied for power generation.

⁵⁹Currently (December 2010 – January 2011), about 33 to 34 per cent of the total gas produced is supplied for power plants. Due to increasing demand by the fertiliser plants (about 12-13 per cent) for the upcoming *Boro* season, the supply of gas for power has been reduced by about 12 to 13 per cent.

As the number of liquid fuel-based power plant is increasing, demands for diesel and furnace oil are increasing as well. The demand for diesel for power generation was 15,525 MT in the month of November 2010 which is expected to shoot up to 21,658 MT in December, 2010 and to 42,000 MT from July 2011. On the other hand, demand for furnace oil in December 2010 was found to be 9,454 MT, which is expected to increase to 88,495 MT from July 2011.⁶⁰ Given the huge demands for diesel and furnace oil for rental and quick rental plants, it is important to ensure smooth supply of fuel for uninterrupted operation of power plants.

Railways and waterways are two key transportation systems for fuel supply. In view of the rising demand for fuel, overall transportation and storage capacity is lagging behind considerably in the present context. At least a total of 800 new wagons and 10 additional engines for railways will be needed in view of the emerging demand. Given the present poor fuel carrying capacity by Bangladesh Railways, it is critically important to increase its carrying capacity by raising the number of wagons, developing more railway tracks and increasing number of goods engines.

There is also a need to undertake dredging of river-beds to keep open the riverine transportation channels to increase the navigation capacity. It is to be noted that the government has already taken some important initiatives to facilitate smooth transport of diesel and furnace oil for rental power plants. There is also a need to put in place adequate human resource development initiatives for efficient fuel supply.

Medium Term Issues

Transmission and Distribution System: The FY2010-11 budget envisaged a number of initiatives to improve power transmission and distribution systems in the country. These include developing another 837 km of power grid lines and more than 15,000 km of distribution lines, as well as

⁶⁰Number of rental and quick rental power plants are expected to start their productions by 2011.

constructing 17 more sub-stations across seven divisions in the country. In view of the need for smooth supply of power at the consumer end, this is of crucial importance. Moreover, for the period beyond 2012, when the government's plan envisages surplus power generation, there is also a need to develop required storage capacity and develop KVA transmission lines in the country immediately in view of planned coal-fired plants.

Import of Electricity from India: In order to import electricity from India, work on setting up of a grid sub-station at Bheramara and construction of 40 km long transmission line linking India's national power grid with the Bangladesh one have already been initiated. If things go smoothly, by 2012 at least 250 MW of electricity can be imported from India. But just to develop the required infrastructure the cost is estimated to be a whopping Tk. 1,400 crore. Experts opine that a brand new power plant of 500 MW capacity could be installed by an investment of only Tk. 1,100 crore, a much cheaper option. On the other hand, talks have been initiated with Bhutan, Myanmar, Nepal and Tripura to arrive at similar agreements but nothing concrete has come out yet.

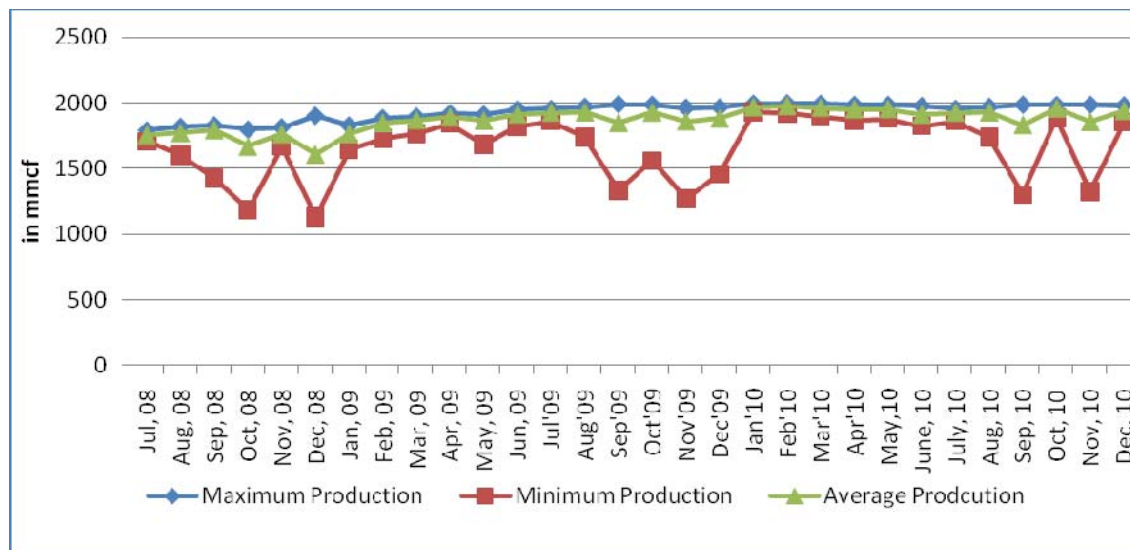
Energy Sector

There is yet to be a significant turnaround as far as the energy sector was concerned. An attempt here has been made to evaluate the current state of gas and coal exploration and exploitation.

Gas: Against the total reserve of 20.6 tcf in 23 fields, about 2000 mmcf gas is at present extracted daily from 79 gas-wells, equal to 710 bcf of gas extraction per year. Till date, about 9.0 tcf of gas has already been extracted in Bangladesh. Current production capacity by the international oil companies (IOCs) is about 52 per cent of the total from 31 producing wells, including 600 mmcf by Shevron from Bibiyana field. Compared to a demand of 2,500 mmcf, the average gas supply situation

has remained stagnant (below 2000 mmmcf) since July 2009⁶¹ (Figure 14). The current gas shortage is about 500 mmcf, i.e. about 20 per cent shortfall in view of the daily demand. Moreover, the annual demand for gas is increasing by over 10 per cent in recent years (after 2008).

Figure 14: Monthly Gas Supply Situation since July, 2008



Source: Petrobangla.

Petrobangla has taken some initiatives to improve gas supply situation by conducting 3D seismic surveys in *Hatia* and *Magnama* under Block No. 16. For other fields such as *Titas*, *Fenchuganj* and *Rashidpur*, it is envisaged that the estimates will be revised upward. For *Rashidpur*, a 3D seismic survey is now being conducted. The possibility of discovering more gas fields in the *Netrokona-Sunamganj* belt is very high. Besides BAPEX has started drilling a well at *Sundalpur* after six long years; it is going to start another two exploratory well drilling at *Srikail* and *Kapasias* in 2011. It is also expected to undertake further operation to reassess the reserves in *Titas*, *Fenchuganj* and *Rashidpur* by next year. A re-assessment on *Bibiyana* gas field has confirmed the reserve at 5 tcf (double the earlier estimate). Regrettably, not much has been done regarding bidding for the undisputed

⁶¹Since 2009, additional 372 mmcf gas production has been increased in the country, including about 240 mmcf from Bibiyana. But the increase since July to December 2010 is a mere 114 mmcf.

offshore blocks, excepting some preliminary discussions to sign PSCs with Conoco Phillips and Tallow (Block No. 10, 11 and 5) was carried out during the time of the Caretaker Government of the immediate past. Despite some discussions by the current government, there has not been any breakthrough in that regard. The Petrobangla expects to meet the ongoing demand-supply gap by end of 2012 or early 2013. However, under the present scenario this appears to be highly challenging.

Coal: With regard to the coal issue, except finalisation of the draft of Bangladesh Coal Policy 2010, significant initiative is yet to be seen. The possibility of generating power using indigenous coal reserves⁶² has remained unrealised because of dearth of initiatives in this regard. On the other hand, four thermal power plants, two each at *Anwara, Chittagong, Rampal* and *Bhagerhat*, with a total of 2600 MW generation capacity, in collaboration with NTPC of India, is expected to go into operation, using imported coal, by 2015. At present the country doesn't have the required infrastructural facilities for importing coal by sea and this is true for others too. Developing such infrastructure will require huge resources. It will also be every expensive to transport coal from Northern Bangladesh to these sites if government decides to use local coal instead of imported coal in future. As the plants are expected to go into operation by 2015, it could be a wise decision to start at least one of the thermal plants somewhere in the North Bengal by using local coal. This could not only save substantial foreign currency arising out of import of coal but also create a base to start larger thermal power plant in near future using local coal resources.

Against this backdrop, there is a need to accelerate gas exploration both in the offshore and the remaining onshore blocks immediately. It is possible to increase extraction of gas by drilling additional development-wells in large sites such as *Titas, Fenchuganj* and *Rashidpur*. Besides

⁶²The country has a reserve of about 3 billion MT of coal equivalent to 27 tcf of natural gas. It is estimated that this may be used to produce 10,000 MW of electricity over the next 50 years.

rationalisation of gas price⁶³, there is also a need to increase gas transmission and compressor facilities across different important locations in the country. In this context, the proposed gas plan⁶⁴ needs to be finalised soon. On the other hand, coal extraction for power generation is of utmost importance at present. It is also advisable to increase coal extraction at Barapukuria site to strengthen generation capacity at the site.⁶⁵ Also the government may give careful consideration to proposals made by such firms as Mitchell Group of Australia, to increase coal-fired power generation in the country. A medium term strategy for the use of Bangladesh's coal resources has assumed critical importance as this is interlinked with the investments that will need to be made at present.

