Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2013

(First Reading)

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Contents

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As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation on 2 January 2013 at the CPD Dialogue Room. The working document of the *Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2012-13 (First Reading)* prepared by the CPD-IRBD 2012-13 team was shared at this in-house meeting with a distinguished group of policymakers, academics and professionals. The CPD team is grateful to all of those present at the consultation for sharing their views, insights and comments on the draft report. A list of the participants of the meeting is provided below (in alphabetical order):

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The CPD IRBD 2012-13 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

1. Introduction

The present interim review of macroeconomic performance of Bangladesh focuses particularly on the developments of the economy during the first few months of FY2013. This analysis takes developments in FY2012 and targets set for FY2013 by various policy documents as its benchmarks, reviews the movements in major macroeconomic indicators for the period for which latest data and information are available. Simultaneously, the review also makes an attempt to project future direction of these indicators as the economy moves towards the end of FY2013 in the backdrop of current policy stance of the government. As is known, the increasingly globalised economy of Bangladesh is facing a number of challenges in recent times in view of the ongoing global economic stagnation. FY2013 is a period when the Sixth Five Year Plan (SFYP) will cross its mid-point. Additionally, for the present government, 2013 will be the final year of its regime and FY2013 will be a period when the government will implement its fiscal budget to the fullest for the last time. Indeed, the policy environment in this period will be impacted by the fall-outs of Padma bridge financing debate and the Hall Mark scam, and in addition policy direction will be significantly influenced by the ongoing IMF-ECF programme in Bangladesh.

In FY2012, the economy, after having passed through a period when major domestic and external sector indicators were under significant pressure, appears to have stabilised, albeit at somewhat of a lower level than was targeted. The weaknesses in the macroeconomic situation were manifested by high inflation, stagnation in private investment and economic growth. Indeed, lax macroeconomic management was greatly responsible for many of the economic woes, particularly during the first half of FY2012. The target for economic growth rate could not be achieved in FY2012 and the early trends in FY2013 indicate that there is a possibility that GDP growth target may not be achieved in this fiscal year as well. One has to appreciate the fact that, compared to previous fiscal year, macroeconomic situation has been more stablised. The external balance is expected to be at a comfort zone. However, this low level outcome undermines the fiscal balance as overall revenue mobilization including import duty has suffered from contraction in import payments. Government targets for fiscal framework was found to be far from on track as bank borrowing may again have to step forward to compensate for non-bank borrowing. The government has tried to maintain fiscal balance by containing subsidy requirement through adjustments of administered prices. However, it will keep the commodity price level at a high level. Admittedly, policy stance of the government appears to be, by and large, stability-centric. However, this stability could come under pressure if the downside risks are not appropriately addressed through emphases on enhancing domestic resource mobilisation, stimulating private sector investment, further improvement in public investment, both in quantitative and qualitative terms, and raising the quality of governance across all spheres of economic management.

No doubt, performance of the economy in FY2013, and also beyond, will critically hinge on how the political challenges facing Bangladesh at the moment are addressed in the coming months. Any prolonged uncertainty in this context will have serious implications for the performance of the economy.

The present review is prepared in two parts. In the first part, Section 2 recalls the performance of Bangladesh economy in FY2012 which sets the benchmarks for following section. Section 3 presents the review of the initial months of FY2013 which indicates that the economy is moving towards a lower-level equilibrium. The second part includes three thematic issues of interest in the present context of Bangladesh economy. Section 4 presents a brief interim review of the implementation of the SFYP with a specific focus on macroeconomic framework and a selected set of sectoral issues. A review of the performance of the manufacturing sector of Bangladesh is prepared under Section 5. Section 6 deals with state of governance in the banking sector in the backdrop of the recently unveiled Hall Mark scam.

2. Review of FY2012: Setting the Benchmark

Economic Growth: Lower than Target

The provisional estimates made by the Bangladesh Bureau of Statistics (BBS) indicate that the Bangladesh economy was not able to meet its GDP growth target of 7.0 per cent set for FY2012. The provisional figure for GDP growth for the last fiscal year was to the tune of 6.3 per cent; i.e. 0.7 percentage point lower than the target. This is definitely a setback for the present government's plan to move the economy towards a higher growth trajectory as was envisaged in the Sixth Five Year Plan (SFYP). It may be recalled that in previous year (FY2011) the GDP growth target of 6.7 per cent was attained. According to the BBS estimate, a repeat strong performance by the industry sector (9.5 per cent), particularly its manufacturing component (9.8 per cent) played the role of the key driver of the projected GDP growth rate in FY2012. Along with it, the construction sector surpassed its growth target for FY2012 (6.6 per cent) to attain a robust 8.5 per cent growth. On the other hand, agriculture sector, particularly the crop production component, failed to maintain its remarkable track record of the past two fiscal years (6.1 per cent against a target of 5.7 per cent). Services sector maintained its traditional 6 per cent plus growth rate, although this was somewhat lower than the target.

A decomposition of the GDP growth rates in FY2011 and FY2012 bears out that in the overall growth in FY2012 (6.3 per cent) only 0.5 per cent was the contribution of the agriculture sector; in contrast the figure was 1.0 per cent in FY2011 (Table 2.1). This decline in agriculture sector's contribution to the GDP was more than the overall decline in the GDP growth (0.4 per cent). Accordingly, it appears that the decline in GDP growth was mostly accounted for by the relatively depressed performance in the agriculture sector, more particularly, its crop component. In contrast, industry sector, backed up by its manufacturing and construction sub-sectors, improved their contribution to growth. Indeed, out of 6.3 per cent growth in FY2012, 2.8 per cent originated from the industry sector, the highest in recent history. Service sector's growth contribution was limited to about 2.9 per cent. FY2012 related to a period of sluggish economic performance in the developed economies with its knock-on affects on the export-oriented sectors and export sector performance of Bangladesh. On the other hand, growing domestic demand sustained by robust remittance flows had positive impact on the performance of the economy.

TABLE 2.1: CONTRIBUTION TO GROWTH (%)

Sector	FY06	FY07	FY08	FY09	FY10	FY11	FY12	Difference (FY11 and FY12)
Agriculture Sector	***1.1***	***1.0***	***0.7***	***0.8***	***1.0***	***1.0***	***0.5***	***-0.5***
Crops	0.6	0.5	0.3	0.5	0.7	0.6	0.1	-0.5
Industry Sector	***2.6***	***2.3***	***1.9***	***1.8***	***1.9***	***2.4***	***2.8***	***0.4***
Manufacturing	1.7	1.6	1.2	1.1	1.1	1.6	1.7	0.1
Construction	0.7	0.6	0.5	0.5	0.5	0.6	0.7	0.2
Service Sector	***3.0***	***3.3***	***3.1***	***3.0***	***3.1***	***3.0***	***2.9***	***-0.1***
Import Duty	***-0.1***	***-0.1***	***0.5***	***0.1***	***0.1***	***0.3***	***0.1***	***-0.2***
GDP	**6.6**	**6.4**	**6.2**	**5.7**	**6.1**	**6.7**	**6.3**	**-0.4**

Source: Estimated from BBS data.

Investment: Improved Public Sector Performance but Stagnation in Private Sector

Investment, as a share of GDP, failed to accelerate in line with expectations in the second year of the SFYP. Private investment as a share of GDP declined in FY2012 to 19.1 per cent from 19.5 per cent of the preceding year. Public investment rate was reported to be 6.3 per cent of the GDP; however, this estimate, in all probability, will perhaps need to be revised downward because of the under achievement of the targets of the Revised Annual Development Programme (RADP). The current estimate of public investment is based on the allocations of the RADP. The final expenditure estimates of the ADP suggests that of the total RADP allocation for FY2012 about 7.8 per cent had remained unutilised. According to the mid-term plan, the investment target for FY2013 was 29.6 per cent of the GDP. This would require a rise in investment as a share of GDP to the extent of 4.2 percentage points. Private investment will need to rise significantly to reach 22.7 per cent of GDP from 19.1 per cent in FY2012. This would imply that in the absence of faster accumulation of investment, particularly on the part of the private sector, and improved implementation of government investment plan (i.e. ADP), achievement of the targeted GDP growth in FY2013 (according to SFYP) is likely to remain a long shot.

Revenue Collection: Impressive NBR

Revenue collection from the NBR proved to be a source of some comfort in view of the performance of key macroeconomic correlates in FY2012. Indeed, for the second consecutive year, NBR revenue target was adjusted upward; this time from 15.7 per cent to 16.3 per cent. Backed by strong revenue mobilization thanks to rising import duty, VAT (local) and income tax, NBR was able to surpass its annual revenue collection target by Tk. 2,587 crore. The stellar performance from NBR was somewhat moderated though by underachievement from non-tax sources. Indeed, the target for non-tax revenue collection had to be slashed by Tk. 4,000 crore which resulted in the overall revenue collection to be at a level below the target.

Revenue Expenditure: Surpassed the Target

In addition to revenue shortfall, significant rise in revenue expenditure put further pressure on the fiscal balance. Revenue expenditure (augmented) posted 14.7 per cent growth in FY2012 surpassing the original growth target of 12.0 per cent. Major rise in expenditure was observed on account of acquisition of assets and works, interest payments and subsidies and current transfers. It is to be noted that, subsidies and transfers alone (excluding those to public institutions like BPC, PDB etc.) contributed to about 42.5 per cent of the incremental revenue expenditure during this period. Domestic interest payments contributed another 38.3 per cent underwritten primarily by the high borrowing of the government from the banking system. The rising cost of public debt servicing and its attendant fiscal burden is transmitting worrying signs and could emerge as a problem with long term adverse consequence. However, as of now, the debt situation has not crossed the critical zone.

Subsidy Requirement: Growing Fast with Concomitant Fiscal Pressure

A major destabilizing feature of the fiscal management in FY2012 was the unforeseen growth in subsidy requirements. Original allocation for subsidy was about Tk. 20,447 crore for FY2012. As the year progressed, this allocation proved to be way off the mark. Until FY2011, agriculture sector was the single-largest recipient of subsidies incurred in the form of fertiliser and irrigation price support (around 42 per cent in FY10). During the last couple of fiscal years, fuel and electricity sectors had received about half of the total allocation for subsidies. Mounting fuel demand from the rental power plants proved to be too costly to bear, forcing the government to maintain a large part of the installed capacity unutilized by restraining the flow of fuel to the plants. At the same time, several upward adjustments in prices of fuel and electricity had to be made to reduce the subsidy demand. However, these measures proved to be insufficient in limiting the demand on subsidy payments - total subsidy demand for the year approached to 3.3 per cent of the GDP. This was a significant rise compared to the figure of 2.4 per cent in FY2011. The government went one step further and decided to transfer Tk. 10 thousand crore of subsidy payments from the FY2012 to FY2013. According to the Bangladesh Petroleum Corporation (BPC)'s statement of profit (loss), the organisation incurred a loss to the tune of around Tk. 10 thousand crore in FY2012. Indeed, the subsidy portfolio of the government undermined the efficacy of overall macroeconomic management in FY2012.

ADP: Underutilisation of Project Aid Undermined Overall Utilisation

ADP implementation during FY2012 stood at Tk. 37,871crore, which was Tk 8,129 crore less than the original target, implying an implementation rate of 82.3 per cent (of the original budget). This was about 3 percentage points lower than that of the last year (85.3 per cent). As a result, ADP-GDP ratio in FY2012 was same as that of the previous year (4.1 per cent). An added concern as regards the ADP had been the higher share of local financing in the absence of envisaged foreign financing. Of the implemented ADP of FY2012, about 66 per cent had to be financed from local sources; while the figure stood at 59 per cent in the original allocation. Indeed, only 68 per cent of the total project aid allocation was utilised in FY2012. This led to increased government borrowing from the banking system, putting pressure on availability of credit for the private sector.

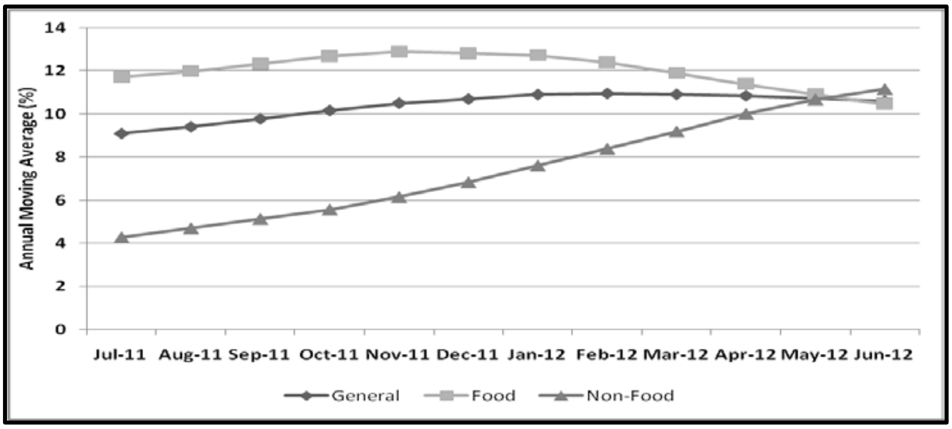
Deficit Financing: Riding on Bank Borrowing

With financing pressure emanating from the overshooting of the revenue expenditures, overall budget deficit (excluding grants) stood at Tk. 36,025 crore in FY2012, which was 3.6 per cent of GDP (excluding grants). Modest level of net foreign financing and low contribution of financing from the non-banking sources made financing the deficit a major macroeconomic challenge in FY2012. From the very onset of the current fiscal year, the government had to resort to borrowing from the banking sources which turned up to be alarmingly high and had already exceeded the budgetary annual target of Tk. 18,957 crore by the end of February (Tk. 19,483 crore). As a result, the government revised the target for bank borrowing by Tk. 10,158 crore (to Tk. 29,115 crore). Eventually, the government managed to restrain overall bank borrowing to Tk. 27,188 at the end of fiscal year which was Tk. 1,927 crore less than the revised budget target. The underutilisation of domestic financing part of the ADP (by Tk. 949 crore) helped the cause of curtailing bank borrowing to a large extent. However, the government was not able to accumulate the targeted domestic financing from selling of NSD certificates. While the revised target for financing from NSD was Tk. 6,000 crore, only Tk. 271 crore could be mobilised at the end of FY2012. Hence, the government had to seek financing from other non-bank borrowing sources. During the last quarter of FY2012, the government borrowed Tk. 12,342 crore from such sources as provident funds of government employees. As past experience suggests, this borrowing was short-term in nature and had put pressure on deficit financing in FY2012.

Inflation: Non-Food Inflation Elevated Price Level

As is know, inflation rate has been on the rise over the past three years. In the backdrop of high level of commodity prices, the annual average inflation target for FY2012 was set at 7.5 per cent. However, general inflation (annual average) rate reached 10.6 per cent in FY2012 which was 8.8 per cent in FY2011 (Figure 2.1). Since the mid-2000s price level of food items became the dominant contributor to inflation in Bangladesh. However, food inflation started to somewhat slow down since January 2012 after the Aman harvest and indeed inflation rate of non-food items had a greater influence on the final outcome in FY2012. Non-food inflation was on the rise since July 2011 mainly due to the upward adjustment in the administered prices of fuel and electricity and falling value of BDT against USD leading to imported inflation. At the end of the fiscal year, annual average non-food inflation reached as high as 11.2 per cent and exceeded the annual average food inflation (10.5 per cent). Within non-food commodities, prices of clothing and footwear, gross rent, fuel and lighting and transport and communication experienced notable rise in FY2012.

FIGURE 2.1: ANNUAL AVERAGE INFLATION (%)



Source: BBS.

Monetary Policy: Contractionary Policy pursued with Limited Success

A major focus of the monetary policy statement (MPS) for first half of FY2012 which was released in July 2012, was to restrain money supply. However, at the end of first half of the fiscal year (December 2011), the overall growth of money supply was close to the target (19.1 per cent against the target 18.5 per cent) and well below the benchmark growth rate (21.3 percent at the end of FY2011) (Table 2.2). Admittedly, the growth of money supply beyond what was targetted was primarily due to excessive government borrowing from the banking sources. Growth of government bank borrowing was 73.5 per cent at the end of December 2011. In view of the above, the second MPS of the Bangladesh Bank (in January 2012) had reduced the target for growth of credit flow to the private sector and raised government borrowing targets. The monetary policy for the second half of FY2012 set growth targets for private and public sector credit at 16.0 per cent and 31.0 per cent respectively whereas the target for growth of broad money was brought down to 17.0 per cent. At the end of fiscal year, the growth of government borrowing was reduced to 25.2 per cent. Thanks to negative growth of other public sector credit, overall public sector credit growth was limited to 18.9 per cent. In contrast, private sector credit remained 19.7 per cent and had exceeded the target. The overall money supply growth remained at 17.4 per cent towards the end of FY2012. Indeed, restraining credit growth, particularly growth of government borrowing, had helped to restore macroeconomic balance to a certain extent. Regrettably, the effectiveness of monetary contraction in controlling overall inflation as well as its non-food component was rather limited. As mentioned earlier, non-food inflation continued to soar throughout the fiscal year as a result of upward adjustment of administered prices of fuel and electricity. In the end, demand side management was outplayed by cost-push inflation.

TABLE 2.2: GROWTH OF MONETARY AGGREGATES (%)

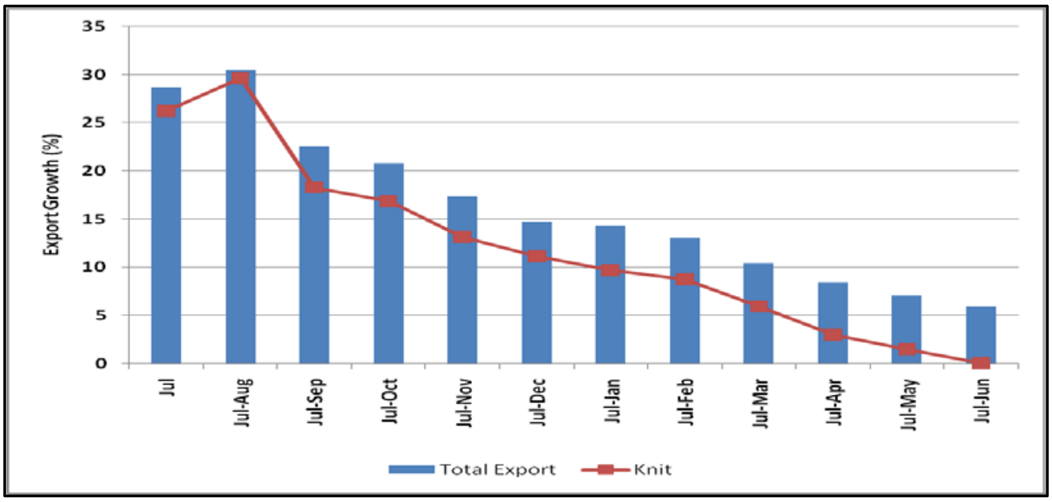
Monetary Aggregates	Target Jun-11	Actual Jun-11	Target Jun-12 (MPS Jul-11)	Target Jun-12 (MPS Jan-12)	Actual Dec-12	Actual Jun-12
Broad Money (M2)	15.2	21.3	18.5	17.0	19.1	17.4
Domestic Credit	17.9	27.4	20.0	19.1	25.9	19.5
Credit to Public Sector	25.3	33.6	28.1	31.0	54.4	18.9
Net Credit to the Govt. Sector		35.0			73.5	25.2
Credit to the Other Public Sector		28.7			1.7	-5.0
Credit to the Private Sector	16.0	25.8	18.0	16.0	19.4	19.7

Source: Bangladesh Bank data.

Export: Target Missed and by a Large Margin

Robust performance of export was one of the major achievements in FY2011. Growth target of export for FY2012 was set at 15.6 per cent. Regrettably, at the end of the fiscal year, overall export earnings growth stood at 5.9 per cent; this was only 86.5 per cent of the target (USD 26,500 million) (Figure 2.2). Indeed, since September 2011, export growth experienced a secular fall. As a result, during the last ten months (September-June) of FY2012, export earnings increased by only 1.3 per cent compared to the same period of FY2011. Of the exported items, knit-RMG had underperformed significantly, registering zero growth during FY2012. The fall in export earnings might perhaps be partially attributed to the fall in cotton prices. During September 2011- June 2012, average international price of cotton declined by (-) 44.7 per cent compared to the matching period of the previous fiscal. Thus, there was perhaps some 'price effect' in the decline in the earning from the RMG sectors in contrast with the 'volume effect'. Export to the US market had been rather weak, failing to register positive growth ((-) 0.1 per cent) in FY2012. Additionally, export earnings from the EU have also started to decline in the second half of FY2012, since January 2012. Export earnings from non-traditional markets were impressive, but inadequate to sustain the overall export growth.

FIGURE 2.2: EXPORT GROWTH (%)



Source: Calculated from EPB data.

Import: Petroleum Products Defined Overall Import Direction

Contrary to the export agenda, imports did not see a significant reduction until last quarter of the fiscal year, leading to heightened pressure on the Balance of Payment (BOP) position of the country. At the end of the third quarter, growth of import payments was about 12 per cent. This came down to 5.7 per cent at the end of FY2012. Growth of import payments in the current fiscal year originated mainly from the higher import demand for liquid fuel as about 44 per cent of the incremental import payments generated from the import of these products. Import of petroleum products registered a whopping 39.1 per cent growth in the July-March phase of FY2012 which later came down to 19.5 per cent at the end of FY2012. In contrast, import payments for other commodities registered only 3.7 per cent growth. Indeed, in the backdrop of import pressure (along with subsidy requirement), the government is not able to utilise fully the capacity of liquid fuel-run quick rental power plants. According to BPC statistics, import payments for petroleum products increased by 33.5 per cent in FY2012 (in BDT terms). A division of the increase was attributed to higher prices of petroleum products, which increased by 21.3 per cent in USD terms. Slowdown in export also helped to reduce pressure of import payments as a significant proportion of import is directly related to export performance. At the same time, stringent policies of Bangladesh Bank to restrict financing of import have also contributed to slowdown in imports.

Balance of Payment (BoP): Pressure Somewhat Released

In the face of a widening trade balance during the first ten months of FY2012, the BoP continued to remain under severe pressure. At the end of April, the overall balance was in the negative terrain ((-) USD 106 million) (Table 2.3). However, during the last two months of the fiscal year (May-June), when trade balance remained under control due to falling import payments, the BoP situation began to see some positive turn. At the same time, impressive growth of remittance inflow (22.4 per cent in FY2012), played an important and impressive role in improving the BoP scenario. Foreign aid inflow, which remained below par during the major part of the fiscal year, also showed signs of improvement during this time. In FY2012 net inflow of foreign aid was about USD 1.2 billion in comparison to USD 1.0 billion in FY2011. The BoP and consequently the value of BDT against foreign currencies remained on shaky grounds until January 2012 and started to improve thereafter.

TABLE 2.3: BALANCE OF PAYMENTS IN FY2012 (USD MILLION)

Indicators	Jul-Apr	May-Jun	Jul-Jun
Trade balance	**-7,345**	**-650**	**-7,995**
Export f.o.b.(including EPZ)	19,543	4,449	23,992
Import f.o.b (including EPZ)	26,888	5,099	31,987
Current Account Balance	**509**	**1,121**	**1,630**
Capital account	**429**	**40**	**469**
Financial account	**-934**	**-21**	**-955**
Foreign direct investment (net)	580	415	995
Portfolio investment (net)	142	56	198
Errors and omissions	**-110**	**-540**	**-650**
Overall Balance	**-106**	**600**	**494**

Source: Bangladesh Bank.

Thus, as FY2012 drew to a close the economy had started to recover some of the early weaknesses with reduced reliance on bank borrowing for financing of budget deficit, improved foreign aid disbursement, somewhat slowdown in the pace of (food) inflation, restrained excessive import payments, improved balance of payment position and stabilised exchange rate (of Taka against USD). The resilience of the economy, in terms of attaining positive export earnings and remittance inflow in the face of the global economic slowdown gave hope. Revenue collection by the NBR turned out to be the only consistent performer throughout the fiscal year. At the same time, no tangible breakthrough was visible in terms of investment, productivity growth, quality of macroeconomic governance and putting in place the needed infrastructure that would propel the economy to a higher trajectory of economic growth.

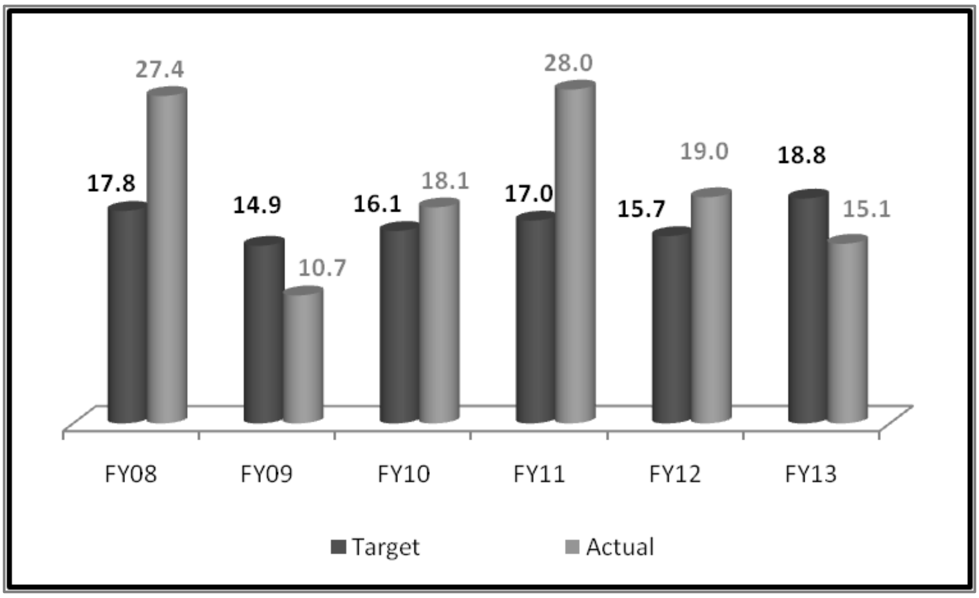
3. Early Signals from FY2013: Economy Approaching towards a Lower-Level Equilibrium

3.1 PUBLIC FINANCE

3.1.1 Revenue Receipts: Lagging Behind

NBR's performance record showed revenue mobilisation to be a reliable performer among key macroeconomic correlates in recent years (FY2008-FY2012). In the past five years, NBR had comfortably surpassed the respective targets four times. The only exception was FY2009, a period when Bangladesh economy was confronted with the lagged impact of the global economic crises, when revenue growth rates suffered in the backdrop of lower collection from import duties due to falling global commodity prices and slowdown in economic activities. Indeed, the GDP growth rate in FY2009 was only 5.7 per cent, the lowest in last nine years (FY2004-FY2012). In FY2013, NBR revenue growth may once again witness a shortfall when compared with the targets set in the budget. Over the first five months, during July-November period, growth of NBR revenue was 15.1 per cent against the target of 18.8 per cent for FY2013 (Figure 3.1). This would imply that to achieve the growth target during the last seven months of the fiscal year about 20.8 per cent growth will be required. In view of the present economic prospects, this appears to be unlikely.

FIGURE 3.1: NBR REVENUE GROWTH (%) – TARGETS VS ACTUAL



Source: Calculated from NBR data.
Note: FY13's actual growth figure (15.1%) is for July-November period.

Within the NBR, revenue collection in the form of income tax and VAT are generally in line with the respective targets. Indeed, VAT collection (from both import and domestic) may surpass the target at the end of the year. However, it is apprehended that collection of income tax may face a setback over the coming months. Banking sector, traditionally the largest income tax paying sector of the economy, had faced a decline in profit during the first quarter of FY2013. In fact, seven large commercial banks experienced net loss during this period. Inability of some borrowers to repay bank loans has dented the profit making prospects of the commercial banks. This is also evident from the rising *doubtful* and *classified* loans in recent quarters. The slowdown in (import) trading business arising out of some of the recently enforced restrictive policies (towards controlling import payments) has also resulted in relatively low profit performance of the banking sector. Income tax collection from Banks in the first five months was largely accounted for by advance income tax payments under Article 64 of Income Tax Ordinance (along with withholding income tax). It is expected that the advance income tax payments will be adjusted in the last quarter of the fiscal year and hence the lower projections. Slowdown in import has also had adverse impact on import duty collection by NBR. During July-November period, import duty collection increased by only 7.0 per cent against the target of 16.1 per cent (Table 3.1).

Although NBR has in recent times intensified its effort to mobilise domestic resources, with commendable success in terms of achieving the high targets, it is apprehended that in FY2013 it will be difficult to attain the target set in the budget for FY2013.

TABLE 3.1: NBR REVENUE – GROWTH TARGETS AND ACHIEVEMENTS (%)

Tax Sources	Share	Annual Growth Target FY13	Achieved Growth Jul-Nov FY13	Required Growth Dec-Jun FY13
External Indirect Tax	**31.7**	**13.8**	**9.9**	**16.2**
Import Duty	13.7	16.1	7.0	21.5
VAT (Import)	13.1	8.2	16.2	3.6
Supplementary Duty (Import)	4.9	25.5	1.7	43.6
Local Indirect Tax	**36.0**	**17.3**	**12.1**	**20.0**
Excise Duty	0.9	51.3	51.2	51.3
VAT (Domestic)	21.9	12.6	20.1	8.7
Supplementary Duty (Domestic)	13.2	24.0	-2.3	38.9
Total Direct Tax	**32.3**	**26.2**	**27.2**	**25.9**
Income Tax	31.5	25.0	27.1	24.1
Grand Total	***100.0***	***18.9***	***15.1***	***20.8***

Source: Calculated from NBR data.

Information on non-NBR[1] tax and non-tax[2] revenue is available only for the July-September period of FY2013. Data shows that collection of non-NBR tax revenue earnings had slowed down quite considerably during the first quarter. Against a target growth of 25.6 per cent for FY2013, this revenue head recorded only 16.2 per cent increase during the reported period (Table 3.2).

[1] Non-NBR tax is expected to contribute about 3.3 per cent to total revenue.
[2] Non-tax revenue is projected to augment about 16.4 per cent of total revenue intake.

TABLE 3.2: GROWTH IN NON-NBR TAX AND NON-TAX REVENUE COLLECTION (%)

Particulars	Growth Target FY13	Achieved Growth Jul-Sep FY13	Required Growth Oct-Jun FY13
Non-NBR Tax	**25.6**	**16.2**	**28.2**
Narcotics &Liquor	9.1	14.3	7.7
Vehicles	62.7	1.9	81.3
Land	23.1	12.2	25.8
Stamp	16.1	21.4	14.7
Non-tax Revenue	**22.5**	**89.9**	**-5.7**
Dividend & Profit	24.2	107.1	-145.5
Post Office & Railway	14.7	-17.8	19.0
Interest/Fees/Tolls & Other receipts	22.7	85.0	2.9

Source: Calculated from MoF data.

On the other hand, the remarkable 89.9 per cent growth in non-tax revenue was primarily due to Tk. 4,664 crore received from Bangladesh Telecommunication Regulatory Commission (BTRC). It is expected that the auction for 3G license will be opened in mid-January. If any part of this license fee is collected within next June, this could play an important role in augmenting non-tax revenue and compensate the expected revenue gap originating from NBR collection in FY13[3].

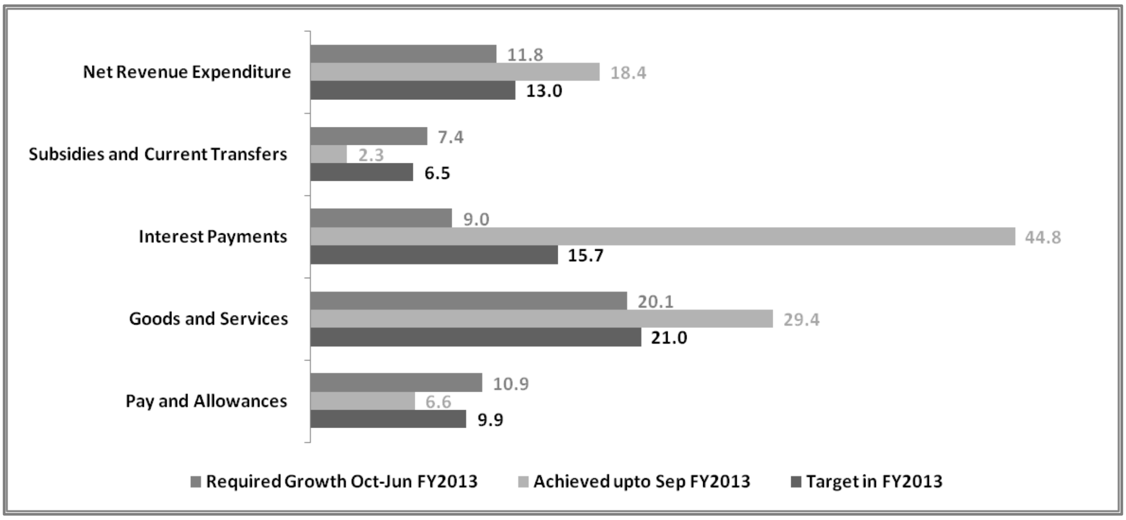
3.1.2 Public Expenditure

Revenue Expenditure – interest payments may surpass the planned allocation

In FY2012 revenue expenditure was higher compared to their programmed levels (budget allocation) primarily due to higher interest payments. During the first quarter of FY2013 this trend had continued. Overall, net revenue expenditure recorded 18.4 per cent growth during the first three months compared to the matching period of the previous year, while target growth for FY2013 was only 13.0 per cent. This would mean that during the last three quarters, growth of net revenue expenditure requires to be limited within only 11.8 per cent which will be a difficult task.

[3] BTRC expects around Tk. 12,000 crore from the 3G spectrum fees.

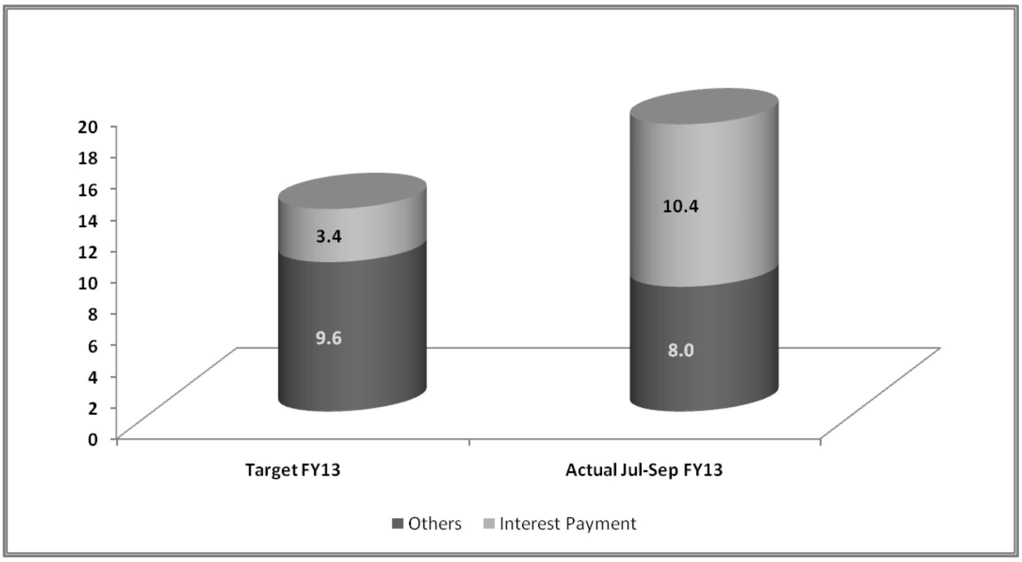
FIGURE 3.2: GROWTH IN REVENUE EXPENDITURE COMPONENTS (%)



Source: Calculated from MoF data.

The most visible deviation from the net revenue expenditure targets were recorded for interest payments. Interest payments increased by 44.8 per cent during the first quarter of FY2013 against its target of 15.7 per cent, a consequence of the high borrowing of the government during FY2012. Indeed, of the 18.4 per cent of net revenue expenditure growth contribution of interest payments was about 10.4 percentage points. The budget for FY2013 envisaged this contribution to be limited to only 3.4 per cent by the end of fiscal year. As the fiscal year will move towards its end the requirement of government borrowing is likely to be higher and hence it will be difficult for the government to bring down this expenditure pressure to the programmed level. From the vantage point of first quarter of FY2013, it appears that revenue expenditure may once again surpass the budgetary target.

FIGURE 3.3: CONTRIBUTION TO GROWTH IN REVENUE EXPENDITURE (%)

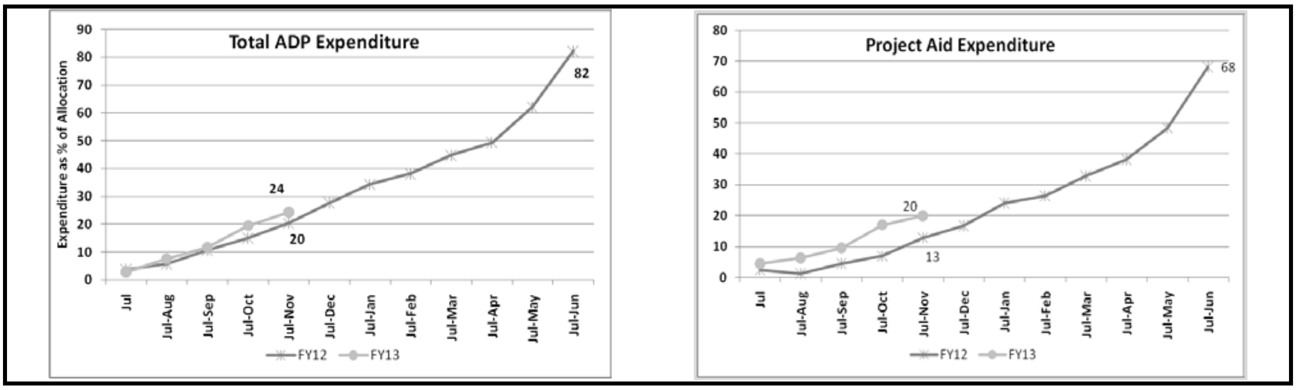


Source: Calculated from MoF data.