Proposals for Power Sector Development

- a. Besides current practice of imposition of penalty in case of delay in power supply, the government may also consider additional penalty for the defaulting enterprises in case they fail to start delivery by more than 3 months and rewards for early providers. The government may also consider setting up a 'Citizen's Forum' with participation of civil society representatives and power sector experts to monitor the implementation of planned activities.
- b. Power tariff rationalisation will need to be undertaken periodically, taking into consideration the need for reducing the looming fiscal burden. Gas price rationalization may also be considered to increase gas use efficiency.
- c. Retrofitting the aged power plants demands serious policy attention to increase their level of efficiency. Introduction of smart grid for efficient power generation, transmission, distribution and end-use demands should also be given high priority in the policy agenda.
- d. There is a need to start drilling more development-wells in the existing gas fields, on an urgent basis, to improve gas extraction situation. Besides BAPEX, contract signing MNCs like Chevron,

⁶³Rationalisation of gas pricing needs immediate policy attention. This should be adjusted upward soon.

⁶⁴Under this plan the government is expecting to double the daily gas production by strengthening the capacity of BAPEX and increasing involvement of the private sector players, including the IOCs.

⁶⁵At present the generation capacity at the Barapukuria thermal power plant is 220 MW against its maximum capacity of 250 MW.

Tallow and Santos should be induced to increase their extraction by drilling more development-wells.

- e. Further delay in off-shore gas exploration will exacerbate the crisis situation in the long term.

Government needs to finalise discussions with companies like Conoco Phillips and Tallow and go for further bidding for the remaining uncontested blocks.

- f. Coal-based power generation using indigenous coal needs to be given highest priority. There is a need to increase power generation capacity at the Barapukuria thermal power plant besides ensuring its full generation capacity. Adoption of new technologies to produce clean coal-power by underground coal gasification (UCG) using coal from the unmineable parts at Barapukuria or Jamalganj needs to be given careful consideration.

3.4 RECENT TRENDS IN THE CAPITAL MARKET

The capital market in Bangladesh is increasingly coming under scrutiny as it is detracting from its core purpose i.e. raising equity for industrial activities. It is maintained that *recent growth in the capital market is difficult to relate to the growth of real economy, rather it is indicative of inadequate investment opportunities in productive sectors, short-term speculative trading behaviour underpinned by market irregularities and anomalies, weak oversight functions of regulatory bodies and poor policy framework for the financial sector.* From this perspective, four key issues may be highlighted in the context of the current state of affairs in the sector. These are: a) lack of investment opportunities in productive sector; b) poor governance in the capital market; c) market manipulation; and d) anomalies in the financial sector.

Since FY2005-06, stock market related indicators have registered significant rise⁶⁶; these trends have continued in FY2010-11. Between July 2010 and December 2010, DSE General Price Index (DGEN) has registered a growth of 34.7 per cent, market capitalisation has increased by 29.5 per cent and Price Earnings (P/E) ratio has increased to 26.3 (Table 11). Overall market capitalisation at the end of December, 2010 was as high as 51.5 per cent of GDP, which was 38.5 per cent of GDP even in June, 2010. Market related factors such as issuance of the highest number of Initial Public Offerings (IPOs) in FY2009-10⁶⁷, entry of large number of small investors in the market with large volume of liquidity and revealed market anomalies in an inefficient market can only explain a part of this growth.⁶⁸

Table 11: Major Indicators related to the Stock Market: FY2008 to November, FY2011

Indicators	FY08	FY9	FY10	FY11 (Jul.-Dec.)	% Change		
					FY09 over FY08	FY10 over FY09	FY11 over FY10 (Jul.- Dec.)
DSE General Index	3000.5	3010.26	6153.68	8290.41	0.33	104.42	89.24
No. of listed securities	378	443	450	445	17.2	1.58	7.23
Total number of companies	271	282	243	246	4.06	-13.83	4.24
Market capitalisation (billion USD)	14.07	19.02	38.51	49.86	35.18	102.47	86.11
Issued capital (million USD)	4149.71	6634.94	8755.02	9220.5	59.89	31.95	22.16
Turnover (million USD)	47.97	136.55	273.53	233.77	184.66	100.31	76.74
Market P/E	22.8	18.44	24.08	26.29	-19.12	30.59	2.50
GDP at current price(billion USD)	79.56	89.36	98.75	101.22	12.31	10.51	7.61
Market capitalisation as % of GDP	17.68	21.28	38.5	51.52	20.36	83.22	80.90
No. of IPOs	12	14	21	9	16.67	50	28.57
% of over-subscription for IPOs	-	94	93.6	-	-	-0.43	-
Growth of total investment	14.31	13.4	12.23	-	-	-	-

Source: Based on information available in the websites of DSE and Ministry of Finance, GoB.

⁶⁶Between FY2005-06 and FY2009-10, DSE General Price Index has increased by about 200 per cent.

⁶⁷During FY2009-10, a total of 21 IPOs were offloaded in the market.

⁶⁸Anomalies in the capital market usually indicate the distortion in price and return of shares. Various kinds of market anomalies are observed in an inefficient market, such as fundamental anomalies (e.g. value investing), technical anomalies (e.g. moving averages, trading range break), calendar based anomalies (e.g. year-end effect, turn of the month effect, opening day of the week effect), and other anomalies (data mining, size effect, announcement based effects and post-earnings announcement draft, insider trading, stock buy-back). These kinds of anomalies occur because of structural factors such as unfair competition, lack of transparency, regulatory actions etc. and behavioural biases by economic agents. (See, <http://schwert.ssb.rochester.edu/hbfech15.pdf>).

Lack of investment opportunities in the productive sector

a) Lack of investment opportunities in the productive sector and presence of excess liquidity

Growth of investment in the productive sectors experienced a slow down during the recent years mainly because of adverse impact of the global recession, and crisis of energy and power. A large number of export-oriented and other industries are struggling to secure their return on investment. Private investment during FY2009-10 was Tk. 1362.8 billion (i.e. 19.7 per cent of GDP), with the lowest level of growth over the last five years (12.7 per cent). As a result, a large volume of investible surplus was available in the banking sector (Tk. 28849 crore at the end of October 2010). Banks had been offering modest rate of interest (7-10 per cent) on various savings instruments such as time deposit, wage earner's bond and NSDs, which in the face of growing inflation meant that in real terms yields on these instruments was significantly low.⁶⁹ Small savers, who are the main investors in these savings instruments, were further discouraged because of reduction of deposit rates of NSD certificates and interest rate of wage earners' bonds as well as imposition of tax at source on interest income and cancellation of automatic re-investment of wage earners' bonds. Net investment in NSD certificates has declined by 49 per cent during July-September 2010, while it was as high as 270 per cent for the comparable period of the previous year.⁷⁰ Consequently small savers were prompted to look for alternate investment opportunities, more specifically in the capital market.

Investment in the capital market, particularly short term trading in small size securities is found to be profitable compared to that of long term investment in the stock market as well as investment in various savings certificates including the NSD certificates. This is evidenced by empirical data. According to Table 12, investors received relatively higher rates of return for long term investment in

⁶⁹According to the data of October, 2010, general inflation rate was 6.9.

⁷⁰Investment in Family Savings Certificate, a newly introduced savings instrument, has registered growth during July-September 2010. One of the reasons for investment in this instrument is the opportunity of tax-free income.

the capital market. More than 80 per cent companies holding Annual General Meeting (AGM) in recent years have offered a return which was higher than that on savings certificates. Besides, 22 per cent of the companies holding AGM, offered right shares during FY2009-10. However, in some instances companies could not hold AGMs in due time and did not offer return to their investors which indicate risks associated with long term investment.

Table 12: Return to Investment in the Capital Market for Over One Year

Type of Benefit	FY2007-08		FY2008-09		FY2009-10	
	No of companies	Cumulative share (%)	No of companies	Cumulative share (%)	No of companies	Cumulative share (%)
Right share		0	3	1	25	22
50% and Above	23	12	30	14	20	41
40%-49%	5	15	12	20	2	43
30%-39%	34	34	40	37	9	51
20%-29%	36	55	38	54	18	67
10%-19%	56	86	80	90	21	87
1%-9%	14	94	11	95	7	93
No dividend	10	100	11	100	7	100
Total companies held AGM	178		225		109	
Total Number of Listed companies	271		282		243	

Source: CPD Estimates, 2010.

Short-term return on trading appears to be much higher as is revealed from the estimation of capital gains of DSE 20 and Z category shares (Table 13). Although the return on a number of shares was negative which indicates the related risks associated with short-term trading of shares, on average return to blue chips and Z-category shares was considerably high. This may be true for other categories of shares. Low risk with high return in case of short term trading has acted as a 'pull factor' and has encouraged investors (mostly small investors) to divert funds from other sources to the stock market.

Table 13: Potential Capital Gain on Different Categories of Shares

Year	FY2007-08			FY2008-09			FY2009-10		
	Highest	Average	Lowest	Highest	Average	Lowest	Highest	Average	Lowest
DSE20	345.98	93.58	-21.51	99.39	11.78	-31.85	184.32	48.73	-25.85
Z- category	371.43	100.3	-6.82	330.77	78.68	-34.87	2198.73	341.1	-29.93

Source: CPD estimates, 2010.