Annual Development Programme (ADP): Project aid utilisation has improved

In contrast to the last couple of years (FY2011 and FY2012) expenditure under the ADP has improved in the early months of FY2013. During the first five months, 24.3 per cent of the ADP allocation has been utilised; which was 20.2 per cent for the comparable period of the previous year. On a positive note, this improvement has largely been attributed to higher spending on account of project aid; about 20.0 per cent of the total project aid allocation was spent in this time (12.8 per cent in FY2012). Better spending of project aid has also helped maintain healthy balance of payment during this period. Thus far, October turned out to be the most successful month in terms of ADP spending when about 7.9 per cent of total ADP allocation and 7.4 per cent of project aid were spent. Regrettably, this positive trend could not be sustained in the next month. In November, only 4.8 per cent of ADP (and 3.0 per cent of project aid) allocation could be utilised.

FIGURE 3.4: EXPENDITURE OF TOTAL ADP AND PROJECT AID (%)



Source: Calculated from IMED data.

A sectoral decomposition indicates that ADP implementation by the ministries/divisions with largest allocations was observed to be better than others. If considered together, the top 10 ministries/divisions (in terms of largest ADP allocations) spent 30.2 per cent of their total allocation as distinct from the other ministries/divisions which could spend only 10 per cent. The performance of these ministries/divisions (outside top 10) was in fact lower than that of the last year when they had utilised 13 per cent of their allocation. Within the top 10, implementation by M/O. Health & Family Welfare, M/O Railway and M/O Industries were, however, below par. In fact M/O Industries could not spend any amount from its project aid portfolio (Tk. 1,320 crore). Among the better performers, utilisation rate of Power Division has been the most impressive. The division spent about 38.9 per cent of total allocation and 62.2 per cent of project aid allocation. One may recall that about three-fourths of the total allocation for Power Sector under ADP was allocated to concluding and carry over projects. This may have helped the utilisation rate of this division.

TABLE 3.3: EXPENDITURE OF TOTAL ADP AND PROJECT AID IN FY2013 (JUL-NOV) (%)

Ministries/ Divisions	GoB	PA	Total
Local Govt. Division (including block allocation)	36.5	16.5	29.8
Power Division	26.3	62.2	38.9
M/O Primary & Mass Education	36.0	39.7	36.4
M/O. Health & Family Welfare	15.4	14.9	15.1
M/O Railway	12.9	12.6	12.8
Roads Division	34.2	20.0	32.4
M/O Education	86.7	22.7	63.5
M/O Water Resources	28.6	4.0	22.0
M/O Industries	24.4	0.0	5.7
Energy & Mineral Resource Division	40.3	13.9	25.6
Top 10 Total	33.8	23.7	30.2
Other than Top 10 ministries	6.2	14.6	10.0
Grand Total	**27.1**	**20.0**	**24.3**

Source: Calculated from IMED data.

Overall, as it appears from the early signals, despite some progress, in FY2013 it is unlikely that there will be any significant improvement in ADP implementation. However, one may expect some improvement in financing composition of the ADP in the form of better project aid utilisation when compared to FY2012.

One may recall that in its June 2012 review of macroeconomic performance analysis the CPD identified that the implementation performances of larger projects in the ADP, which were initiated by the present government, were found to be at a slow pace. In a welcome note, average expenditure of these projects during July to October FY2013 was marginally better (20.9 per cent of allocation) than the overall ADP expenditure (19.5 per cent of allocation) (Annex Table 1)[4]. Regrettably, average expenditure of aid component of these projects (15.3 per cent) lagged behind compared to the average expenditure of total project aid allocation (17.1 per cent). One may note that, among these projects, three were carried over to ADP for FY2013. Six projects are expected to be completed by 2013. The cumulative expenditure status of these projects suggests that many of them will also fall under 'carry over' criterion in future.

3.1.3 Budget Deficit: In Safe Zone So Far

As would be recalled, FY2012 was a year of turbulence as far as budget deficit and its financing perspectives were concerned. FY2013 appeared to be in line with the usual trend. Traditionally, during the first quarter of the fiscal year, budget deficit remains within the safe zone. Government budget in the first quarter of FY2013 recorded a surplus to the tune of Tk. 5,672 crore. As a result, low off take of foreign grants (Tk. 123 crore) and net foreign borrowing (Tk. 200 crore) did not put

[4] Information on 17 among the 20 projects identified during the earlier CPD review was found. The analysis here is based on available information only.

any serious pressure on the budget deficit financing thus far (up to the first quarter) (Table 3.4). The large revenue surplus was in fact used to repay government borrowing from non-bank sources (sources outside borrowing from sale of NSD certificates). Borrowing from the banking system was only Tk. 14 crore. However, less than expected net sale of NSD certificates may give rise to some concerns with regard to managing deficit financing in the latter half of the fiscal year.

TABLE 3.4: FINANCING OF BUDGET DEFICIT (CRORE TK.)

Description	Budget FY12	Actual FY12	Budget FY13	Actual Jul-Sep FY12	Actual Jul-Sep FY13
Foreign Grants	4,938	4,097	6,044	72	123
Foreign Borrowing-Net	13,058	1,886	12,541	-1,074	200
Foreign Loan	18,685	7,775	20,398	364	1,877
Amortization	-5,627	-5,888	-7,858	-1,437	-1,677
Domestic Borrowing	27,208	30,939	33,484	3,457	-5,995
Bank Borrowing (Net)	18,957	27,187	23,000	7,668	14
Non-Bank Borrowing (Net)	8,251	3,752	10,484	-4,211	-6,009
National Savings Schemes (Net)	6,000	271	7,400	414	472
Others	2,251	3,481	3,084	-4,626	-6,481
Total Financing (Excluding Grants)	*45,204*	*36,923*	*52,069*	*2,455*	*-5,672*

Source: Calculated from MoF data.

3.1.4 Outlook for Fiscal Balance: Difficult Times Ahead?

At present complete information on most government income and expenditure related variables are available for only three to five months. As was found, in the first quarter of the fiscal year the government's fiscal balance was in a comfort zone. However, as the year will progress towards the finishing line, one may expect growing pressure on the fiscal balance. Unlike the past three years, the government's revenue earnings may fall short of the target in FY2013, given the present trends. In absence of any lumpy amount received in the form of non-tax revenue (such as 3G license fee), revenue collection by the government may fall short of Tk. 3,500 crore[5]. In contrast, non-development expenditure may require an additional amount equivalent to Tk. 1,025 crore considering the trend of the first three months. Indeed, underutilisation of ADP has systematically helped the government, in an undesirable way, in reducing the fiscal burden. If we expect that this year's ADP implementation will duplicate a scenario similar to that of FY2010 (the best performance in recent years), 86 per cent of the original ADP allocation will be spent. If the other expenditures remain in line with the budget allocation, overall deficit may turn out to be lower than the original limit, by about Tk. 1,000 crore. However, for this to be the case the subsidy requirement for FY2013 will need to be within the limit set in the budget.

[5] The projection considers revenue collection trend of NBR during the first five months. It is also assumed that foreign grants will be equal to the figure received in FY2012.

TABLE 3.5: PROJECTION OF BUDGET STRUCTURE FOR FY2013 (CRORE TK.)

Particulars	Actual FY2012	Budget FY2013	Projection FY2013
Revenues	113,779	139,670	136,170
Foreign Grants	3,558	6,044	3,558
Revenue and Foreign Grants	**117,337**	**145,714**	**139,728**
Non-Development Expenditure	95,186	111,675	112,700
Annual Development Programme	36,269	55,000	47,053
Other Expenditures	18,462	25,063	25,063
Total Expenditure	**149,918**	**191,738**	**184,816**
Financing	**32,826**	**46,024**	**45,088**
Foreign Borrowing-Net	1,886	12,540	6,950
Domestic Borrowing	30,939	33,484	38,138
Bank Borrowing	27,187	23,000	33,054
Non-bank Borrowing	3,752	10,484	5,084
National Savings Scheme-Net	271	7,400	2,000
Other	3,481	3,084	3,084

Source: MoF data and CPD Projections.

On the financing side of the deficit, it is understandable that the underutilisation of ADP will also mean lower availability of foreign resources for the deficit financing. As a result, the incremental burden from lower revenue intake and higher non-development expenditure will need to be borne by the domestic sources. Recent experience suggests that deficit financing from sale of NSD certificates has not been impressive. The target for net sale of NSD was set at Tk. 7,400 crore. During July-November of FY2013 only Tk. 385.3 crore could be generated on this account (to recall, the amount was Tk. 570.3 crore in the corresponding period of FY2012). It is to be noted that the last time when the interest rate was increased in FY2012 (in March 2012), it net with limited success (net sale in FY2012 was only Tk. 271.0 crore). In all likelihood, the net sale of NSD certificates may not surpass Tk. 2,000 crore in FY2013. Considering all these possible scenarios, if we residually calculate the requirement of bank borrowing of the government for FY2013, it is found that an additional amount to the tune of about Tk. 10,000 crore will be needed over the planned figure. Hence, even if though the budgetary structure appears to be within the government plan at the moment, serious revisiting of the targets may be needed in the latter half of the fiscal year.

3.2 MONETARY POLICY

3.2.1 Falling Rice Price Pushed Down Overall Inflation

FY2012 had ended with record highest inflation rate of 10.6 per cent (Table 3.6). In the backdrop of high price levels, the budget for FY2013 (and the monetary policy statement of Bangladesh Bank for the first half of FY2013) had set the lower inflation target at 7.5 per cent. The latest available figure from BBS suggests, in November annual average inflation was 9.0 per cent. In November 2012, food inflation came down to 7.7 per cent (from 10.5 per cent in June 2012), while non-food inflation had reached a high 11.7 per cent (from 10.5 per cent in June 2012)[6]. As may be recalled, since the mid-2000s price level of food items became the dominant contributor to inflation in Bangladesh. In contrast, point-to-point food inflation had started to slow down since July 2011. Indeed, non-food inflation had exceeded food inflation in December 2011. Within non-food commodities, prices of 'clothing and footwear'; 'gross rent, fuel and lighting' and 'furniture, furnishing, household' experienced double-digit inflation. As a matter of fact, average inflation of gross rent, fuel and lighting increased in November 2012 compared to June 2012 – thanks to upward adjustments of electricity tariff by the BERC. If the current falling trend in inflation continues, the annual average inflation at the end of FY2013 may come down to about 7.7 per cent.

TABLE 3.6: CATEGORY WISE ANNUAL AVERAGE INFLATION (%)

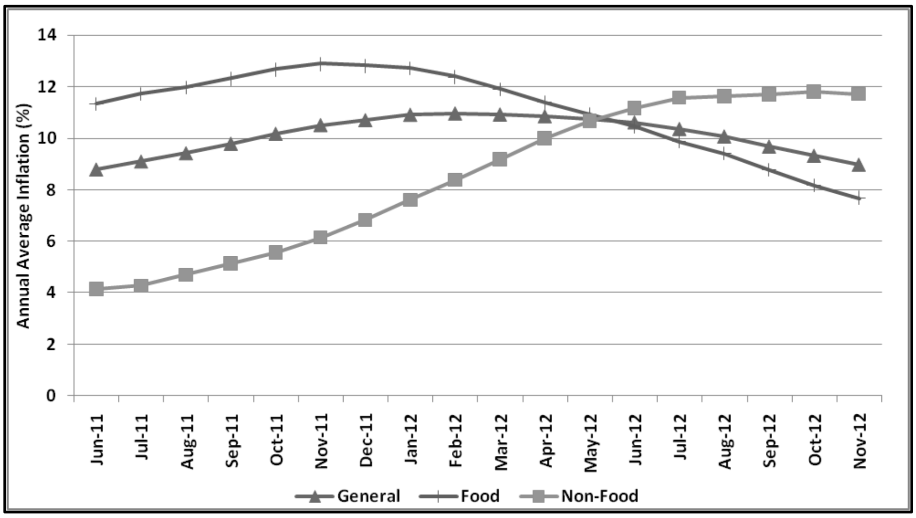
Commodity Group	Jun FY12	Nov FY13
General	**10.6**	**9.0**
Food, beverage & tobacco	**10.5**	**7.7**
Non-food	**11.1**	**11.7**
I. Clothing & footwear	17.6	15.7
II. Gross rent, fuel & lighting	10.3	13.5
III. Furniture, furnishing, household	11.8	11.6
IV. Medical care & health expenses	5.9	7.3
V. Transport & communication	11.3	8.7
VI. Recreation, entertainment,	2.3	2.2
VII. Misc. goods & services	13.5	11.7

Source: Estimated from BBS data.

Apparently, the inflationary pressure has been declining steadily since March 2012 (Figure 3.5). The recent decline in general inflation was largely attributed to decline in food inflation. Indeed, food inflation had started to decline since December 2011, whereas, non-food inflation figure had somewhat stagnated in FY2013, at about 11.6-11.7 per cent.

[6] In July 2012, BBS introduced a new measure of inflation with a new base year (2005-06). This inflation accounting also included prices of a number of new commodities. In near future, this new measure may replace the present inflation estimate based on the base year of 1995-96. According to the new base year, in November annual average inflation was 6.3 per cent (8.7 per cent in June 2012). In November 2012, food inflation came down to 3.5 per cent (from 7.7 per cent in June 2012), while non-food inflation reached as high as 10.7 per cent (from 10.2 per cent in June 2012).

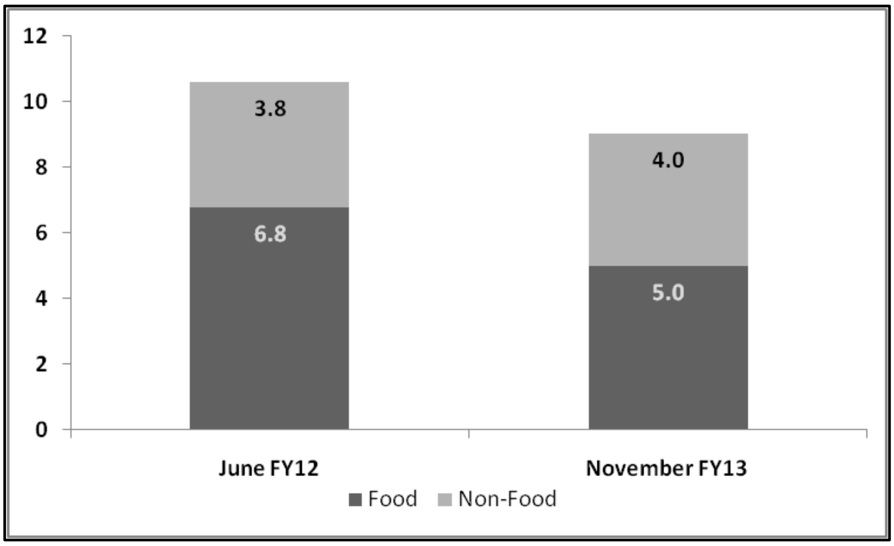
FIGURE 3.5: ANNUAL AVERAGE INFLATION (%)



Source: Estimated from BBS data.

A decomposition of inflation figures as of June 2012 and November 2012, indicates that, of the 10.6 per cent inflation in June 2012, only 6.8 per cent came from food inflation, while the rest 3.8 per cent came from non-food inflation. Of the 9.0 per cent inflation in November 2012, 5.0 per cent was contributed to by food inflation and 4.0 per cent was on account of non-food inflation. This would imply that the food inflation declined (by 1.8 percentage points) more than the total decline in the inflation between the two periods, i.e. 1.6 percentage points, while contribution from the rise in non-food commodity prices increased by 0.2 percentage points. Indeed this incremental contribution originated from the rise in *gross rent, fuel and lighting*, contribution of which increased by 0.4 percentage points. Indeed, the adjustment of administered tariff of electricity made a mark on price level of non-food items. However, one needs to be mindful that food inflation still remains higher than its non-food counterparts.

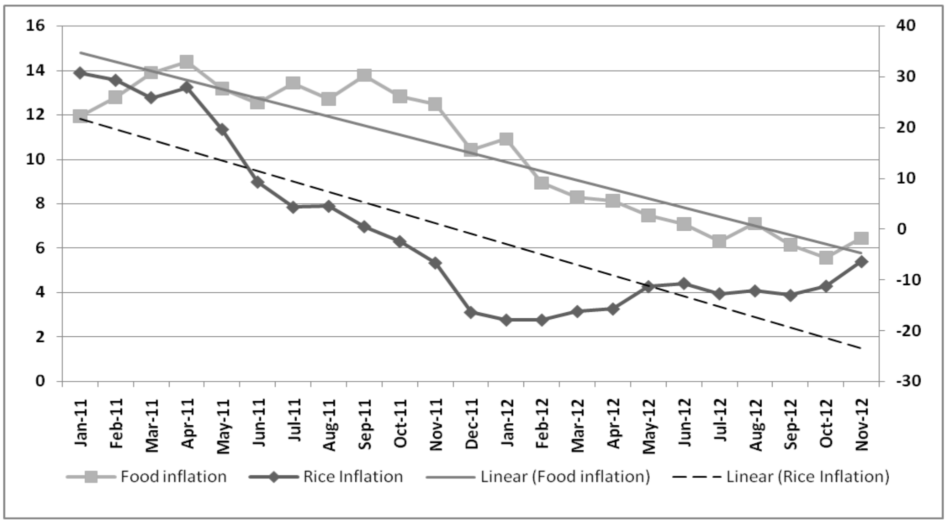
FIGURE 3.6: SOURCES OF ANNUAL AVERAGE INFLATION



Source: Estimated from BBS data.

As is noted earlier, the recent fall in inflation has largely originated from the fall in food inflation. The price of coarse rice in domestic market stabilised at around Tk. 28-29 per kg and remained stable for the most part of FY2013 (July-November). It may be concluded that this fall in food inflation is largely attributed to the fall in prices of rice in the domestic market. Figure 3.7 reveals that rice inflation in domestic market and food inflation are following similar trends in recent times. It has been found that in the Bangladesh context, price of rice controls about one-fourth of the overall price index. Thus, there is little surprise that falling rice price made an impact in food inflation and overall inflation. Indeed, annual average rice price (according to FAO data) in November 2012 declined by (-) 13.6 per cent. Rice price was expected to remain stable in the global market in the near future as FAO has recently raised its forecast of global paddy production in 2012 by 4.2 million tonnes to 729 million tonnes (486 million tonnes, milled). FAO Rice Price Index averaged 244 points in October 2012, nine points lower than in October 2011. Food Planning and Monitoring Unit (FPMU) indicate that in the week ending 14 December 2012, rice prices including Thai 5% broken (545 USD/MT), Vietnam 5% white (405 USD/MT), and Kolkata wholesale price (329 USD/MT) declined by 1.8 per cent, 5.8 per cent, and 10.5 per cent respectively. During the same period, Dhaka city wholesale rice price stood at 293 USD/MT.