Note: Potential capital gain of DSE 20 and shares of Z category is the difference between share prices of the first day and closing day of trading in the fiscal year.

b) Huge inflow of new investors in the stock market eager to participate in the ‘Keynesian Beauty Contest’

In recent years there is an unexpected rise in the number of investors in the stock market. Total number of Beneficiary Owner (BO) account holders till 20 December, 2010 was 3.21 million.⁷¹ This number increased by 154 per cent between January to December 2010.⁷² A large part of these investors have little knowledge about the market and participate in trading as if they are participating in a ‘Keynesian Beauty Contest’.

A number of factors have facilitated the influx of investors to the stock market, such as opening of brokerage houses in various districts (590 branch offices of 238 brokerage houses of DSE are currently being operated in 32 districts)⁷³, organization of ‘share mela’ in different districts and introduction of internet-based trading operation. Also market-related information are now easily accessible through electronic and print media as well as internet. According to a number of studies

⁷¹About 99.7 per cent are individual account holders and the rest are companies. The participation of non-resident Bangladeshis was 4 per cent of total BO account holders.

⁷²Number of account holders in December 2009 was 1,259,320.

⁷³215 branch offices of 148 brokerage houses are currently being operated in the CSE.

(Tetlock (2007); Tumarkin and Whitelaw (2001)⁷⁴), a large number of investors are now participating in short-term trading. Besides, prediction about future flow of funds to the stock market is encouraging investors to participate more in the short-term trading.

Poor governance of the capital market

a) Weak Performance of the Regulatory Authority

The capacity of the Securities and Exchange Commission (SEC) appears to be inadequate in ensuring market regulation of the type that is required in view of the current scale and scope of the country's stock market. Various market regulating instruments⁷⁵ made use of by the SEC often appears to lack both appropriateness and effectiveness from the perspective of providing the required stewardship in the market.

There are several reasons for this observation. *First*, frequent changes in the rules by the SEC concerning margin loans have led to volatility during the 'buffer period'. This has also led to confusion with regard to the method of calculation of the margin. *Second*, application of lock-in period in case of sale of placement shares is not being properly maintained; rather in a number of incidence the rule has been relaxed. *Third*, floating of right shares is increasingly becoming a way of mopping up money from the market.⁷⁶ A total of Tk. 2,014.5 crore was raised by 16 companies by way of issuance of right shares between July 2010 and second week of December 2010.⁷⁷ *Fourth*, lack of expertise in the area of competent examination of audited reports of listed companies, submitted in support of revaluation of assets, is a major operational weakness of the SEC. A number

⁷⁴See, <http://pages.stern.nyu.edu/~rwhitela/papers/internet%20faj01.pdf>;
<http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.115.3757>;
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=685145;

⁷⁵These include changes in margin loan ratio, application of lock-in period, use of circuit breaker, taking punitive measures against illegal operations of market players, and in extreme cases, delisting the companies from the stock market.

⁷⁶One of the reasons for floating of right shares by the companies was the compulsion to comply with the requirement of minimum paid-up capital as per the rules of *BASEL II* and the *Insurance Act*.

⁷⁷During FY2009-10, only two companies raised capital through offering of right shares which was to the tune of Tk. 716.22 crore.

of companies have used the method of revaluation of assets with a view to raising the share prices and thereby to collect additional funds from the market. *Fifth*, SEC has taken an inordinately long time to implement the guidelines set by the International Organisation of Securities Commissions (ISCO); because of the delay to apply these guidelines share prices of a number of listed companies have experienced unusual volatility.⁷⁸ *Sixth*, because of weak monitoring and surveillance system, the SEC is not suitably equipped to take actions against the incidence of possible insider trading in the market. *Seventh*, although price-sensitive information is supposed to be made public through daily trading operations, often such information is leaked out earlier or rumours are purposefully spread to influence the market behaviour.

b) Weak Institutional Capacity

SEC at present has to work with limited office staff, with lawyers who in many instances lack the required competences; SEC also has to work without chartered accountants.⁷⁹ With its limited human resource capacity SEC is able to monitor only two brokerage houses in a month. Moreover, SEC has no surveillance software of its own; rather it uses the softwares of DSE and CSE to monitor the market. Proper surveillance of transactions often becomes difficult because SEC has to depend on the support of others.⁸⁰ SEC is yet to initiate the project titled *Improvement of Capital Market* which includes a component of support to purchase a high-powered computer software for monitoring and surveillance operation.⁸¹

⁷⁸Without taking the approval of the SEC from 1 July 2010 DSE has started to compute share price index of 24 newly listed companies by taking consideration of free floated shares, although market capitalization of all shares should have been taken into account.

⁷⁹There are 134 staffs in the SEC of which only 47 are officers. Four persons are currently working in the law department of the SEC to support the lawyers on different legal issues.

⁸⁰The automated trading was initiated on 10 August 1998, while DSE 20 Index was introduced on 1 January 2001. The Central Depository System was initiated on 24 January 2004.

⁸¹Asian Development Bank (ADB) has allocated USD 3 million for this project. The main objective of this project is to improve technical, operational and management capability of the stock and insurance markets. The project includes, among others, purchase of high-powered computer software for monitoring and surveillance operation in the market (which costs USD 0.3 million). The project is supposed to be started in 2007 and to be ended in 2011.

The nature of relationship maintained by the SEC with the Ministry of Finance⁸² is not helpful for the market (e.g. face value harmonisation issue).⁸³ The Parliamentary Standing Committee for the Ministry of Finance in certain cases has taken an ‘adversarial position,’ thus creating unwarranted pressure in the operation of the SEC and the capital market.

The operation modalities of the DSE and CSE, on the other hand, are being questioned on many accounts. *First*, the software used in case of daily trading in DSE is alleged to be ‘faulty’ as all the trading baskets cannot open at a time, and it requires some time to get access to all the baskets after the trading starts at 11 am. To adjust such delays CSE has introduced the so-called ‘pre-hour transactions.’ *Second*, there is a possibility of interruption of daily trading at DSE even if a few branches of brokerage houses do not operate properly due to technical problem. *Third*, often the directives of the SEC related to trading are found to be difficult to implement because of lack of updated softwares in the DSE.⁸⁴ While DSE needs to invest more on improvement of its trading softwares, it has come under criticism for its investment in land purchase, for establishing a resort, raising questions about its allocative priorities.⁸⁵ *Fourth*, there is a clear conflict of interest between DSE management board and brokerage houses as owners of different brokerage houses are also the members of DSE management board.

⁸²SEC is a statutory body and is attached to the Ministry of Finance.

⁸³A consultative committee of SEC proposed to harmonise the face value of all listed securities at Tk.10. However, the proposal was in limbo because of no guideline for few months from the Standing Committee of the Ministry of Finance. The proposal was revised several times, and it was finally decided that all new companies will off load their shares at Tk.10 while the existing listed companies may fix the face value at Tk.10 upon receiving the approval of the board of directors of the company.

⁸⁴Software used by the members is not updated.

⁸⁵Interestingly, the building of DSE where transactions take place is found to be risky, as mentioned by the Bangladesh Fire Service and Civil Defense.

Market Manipulation

A number of irregular practices have been reported in various national dailies which indicate market manipulation by a number of bull cartels.⁸⁶ It is alleged that these bull cartels comprise of only a limited number of people including some members of DSE/CSE, officials of SEC, political leaders, big businessmen, officials of financial institutions, and owners of brokerage houses. Various incidence has been reported in the newspapers as regards manipulating practices such as operation of curb market in case of offering placement shares of IPOs, lifting of lock-in period in favour of selected companies, speculative trading of 'Z' category shares to artificially raise share prices, use of book building system through syndicated practices (see Box 6), fake transactions through brokerage houses, and access to price sensitive information prior to public announcement.⁸⁷ Because of weak surveillance and monitoring system, SEC is usually unable to prevent such illegal practices.

Box 6: Book Building System - Who is getting the benefit of the system?

Introduction of book building system in the recent past has regrettably, in some cases, turned out to be a tool for manipulating market prices. Instead of ensuring competition among big investors during the 'price discovery' stage, it is alleged that the system has been used by market syndicates for placement of shares at an artificially high price. This artificial price is maintained for a certain period (usually till the lifting of the lock-in period, i.e. 15 trading days) following which investors tend to offload their shares at a higher price. There are only three instances where book building system was practiced, of which two companies were directly listed in the market.

On one occasion, those who hold the private placements were able to siphon off a considerable

⁸⁶ According to newspaper reports the number of bull cartel operated in the stock market is more than ten. These kinds of bull cartels were operational in 1996 as well and played a major to crash the market.