FIGURE 3.7: RICE INFLATION VS FOOD INFLATION (%)



Source: Estimated from FAO and BBS data.

Note: Left hand vertical axis is for food inflation while right-hand vertical axis is for rice inflation.

Comfortable food stock of the government also transmitted positive signals to the market which helped to stabilise the foodgrain prices. As of 13 December 2012, the public food grain stock stood at 14.0 lakh MT (of which 11.4 is rice) and is expected to remain at a comfortable zone in the near future. The government set the Aman procurement target at minimum 300 thousand MT rice (250 thousand MT parboiled and 50 thousand MT white) to be procured with a price of 26 Tk/kg for parboiled rice and at 25 Tk/kg for white rice from the domestic market. The procurement drive began on 9 December 2012 and will continue until the end of February 2013. However, the present minimum price set by the government appears to be inadequate to provide price incentive to the farmers in view of the currently experienced continued fall in prices of rice. Keeping rice prices within reasonable limits and ensuring producer incentives in terms of rice price will be a major policy challenge for the government in FY2013 and also beyond.

Favourable global commodity price level has also helped to contain domestic inflation in Bangladesh. According to IMF data, global commodity price level has declined by (-) 3.3 per cent during July-November period of 2012 compared to July-November of 2011. Among the other contributors, stable exchange rate of Taka (against USD) has helped restrain further elevation of price level. One could also argue that the contrationary monetary policy pursued by the central bank has also played a role in bringing down inflationary pressure. At the same time, in the course of the last one year the government did not raise administered prices of petroleum products. As a result, the negative impact of last year's raise has somewhat reduced. The government has recently made an upward revision of the petroleum prices and one may expect in coming days the price of electricity will also need to be increased as a consequence. This will create further pressure on price level, both directly and indirectly. As a result, the inflation rate in FY2013 is likely to remain higher than the target of 7.5 per cent.

3.2.2 Movements of Monetary Aggregates: Growth of Net Foreign Assets Drove Money Supply Beyond Target

The central bank was reasonably successful in containing the monetary aggregates to their respective targets by the end of June 2012. Monetary policy for the first half of FY2013 aimed to contain the growth of the broad money and its components further. At the end of October 2012, net domestic asset and its components were well within their respective targets. Growth of private sector credit was 18.4 per cent as of October 2012 – down from 19.7 per cent as of June 2012 (Table 3.7). Weak bank borrowing requirement on the part of the government helped reduce the growth of net credit to government to 13.4 per cent. However, robust inflow of remittances pushed the growth of net foreign asset beyond its programmed limit. Target for growth of which was set at 7.2 per cent by the end of December 2012. At the end of October 2012, the growth figure turned out to be 37.2 per cent. As a consequence, growth of broad money supply recorded a growth of 19.5 per cent at the end of October 2012 against the target of 16.0 per cent (as of December 2012). It appears that, despite considerable credit tightening, the growth of broad money may surpass its target and may remain well above of the figure of June 2012.

TABLE 3.7: GROWTH OF MONETARY AGGREGATES: TARGET VS ACTUAL (%)

Indicator	Target FY12	Actual FY12	Target Dec FY13	Target Jun FY13	Actual Oct 2012
Broad Money (M2)	17.0	17.4	**16.0**	16.5	**19.5**
Net Foreign Asset	-8.9	11.7	**7.2**	0.9	**37.2**
Net Domestic Asset	21.9	18.5	**17.4**	19.0	**16.3**
Domestic Credit	19.1	19.5	**17.2**	18.6	**17.0**
Credit to Public Sector	31.0	18.8	**13.5**	20.8	**12.1**
Net Credit to the Govt. Sector		25.2	**NA**	NA	**13.4**
Credit to the Other Public Sector		(-) 5.0	**NA**	NA	**5.5**
Credit to the Private Sector	17.0	19.7	**18.3**	18.0	**18.4**

Source: Bangladesh Bank data.

3.2.3 Monetary Policy Stance for the Second half of FY2013: Improved Governance Warranted

Over the years successive monetary policies of the Bangladesh Bank were designed to accommodate concurrently the targets set for economic growth and inflation. The last two MPSs have tried to move towards, primarily, containment of the inflationary expectation and took a rather contractionary stance. The MPS for first half of FY2013 had come up with two major objectives: "(i) maintaining inflation at moderate levels and (ii) supporting inclusive growth objectives of the Government". However, it appears that containing inflation remained the "core focus of the announced monetary program".

The MPS also announced four major policy objectives. The first one was about maintaining close coordination with the Ministry of Finance to limit Government borrowing from the banking sector. The MPS has aimed to accommodate the budgetary target of bank borrowing by the government (Tk. 23,000 crore). However, CPD estimates (mentioned earlier) suggests that the credit requirement of the government from the banking sector may surpass the budgetary target by a considerable margin at the end of the fiscal year. It will be interesting to see if the central bank would prepare its next MPS (for second half of FY2013) to accommodate this.

Secondly, Bangladesh Bank expressed its intention to "focus on the quality/composition of private sector credit". At present it is difficult to assess how this quality control of bank lending has been maintained. One may expect a more comprehensive assessment from the Bangladesh bank itself which would use beyond the bank advances data. Issues have been raised periodically about the mismatch between the documented purpose of bank loan and its actual use. The incident with regard to the Hall Mark scandal (more of this in later section) and some of the other developments of similar disquieting nature reinforce these apprehensions. The next monetary policy statement will hopefully come up with more credible data on the distribution of private sector credit.

In addition, the MPS also aimed to reduce the interest rate spread to ensure a more competitive banking sector. In September 2012 interest rate spread was 5.5 percentage points – down from 5.6 percentage points in June 2012. However, it is still above the 5.3 percentage points figure of September 2011. To maintain a competitive and investment friendly banking sector interest rate spread needs to be brought down to below 5 percentage points. The next MPS may lay out a realistic plan towards this objective.

Thirdly, the central bank recognised the need to strengthen the financial sector for 'effective transmission of monetary policy'. The central bank has put in place new provisioning and rescheduling procedures for bank loan as of January 2013 in line with international practice, in face of significant resistance from banking and private sector actors. In view of the urgent need to improve financial sector governance, the steps taken by the central bank are welcome. It may be noted that, during the period under the present MPS, classified loans had indeed showed considerable rise. As of the first quarter of FY2013, percentage share of classified loan to total outstanding loan has increased to 8.8 per cent (from 7.2 per cent as of June 2012). This is the second successive quarter in which classified loan had increased as a share of total outstanding loan. Indeed, the overall governance of the banking sector has come under scrutiny in recent months. The aforesaid biggest banking sector scam in the history of Bangladesh (Hallmark scam), lax supervision of the banking sector, both internal and external, and the delayed in appointment of directors of the state-owned commercial banks – all these have undermined financial sector management in FY2013 and have had an adverse impact on overall financial sector performance.

Fourthly, the MPS for first half of FY2013 also aimed "to preserve the country's external sector stability". Certainly, the external sector balance is more stable compared to the corresponding period of FY2012. However, this has come at the expense of the slowdown of both export growth and import growth. This low level of external sector activities will surely have adverse implications for the economic growth prospect in FY2013. Moreover, it appears that commercial banks also faced considerable decline in their profit in the first quarter of FY2013. It is expected that new commercial banks will come into operation some time in the second half of FY2013. At a time when the commercial banks are struggling to operate profitably, new banks will also bring more competition. Under such circumstances, the central banks will need to remain vigilant to maintain the health of the banking sector in the coming days.

Overall, the forthcoming MPS will need to present an assessment of the July-December, 2012 MPS; along with this the MPS should also examine the overall implications of the stated measures for economic growth, employment and inflation. On the one hand, the central bank is expected to examine the contribution of monetary policy to the decline in inflation. On the other hand, the monetary policy should also estimate its impacts on economic growth and investment. Indeed, according to the new estimates of Bangladesh Bank, economic growth in FY2013 will be around 6.1-6.4 per cent. However, this will also imply that the growth rate in FY2013 may fall short of its target (7.2 per cent) by about 1 percentage point. 6.2 per cent as an economic growth outcome perhaps will be considered respectable. This will be a further setback for the government when compared with the medium term development targets as set out in Sixth Five Year Plan (SFYP). It is more likely that the central bank will continue to pursue a contractionary monetary policy stance for the coming half of FY2013 – however, this will surely entail a trade-off with growth prospects of the Bangladesh economy.

3.3 EXTERNAL SECTOR

3.3.1 Export Earnings: Lower than Expected Growth

Export earnings stood at USD 24.31 billion in FY2012, registering a moderate growth of 6.0 per cent. This modest growth rate was a significant departure from the impressive growth rate of 41.5 per cent posted in FY2011. The slow down experienced in FY2012 has continued into the early months of FY2013. As can be seen from the Table 3.8, in the first five months of FY2013, during the July-November period, export earnings registered a growth rate of 4.1 per cent as opposed to the robust growth rate of 17.6 per cent in FY2012 compared to the comparable months of FY 2011. Sectoral composition for this period shows that RMG sector posted a modest growth rate of 5.7 per cent whereas the non-RMG exports experienced a negative growth rate of 9.6 per cent compared to the matched period of FY2012. To attain the export target for FY2013 which has been set at 15.3 per cent, growth rate in the coming months of FY2013 will need to be significantly high: 17.5 per cent and 31.0 per cent for RMG and non-RMG respectively. It is projected that growth in export earnings in FY2013 will approximate that of the previous fiscal (about 6 per cent in FY2012).

TABLE 3.8: EXPORT GROWTH OF MAJOR PRODUCTS, JULY-NOVEMBER, FY2013

Product	Growth Target for FY2013	Growth in FY2012 (July-November)	Growth in FY2013 (July-November)	Required growth for rest of the year to attain export target
RMG	**12.8**	**17.9**	**5.7**	**17.5**
Knit	11.9	13.1	1.7	19.2
Woven	13.8	23.6	10.2	15.9
Non RMG	**24.3**	**15.2**	**-9.6**	**31.0**
Raw Jute	13.4	-21.6	-13.1	33.1
Leather	21.2	19.0	-0.6	35.4
Home Textiles	26.9	37.3	0.6	40.5
Frozen Food	17.0	15.1	-22.5	58.4
Total	**15.28**	**17.6**	**4.1**	**21.2**

Source: Export Promotion Bureau (EPB), 2012.

The ongoing economic slowdown in the Euro Zone and sluggish recovery and lower economic growth in many developed countries will likely to have adverse implications for Bangladesh's overall export performance in FY2013. IMF (2012) found that emerging markets are being affected by the lower growth and uncertainty in developed countries and it is also important to note that growth in world trade volume is projected to slump to 3.2 per cent in 2012 from 5.8 per cent in 2011 and 12.6 per cent in 2010 (IMF, 2012).

Market decomposition of Bangladesh's export performance for the RMG sector depicts a mixed scenario. Export performance of Bangladesh in the US market clearly illustrates that export of RMG products failed to maintain the earlier momentum and has remained stagnant in value terms posting a growth rate of only about 0.33 per cent in FY2012. Other competitors of Bangladesh in the US market, top ten exporters have managed to register higher growth in FY2012: e.g. Vietnam (7.9 per cent), Indonesia (4.1 per cent), China (1.0 per cent), Cambodia (6.4 per cent), Mexico (4.0 per cent) and Turkey (20.8 per cent).

US's total RMG imports declined by 3.2 per cent during the July-October period of FY2013. Export of RMG from Bangladesh to the US decreased by 4.2 per cent over the corresponding period. China also witnessed a negative growth rate (- 3.4 per cent); however, export from Vietnam and Cambodia have continued to grow, by 6.9 and 5.9 per cent respectively over the matched period. Over this period when Bangladesh's export earnings from both knit and woven wear declined by 3.2 and 5.6 respectively, export earnings for Vietnam posted a rise of 8.9 and 4.5 per cent respectively for these two items.[7]

[7] As may be recalled, as a beneficiary of the Trans-Pacific Partnership (TPP) with the US, Vietnam is receiving additional opportunities in the US market, particularly preferential tax benefit for footwear and leather industry. The TPP arrangement with US is likely to result in preference erosion for Bangladesh's export items in US market, vis-à-vis Vietnam, in near future.

TABLE 3.9: COMPARISON OF GROWTH PERFORMANCE BETWEEN BANGLADESH AND VIETNAM IN US MARKET (JULY-OCTOBER, 2013 OVER JULY-OCTOBER, 2012)

Product	Bangladesh	Vietnam
RMG	-4.19	6.99
Knit	-3.21	8.87
Woven	-5.58	4.46
Footwear	0.81	16.49
Shrimp	-40.5	-22.7

Source: Estimated from USITC, 2012.

In contrast to the US market, the EU market fares somewhat better. Total exports to the EU countries had registered a 10 per cent growth rate in FY2012 with the RMG earnings posting a 13.9 per cent rise in 2012. Despite the euro zone crises, Bangladesh's apparel export growth in the EU has sustained in view of the relatively better economic situation of its major destination backers. Germany (9.6 per cent), United Kingdom (20.9 per cent), Italy (15.6 per cent) had been good with the exception of France (- 4.9 per cent). Of heightened interest here is to note is the export record of Vietnam in FY2012 in major destination countries: Germany (36.3 per cent), France (47.6 per cent), United Kingdom (43.8 per cent), and Italy (42.8 per cent).

Bangladesh's export growth for RMG items in the euro zone came down further during July-November, 2013 posting a growth rate of 6.5 per cent compared to the corresponding period of FY2012. Whilst export earnings from woven sector were impressive, with a 23.1 per cent growth, it is notable that export of knitwear actually declined by 1.2 per cent.[8] Indeed, total global import of RMG by the EU had declined by 15.1 per cent over the corresponding period. WB (2012) also concluded that commodity export-dependent countries are most at risk in the event of a renewed global slowdown.

[8] The change in the rules of origin, from two-stage to one stage, has been beneficial for Bangladesh's woven wear exports to the EU and this is a reflection of this robust performance. However, whether this is a one-shot boost, or one of a more sustained nature, will need to be seen.

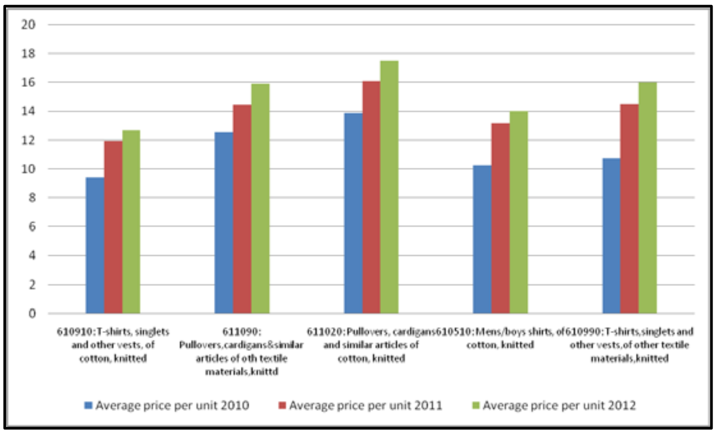
TABLE 3.10: AVERAGE PRICE FOR TOP FIVE WOVEN ITEMS, FY2010-FY2012

RMG Items	Total Export, FY2012 (in million USD)	As a % of total Knit	Average price per unit, FY2010 (in USD)	Average price per unit, FY2011(in USD)	Average price per unit, FY2012 (in USD)
Woven Garments					
620342: Mens/boys trousers and shorts, of cotton, not knitted	3664.08	38.3	10.72	12.65	14.88
620462: Womens/girls trousers and shorts, of cotton, not knitted	1433.02	15.0	12.67	14.70	16.51
620520: Mens/boys shirts, of cotton, not knitted	1109.86	11.6	13.76	16.18	18.86
620590: Mens/boys shirts, of other textile materials, not knitted	598.85	6.3	11.83	14.12	17.00
620349: Mens/boys trousers and shorts, of other textile materials, not knitted	312.54	3.3	10.51	12.76	14.39
Knit Garments					
610910: T-shirts, singlets and other vests, of cotton, knitted	4490.12	47.33	9.40	11.94	12.73
611090: Pullovers, cardigans & similar articles of oth textile materials, knittd	1494.20	15.75	12.59	14.48	15.93
611020: Pullovers, cardigans and similar articles of cotton, knitted	665.96	7.02	13.89	16.12	17.51
610510: Mens/boys shirts, of cotton, knitted	624.23	6.58	10.28	13.16	14.03
610990: T-shirts, singlets and other vests, of other textile materials, knitted	222.99	2.35	10.78	14.52	16.00

Source: Estimated from EPB Data, 2012.

As can be seen from the Table 3.10, in recent years average price per unit for woven products has registered some increase over time inspite of the volatility in the cotton market. Average price for RMG remained stable (and somewhat rising) inspite of the recent fall in cotton prices.[9]

FIGURE 3.8: AVERAGE PRICE FOR TOP FIVE KNIT ITEMS, FY2010-FY2012



Source: Estimated from EPB Data, 2012.

[9] The average price for top woven items increased from USD 10.72 to USD 14.88 during the period of 2010 to 2012 while the price of the knit item ranked first (T- shirts, singlets and other vests, of cotton, knitted) increased from USD 9.40 to USD 12.73 over the same period. However, CPD analysis (2012) showed that the total volume of export has decreased for top five knit items in FY 2012 compared to FY 2011.

Apart from the country's principal export items, the RMG, in the EU market encouraging growth rates were posted in FY2012 for footwear and shrimp, 21.3 per cent and 7.4 per cent respectively. On the other hand, in the US market, export earnings from footwear remained almost unchanged (0.81 per cent) whereas shrimp export declined by a significant 40.5 per cent.

Whilst Bangladesh's exports have been experiencing fluctuating fortunes in the North American and EU markets, her South-South trade has been on the rise.10 In FY2012, Bangladesh experienced robust export growth in China (25.7 per cent), Malaysia (27.9 per cent), Korea (28.1 per cent), Myanmar (39.4 per cent), Thailand (55.8 per cent), Singapore (58.0 per cent), Brazil (40.9 per cent) and South Africa (16.9 per cent). Export basket in these countries mostly concentrated on non-RMG products which speak of the significant opportunities for export diversification and Bangladesh should put more emphasis on this emerging opportunity for market and product diversification.

Bangladesh export to India has experienced a robust growth in recent years and stood at USD 498 million in FY2012. During the July-November period of FY2013, export earnings reached USD 221 million, registering 3.8 per cent growth over the corresponding period of FY2012. The recent duty free market offer to Bangladesh from India have created favorable window of opportunity to enter the fast growing Indian market.11 To take advantage of the duty free offer of India, a dedicated strategy should be developed including in areas of attracting Indian and other investment targetting the Indian market, developing bilateral/regional supply networks and value chains, development of physical infrastructure and connectivity, ensuring better investment environment, capacity to address non tariff barriers, simplification of custom procedures, improved trade facilitation, etc.