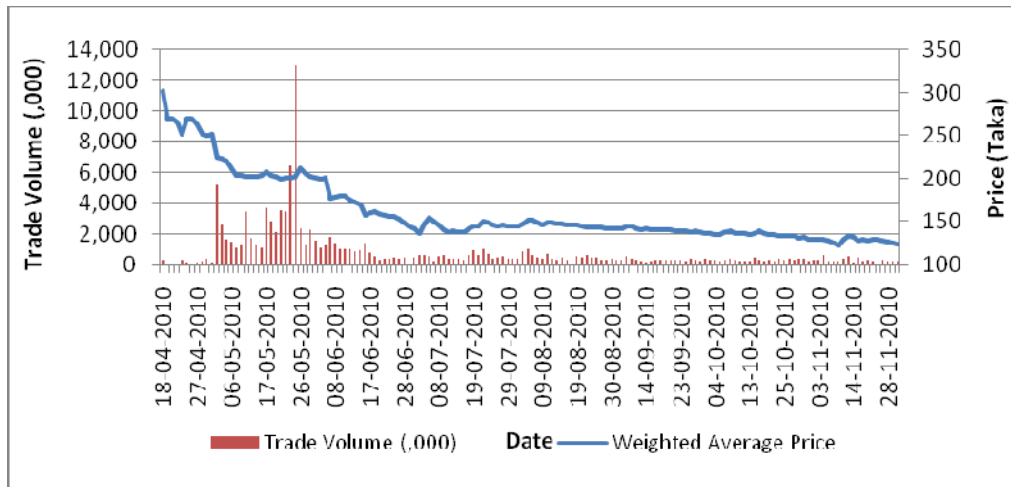
⁸⁷ There are rumours that these bull cartels with the support of share departments of the respective companies have access to undisclosed and secret information of the company such as information on buying and selling of shares by a large quantity.

amount of money by selling shares at a high price within the span of one month after the offloading of the shares. As a result, share price of the company fell by 33 per cent within one month and by 50 per cent in next two months and did not rise thereafter (Figure 15). Capital flight during the first 15 days of the transaction of the shares of this company is estimated to be at least Tk. 83.7 crore. Similarly, in case of yet another company, only in the first two days of trading flight of capital has been estimated to be to the tune of Tk. 64.8 crore. However, this was not the case for a third company which was not directly listed and indicative price of this share did not experience much volatility. However, the SEC was unable to take appropriate measures to address this type of abnormal market behaviour and those who were involved with such abusive practices were not met with sanctions.⁸⁸

Recently SEC has revised several aspects of the book building system such as putting a bar against mentioning the expected future earnings in company's prospectus, making it mandatory for bidders to participate in the road show organised by the issuer company and shortening the period of processing the book-building for new companies. Implications of the revised system of book building will need to be closely studied and appropriate lessons will need to be drawn.

⁸⁸Although SEC identified a number of incidences of illegal practices and also penalised some of the concerned persons, because of lack of authority to enforce these decisions (e.g. through deduction of penalty amount from the BO account of the persons concerned), these measures are yet to be enforced.

Figure 15: Daily Share Price of Company X Following Book Building System



Source: Based on Dhaka Stock Exchange (DSE).

Anomalies in the Financial System

Certain anomalous provisions of the financial system of the country concerning the capital market are adversely affecting the development of the capital market. *First*, although commercial banks are not allowed to invest more than 10 per cent of their deposits in the stock market⁸⁹, a total of 12 commercial banks have been identified by the Bangladesh Bank which have violated this rule. Though the central bank has instructed these banks to adjust their investment within the stipulated time of November 2010, things have not changed much. *Second*, funds disbursed to industrial enterprises in the form of term loan, working capital and over-draft against workers' salary is reported to have been diverted to the capital market. The central bank has instructed commercial banks to adjust such loan portfolios (particularly loans worth more than Tk. 10 million) by 15 February 2011. *Third*, unsubstantiated gossips and rumour with regard to enforcement of the *Insurance Act 2010* and the *Insurance Regulatory Authority Act 2010* have fuelled prices of shares of some of the listed insurance companies. *Fourth*, while merchant banks are supposed to be issue-

⁸⁹According to Bank Company Act 26(2).

managers, at least for one IPO in a year, a number of these banks were unable to comply with this target.⁹⁰ This would indicate that the number of merchant banks in operation is large compared to what the market could sustain.⁹¹ Where the operation of the merchant banks should have been confined to portfolio management, often these banks are alleged to act as 'brokerage houses'.

Lack of coordination among various financial markets including debt market, equity market and bond market is considered to be a major weakness for sustainable growth of the capital market. Decisions (or indecisions) of different market regulatory bodies taken at various points of time, have often contributed towards significant volatility in the market. For example, possible diversion of industrial credit to the capital market was anticipated by the Bangladesh Bank in its Monetary Policy Statement for July-December 2010, but the required surveillance came only at a much later stage. Further, the margin rule instrument available to the SEC appears to have been applied without proper assessment of the overall money supply and demand situation prevailing in different sectors. Moreover, notwithstanding their mandated responsibilities, most market agents, such as brokerage houses, merchant banks, investment banks, institutional investors, members of DSE, are involved in short term 'trading'. Overall, lack of proper coordination between two leading regulatory bodies of the financial sector, namely the Bangladesh Bank and SEC is said to have contributed to the current volatile behaviour that is observed in the country's capital market.

Prospect of smooth landing of the market?

In the backdrop of much apprehension about severe market correction, the capital market has experienced some hiccups in December, 2010.⁹² In this connection, on 19 December 2010 DSE witnessed the highest fall in a day in the history of stock market (6.7 per cent fall of total share price

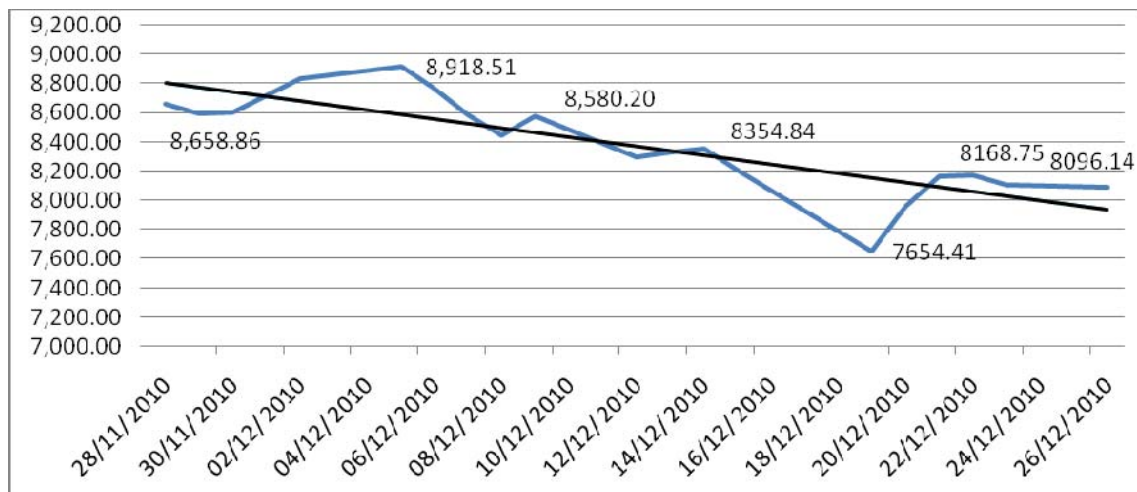
⁹⁰During FY2009-10, 21 IPOs were issued which is the highest number of IPOs floated in a year, and the number of offloading of shares in July-November FY2010-11 was 9.

⁹¹A total of 35 merchant banks are currently operating in the market.

⁹²On 6 December, 2010 about 147 points, 7 December 186 points, 8 December 134 points, 15 December 149 points and on 19 December 551 points.

index in a day). It is to be noted that within 15 days (6-19 December 2010) share price index dipped by 1264 points (-16.1 per cent) incurring an estimated loss of capital of about Tk.41,984 crore (Figure 16). Whilst a number of actions (and inactions) of the SEC is alleged to have contributed to this situation, mopping up of liquidity by the financial institutions in view of instructions of the Bangladesh Bank is may have played a major role in this downward spiral in the share price index.⁹³ SEC has taken a number of urgent measures, such as re-fixing margin loan ratio, withdrawal of the requirement of extra deposit of the brokerage houses, bringing back the shares of *Grameen Phone* and *Marico* to normal trading floor from spot market, and extending the timeline for reporting of loans of the commercial banks (as per instruction of Bangladesh Bank), which has temporarily smoothed the volatility in market prices.

Figure 16: Fall of the DSE Share Price Index between November 2010 and December 2010



Source: Based on DSE.

It is widely accepted that the current behaviour of the capital market is totally at variance with market fundamentals. The critical question is whether the stock market will ultimately experience a crash à la November 1996 or is it going to adjust smoothly? In 1996, within five months the share

⁹³From 15 December 2010, Bangladesh Bank has increased CRR to 6 per cent from 5.5 per cent and SLR to 19 per cent from 18.5 per cent.

price index rocketed from 959 (June 1996) to 3,064.9 (November 1996) recording a rise of as high as 219 per cent, but within the next few months it reverted back to the earlier position (957.4 in April, 1997, -68.8 per cent) (see Appendix 1). The 1996 is stated to be a 'generated market' with a few players ('bull cartel') who had inside information about the market. Initially the market was interpreted as 'buoyant and robust', but soon went bust causing huge losses to small investors.⁹⁴

Optimists would like to stress that 2010 differs significantly from 1996 because of a number of distinctive features.⁹⁵ However, developments in the 'hardware' of the stock market should have been accompanied by effective 'software' instruments. An absence of those instruments has tended to encourage investors to invest more in the short-term trading segment of the market. In the absence of effective 'software' instruments market may experience some claming down for a short time, through various reactive initiatives and interventions; however, it will be very difficult to sustain current 'buoyancy' in the long term. The 'boom' market may go 'bust' unless appropriate measures and initiatives are not taken immediately. In the following paragraphs, some of those measures are highlighted.

Policy Suggestions

The analysis in the previous sections reveals that challenges confronted by the stock market involves not merely lack of good stocks but rather it is related to a number of problems associated with bad governance and manipulation in the market itself and anomalies in the financial sector. Following measures can be considered to address the attendant market anomalies and irregularities in the stock market.

⁹⁴The bust of 1996 stock market was termed as 'slaughter of the innocent' by the *Economist*.