Along with the external factors some of the internal disquieting developments also do not augur well for Bangladesh's RMG export. Recent devastating fire incident in Tazreen garments in Ashulia has once again drawn attention to the need for ensuring safety and security of RMG workers.12 Besides, this is likely to have adverse implications for Bangladesh's credibility as a supplier when Bangladesh was trying to consolidate its foothold as the second-largest RMG exporter in the world, and major buyers were showing keen interest in Bangladesh as part of their China Plus One strategy for sourcing. Whilst RMG is not covered under US-GSP scheme, US-GSP hearings and likely adverse decision could also impair Bangladesh's overall export interest in the US market. The issue of allowing RMG workers on their trade-union rights has also been highlighted by the CPD. If the GoB and concerned institutions fail to take adequate measures in the above regard, the adverse implications will seriously undermine Bangladesh's export potentials in the near future. Additionally, the increasing number of bilateral and regional trade agreements will likely lead to preference erosion for Bangladesh, as will unilateral tariff reductions by developed countries. Bangladesh's should strategise in view of the above if she is to realise her potential to match China's track record. Thus, Bangladesh will need to give adequate attention to both software (regulatory regime, trade union rights, compliance etc.) and hardware (infrastructure development, trade facilitation, supply-side capacity building) related measures on an urgent basis.

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[10] This is a general trend for the LDCs and indeed according to the ADB (2011) the volume of south-south trade is projected to double by 2030 (ADB, 2011).

[11] Whilst the ratio of Bangladesh's global export of RMG and non-RMG items was 80:20, in case of India this was 20:80 which alludes to the potential for significant export diversification for Bangladesh in the Indian market.

[12] CPD will study the issue of compliance and safety at factory level and present the findings at forthcoming dialogue.

3.3.2 Import Payments: Contraction Contributed to Improved External Balance

Performance of the import sector had been rather sluggish in FY2012. Registering a growth rate of 5.3 per cent, total imports amounted to USD 35442.30 million in FY2012. Growth in import payments in the first quarter of FY2013 was 2.0 per cent compared to the corresponding period of FY2012 (Table 3.11). Fall in some of the key commodity prices and the overall contractionary policy pursued by the central bank played its role. Statistics with regard to global commodity prices shows a fall in prices of food grains and fuel and a number of other items in the global market. It needs to be noted that there was also a drastic reduction in the import of rice (- 97.6 per cent) which also contributed to containing total import payments.

TABLE 3.11: IMPORT PAYMENTS FOR SELECTED COMMODITIES

Items	FY2012 July-Sep (In million USD)	FY2013 July-Sep (In million USD)	Changes (%) FY2013 July-Sep	Changes (%) FY2013 July-Oct
A. Food Grains	**195.3**	**62.0**	**-68.3**	**56.2**
Rice	143.2	3.5	-97.6	NA
Wheat	52.1	58.5	12.3	NA
B. Consumer goods	**1385.9**	**1272.6**	**-8.2**	**NA**
Edible oil	840.5	824.9	-1.9	17.4
Pulses	71.1	103.1	45.0	NA
Sugar	403.4	271.4	-32.7	NA
C. Intermediate Goods	**4466.1**	**5161.6**	**15.6**	**NA**
Crude petroleum	104.7	15.2	-85.5	31.4
POL	453.0	680.0	50.1	
Pharmaceutical products	47.1	61.0	29.5	NA
Fertilizer	452	508.1	12.4	NA
Raw cotton	415.5	618.3	48.8	10.5
Yarn	419.8	395.8	-5.7	
Textile and articles thereof	991.5	992.9	0.1	-0.3
D. Capital Goods	**2171.7**	**1958.9**	**-9.8**	**NA**
Capital machineries	632.2	546.5	-13.6	-7.5
Others	1539.5	1412.4	-8.3	NA
E. Others n.i.e.	**673.8**	**619.2**	**-8.1**	**NA**
Grand Total	8892.8	9074.3	2.0	-4.0

Source: Bangladesh Bank data and NBR and BEPZA data provided by Bangladesh Bank.

Among other import items, import of POL recorded a robust growth of 50.1 per cent in the first quarter in 2013. In contrast, import of machineries, an important import items having significance for investment, faced a negative growth rate both in fiscal year 2012 (-14.0 per cent) and in the first quarter of FY2013 (-13.6 per cent) with attendant adverse implications for investment. However, fertilizer growth was high (12.4 per cent) and import of raw cotton was also high (48.9 per cent).

The latter was likely to have positive impact on performance of export-oriented RMG sector in the near term. However, data for import of textile related machineries, collected from NBR, (Table-3.12) gives a mixed picture.

It is to be noted that import payments indeed has experienced a negative growth of (-) 6.9 per cent over the July-November, FY2013 period.

TABLE 3.12: DYNAMICS OF IMPORT OF TEXTILE RELATED MACHINERIES

Four Digit Code	Type of Machineries	FY2012 July-November (in Million USD)	FY2013 July-November (in Million USD)	Growth rate
8445	Machine for preparing Textile fibre	130.55	73.36	-39.09
8446	Weaving Machine (looms)	47.19	39.65	-8.91
8447	Knitting Machine (Stich-Bonding)	58.86	69.34	27.70
8448	Auxiliary machine for extrude-draw machine (text)	28.77	30.76	15.88

Source: Estimated from NBR data, 2012.

L/C opening and settlement declined by (-) 9.7 per cent and (-) 13.2 per cent respectively during the first five months of FY2013. It is important to note that L/C opening for petroleum decreased by (-) 16.7 per cent during the same period. Anecdotal information suggests that commercial banks are also showing reluctance in opening L/Cs in general although Bangladesh has gone for moral persuasion in discouraging import of particularly consumer and luxury goods only. The declining tendency of overall import was likely to continue in the coming months of FY2013 in view of the restrained monetary policy pursued by the central bank in order to maintain external balance stability.

3.3.3 Remittances: Stellar Performance

The flow of inward remittances to Bangladesh stood at USD 5.01 billion during July to November of the current fiscal year, marking 24.9 per cent impressive growth over the comparable months of the previous fiscal year. This is a remarkable achievement also because remittance earning in FY2012 (USD 12.84 billion) was a significant 10.3 per cent higher compared to FY2011. In part, significant depreciation of exchange rate has helped to achieve this higher growth. Celebration of Eid ul Azha and Durga Puja in the first quarter in FY2013 may have also contributed to this higher growth.

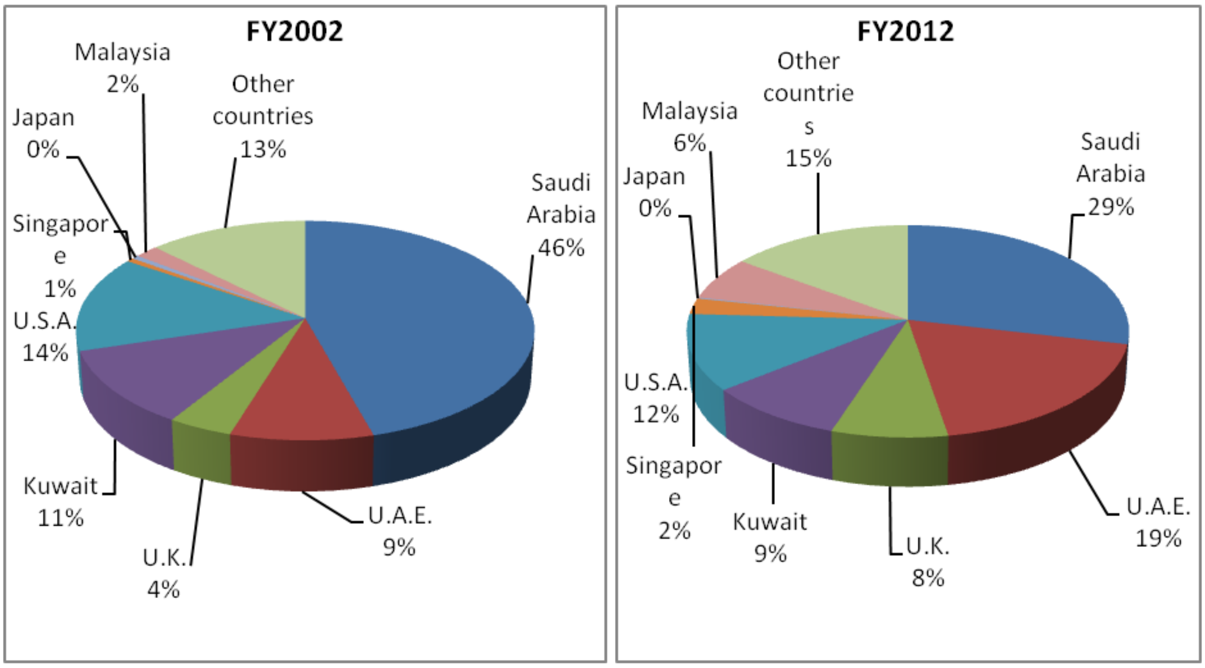
TABLE 3.13: YEARLY TREND IN THE FLOW OF INWARD REMITTANCE: FY2005- FY2012

Year	Remittance (in USD million)	Growth rate of remittance (%)
2004-2005	3848.29	14.13
2005-2006	4802.41	24.79
2006-2007	5998.47	24.91
2007-2008	7914.78	31.95
2008-2009	9689.26	22.42
2009-2010	10987.4	13.4
2010-2011	11650.32	6.03
2011-2012	12843.43	10.24

Source: Bangladesh Bank, 2012.

Despite the recent diversification of remittance sources, Middle East countries continued to be the major sources of remittance inflow in Bangladesh. Saudi Arabia was the largest source of remittance with total amount of remittance stood at USD 3.68 billion in 2012 with 28.7 per cent growth rate in 2012. According to the Bangladesh Bank's official figure for remittances inflow in FY2012, other important sources for remittances were UAE (18.7 per cent), USA (11.7 per cent), Kuwait (9.8 per cent), UK (9.0 per cent) and Malaysia (6.6 per cent).

FIGURE 3.9: CHANGES IN THE MARKET COMPOSITION FOR REMITTANCE EARNINGS, FY2002 AND FY2012



Source: Adopted from Bangladesh Bank Data, 2012.

During FY2012, the total number of migrant workers going abroad stood at about 692 thousands, registering a robust growth of 57. 4 per cent compared to the previous fiscal year. It is of interest to note that impressive growth has occurred after a significant deceleration of migrant workers in 2009 and 2010, (-) 50.9 per cent and (-) 34.3 per cent respectively. Though the growth rate of the number of migrant workers was a negative (-) 6.7 per cent in the first quarter, the number of workers was likely to increase in the coming months of FY2013 as Malaysia has indicated its interest to recruit a significant number of workers from Bangladesh under the government-to-government (G to G) arrangement. This could reduce the cost of migration but will require significant strengthening of the capacity of all involved institution of the GoB.

3.3.4 Balance of Payments: Safe Terrain

In the backdrop of the volatility observed in FY2012, the first four months of the current fiscal year observed a balance of payment surplus mainly because of higher inward remittance and lower import growth. The overall balance reached USD 1923 million in July-October period of FY2013 from a negative balance of 384 million USD for comparable months in FY2012. Trade deficit started to come down and, current account registered surplus of 464 million USD over the same period in of FY2013.

TABLE 3.14: BALANCE OF PAYMENTS

(In Million USD)

Items	FY2011	FY2012	FY2012 (July-October)	FY2013 (July-October)
Trade Balance	-7744	-7995	-3180	-2517
Workers' Remittance	11650	12843	3974	4964
Current Account Balance	885	1630	-625	464
Capital Account Balance	642	469	126	158
Financial Account	-1920	-955	987	1247
Foreign Direct Investment	775	995	466	588
MLT loans	1032	1460	203	579
Errors and Omissions	-263	-650	-872	54
Overall Balance	-656	494	-384	1923
International reserve	10911.6	10364.4	10338.3	12339.5

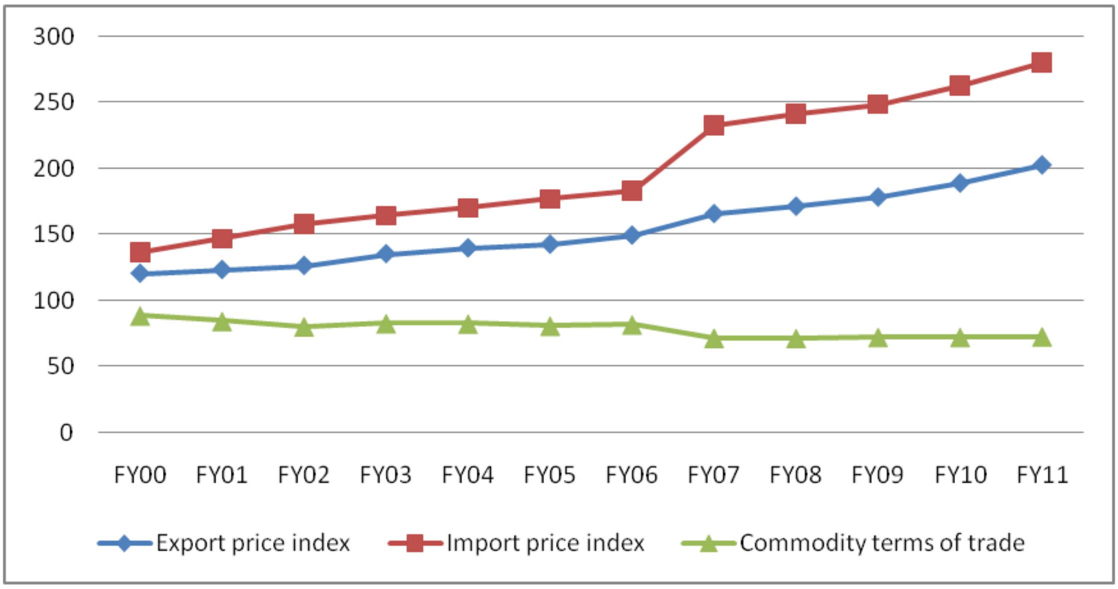
Source: Compiled from Bangladesh Bank data, 2012.

According to the Bangladesh Bank, over July-October period in FY2013, Foreign Direct Investment (FDI) inflow increased to USD 588 million from USD 466 million over the corresponding months in FY2012, registering a growth of 26.3 per cent. Medium and Long Term (MLT) loans stood at 579 million in 2013 with a significant growth rate (185 per cent) in July-October period of FY2013.

Gross Foreign exchange reserves stood at USD 12.8 billion as of 1 January FY2013, equivalent to more than four months imports bills, which was about 32.3 per cent higher than the same period in 2012. Despite the rising reserves in recent times, Bangladesh bank projects a modest growth in FY2013 in light of the subdued forecast for global trade in the coming year.

After two years of uncertainty, the Government has now decided to participate in the 'sovereign bond' market. Sovereign bonds, worth of USD 500 million, will be issued during March-April, 2013. The government expects that the interest rate to be in the range of 5-5.5 per cent. Bangladesh's stable credit rating has perhaps played a role in this expectation although due caution will need to be exercised in dealing with the possible attendant risks emanating from this form of government borrowing.

FIGURE 3.10: TERMS OF TRADE IN BANGLADESH (BASE YEAR: 1995-96)



Source: Annual Report, Bangladesh Bank, 2012.

It is important to mention here that Bangladesh's terms of trade has been following a declining trend in recent years. Whilst reliable up to date data is lacking, according to Bangladesh Bank information, TOT has improved marginally, by 0.5 per cent, in FY2011 compared to the FY2010. In view of volatility of commodity prices in the global market, a renewed effort to move up the value chain in exportables, away from basic manufactured items where price movements are slow, is required to change the situation in Bangladesh's favour.

3.3.5 Foreign Aid: Improved Thanks to Better Project Aid Implementation

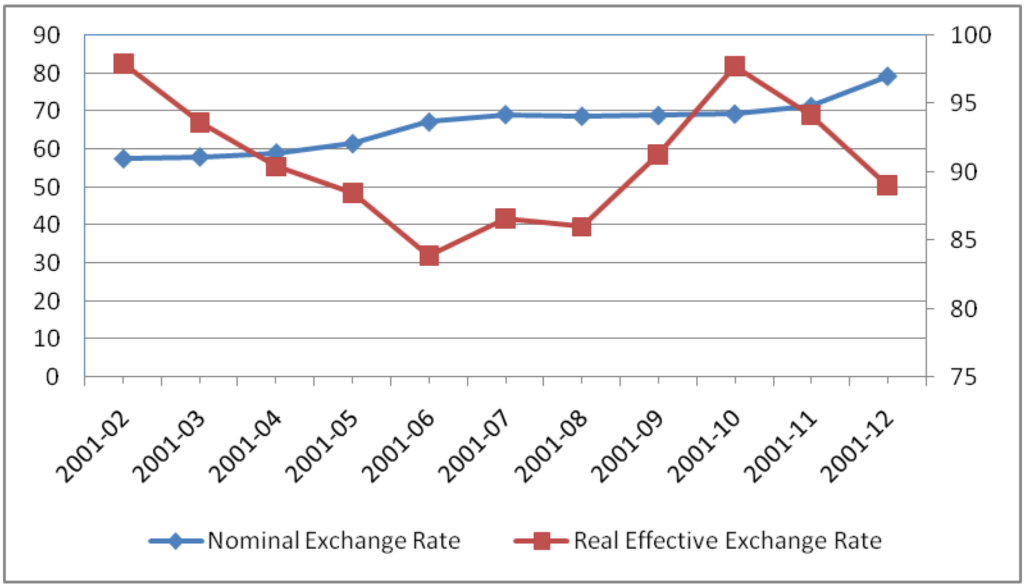
Foreign aid inflow in July-November period, FY2013 stood at USD 906.6 million, posting an impressive growth of 107.4 per cent compared to the corresponding months of FY2012. Net foreign aid inflow during the first five months (USD 568.4 million) was significantly higher compared to the same period of FY2012 (USD 97.1 million). This significant improvement in aid inflow mainly originated from disbursement by Japan (USD 150 million), WB (USD 285 million) and ADB (USD 136 million). Close monitoring and better coordination have perhaps helped. In the current fiscal year, government has set a gross foreign aid target of USD 3.2 billion. Developments related to the Padma bridge financing by the World Bank has cast a dark shadow on the management of large development projects, transparency and overall economic governance and appropriate lessons will need to be drawn from this experience (CPD is preparing a separate report on the padma saga). The

IMF also delayed the disbursement of second part of 'Extended Credit Facility' loan which was due in November, 2012. Though the country is gradually moving out from aid dependency, but the aid inflow has its own significance to meet the country's increasing development needs.

3.3.6 Exchange Rate Movements: Towards Appreciation of Taka

During July-October, FY2013 period, Taka had appreciated against all the major currencies including dollar, Euro, British Pound and Chinese Yuan, except the Indian Rupee. This trend was a reversal of the trends experienced during the comparable months of FY2012. The underlying causes for this are higher inward remittances, the lower import demand and the resultant replenishment of the foreign exchange reserves. Figure-3.11 shows the Taka-USD exchange rate and real effective exchange rate over the last ten years.

FIGURE 3.11: TAKA-DOLLAR EXCHANGE RATE AND REAL EFFECTIVE EXCHANGE RATE, FY2002-FY2012



Source: Adopted from Bangladesh Bank Data, 2012.

Whilst export sector and remittances flow were incetivised by the large scale depreciation experienced in FY2012, recent strengthening of the BDT changes the scenario in a significant way; however, this is likely to have some positive impact on the price of imported commodities in the domestic market.

3.4 GROWTH AND ECONOMIC OUTLOOK

Bangladesh economy had passed through a difficult period in FY2012 from the perspective of macroeconomic management. The defensive adjustments adopted by the government, in the course of FY2012 (particularly during the latter half), were manifested in various policy actions including those related to fiscal and monetary policies. On the one hand, the policy package had contributed to the restoration of macroeconomic stability to some extent; however, this entailed a cost in terms of the realised economic growth. As the halfway mark of FY2013 approached, economic policy of the government had continued to maintain a similar cautious approach. In the backdrop of unattainment of growth target in FY2012 and its likely repetition in FY2013, the gap between SFYP growth target and actual performance will widen. There may be a need to revisit the SFYP targets in view of this. The signals emanating from the first few months of FY2013 indicate that, the policymakers will have to confront a more challenging phase in the coming months.

3.4.1 Challenges for Macroeconomic Management

The present government, for the first time in its tenure, may have to deal with a NBR revenue shortfall during FY2013[13]. Over the last three fiscal years the NBR was able to surpass the targets set for in the budget. If the current trend in FY2013 continues, it is apprehended that there will be some shortfall (about 1.8 per cent of the total budget for FY2013). A significant part of this is likely to be on account of shortfall in import duty collection. While restrictive policies pursued by the government were partly successful in limiting import payments to maintain external balance of payments, the underside of this had been manifested in adverse impact on revenue collection. Moreover to avoid revenue shortfall from collection of supplementary duties (domestic), NBR will need to put up a heroic effort in the remaining months of the fiscal year. NBR has taken up initiatives to realise additional revenues through ADR particularly in view of the significant amount, estimated to be about Tk. 27,000 crore which remained unrealised because of disputes with the taxpayers. Surprisingly, NBR has been (verbally) instructed to collect an additional amount to the tune of Tk. 8,000 crore, which perhaps indicates that the government itself is also expecting some pressure in terms of fiscal management. If this be the case, overall revenue collection growth target in FY2013 will rise to 27.3 per cent. To meet this target attaining a growth rate of 33.5 per cent in revenue collection will be required over the remaining seven months of FY2013. In all likelihood, this appears to be an impossible task. However, the fact remains that there is a need to intensify NBR revenue mobilisation effort and there is a significant scope to raise more revenue. As discussed earlier, CPD estimates indicate that an additional Tk.10,000 crore may be required in FY2013 in the form of bank borrowing to replenish budgetary allocation. Subsidy pressure may once again steal the limelight, as BPC has already sought Tk. 11,700 crore from the government to pay its debt to commercial banks. The government has a slim chance to receive another lump amount from the telecommunication sector in the form of 3G license fee. Recently, the government has decided to float sovereign bond to augment USD 500 million (about Tk. 4,000 crore) from abroad. It is speculated that the government wants to make use of this fund to finance large projects, including the Padma Bridge. This decision of the government requires further consideration given its adverse long term impact on the Bangladesh economy. Under the circumstances, it appears that macroeconomic stability may come under considerable pressure if heavy borrowing from banks remains 'the preferred source' for the government to finance its deficit. As is the case, bank

[13] One may recall that, the last time the NBR failed to meet to its revenue target was in FY2009.

borrowing has already been on the rise. According to the Bangladesh Bank data, up to 13 December 2012 net borrowing of the government from the banking sources increased sharply to Tk. 10,400 crore (about 45 per cent of the budget limit).

It is expected that monetary policy for the second half of FY2013 will continue to remain contractionary. The decline in inflation in recent times may primarily be attributed to price stabilisation in the rice market and hence food inflation. However, non-food inflation will continue to hurt the purchasing power of the people as administered prices of fuel and electricity have received yet another set of upward revisions. Money supply is expected to remain higher than the programmed limit. Robust remittance inflow is expected to continue during the rest of the months in FY2013. As a consequence, net foreign assets will be well above the target and hence, will pull the broad money supply with it. Moreover, as discussed earlier, it will be the central bank which will again have to accommodate the higher government borrowing from the banking system. The targeted growth rates of monetary aggregates will require a revisit with a view to setting these at a more realistic level. Besides, the central bank will immediately need to restore good governance in the banking system which has been afflicted by high profile malfeasance. The role of the central bank in managing the financial sector will remain under spotlight in the coming period. With regard to this, a better coordination between the two policy institutions, the government (MoF) and the central bank will be called for. The role of financial sector as supportive ally to promote higher investment and economic growth will also be tested in the second half of FY2013. The high interest rate on lending is making business uncompetitive; loan default is rising.

The external sector stability appears to be more secured for the rest of FY2013. Regrettably, this is largely aided by falling import payments. Besides, one needs to take cognisance of the fact that, for a developing country like Bangladesh slowdown in trade deficit may not be always helpful when the interests of economic growth are kept in the perspective. Economic growth requires higher levels of investment which in Bangladesh case is highly dependent on imported capital machineries and intermediate goods. Decline in import payments for capital goods is certainly a major setback. As is known, the government has planned for higher growth of 7.2 per cent in FY2013 which will need to be underwritten by higher investment. It appears that, the government is looking for more foreign resources, even if this entails higher financial and economic cost. The central bank has recently allowed a number of companies to borrow from the foreign sources (USD 293 million). Indeed, the IMF-ECF loan needs to be a mentioned in this context. In the backdrop of growing balance of payment pressure the government sought IMF-ECF support (USD 1 billion for three years) which is tied to a number stringent conditionalities. The second installment of the loan was due on November 2012, which is now expected to be released in January 2013 if the government undertakes the necessary policy initiatives advised by the IMF. However, one can argue that the impact of an amount equivalent to USD 141 million (only 1.8 per cent of trade deficit in FY2012) will be rather insignificant[14].

The policymakers in Bangladesh should give serious attention to the issue of illicit financial outflow. A number of international studies have identified that a significant amount of resource capital outflow has taken place over the last decade. UNDP study (Kar 2011) estimated this illicit flow to be between 2001 and 2008, on an average, USD 3.1 billion have been taken outside from Bangladesh each year (Table 3.15). This was the highest among all the LDCs. A recent study initiated from Global Financial Integrity (GFI), which has chosen a rather conservative estimation approach, showed that

[14] One may recall that the seventh installment of IMF-PRGF loan for Bangladesh (in 2007), which was not released, was equivalent to 3.6 per cent of trade deficit in FY2007 (USD 123 million).

the annual average (illicit) capital flight from Bangladesh was USD 1.4 billion (between 2001 and 2010). This outflow, arising from transfer mispricing, trade mispricing and money laundering, has tended to be more visible in recent years. For example, at a time, when RMG export growth is at low level (particularly knit products), a robust growth in cotton import payments (48.8 per cent in July-September FY2013) is difficult to explain. It needs to be noted that the government has recently set up a Transfer Pricing cell under the NBR. This is a welcome move but the cell needs to be fully functional at the earliest. Surely Bangladesh requires a strong and well-equipped specialised institution to confront this issue in near future where a number of public institutions (e.g. NBR, Bangladesh Bank and others) will need to act in a coordinated manner.

TABLE 3.15: ILLICIT FINANCIAL OUTFLOW FROM BANGLADESH (MILLION USD)

Estimates	Time Period	Cumulative	Average per Year
Global Financial Integrity (GFI), 2012	2001-2010	14,059	1,406
Christian Aid, 2009 (only in US and EU)	2006-2008	1,190	397
UNDP 2011	2001-2008	24,514	3,064

Source: GFI 2012; Christian Aid 2009 and Kar 2011.

From economic policy perspectives, it appears that, the government at present is busy with maintaining macroeconomic stability, even at the expense of investment and economic growth prospect. Higher burden of subsidy requirements has forced government to take unpleasant decisions – another set of increase in administered prices of electricity and fuel. BERC has recently raised the tariff for electricity supplied by two companies by about 5 per cent. However, there is a growing concern from the consumers about this rapid increase. In the course of its tenure, the present government had earlier raised the tariff six times at various points in time.

The government has revised administered prices of petroleum products at higher levels on 04 January 2012. The prices of diesel and kerosene have been raised by Tk. 7 per litre (11.5 per cent) while the prices of petrol and octane increased by Tk. 5 per litre (5.5 per cent and 5.3 per cent respectively). According to the government, even after this revision of prices, the BPC will incur a loss equivalent to Tk. 11.8 from selling per litre of diesel and Tk. 12.2 from selling per litre of kerosene. According to the CPD estimates, the BPC can now reduce its loss by about Tk. 2,900 crore every year (the government has however indicated that the BPC loss will be reduced by Tk. 2,500 crore). According to media report, the government has already spent Tk. 2,700 crore during the first half of the ongoing fiscal year in the form of fuel subsidy. As is known, as a result of fuel price adjustment, a part of the subsidy requirement will now be transferred to the BPDB. Hence, unless the electricity price is revised upward, the reduction of government subsidy will be lower than the reduction of loss on the part of the BPC. Regrettably, the government did not make its position clear about the consequences of this price hike for the farmers. Diesel subsidy to the farmers for irrigation needs to be increased to prevent the rise in cost of production of agricultural commodities including Boro paddy. In the backdrop of falling rice prices, the government will need to incentivise paddy farmers to ensure food security in the country.

It needs to be appreciated that, a significant amount of subsidy originates from the increasing reliance of the government on liquid fuel based electricity. One may recall that, according to the present government's original (master) power plan, the liquid fuel based quick rental power plants were supposed to be phased out beginning from 2013. It appears that, due to the government's inability to implement the master plan in accordance with the programmed activities, contracts with these quick rental power plants are expected to be renewed. Hence, people will continue to carry on with the financial burden along with the government.

CPD, as part of the present study, has undertaken a Computable General Equilibrium (CGE) exercise to estimate the economy-wide impacts of increase in oil prices. The estimates have considered two different scenarios under three assumptions (closures): (i) Capital is fully employed and mobile (Simulation 1) and (iii) Capital is fully employed and activity-specific (Simulation 2)[15]. The simulations examined the impact of rise in the petroleum prices by 11.5 per cent. The results show that the rise in petroleum prices will be helpful for restoring macroeconomic balance in terms of improving government deficit. However, adverse impacts are observed in the areas of GDP (in the range of (-) 0.2 per cent to (-) 0.3 per cent), export (in the range of (-) 0.4 per cent to (-) 1.8 per cent) and import ((-) 0.8 per cent) (Table 3.16).

TABLE 3.16: IMPACT OF RAISING PETROLEUM PRICE ON NATIONAL ACCOUNTS

Indicators	Simulation 1	Simulation 2
GDP at factor cost (% change)	-0.3	-0.2
Exports (% change)	-1.8	-0.4
Imports (% change)	-0.8	-0.8
Private Consumption (% change)	-0.6	-0.7
Government Savings as % GDP (percentage points)	0.4	0.4
Private Savings as % GDP (percentage points)	-0.1	-0.1
Current Account Balance as % GDP (percentage points)	0.2	0.1
CPI (percentage points)	0.3	0.2

Source: CPD estimates from CGE Model

Among the economic sectors clothing manufacturing will be the most affected as its value addition loss could be in the range of (-) 0.4 per cent to (-) 2.4 per cent (Table 3.17).

[15] The CGE model is constructed following the IFPRI standard model which has been adapted for Bangladesh. The Social Accounting Matrix (SAM) for 2007, prepared by the Planning Commission has been used. The other assumptions (closures) are (a) Domestic price index (DPI) is fixed and consumer price index (CPI) is flexible; (b) Investment is savings driven; (c) Exchange rate is fixed while current account balance is flexible; (d) Government savings are flexible, while direct tax rate is fixed; (f) Land is fully employed and activity-specific; and (g) Labour (both skilled and unskilled) can be unemployed and are mobile.

TABLE 3.17: IMPACT OF RAISING PETROLEUM PRICE ON SECTORAL GDP (% CHANGE)

Sector	Simulation 1	Simulation 2
Rice cultivation	-0.4	-0.3
Clothing manufacturing	-2.4	-0.4
Electric, gas and water	-0.9	-0.3
Trade	-0.6	-0.3
Transport and communication	-0.6	-0.4
Hotel and restaurants	-0.4	-0.3
GDP	***-0.3***	***-0.2***

Source: CPD estimates from CGE Model

The loss of GDP for clothing manufacturing originates primarily from decline in exports of RMG sector. The estimated decline in quantity of RMG exports will be around (-) 0.4 per cent to (-) 2.6 per cent (Table 3.18).

TABLE 3.18: IMPACT OF RAISING PETROLEUM PRICE ON QUANTITY OF EXPORTS (% CHANGE)

Commodity	Simulation 1	Simulation 2
RMG	-2.6	-0.4
Total	***-1.8***	***-0.4***

Source: CPD estimates from CGE Model

The decline in GDP is manifested by the decline in employment for unskilled labour by about (-) 0.5 per cent and for skilled labour in the range of (-) 0.5 per cent to (-) 0.7 per cent (Table 3.19).

TABLE 3.19: IMPACT OF RAISING PETROLEUM PRICE ON QUANTITY OF FACTOR SUPPLY/DEMAND (% CHANGE)

Factor	Simulation 1	Simulation 2
Unskilled labour	-0.5	-0.5
Skilled labour	-0.7	-0.5

Source: CPD estimates from CGE Model

It is also estimated that, households across the economy will suffer losses in both income and consumptions (in the range of (-) 0.5 per cent to (-) 0.9 per cent). As a result, welfare impact of such increase in petroleum prices is likely to be adverse (Table 3.20).

TABLE 3.20: IMPACT OF RAISING PETROLEUM PRICE ON HOUSEHOLD CONSUMPTION (% CHANGE)

Household	Simulation 1	Simulation 2
Landless Farmer	-0.8	-0.7
Marginal Farmer	-0.8	-0.7
Small Farmer	-0.8	-0.7
Large Farmer	-0.8	-0.7
Rural Non Farm Poor	-0.8	-0.6
Rural Non Farm Non Poor	-0.9	-0.8
Low Education	-0.6	-0.5
High Education	-0.7	-0.5
Total	***-0.8***	***-0.7***

Source: CPD estimates from CGE Model

Firms will also face a negative impact on their income due to the slowdown in aggregate demand ((-) 0.7 per cent) (Table 3.21). The CGE results also confirm that the government's future actions in the form of rise in fuel prices will undermine economic growth and overall welfare of the households.

TABLE 3.21: IMPACT OF RAISING PETROLEUM PRICE ON INCOME OF HOUSEHOLD AND ENTERPRISES (% CHANGE)

Agent	Simulation 1	Simulation 2
Landless Farmer	-0.3	-0.5
Marginal Farmer	-0.4	-0.5
Small Farmer	-0.6	-0.5
Large Farmer	-0.6	-0.6
Rural Non Farm Poor	-0.5	-0.5
Rural Non Farm Non Poor	-0.6	-0.6
Low Education	-0.5	-0.4
High Education	-0.6	-0.5
Enterprises	-0.7	-0.7

Source: CPD estimates from CGE Model

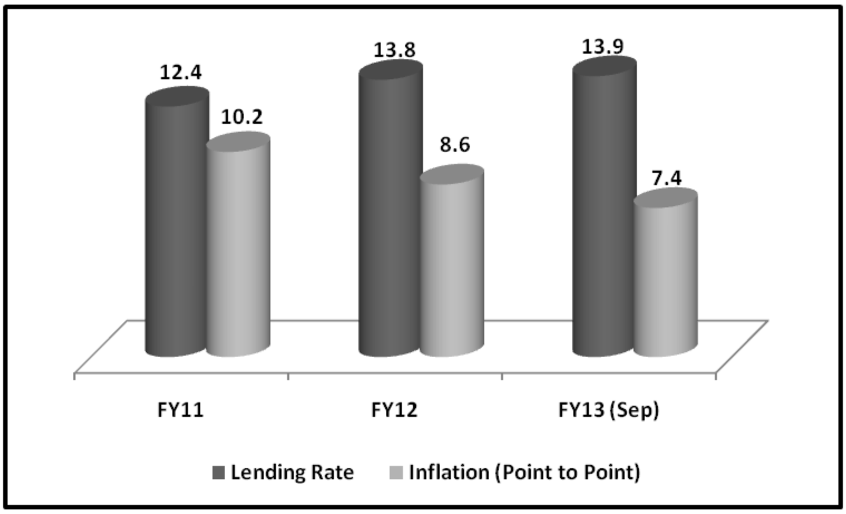
Moreover, it needs to be mentioned that an increase in administered prices of fuel will eventually transfer a part of the subsidy from BPC to BPDB. This implies that another raise in electricity prices will be on cards.

3.4.2 Growth and Investment Outlook

Higher level of investment is a binding constraint for higher economic growth. According to the SFYP target, share of total investment to GDP needs to be 29.6 per cent of GDP in FY2013 (i.e. 4.6

percentage points over FY2012). In other words, it will need an additional Tk. 75,460 crore of investment; of which more than 81.0 per cent should come from the private sector. Certainly this will be an impossible target to chase. Additionally, an overwhelming part of the investment has to go to manufacturing sector to acquire the incremental 1.0 per cent GDP growth in FY2013 over FY2012. Signs of slowdown in investment trend are becoming increasingly visible. A combination of a number of factors, including weakening of global demand, inadequate infrastructural facilities, constricted access to finance, increasingly dysfunctional development administration and institutions, unsatisfactory industrial relation have depressed the investment outlook further. High cost of borrowing has been repeatedly mentioned by the business community as an impediment for private investment. In this connection, high level of inflation is often blamed for high interest rate. Interestingly, at a time when inflation is coming down, interest rate is creeping up. The real interest rate (both nominal and real) in FY2011 was 2.2 per cent which is now increased to 6.5 per cent in September FY2013 (Figure 3.12).

FIGURE 3.12: LENDING RATE VS INFLATION RATE (%)



Source: Bangladesh Bank and BBS Data

The depressing sign of investment scenario is visible from the decline in import of capital machineries. In contrast, term loan disbursement in the first quarter of FY2013 has been impressive compared to the corresponding quarter of the previous fiscal year. However, this disbursement was ((-) 4.9 per cent) lower than last quarter (April-June FY2012). It is, however, found that overall private sector credit growth was at a moderately high level. At a time when investment in terms of import capital machineries is declining and economic activity including trade related activities are slowing down, such a growth in private sector credit and term loan is somewhat perplexing. The Hallmark scam has put forward an important lesson to the economy that loans acquired from the commercial banks may not always be destined for the intended purpose (as is evidenced in the bank documents). In view of the disquieting signs in the financial sector, it is proposed that a high-powered task-force is set up by the central bank to investigate the mismatch between credit and investment related data.