⁹⁵These distinguishing factors included introduction of automated trading system, introduction of central depository system, and abolition of paper trading which was afflicted with forged and fake shares, abolition of curb market, operations of BO accounts to identify investors and opening of brokerage houses in and out of Dhaka.

Operational Measures

- a) *Discourage short term trading in the stock market:* Imposition of capital gains tax on short term trading which is currently applicable on institutional investors may be extended to private investors to be applicable for short-term trading.⁹⁶ Capital gains tax on short term trading by private investors can be a good source for revenue generation. Advanced trading software needs to be installed both at SEC as well as at brokerage houses to estimate capital gain for each transaction and the related revenue to be paid to the NBR.
- b) *Strengthen surveillance mechanism of the SEC:* Current strength of SEC needs to be increased to monitor the various brokerage houses to ensure that transactions in the stock market are made in accordance with the relevant rules. SEC should strengthen its legal advisory support system as well as financial auditing and monitoring capacities by appointing experienced and well-reputed professionals for these purposes.
- c) *Appropriate measures for effective operation of the market:* SEC may consider a number of measures in order to improve the operational efficiency of the market. This includes extension of lock-in period for trading of placement shares, particularly for institutional placements, especially under the book-building system; appropriate scrutiny of audited reports submitted by the listed companies in order to ensure their quality and authenticity.
- d) *Enforce disciplinary measures against improper/illegal activities:* SEC should take disciplinary measures against various kinds of illegal activities such as, punishment for spreading rumours and short buy/sale; halting transaction of shares showing abnormal rise/fall in the prices and penalizing brokerage houses or cancellation of their licenses if settlement of accounts is not carried out in an appropriate manner.

⁹⁶At present capital gains tax is imposed on companies (10 per cent), sponsor shareholders or directors (5 per cent) and premium value shares of companies (3 per cent).

- e) *Strengthen educational programmes for new investors:* SEC should undertake more educational programmes through its newly established Capital Market Institute for new investors to educate them on market fundamentals, market players and their role, anomalies and irregular practices in the market and their impact on share prices, legal measures at the disposal of SEC and law enforcing authorities when rules of game are violated or tampered with.

Management related measures

- a) *Strengthen the SEC Management:* The SEC should be staffed by a group of people who are conversant with the nitty-gritties of the market, are highly competent, and are of good reputation with wide public exposure. They should be honest and be able to take stern actions against misdeeds, wrong doings and illegal practices. The high profile of the management body of SEBI in India should act as an example for Bangladesh if any such restructuring of the management of the SEC is contemplated.
- b) *Demutualization:* DSE should take appropriate measures for demutualisation in the market through enforcement of appropriate regulations by putting in place restrictions so that owners of brokerage houses cannot become members of DSE management board.

Policy measures

- a) *Government's decision to off-load shares in the market:* The progress with regard to offloading of shares of SoEs has been rather scant, although on a number of occasions government had announced (latest in November 2010) offloading of those shares, particularly of eight SoEs. Government should offload those shares without delay.
- b) *Increase spread of corporate tax rates between listed and non-listed companies:* The existing spread of corporate tax rates between listed and non-listed companies (10 per cent) may be further widened (15 per cent) from its existing level (27.5 per cent) by further reducing tax rates to encourage new enlistment in the market.

3.5 OVERSEAS EMPLOYMENT AND REMITTANCES

Both in terms of the number of workers going abroad and the remittance flow, the first half of FY2010-11 has posed formidable challenges for Bangladesh. Number of migrant workers has decreased by almost half compared to average figure for comparable periods of FY2006-07 and FY2007-08, and for the first time growth of remittance has entered into negative terrain. Both of these performance indicators are likely to have adverse impact on Bangladesh's labour market situation and balance of payment.

Deceleration in Overseas Migration

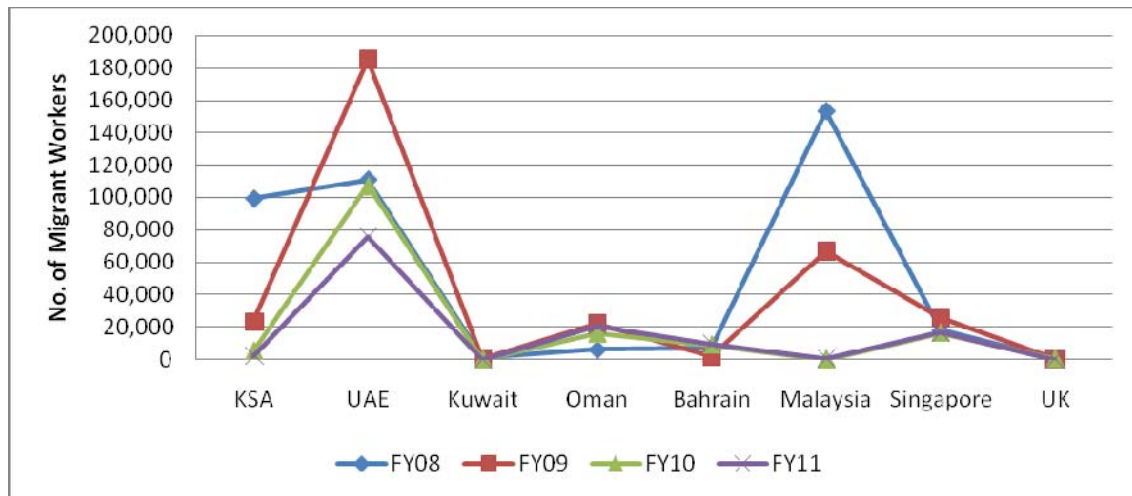
During the first five months of FY2010-11 (July to November), overseas migration fell by about (-) 24 per cent compared to the corresponding period of the previous fiscal year. This disturbing development owes to both demand side developments in importing countries and the supply side constraints arising from the structural weaknesses which characterise Bangladesh's migrant workforce.

Changing Economic Scenario in the Post-Crisis Period

In the backdrop of the post-crisis macroeconomic scenario, particularly the slowdown in economic activities in the construction sectors, traditional manpower destinations of Bangladesh have hosted lower number of migrant workers in the recent past. Although by now recovery has set in motion in most of these countries, the lagged response of the crisis is reflecting on the number of workers demanded in various sectors of the economy in these host countries. This is corroborated by the fact that overseas migration from Bangladesh to Kingdom of Saudi Arabia (KSA) and the UAE, two of her key manpower export destinations, fell respectively by (-) 51.7 per cent and (-) 10.3 per cent during July-November period of the current fiscal compared to the corresponding period of FY2009-10

(Figure 17). Similar trend is also found for several other markets where Bangladesh has been a major supplier of migrant labour force in the past.

Figure 17: Overseas Migration from Bangladesh to Major Manpower Importing Countries (July – November)



Source: Bureau of Manpower Employment and Training (BMET).

Increased market share of non-Middle Eastern countries in recent times is indicative of some market diversification away from the Middle Eastern countries; however, share of these countries is relatively low, also because these tend to demand more skilled manpower. In spite of some improvements in the skill composition of migrant labour force in recent times, the share of ‘less’ and ‘unskilled’ category continues to dominate Bangladesh’s migrant workforce (more than 74 per cent of total overseas migrants from Bangladesh during July-October, 2010 belonged to the ‘less-skilled’ category). This has handicapped Bangladesh’s capacity to access the newly emerging opportunities in the post-crisis global labour market.

Stringent Regulatory Measures in the Host Countries

Bangladesh’s problems have been compounded by the moratorium on issuing of new work permits (Akamas) and their renewal by the Saudi government. Although they had earlier indicated that it

would allow transfer of *Akama* for Bangladeshi workers, which would enable them to switch to new employers after expiry of the initial job contract, till now no progress has been made on this front. Discussion with various stakeholder groups⁹⁷ indicate that due to the current policy, Saudi employers are unwilling to issue work visas to Bangladeshi citizens. This has undermined employability, and led to illegal status of workers in the many instances. As a consequence, remittance flow from Saudi Arabia has been adversely affected.

Illegal Stay of Bangladeshi Workers Abroad

As was noted above, because of *Akama* related complexities, a large number of Bangladeshi workers have lost their legal status in Saudi Arabia. Similar has also been the case in Malaysia where a large number of Bangladeshi migrant workers have lost their legal status. This had two negative impacts: As was found from discussion with returned migrants from Malaysia, many such workers are discouraged to leave Malaysia and return since they are apprehensive that once they leave Malaysia they will not be able to go back.⁹⁸ Recent reports suggest that more than 0.4 million Bangladeshis are now residing illegally in Malaysia. Secondly, the emergent situation has induced the Malaysian Government to put embargo on recruitment of workers from Bangladesh.

High Cost of Migration

Cost of overseas migration has traditionally been higher in Bangladesh compared to neighbouring countries. Many of the players involved, including recruiting agents, have connived to exploit the workers. This has led to this higher migration cost in Bangladesh. It has been found that in most cases a worker from Bangladesh has to incur more than twice or thrice the cost borne by a worker from India, Pakistan or Nepal to go overseas. For instance, although the government has fixed payment for workers going to Malaysia at a maximum of 84 thousand taka/workers (as of 2009),

⁹⁷This included manpower exporters, returned migrants, and officials from BMET and WARBE.

⁹⁸Since they had already spent significant amount of money to go to Malaysia, this reluctance is well-understood.

interviews with returned workers reveal that they had to spend on average about Tk. 2 lakh. Besides, discussion with a group of South Africa bound Bangladeshi migrant workers at Dubai Airport revealed that, the workers were contracted to pay Tk. 6 lakhs each if they were successful to finally enter South Africa.⁹⁹

As is known, three banks are currently offering specialised loan facilities to the migrant workers. A study on migrant workers conducted by Refugee and Migratory Movements Research Unit (RMMRU) indicates that, only 97 aspirant workers had so far received loans from these banks in 2010. The study also pointed out that high interest rate and lack of efforts on the part of the banks' officials at the field level tends to discourage potential migrant workers from taking loans from the offering banks.

Changing Preferences of Major Labour Importing Countries

The problem from the supply-side has been compounded by the policies of some of the host countries. KSA and Malaysia are two relevant examples. The GoB has been trying to address the situation through high-level official visits and discussion at various levels. Tangible results of these efforts are yet to be seen.

Some of the key manpower importing countries appears to have shifted their focus from traditional manpower exporting countries to prospective new ones. According to a number of returned migrants and recruiting agents, Saudi Arabia and Malaysia now prefer workers from Nepal. It may be mentioned here that Nepal alone has sent about 18,019 workers to Saudi Arabia and more than 42,454 to Malaysia during July-October period of FY2010-11.¹⁰⁰ To compare, Bangladesh's manpower export to these two countries during the same period was 1,742 and 434 respectively.

⁹⁹Findings from the Expert Group Meeting at CPD held on 23 December 2010.

¹⁰⁰Department of Foreign Employment, Government of Nepal

There is a need for more persistent diplomatic efforts to change the situation. It may be recalled here that recently the Malaysian government has offered to recruit a sizeable number of Bangladeshi workers on 'G to G' basis (i.e. government to government basis). Bangladesh should try to take advantage of this opportunity by ensuring that the rules and regulations stipulated by the host country are strictly adhered to.

Unscrupulous Practices by Recruiting Agents

Besides charging abnormally high processing fees, a number of recruiting agents in Bangladesh are reported to provide false information to aspirant migrant workers regarding job contract, wages, tenure, fringe benefits, etc. This, on many occasions, result in illegal stay of workers in the host countries as they leave the initially contracted job due to disagreement over wages and benefits. Furthermore, some of the returned migrants have also informed that a number of recruiting agents offer job contracts in overseas companies which do not have appropriate vacancies. As a consequence, these migrants get engaged in jobs offered by other companies, a practice which is considered to be illegal by the host countries.

Besides, anecdotal information also suggests that some recruiting agents from a number of other labour exporting countries (including Nepal) are engaged in sending Bangladeshi workers to the Middle-East and other destinations, with fake passports, by introducing them as citizens of their own country. This does not seem unreal in view of the fact that Bangladesh has an abundant supply of workers willing to go overseas and countries such as Nepal are short of workers when compared to the large number of offered job opportunities. Such practice also increases migration cost as the aspirant migrants have to go through indirect routes to reach the destination countries.

Falling Remittance Flow

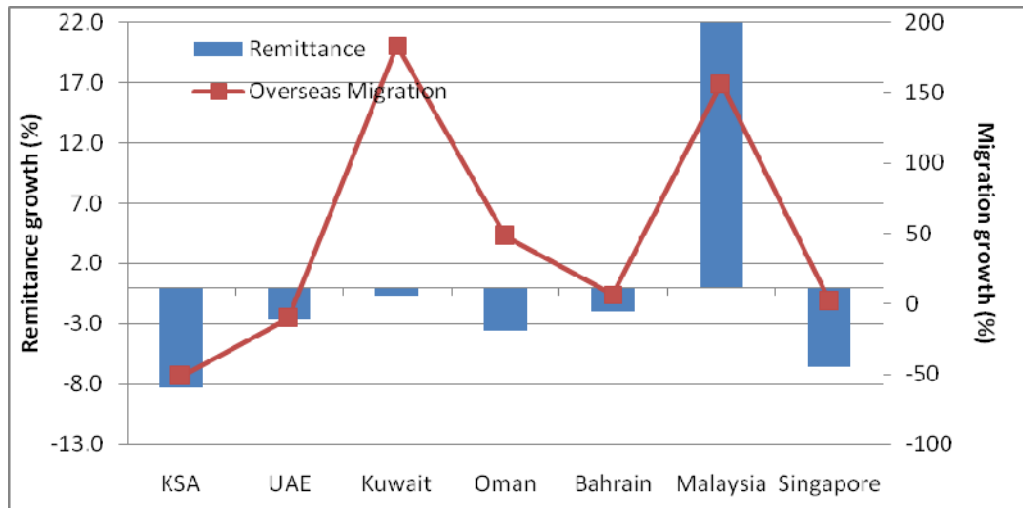
There has been a significant deceleration in the growth of remittance inflow to Bangladesh during the first five months of the current fiscal (July to November). Total remittance inflow has declined by (-) 1.7 per cent over this period compared to the same period of FY2009-10. To compare, remittance rose by 24.4 per cent in FY2009-10. A number of factors have contributed to this situation.

Decelerating Manpower Export

As Figure 18 suggests, there is a correlation between the negative growth in remittance inflow and the deceleration in the flow of overseas migration. Remittance inflow from major manpower importing countries except Malaysia has seen a fall over the recent months, to varying degrees. Although the ‘stock effect’ should have, at least in the near-term, compensated for the (lower) ‘flow effect’, it is disquieting to see that lower levels of migration has tended to be accompanied by lower remittance flow.

Figure 18: Market Specific Growth in Overseas Migration and Remittances:

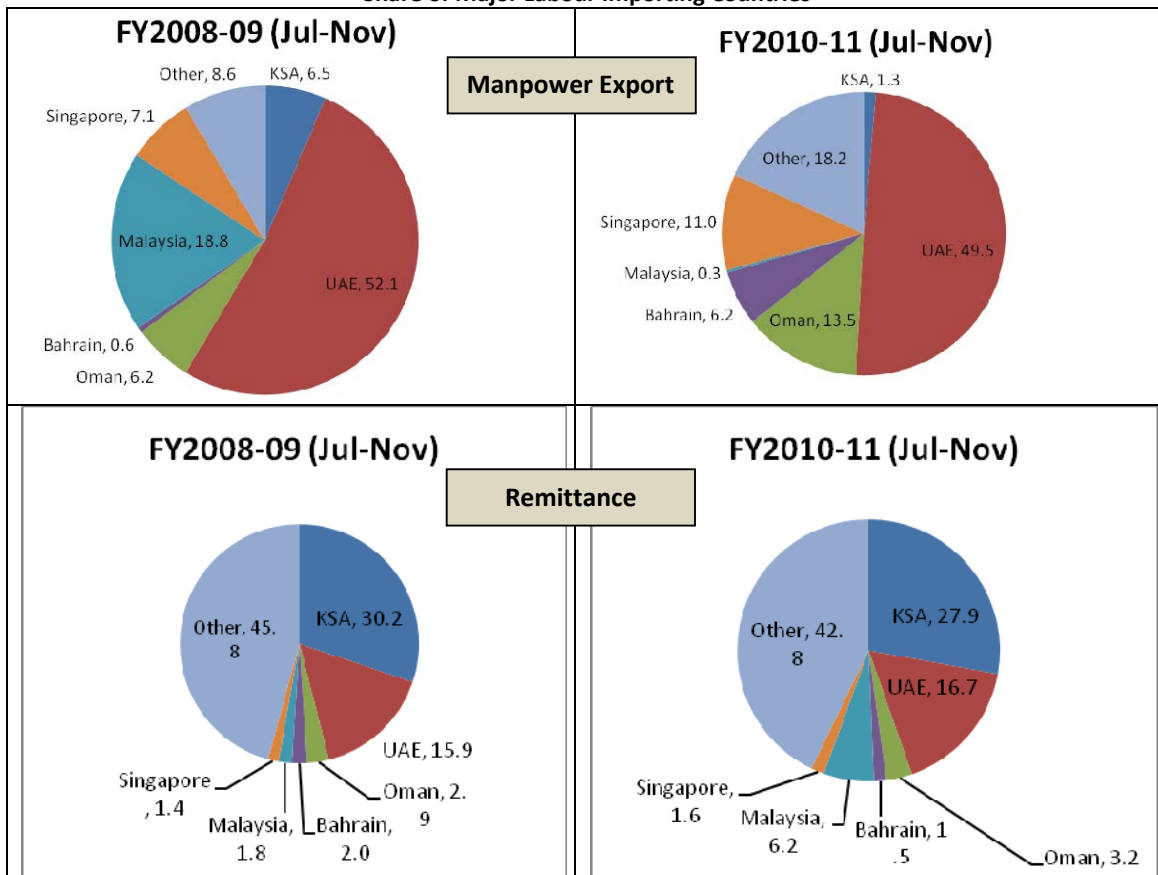
FY2009-10 vs FY2010-11 (July – November)



Source: BMET.

However, one needs to be cautious in interpreting the impact of compositional changes in manpower export markets on remittance inflow to Bangladesh. As Figure 19 shows, despite some significant changes in the share of different countries as manpower importers from Bangladesh, their share in terms of sources of remittance has remained rather less differentiated in the recent past. This would indicate that while lower overseas migration might have contributed to decreased remittance inflow, the stock effect has somewhat compensated for this, particularly in host countries where there is a sizeable number of workers already exist. Nevertheless, if the deceleration in overseas migration continues, its lagged impact on remittance inflow will eventually catch up in the medium term, even in those countries; in that case the growth in remittance flow is likely to go down further.