The above analysis of the macroeconomic performance in current fiscal, based on early data, transmits the signal that a growth target of 7.2 per cent for FY2013 is unlikely to be achieved. The

GDP growth projections made by the multilateral donors (i.e. the World Bank, IMF and ADB) corroborate that GDP growth rate in FY2013 would be around 6.0 per cent. A more recent projection by the Bangladesh Bank has also estimated that the GDP growth rate in FY2013 will be in the range of 6.1-6.4 per cent (Table 3.22). At this point in time, the available data on real sectors' performance are not adequate to estimate the final outcome for the GDP growth in FY2013. The crop production data (on *Aus* and *Aman*) is yet to be finalised; however, anecdotal information suggests that, the production figure could be better in FY2013 compared to the previous fiscal year. On the other hand, QIP index for large and medium industries for the first two months of FY2013 shows that manufacturing production growth in large and medium industries was only 4.9 per cent. The relatively slow pace of growth in export will also likely have a dampening impact on industrial sector performance in FY2013. In all likelihood, given the current scenario, the economic growth rate in FY2013 is unlikely to surpass the growth record of FY2012.

TABLE 3.22: GROWTH PROJECTIONS BY SFYP AND BANGLADESH BANK FOR FY2013

Sector	SFYP	BB Low Case	BB High Case
Agriculture	4.4	3.5	3.8
Industry	9.9	7.5	7.8
Services	7.1	6.2	6.5
GDP	***7.2***	***6.1***	***6.4***

Source: SFYP and Bangladesh Bank data

Compared to previous fiscal year, at the halfway mark of FY2013, macroeconomic situation is more stabilized. The analyses of macroeconomic performance in this paper indicate that apparently this stability is underpinned by a number of risks. It appears that, the government has settled for a "second best" option by holding on to macroeconomic stability with moderated economic growth, investment and employment prospects. Regrettably, even this modest ambition could come under serious challenge in view of the looming uncertainties in the political front.

4. A Brief Interim Review of the Implementation of the SFYP: Macroeconomic Framework and Sectoral Issues

4.1 Introduction

The sixth five year plan (SFYP: FY2011-FY2015) started its journey of implementation beginning from FY2011 with the goals of 'accelerating growth and reducing poverty'. It has passed the half way mark in this journey, in 2012. SFYP is informed by political commitment on the part of the government which sees the plan as key strartegic intervention to reach middle income country status by 2021. Time has come to take a close look at where the SFYP targets stand, and how feasible are the possibility of their attainment at the end of 2015. One should also note that implementation of the SFYP so far has to be exercised at a period of adverse global environment which accentuated the domestic problems which implementation had to face in the past three years.

In this context, an objective assessment of the implementation of the SFYP is important which will highlight not only the gaps between targets and achievements, but will also highlight major policy weaknesses and implementational challenges faced during this period. It may be noted here that the government has recently completed its internal review of the performance of the first two years of the Plan period. The report is titled 'The First Implementation Review of the Sixth Five Year Plan' and it was prepared by the General Economic Division of the Ministry of Planning. Using result-based monitoring technique, the report has tried to explain domestic and external shocks as major causes of the underperformance. However, the report did not adequately highlight the problems related to institutional weaknesses which undermined macroeconomic management during the plan period. Hence the result-based performance evaluation technique needs to be broadened by putting emphasis on institutional issues and concerns which is needed to make an objective mid-term assessment of the Plan implementation of SFYP.

4.2 Methodological Framework for Assessment of the SFYP Implementation

'The First Implementation Review of the Sixth Five Year Plan' prepared by the Planning Commission has tried to apply a result-based framework for monitoring and evaluation of the Plan by using 35 measurable indicators under 9 broad themes.[16] The methodology has put emphasis on measurable indicators which would assess the progress of 'a limited set of development outcomes' that will 'suffice to judge the level of progress in implementing the strategy' (GoB, 2012). While the 35 measurable indicators are linked with the targeted variables, it is felt that these are not adequate to assess the performance particularly when institutional issues are found to play critical role.[17] A number of related indicators for macroeconomic stability such as money supply, credit to the public and private sector etc. should have been taken into account. The issue of governance should have been broadened to accommodate institutional weaknesses and malgovernance aspects. Besides, drives for undertaking institutional reform as per the strategies set forth for different sectors should have been highlighted in the assessment exercise.

In this backdrop, present review has put focus on both measurable indicators and sectoral strategies set forth in the Plan for attaining the SFYP targets. The macroeconomic framework has been assessed through two types of variables - core and associate variables. Core variables include: public and private investment, production of agriculture, industry and services, export, revenue and savings while associate variables include credit to public and private sector, government subsidy to different sectors, inflation, interest rate, exchange rate and import. On the other hand a number of core and associate strategies have been analysed in the sectoral part with a view to assess the qualitative dimension of implementation of the Plan. These variables are shown in Table 4.1.

[16] The framework has been developed by following techniques applied in China, South Africa, Sudan, Zambia and Uganda with regard to methodology, focus, macro-micro issues.

[17] The number of indicators include under different themes are: income and poverty (10), human resource development (4), water and sanitation (2), energy and infrastructure (4), gender equity (1), environmental sustainability (4), ICT (2), urban development (2) and governance (6).

TABLE 4.1: CORE AND ASSOCIATE VARIABLES AND STRATEGIES FOR ASSESSMENT OF THE MACRO AND SECTORAL TARGETS

Core Variables	Associate Variables
Public investment Private investment Production of agriculture, industry and service sectors Export Revenue Savings	Credit to public sector Credit to private sector Subsidy Inflation Interest rate Exchange rate Import
Core Strategies	**Associate Strategies**

4.3 Accounting Exercise: Performance Assessment (Targets vs. Achievements)

The macroeconomic performance was better in the first year of the Plan period as most of the targets were achieved (Table 4.2). This includes GDP growth, gross investment, growth in production of agriculture and industry, export, national savings, current account balance and fiscal balance etc. However, performance record achieved in the first year could not be continued in the second year; most of the variables were behind the targets except that of national savings. As a result, overall GDP growth in FY2012 was lower compared to that in FY2011 (gap: 0.7 per cent). However, given the adverse global economic environment, Bangladesh has performed better than many other developing countries including Indonesia (GDP growth: 6.5 percent in 2011), Pakistan (2.9 per cent) and Vietnam (5.9 per cent).[18]

The poor performance in the second year of the Plan period (FY2012) is mainly attributed to a number of internal and external shocks. However, these shocks were not exogenous in nature. Weak fiscal and financial management and lack of good governance accentuated the problems. Poor performance in FY2012 has widened the gap with plan targets. If the targets for the end period are to be achieved many indicators will need to be reset, at higher levels. Most of the macroeconomic and sectoral variables have to attain a significant growth over the rest of the Plan period if the desired level of growth and development are to be attained. This would be difficult to attain perhaps because of the lingering global economic slowdown in 2013 (IMF, 2012) particularly in USA and EU, possible rise of petroleum price in the global market and possible adverse impact of 'fiscal cliff' on US economy. A major factor which will influence performance in 2013, with its implications for attaining Plan target, relate to domestic political environment. If in the coming days political uncertainties rise, this will adversely affect investment and business, with serious implications for macroeconomic performance in 2013, and also beyond.

[18] According to the World Development Indicators

TABLE 4.2: SUMMARY OF KEY ECONOMIC INDICATORS

Components	FY11		FY12		FY13	FY14	FY15
	Target	Actual	Target	Actual	Target	Target	Target
Real GDP	3850.16 (6.7)	3851.0 (6.7)	4119.67 (7.0)	4093.8 (6.3)	4416 (7.2)	4752 (7.6)	5132.1 (8.0)
Gross investment	1947.9 (24.7)	1947.9 (24.7)	2411.73 (28.8)	2327.8 (25.4)	3032.5 (29.6)	3622.4 (31.0)	4339.08 (32.5)
Private	1535.6 (19.5)	1532.1 (19.5)	1997.7 (22.2)	1751 (19.1)	2325.6 (22.7)	2781 (23.8)	3337.7 (25.0)
Public	417.3 (5.3)	415.8 (5.3)	593.9 (6.6)	576.7 (6.3)	706.91 (6.9)	841.32 (7.2)	1001.3 (7.5)
National Savings	2236.5 (28.4)	2236.5 (28.8)	2402.7 (26.7)	2689.6 (29.4)	3012 (29.4)	2587.3 (30.7)	4285.6 (32.1)
Production growth							
Agriculture	5.0	5.1	4.5	2.5	4.4	4.3	4.3
Manufacturing	9.5	9.4	9.8	9.8	10.1	10.7	11.7
Services	6.6	6.2	6.8	6.1	7.1	7.3	7.8
Export	22405.7 (20.3)	23008.0 (20.6)	25654.5 (21.2)	16006.0 (13.6)	29374.4 (22.1)	33780.6 (23.0)	38847.7 (23.9)
Import	-31012.6 (28.2)	-30336.0 (27.1)	-35354.4 (29.2)	-21707.0 (18.4)	-40304.0 (30.3)	-46148.1 (31.4)	-52839.5 (32.5)
Current Account Balance	-349.9	995	-192.1	681.0	-229.4	-438.5	-648.5
Fiscal Balance (excl. grants)	-346.5 (-4.4)	-348.2 (-4.4)	-449.9 (-5.0)	-452 (-4.9)	-512.2 (-5.0)	-584.3 (-5.0)	-667.55 (-5.0)
CPI Inflation (avr., %)	8.0	8.8	7.5	11.0	7.0	6.5	6.0
Exchange rate	71.51	71.17	74.29	77.72	76.97	79.6	82.17
Subsidy	310	366	352	366	410	479	561

Source: Economic Review 2012.

4.4 Gap Analysis

Since the macroeconomic performance of the economy in FY2012 is far behind the target, huge gaps are observed in all major indicators (Table 4.3). Thus growth in all those indicators needs to be significantly high in the rest of the Plan period, FY2013-FY2015. Although government has set the target of GDP growth of 7.2 per cent for FY2013 keeping in line with the target set forth in the SFYP, because of low level of GDP growth in FY2012 (gap: -0.7 per cent) the required rate of GDP growth for FY2013 ought to be much higher (7.9 per cent). Achieving that level of economic growth would require a significant rise in investment; for example, gross investment will need to be at a rate of 30.3 per cent in FY2013 of which private and public investment to be increased at a rate of 30 per cent and 23 per cent respectively.[19] Under the existing contractionary monetary policy (MPS July-December, 2012), such a high level of growth of investment to be largely driven by credit to the public and private sector would be difficult to attain. Besides, a major challenge for raising private credit is prevailing high rate of interest on term loan and working capital which make the investment costlier.

TABLE 4.3: KEY ECONOMIC INDICATORS: TARGET AND GAP (BILLION TK.)

	GDP in constant term	Investment			ADP (PPP+ Public entities)	FDI	Portfolio investment	National Savings
		Gross	Private	Public				
Gap after FY2012	-25.9	-83.9	-246.8	-17.2	-93	-55	248.0	286.9
Target for FY2013	4416.0	3032.5	2325.6	706.9	545	1250	-50	3012.0
Required rate of growth in FY2013 (%)	7.9	30.3	32.8	22.6	25.51	25.6	-125.3	11.9
Average growth rate between FY09-FY12 (%)	6.5	17.2	14.0	28.8	24.89	30	5.7	13.6
Target for 2014	4752.0	3622.4	2781	841.3	669	1350	-50.0	3587.3
Target for FY2015	5132.1	4339.1	3337.8	1001.3	808	1590	-50.0	4285.7

Source: Based on the SFYP.

Financing public expenditure with limited domestic resources is always a challenging enterprise. After the end of FY2012, total revenue has fallen short of Tk.3.9 billion which needs to be adjusted in the following year by attaining a growth of 12 per cent (Table 4.4). Attaining this target appears to be manageable though. Government has been successful in revenue generation particularly in case of NBR tax and non-tax revenue. Various measures undertaken by the NBR have contributed towards attaining the target. A major challenge for the government would be to meet the huge gap in case of deficit-financing which was as high as Tk.12374 crore. Reaching the targeted level by external resources would be difficult. Instead government has already shifted its focus and has put more emphasis on mobilizing domestic resources for deficit financing as mentioned in the revised MTBF for FY2013-FY2017. Besides, there should also be a strategy to make use of the huge foreign aid in the pipeline amounting to 17 billion at present.

[19] Although inflow of FDI and portfolio investment has registered considerable growth in 2011 because of their limited share in gross fixed capital formation, growth of those investments would have limited implications on rise in private investment.

TABLE 4.4: TOTAL EXPENDITURES AND FINANCING OF BUDGET DEFICIT: GAP AND TARGET (IN BILLIONS TAKA)

	National Savings	Total Revenue	Tax	Total Expenditures	Deficit financing			
					Overall	External	Domestic	Banks
Gap 2012	286.9	-48.14	-5.69	-139.82	-123.74	-162.14	38.39	70.87
Target 2013	3012	1372.8	1147.4	1885.1	509	195	309	229
Required rate of growth in FY2013	11.99	20.7	20.4	25.5	55.06	933.03	-0.13	-15.77
Target 2014	3587.3	1635.9	1378.8	2220.2	581	230	351	260
Target 2015	4285.67	1949.25	1655.5	2616.8	664	261	403	299

Source: Based on the SFYP.

There were gaps in a number of variables related to the balance of payment (BoP) such as export, workers' remittances, FDI, net aid disbursement and other short term loans although a number of other variables have attained the targeted level such as import and export earnings from services etc (Table 4.5). The high export growth in FY2011 did not sustain in FY2012 mainly because of EU's debt crisis and slow growth of US economy. This may also happen due to low level of growth of gross export earnings caused by decline in the price of raw materials (e.g. cotton, cotton yarn) and products (e.g. cotton textiles). The significant rise in import in FY2012 is mainly related with rise in import cost for high-priced petroleum at a substantial amount and import of essential food products at a high price. However high import was not continued in FY2013; it has slowed down due to slowdown in import of raw materials for export-oriented industries and reduced expenditure for import of petroleum and food due to their low price in the international market. The contractionary monetary policy implemented since January, 2012 has partly restrained the growth of import during the second half of the FY2012. The huge gap in net aid loans is mainly related with failure to realize the part of US$3.0 billion loan to be disbursed for the 'Padma Bridge' project.

TABLE 4.5: BALANCE OF PAYMENT: GAP AND TARGET

						Foreign investment		Financial Account				
	Export	Import	Services	Workers' remittances	Current Account Balance	FDI	Portfolio Investment	Net Aid Loans	Debt Amortization	Other Long term Loans (net)	Other Short term Loans (net)	Trade Credits (net)
Gap 2012	-1662.5	3367.4	-180.4	153.4	1822.1	-55.0	248.0	-342.6	-47.5	143.0	-105.6	-200
Required Growth rate (%)	22.4	26.0	-2.8	10.7	-114.1	25.6	-125.3	36.2	14.8	-12.3	68.2	-13.8
Target for FY2013	29374	-40304	-2493	14213	-229.4	1250	-50	1989	-906	-50	407	-1250
Target for FY2014	33781	-46148	-2609	15918	-438.5	1350	-50	2379	-1056	-120	513.3	-1350
Target for FY2015	38848	-52840	-2744	17829	-648.5	1590	-50	2681	-1200	-170	520	-1450

Source: Based on the SFYP.

4.5 Shortfall in Major Strategies Set Forth in the SFYP

The SFYP has set number of strategies for attaining the targets in case of macroeconomic stability, investment, revenue mobilisation, and growth in real sectors. Those strategies can be divided into two parts – core strategies and associate strategies considering the nature of relation with the core variables.

4.5.1 Macro Economic Framework

Taking into account of the macroeconomic targets set forth in the SFYP, Government has prepared a medium term budgetary framework (MTBF) for the period of FY2011-15. However, this was effective only for two years when a revised MTBF was adopted in FY2013 for the period of FY2013-17 taking into cognizance of the poor performance of the first two years of the Plan period (Table 4.6). Although overall growth target remains at 8 per cent of GDP in FY2015 keeping a number of targets remain the same such as revenue generation, total expenditures, but a number of targets have been revised upward such as export and import as well as some have been revised downward such as gross investment and gross savings. Overall, such revision in the MTBF in effective sense indicates government's downward adjustment of the macro framework for the rest of the Plan period. This reflects government's conservative position with regard to implementation of the SFYP.

Taking into cognizance of the performance in revenue generation and deficit financing, the revised MTBF for FY2013-17 in most related variables have made necessary revision of the targets. There is an upward revision in the target for tax revenue given the better performance of the NBR in revenue generation. Revised targets for deficit financing through higher domestic financing would not be a desired policy choice given its implications on growth of private sector credit and inflation etc. Rise in interest payment as set in the MTBF because of possible high bank borrowing is another issue of concern. Thus future path in implementation of macroeconomic framework of the SFYP seems to be less smooth which may cause continuity in less stable macroeconomic framework.

TABLE 4.6: COMPARISON BETWEEN SFYP, MTBF FY11-15 AND MTBF FY13-17 (IN BILLION TAKA)

	2012-13			2013-14			2014-15		
	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17	Target in SFYP	Projection in MTBF FY11-15	Projection in MTBF FY13-17
Total Revenue	1373	1313.9	1396.7	1636.0	1551.3	1667.3	1953.0	1824.8	1986.2
Tax Revenue	1147	1083.2	1168.2	1379.0	1239.0	1406.0	1953.0	1.27.1	1687.7
Non-Tax Revenue	225	230.7	228.5	257.0	262.4	261.3	294.0	297.7	298.5
Total Revenue as % of GDP	13.4	13.1	13.4	14.0	13.6	14.0	14.6	14.1	14.6
Total Expenditure	1882	1745.2	1917.4	2217.0	2030.4	2227.8	2617.0	2342.4	2613.0
Program Expenditure		1499.6			1761.9			2037.2	
Interest Payment	234	220.7	233.0	234.0	239.5	273.1	267.0	271.8	312.0
Other Expenditure		24.9			29.0			33.5	
Total Expenditure as % of GDP	18.4	17.4	18.4	19.0	17.8	18.8	19.6	18.1	19.3
Budget Deficit as % of GDP		-4.3	-5.0		-4.2	-4.7		-4.0	-4.6
Financing Operations		431.3	520.7		479.1	560.5		517.7	626.8
External Borrowing (Net)		201.6	185.8		229.3	210.2		247.2	241.9
Loans		200.6	204.0		228.1	237.5		245.9	271.3
Grants		66.2	60.4		75.3	61.4		85.4	69.9
Amortization		65.2	78.6		71.1	88.7		84.1	99.3
Domestic Borrowing		229.7	334.8		249.8	350.3		270.5	384.9
Bank Borrowing		170.5	230.0		193.9	243.4		220.1	262.8
Non Bank Borrowing		59.2	104.8		55.9	106.9		50.5	122.1

4.5.2 Investment

Public Investment

SFYP has put emphasis on efficient implementation of the Annual Development Programme (ADP) in order to increase its share in GDP to 7.5 per cent by FY2015. In this context major strategic focus has been put in place to take all ministries under the MTBF, building capacity for project implementation by different ministries/agencies and strengthening the monitoring and evaluation processes.

Although ADP utilization has marginally improved during this period, majority of ministries are still struggling with traditional challenges such as lengthy procurement procedure, inadequate capacity of implementing agencies, land procurement problems and lack of proper monitoring of implementing agencies (GoB, 2012). Failure to disburse fund for approved projects (e.g. under the Ministry of Communication) and reduced budgetary allocation for social sectors against the targeted level of SFYP because of poor subsidy in during FY2012 (particularly for the power and energy sector) are a reflection of mismanagement budgetary process.