**Figure 19: Market Composition for Bangladesh’s Manpower Export and Remittance Earnings:
Share of Major Labour Importing Countries**



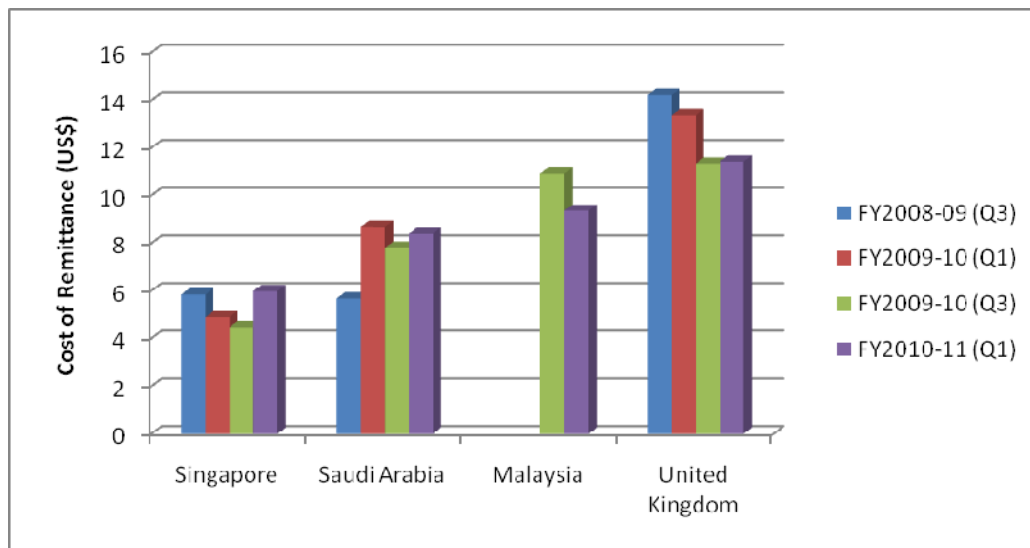
Source: BMET, Bangladesh Bank.

In view of the significant fall in remittance inflow from Saudi Arabia, it is perhaps worth investigating as to whether the restrictions arising from *Akama* has induced the Bangladeshi workers to opt for informal channels (*hundi*) to remit earnings to Bangladesh.

Cost of Remittance

The cost of sending remittances is falling world-wide in recent times. Bangladeshi workers have also been able to take advantage of this, thanks also to a number of steps taken by Bangladesh’s policymakers to facilitate the transfer. An analysis of cost of remitting money to Bangladesh from different countries shows that it has seen some decrease during the first quarter of FY2010-11 compared to the same period of FY2009-10, for Saudi Arab, Malaysia and United Kingdom; however, there has been some rise for Singapore (Figure 20).

Figure 20: Cost of Sending Money to Bangladesh from Selected Countries



Source: World Bank.

While a worker had to pay an average of USD 4.89 to remit USD 200 from Singapore to Bangladesh during Q1 of FY2009-10, the transaction fee increased to USD 5.99 during Q1 of FY2010-11. However, for remitting equivalent amount the processing fee in Saudi Arabia had decreased to USD

8.39 in Q1 of FY2010-11 from USD 8.7 in Q1 of FY2009-10; for UK, the corresponding charges were USD 11.43 and USD 13.37 respectively. Available information suggests that the processing fee for transfer of remittance in Malaysia decreased from USD 10.91 to USD 9.36 between Q3 of FY2009-10 and Q1 of FY2010-11. Indeed, total remittance from Malaysia has increased from USD 158 million in Q3 of FY2009-10 to USD 168 million in Q1 of FY2010-11. However, notwithstanding that the cost of remittance had declined for Saudi Arabia and UK, remittance from these two countries declined by (-) 2.4 per cent and (-) 3.0 per cent respectively during the comparable periods.

Way Forward

- While announcing the National Budget for FY2010-11, the government had set a target of sending 5.77 lakh workers abroad in the current fiscal. In view of the record so far (first five months), to achieve this target, an average of more than 60 thousand workers will need to go abroad for work each month over the next seven months. However, given the current trend, attainment of this target appears to be highly unlikely. Since the number of migrant workers constitute a significant proportion of the annual incremental labour force of the country, such deceleration in overseas migration from Bangladesh will create additional pressure on the already challenged domestic labour market. CPD survey indicates that there is a common understanding among the relevant stakeholders to the effect that if the current deceleration in manpower exports from Bangladesh is to be reversed, the key strategy ought to be the revitalisation of the job markets in the Middle East. The government has been taking a number of initiatives to address the attendant situation, but till now the results have not been very encouraging. A proactive and aggressive diplomacy will need to be pursued in two areas if the present is to be addressed: resolving the *Akama* problem and ensuring the continuation of new recruits from Bangladesh.

- Government should continue the dialogue with major labour-importing countries, particularly in the Middle East, to allow change of jobs by Bangladeshi migrant workers (without transfer fee). A recent study projects that about 500,000 people, in different workmanship categories, will be needed in Saudi Arabia for the ongoing construction of new cities.¹⁰¹ The awarding of Qatar, to host the Football World Cup 2022 is also likely to create hundreds of thousands of jobs in the construction sector. Negotiations should be initiated so that Bangladesh is able to take advantage of these emerging opportunities.
- Efforts should now be strengthened so that Bangladesh is able to cater to the emerging needs in new markets for migrant workers in the developed world, particularly in caring services, nursing, medical technicians, etc. Besides, countries such as Qatar and the UAE are likely demand more workers in the professional and highly-skilled categories for the service-and-knowledge based economy that they are trying to build.¹⁰² To access such opportunities, a time-bound plan should be put in place so that workers willing to travel abroad have the opportunity to undergo skill upgradation training.
- Available reports suggest that demand for migrant workers is set to go up also in South Korea and in Libya. Unfortunately though, only 1,409 people went to South Korea during the first five months of FY2010-11 (however, this number was more than double the number that went to Malaysia during the same period) and none to Libya (whereas more than 12 thousand people went to the country during the last six months of FY2009-10). Efforts should be made to exploit the opportunities in the Libyan market. In recent times, people from Bangladesh have started to go to a number of African countries including Angola, Algeria, Nigeria, Botswana, and South

¹⁰¹A study by Dr Joseph Chamie, Director of Research at the Center for Migration Studies, New York

¹⁰²World Migration Report 2010

Africa. In view of the ongoing deceleration in manpower export to the traditional markets, policy emphasis should be put to facilitate increased migration to these new and emerging markets.

- World Bank (2010)¹⁰³ estimates indicate that low-income countries will attain an average of 8.2 per cent growth in remittance in 2010 and the forecasts are that in 2011 and in 2012 the growth rates could reach 8.7 per cent and 9.0 per cent respectively. Bangladesh's current growth rate of remittance is way below the levels suggested by these optimistic projections. There is thus an apprehension that Bangladesh is not being able to take advantage of the emerging global opportunities. If Bangladesh is to match the expected performance of the low income countries and attain growth rate of about 8-9 per cent by the end of FY2010-11, it will have to maintain a monthly average growth rate of 24 per cent during the remaining period of FY2010-11. Indeed, Bangladesh should carefully study the policies pursued by other countries in this regard and draw the necessary lessons.

- Strict monitoring and implementation of processing and visa fees which is fixed by the government is urgently required. Because of excessively high expenditure that a Bangladeshi worker has to incur, length of stay abroad, level of wages, timely payment of wages, and opportunity for working overtime are critically important for the workers. Rationalisation of cost of migration and ensuring compliance of the same by the recruiting agents must be given high priority on the government's agenda. Work of the recruiting agencies should be monitored on a regular basis. If agencies are found to be involved in malpractice such as failure to provide appropriate and truthful information to aspirant workers, these should be strictly dealt with and those responsible should be legally obliged to pay the due compensation to the migrant workers.

¹⁰³ *Outlook for Remittance Flows 2011-12.*

- Malaysia has recently expressed its intention to import manpower from Bangladesh only through the government channels. The objectives of such a proposal are to reduce migration cost and to ensure some discipline to the process. According to available information, the Government of Bangladesh will need to ensure that migration cost to Malaysia is kept between Tk. 25,000 to Tk. 35,000 and these workers will get work permit for five years. In view of this changing situation, government should play a proactive role to increase the capacity of BMET to send a larger number of migrant workers through legal channel. If required, the BMET should be suitably strengthened towards this. Aspirant workers should be given appropriate information with regard to emigration procedure, laws, language and culture of the destination countries.

- Regrettably, in recent times Bangladesh is losing some of its manpower market to Nepal and a number of other countries. GoB should look into the matter, identify reasons and take measures to address the situation. The allegations of recruitments of Bangladeshi workers by recruiting agencies of other countries should also be properly investigated.

4. SHORT-TERM OUTLOOK AND CONCLUDING OBSERVATIONS

The crucial importance of how the Bangladesh economy performs in FY2010-11 ought to be judged *inter alia*, from the following two perspectives. *First*, globalising economies such as Bangladesh will have to be able to capitalise on the ongoing turnaround in global economy. *Second*, FY2010-11 being the first year of the Sixth Five-Year Plan (2011-2015), a good kick-off in the first year will help to materialise the medium term objectives of the Plan.

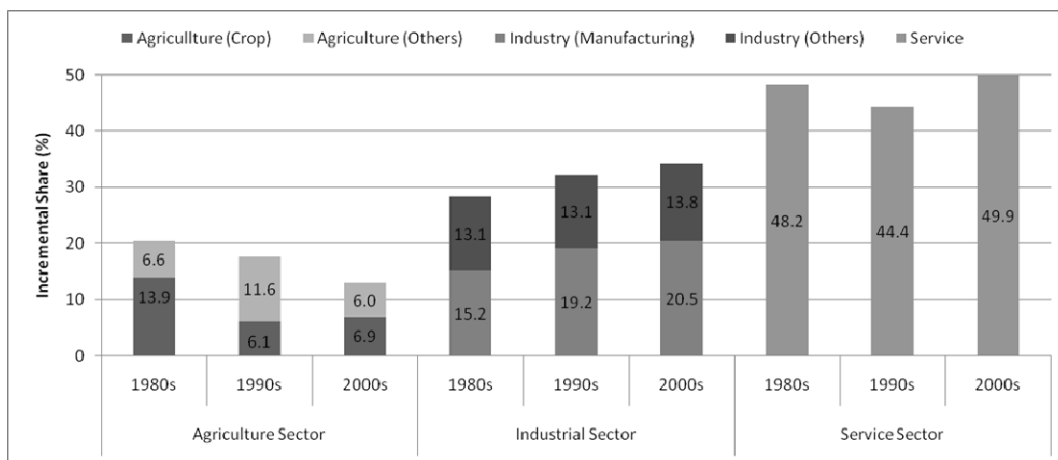
Growth for Structural Change

For sustainable inclusive development, Bangladesh economy needs to experience a structural change based on promotion of productive sectors. Given the resource endowment of the country, it

is maintained that an employment-intensive, but highly productive manufacturing sector has to spearhead such a structural change. In view of the above, growth experience of Bangladesh in past three decades reveals two broad phases.

- (i) GDP growth during 1980s and 1990s had originated mainly in rapid growth of the manufacturing industries (Figure 21).
- (ii) In 2000s, service sector provided a substantial base to augment additional national income, while manufacturing and crop sector held their positions.

Figure 21: Incremental Share of GDP by Broad Sectors (%)



Source: Estimated from MoF (2010).

These relative developments among the GDP components indicate elements of structural change within the Bangladesh economy. In this process, while agriculture sector has ceded its relative share, service sector – not manufacturing sector – has largely picked up the space. This has happened notwithstanding acceleration of the GDP growth rate observed in the recent past. Thus, the *Outline Perspective Plan of Bangladesh 2010-2021: Making 2021 A Reality* has rightly emphasised that the contribution of manufacturing sector in GDP has to be enhanced to 26.0 per cent and 30.0 per cent by FY2014-15 and FY2020-21 respectively (Table 14) from the existing level of 17.3 per cent (FY2009-

10). Admittedly, attaining these challenging targets will require considerable acceleration in the manufacturing production.

Table 14: Sectoral Share of GDP (in Per cent)

Sectors	FY10	FY15 (Target)	FY21 (Target)
Agriculture	19.5	16.0	15.0
Industry	28.9	35.0	40.0
Manufacturing	17.3	26.0	30.0
Service (including Customs Duty)	51.6	49.0	45.0

Source: BBS (2010) and Planning Commission (2010).

Required sectoral contributions for attaining growth target

Given the slowdown in the incremental share of the manufacturing sector in the recent enhanced growth performance, attaining the GDP growth target in FY2010-11 will depend, at the margin, on added contribution from this sector. Indeed, in view of current structure of GDP, economic growth beyond 5 per cent is mostly determined by manufacturing sector's level of output.

GDP growth target for FY2010-11 has been set at 6.7 per cent. The last time a 'more than six and half per cent' growth was achieved was in FY2005-06 when manufacturing sector contributed more than 25.8 per cent of the aggregate growth (Table 15). An analogous performance will need to be registered from the manufacturing sector in FY2010-11 (about 40 per cent). The growth contribution from agriculture sector also has to be as good as in the last year (FY2009-10) (about 10 per cent). Historically, steady performance by the services sector (about 50 per cent) has been underwritten by moderate achievements in the other sectors. About 49.3 per cent incremental contribution in GDP needs to be registered by the service sector in FY2010-11.

Table 15: Sectoral Contribution to GDP Growth (%)

Sector	Contribution to Growth (%)					
	FY06	FY07	FY08	FY09	FY10	Required in FY11 (CPD Projection)
Agriculture Sector	16.7	15.6	11.3	14.0	15.5	11.9
Crops	9.1	7.8	4.8	8.8	10.3	9.0
Industry	39.4	35.9	30.6	31.6	29.3	37.3
Manufacturing	25.8	25.0	19.4	19.3	17.2	25.4
Service Sector	45.5	51.6	50.0	52.6	53.4	49.3
Total	100	100	100	100	100	100

Source: Estimated from MoF (2010) and CPD projection.

Growth Outlook for FY2010-11

At the halfway mark of FY2010-11, there are several indications that the economy has gained some momentum, particularly due to the pick in external demand. Enhanced export receipts during the early months of FY2010-11 also speak about the upbeat manufacturing growth. Greater investment demand is reflected in strong industrial credit flow leading to growing imports demand for capital machinery and other production inputs. The outcome of crop sector is also expected to match the recent past performance. The productions of *Aus* and *Aman* have been satisfactory, while optimistic outcome is being forecasted for the *Boro* yield by several quarters. The performance of service sector generally has been very steady in nature and should be consistent with the energetic performance of the real sectors. Thus, in the final analysis, broad-based manufacturing growth will define the final growth outcome in FY2010-11.

However there are a couple of disquieting factors which may subdue the GDP growth figure for the current fiscal year. The dismal performance of small manufacturing industries could inhibit the

potential expansion of manufacturing output.¹⁰⁴ Further, considering the employment linkages of small scale manufacturing industries, low performance of the sector would have an adverse impact on labour market. Moreover, sluggish implementation of public investment programme is not only failing to provide the much needed infrastructure services, but this is also holding back private investment prospects. Furthermore, the emerging power supply situation may not be adequate to accommodate the potential expansion of agriculture and manufacturing sectors in the coming summer season. Slow visible progress in the energy and power sector is becoming a binding constraint for the growth and competitiveness of the processing activities as well as for further development of business supportive services.¹⁰⁵ In addition, the unhealthy trend in domestic capital market is also diverting funds and attention from the development of the real sectors. Given the current context, it will be challenging to attain the GDP growth target at the end of the fiscal year if the manufacturing sector does not experience a broad-based boost, promoting structural change.

Macroeconomic management in view of the growth target

The review of key economic variables suggests that macroeconomic stability in FY2010-11 is coming under some strains on a number of fronts. These emerging strains may have implications for attaining the GDP growth objective. The size of the budget deficit at the end of the fiscal year will remain within the programmed target, but there is a need to pay specific attention in ensuring balance among the different sources of deficit financing. Rationalisation of prices of public utilities will be necessary to reduce fiscal burden. Rising food inflation may generate an overall cost push, although there is no indication of any foodgrain shortage in the country. There is also a growing concern over the balance of payment situation due to weak remittance inflow and growing trade

¹⁰⁴Small manufacturing industrial production declined by 9.2 per cent in the first quarter of FY2010-11. The data for large and medium manufacturing industries is available for only one month. On the other hand, during July FY2010-11 the production of large and medium manufacturing industries registered 15.3 per cent growth compared to the matching month of previous fiscal year.

¹⁰⁵Including implementing the large public sector electricity generation projects, coal based power plants, the planned nuclear power project, natural gas and coal extraction etc.

deficit. In this context, stability of exchange rate will be of importance in maintaining macro-economic stability.

In order to address the issue of rising commodity prices (including fuel and food), volatile capital market, slow recovery of investment demand and the pressure on balance of payment, appropriate fiscal and monetary policy support for facilitating the growth process will be required. Indeed, in this case fiscal policy has to take the lead with monetary policy taking an accommodative stance commensurate with the emergent needs. It is pertinent to mention that delivery of the envisaged investment plan for achieving the growth target warrants moderately expansionary monetary policy. In view of the current inflationary trend, it is often suggested that, it is time that the monetary authority slows down the credit growth to protect macro-economic stability. However, given the nature of inflation in Bangladesh, reigning in domestic credit growth in the current context will be not only pre-mature, but may also prove to be counter-productive. In a situation of a disincentive to the supply-side, inflation may soar further as one is aware of the limits of the demand-side inflation management which often readjusts the economy at a low level equilibrium.

There is a growing need to backstop the balance of payment in the coming months. However, the current reserve situation does not warrant any panic in this regard. The current BoP situation is yet to generate an adequate rationale for seeking financially expensive and policy conditional loans from foreign sources. It is not clear under what arrangements current negotiation with the IMF is being held. It is important that the government is able to maintain its growth-supportive policy space including fiscal expansion and enhanced subsidies to critical sectors. If the conditionalities of the said loan is at variance with the declared development policy framework of the government such inconsistencies could undermine domestic ownership over the development agenda. Indeed, a public disclosure of the soon-to-be-finalised IMF programme may enable us to have an informed discussion in this regard.

CPD maintains that given the present state of the economy policymakers should not get overly pre-occupied with concerns about stability; rather all possible policy measures should be geared towards a broad-based, inclusive and accelerated growth.



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