A significant share of budgetary allocation over the last three years was targeted for infrastructure development particularly for power and energy sector which was in line with the target of SFYP. During the last three years, overall capacity for electricity generation has improved, but that was not reflected in the actual generation. Failure to initiate large scale infrastructure project such as Padma Bridge, slow progress in Dhaka-Chittagong Highway etc. could not make expected level of contribution in the development of communication network as well as reduction of poverty, particularly in the South-Western region linked with the Padma Bridge project. Weak institutional capacity, poor subsidy management and malgovernance and lack of proactive measures are primarily responsible for those failures. Overall different ministries are found to be less committed and less pro-active in implementing the SFYP towards materializing the political commitment of the government to achieve the goals.

Although the SFYP underscores the necessity of Public Private Partnership (PPP) in infrastructure development with a view to raise investment upto 6 per cent of total GDP by 2015, the progress so far has not been satisfactory. Government has set up only a PPP cell, approved the guidelines for PPP projects and made budgetary allocation in last three national budgets with scant use of those resources. Several infrastructure projects have been identified for the PPP initiative, but only two of such projects have so far have been initiated. Over all, PPP initiative has been advancing at a snail's pace. Major challenges are found in case of unclear financing mechanism, lengthy bidding process and weak regulatory framework. Because of incomplete institutional set up of the PPP, BIFFL was not able to attract external resources for PPP projects (CPD, 2012).

No major reform was initiated in the state-owned enterprises in order to make them economically viable. Without making proper assessment of financial and operational viability, government opened up a number of closed jute mills. The block allocation from the public exchequer still becomes the major source of working capital for a number of corporations (particularly for BJMC). To make them financially viable, government has fridge bad debt of the BJMC which made their financial account clear which make marginal contribution in their yearly net return. Government has identified 28 mills for offloading part/full of their shares to the public through the capital market. This did not happen due to collapse of the capital market in December, 2010 and lack of interest on the part of respective corporations to off load their shares. Privatisation Commission has almost become dysfunctional during this period. Government has decided to return back the mills to the respective corporations which were under the authority of the Privatization Commission. This has been regarded as a backward step with regard to policy reform as mentioned in the SFYP. An alternate initiative undertook by the Privatisation Commission for leasing out unutilised land of different mills for setting up industrial units at the private sector has yet to be implemented even after identification of land.

Private Investment: Local and FDI

A major strategic focus of the SFYP is to promote labour-intensive domestic and export-oriented productive manufacturing industries. The Plan has targeted to improve infrastructural facilities as well as to develop value chain for different industries. It has put focus on improving the incentive structure for private investment with adequate supply of credit at low rate of interest as well as subsidised credit for preferential sectors as well as for SMEs. To diversify the source of capital for industrialisation, the Plan has suggested various reform measures for the capital market.

Private investment based on debt financing has largely been constrained by shortages of fund in banks particularly in FY2012. Government's excess borrowing from commercial banks has partially caused 'crowed out' effect to the private sector (CPD, 2012). The contractionary monetary policy undertaken in the second half of FY2012 and first half of FY2013 has slowed down the growth of credit both at private and public sector. Because of high inflation real expenditure in manufacturing industries (as against in nominal terms) is suffered a setback. An added pressure for the investors is high rate of interest particularly after the ban on the interest rate was lifted with a view to broaden the market-based operation in deposit collection and loan disbursement. These measures instead of incentivizing the growth of private sector credit, have contributed towards slow down the credit growth. Central Bank has undertaken a number of initiatives as part of broadening the financial inclusion within the country.

While banking sector has undertaken necessary measures to be complied with the BASEL II requirements during this period, a number of incidences raised doubt as regards the preparedness towards that direction. Banking sector has faced a number of incidences of malogovernance including bank's investment in the capital market for short term profit violating rules and regulations, largest fraud in banking sector by six companies mainly by a textile and apparels manufacturing group called 'Hall Mark' which siphoned off a total of about Tk.2900 crore, illegal banking operation and fraudulous practices by multi-level marketing companies particularly by companies like Unipay 2 and Destiny. Lack of proper monitoring by the commercial banks as well as by the Central Bank is considered to be a major weakness in these regards. A number of post-facto measures have been undertaken by concerned authorities including banks, the Central Bank, relevant ministries and departments which ought to be taken much earlier. In view of rising bad loans in recent year, the loan classification policy has been tightened. In general, banking sector has faced a number of institutional challenges.

Although government has enacted Special Economic Zones (SEZ) Act 2010 and has opened an office under the Prime Minister's Office, but the office has yet to go for full operation. So far a number of potential areas have been identified to be developed as SEZs. On the other hand, FDI inflow has not registered significant rise because of lack of institutional capacity of the investment promotion agencies such as BOI. Foreign investors participated in the road shows organized by the BOI in different cities abroad have not yet made strong changes in the inflow of FDI in the country.

A major strategic view regarding private investment in the SFYP was to strengthen the capital market as a major source for raising equity for local industries. A number of strategies have been identified in the SFYP particularly with regard to market surveillance, improvement in regulations, transparency and accountability, market research and training etc. In contrast, the capital market has experienced fraudulent practices, huge anomaly and illegal activities which caused an artificial rise of share prices in 2009-2010. This was not sustained and the market has collapsed in December, 2010. This indicates malgovernance and mismanagement in the capital market, lack of coordination between different parts of the financial system and weak operational and institutional capacity of the concerned authority etc. After the collapse of the market, a number of reform measures have been undertaken and various others are under process such as rules for book building system, setting up surveillance and monitoring software at SEC, amendment of SEC act, demutualisaiton of DSE and CSE, increase in number of independent directors and Financial Reporting Act (FRA) etc. However, market has yet to stabilize and not yet able to attract companies at a large number for raising their required equity.

Analysis of performance of investment does not indicate visible change with regard to volume of investment and efficiency and productivity of investment etc. Growth of private sector credit has slowed down and more importantly, share of disbursed credit for large industries has decelerated while that of medium scale industries has significantly increased. Because of high rate interest, growth of advances for working capital has slowed down. The efficiency of capital which is measured by incremental capital-output ratio (ICOR) was found to be higher than the targeted level in the first two years of the Plan period and is likely to be much higher in FY2013 which indicates rise in inefficiency in capital use (Table 4.7).

TABLE 4.7: EFFICIENCY IN CAPITAL USE

	FY2010	FY2011	FY2012	FY2013
ICOR Target	4.0	3.69	3.83	4.1
ICOR Actual	4.29	3.71	4.03	
Gap	+0.29	+0.02	+0.20	

Source: CPD Estimates based the SFYP.

4.5.3 Revenue Mobilization

The strategies for strengthening revenue mobilization included strengthening of the domestic tax base by amendment of VAT Act and Direct Tax Act. Measures also include organizing tax fair, road show, and encourage transfer of savings held by expatriate Bangladeshi workers abroad, initiatives for raising awareness on tax payment through print and electronic media etc. One of the strategies for revenue generation is to reduce the role of supplementary duties substantially by instituting prudential regulations. The Parliament has ratified the VAT Act and Direct Tax Act to be effective from 2015. A number of measures have been undertaken which include strengthening of tax administration such as NBR Modernization Plan 2011-16, initiation of a project called 'Modernization of VAT Environment (MOVE)' under automation, initiation of online income tax return etc. Automation of Dhaka customs house and introduction of ASYCUDA++s are other important measures. It is found that institutional reforms are in line with the targets set forth in the strategies which have contributed to improve the mobilization of resources as discussed earlier. However, the collection of revenue through higher supplementary duties has increased in recent years which were primarily intended to provide support to strategic important local industries.

4.6 Sectoral Issues

4.6.1 Agriculture and Food Security

Considering the prevalence of various challenges with regard to diversification of agriculture, modernization and development of value chain, the SFYP included a number of strategies. In order to incentivise agricultural production, various measures have been undertaken which include open market sale of cereals, reduction in the price of fertiliser in phases, reduction in the price of diesel, genome sequencing of jute and rehabilitation of farmers affected by cyclone 'Aila'. Other important measures include distribution of quality seed for hybrid cereal crops, vegetables like tomato and brinjal etc by BADC and irrigation facility to the northern Borendra region with rebate given at 20% for irrigation run by electricity. With the aim of supporting the farmers diesel facility through agricultural card was initiated along with project undertaken for technological up gradation of agriculture (Tk.150 cr.).

According to the SFYP, the government was to formulate an effective mechanism for maintaining the stabilization of prices of agricultural products. No such initiative has been observed for reducing seasonal price fluctuations. Moreover, no effort has been observed to develop agricultural marketing channel featured by a large number of middlemen which prevent farmers from getting the proper price for their products. The measures for reducing the price of fertilizer and diesel poses questions regarding the actual benefit these will render to the marginal farmers. Concern has been raised as it is believed that the marginal cut in diesel price will hardly make any impact on marginal and poor farmers. An efficient administrative mechanism in the distribution system as well as strong political will of the government is required for the effective implementation and fruitful result of the adopted measures.

4.6.2 Manufacturing Sector

For the export-oriented manufacturing sector four strategic approaches that are included in the SFYP includes export diversification, getting the opportunity from China's falling competitive edge, export restructuring in a globalized economy and working on market access issues. Government has adopted a number of policies with regard to the development of the industrial sector during the plan period which include Industrial Policy 2010, Special Economic Zones Act 2010 and Jute Policy 2010 etc.

RMG and Textiles: Diversification of product and market destination, vertical integration, improving supply of skilled and unskilled workers are the medium term goals set for the RMG sector. The strategies for the development of this sector also include signing bilateral agreements with potential partners, investment in training facilities by BGMEA and BKMEA, improve capacity of owners of RMG on the value chain, greater use of IT etc. For making the RMG sector competitive in the global market and sustain in view of external shocks, various supportive measures have been adopted for the sector. A number of stimulus packages have been given during the period of global financial crisis. The various measures adopted for the development of the textile sector include compilation of Economic Survey on Textile and Jute Sector 2011, Five Year Plan for Textile and Jute Sector (2010-2015), Textile Act 2011 and draft of Jute Act 2011. TPP for strengthening NITRAD, Textile colleges and TSMU for the development of the sector has been completed. There are no measures regarding product diversification or to create facilities for developing skilled human resources as per the SFYP medium term goal for the sector. Progress with regard to market diversification has been slow.

Small and Medium Enterprises: The SFYP emphasizes the role of SMEs in the economy by increasing number of micro and small enterprises through proper monetary and non-monetary incentives, scaling up the size of the existing micro and small enterprises and by enhancing the productivity of the existing micro and small enterprises. The need for strengthening SME Foundation is also required according to the plan. Special measures will be taken to develop women entrepreneurship according to the plan.

Various measures adopted during the SFYP period include: initiative for upgradation of Bangladesh small and cottage industry Act 1957; supporting SME foundation; organisation of "Financial Fair" by SME foundation with commercial banks in divisional, commercial and economic cities; development of SME Foundation webportal; provision of refinancing by BB fund, EGBMP and ADB fund to 31855 enterprises under SME sector. The crucial problem that obstructs in assessing the SME performance in the economy and their requirement is the lack of database on SMEs. There are a large number of SMEs which remain unregistered even though they contribute to the economy and generate income to a large segment of rural population. If not properly brought under a systematic database, these SMEs will not be able to reap the benefits from the government's support programmes and remain vulnerable.

To support the development of SMEs, government has decided to extend the operation of BSCIC. As part to this, initiatives have been undertaken for simplification of the allotment process of industrial plots, plan for establishing BSCIC industrial area, and also establishment of industrial units at Gopalgonj, Comilla, Borguna and Kushtia. The progress of establishment of API Park for pharmaceutical industry and Leather Industry Park has advanced in a snail pace.

Export: According to the SFYP export diversification needs to be the cornerstone of an export strategy. To prevent the adverse impact of the global financial crisis, the SFYP included measures for backward and forward linkage expansion, meeting compliance standards, product/market diversification and product and process up gradation to sustain global opportunities. Trade protections are regularly to be reviewed so that they do not discriminate export enterprises or support inefficient domestic enterprises. According to the plan, supportive measures will be adopted for dynamic national industries that have high potential but require temporary trade protection. A number of measures are set to improve the competitiveness of local industries including reduce trade barriers, increase access to international export markets, focus on production incentives, quality and cost competitiveness and diversification of our export basket, increase ability to export well trained skilled and semi-skilled manpower to existing as well as new destinations, improve private trade logistics such as cold storage facilities, exchange rate flexibility with limited interventions to ensure market stability etc.

Taking into cognizance the adverse impact of the global economic crisis, the government had come up with two fiscal and financial packages (Tk.5035 crore and Tk.2000 crore) particularly targeting the export oriented manufacturing sectors. These measures included additional cash incentive for the selected sectors, support for exporting to the non-traditional markets, relaxing the rules and regulations related to repayment of export credit for a short period of time etc. Those initiatives have contributed to reduce the pressure created by low level export growth in traditional markets.

Besides, exporters got the benefit of depreciation of local currency against US$ (about 15 per cent devaluation) during January- June, 2012. Given the wide gap existed earlier between real effective exchange rate (REER) with nominal exchange rate, such revision of the exchange rate has been considered as 'required'.

4.6.3 Power and Energy Sector

The core targets of the SFYP include generation of electricity to be increased to 15,457 MW by FY15. It also aims to ensure electricity coverage to be increased to 68 percent and to increase energy efficiency by 10%. Considering the energy crisis as the major bottleneck in hampering investment and development of the economy, the SFYP has emphasized on the development of the energy sector with a number of strategies such as ensuring proper pricing of power, establishing private electricity distribution companies, taking efforts to exploit all possible sources of primary energy (hydro-power, gas, coal and solar energy), and energy trade with neighbouring countries etc. This will be pursued in combination with public investment, PPP, and pure private investment for power and energy sector projects. The plan realizes the social needs for primary fuel to be balanced through cross-subsidies and budgetary transfers with a view to reconcile the incentives for private investment and efficient use with social need for ensuring access for the poor.

Despite the fact that total installed capacity as well as actual generation of electricity has increased during the plan period, full capacity is to be realised and the gap between installed capacity and actual generation has widened in each successive year (Table 4.8). Initially government decided to establish diesel based quick rental power plants by the private sector which costs high tariff for electricity. As a result government has to provide huge subsidy against import of diesel for power generation as well as high charges for generation of electricity. Government has to take the burden of excess subsidy beyond the budgetary limit, which has created mismanagement in fiscal and financial issues. Budget for a number projects including for social sector has to cut in order to meet the subsidy requirement. Although government announced a medium to long term plan to reduce the burden over diesel based quick rental power plants to shift to coal based power plants, little progress has been achieved so far. Instead government has renewed contracts with a number quick rental power plant companies.

TABLE 4.8: ELECTRICITY GENERATION (MW)

	Installed capacity	Actual Generation (evening peak)	Gap between Installed Capacity and Usable Load
30.06.08	5272	3386	1886
30.06.09	5710	3735	1975
30.06.10	5927	3183	2744
30.06.11	7574	4852	3351
30.06.12	8871	5518	3889
20.12.12	8931	4622	4693

Source: BPDB.

During the period of the SFYP the government has approved a draft law titled Sustainable Renewable Energy Development Authority (SREDA) Act 2011, Bangladesh Gas Law, 2010 and Power and Energy Fast Supply (Special Provision) Law, 2010. Initiatives have been taken for the conservation of data on gas stock and exploration in Mini Data Bank. Various documentation procedures have been initiated which include Report on Petroleum Resource Management and Petroleum Refining and Marketing by international advisors. Initiatives were taken to import 500 MCM of LNG by December 2012 for meeting domestic demand. Institutional reform included strengthening of BAPEX. Another important step was making of gas transmission pipeline through "Gas transmission and development project" in western and south western region. The test case for all those initiatives will be to ensure adequate supply of power and energy for all kinds of economic activities.

4.7 Conclusion

The core targets of SFYP included reduction of the head-count poverty ratio by about 10 per cent. This was to be achieved, inter alia, among others by creating good jobs for underemployed and new labor force entrants by increasing the share of employment in the industrial sector and increasing the social security spending to 3 per cent of GDP. This will contribute to reduce the level of poverty to 22 per cent in FY2015. Although most of the required changes will be made by the private sector through increasing investment, it is still far below the targeted level. Government's role to facilitate the private investment has been questioned because of weak institutional capacity, mismanagement and most importantly malgovernance.

The political commitment of the government to implement the SFYP in order to become a middle-income country by 2021 was not adequately reflected in the functioning of the various concerned ministries and departments. More importantly, the process was seriously erupted because of mismanagement and malgovernance particularly in case of fiscal and financial issues. As a result the macroeconomic framework which has long been strong and stable in the country has become vulnerable during the Plan period. Government has spent most of its time to reduce the damage of the macroeconomic and budgetary framework except few areas where fresh efforts have been made such as revenue generation by the NBR. Global economic downturn in 2010 and 2011 was a big blow towards ensuring a sustained export-oriented growth in the country which is likely to be continued in 2013 due to Europe's debt crisis, slow growth of US economy and high unemployment and likely adverse impact of Fiscal Cliff etc. Various projections on Bangladesh's economic growth has expected a moderate level of growth in FY2013 - between 6.0 – 6.5 per cent instead of 7.2 per cent which is targeted in the National Budget FY2013 (even though the required GDP growth for FY2013 to catch up the SFYP target is 7.9 per cent). Thus the targets set in the SFYP have become almost unreachable. In fact, Bangladesh has still performed better compared to those of other competing countries. But the performance would be much better if the mismanagement and malgovernance issues have been handled properly which could contribute to narrow down the gap with the targets set forth in the SFYP.

Taking cognizance of the situation, government has already made downward revision in the revised MTMF and MTBF during the time of National Budget FY2013. It may happen that further downward revision in those frameworks would be required given the expected slow growth in FY2013. This would ultimately affect the broader objective of reduction of the poverty in the country at the targeted level. Government should strengthen its social support measures by allocating more resources for safety net programmes.[20] The government according to the plan should launch a comprehensive social protection strategy. Given the slow progress in implementation of different strategies and specific activities, most of the ministries and departments should be proactive in order to implement the stated activities. An 'as-usual' pace of work by the concerned ministries would not help much to achieve the broader goals of the SFYP.

Finally, Government should revisit the targets set forth in the SFYP with regard to the macroeconomic framework and sectoral targets and make the necessary revisions accordingly. The challenge for the government is to determine when is an appropriate time to undertake this exercise? Is it now, or is at the end of FY2013? Or should it be left to the newly elected government after the elections are over? Considering the adequate time needed for effective implementation, it will perhaps be better to go for a mid-term correction without delay.

5. Review of the Performance of the Manufacturing Sector of Bangladesh

5.1 Introduction

Over the past decades manufacturing sector was able to maintain and sustain a relatively high level of growth, surpassing that of the GDP, which contributed to a rise in its share in the GDP (from 10 per cent in 1989 to about 19 per cent in 2012). In the course of particularly the last five years (FY2008 to FY2012) manufacturing sector was confronted with a number of challenges which had important implications both for its domestic market-oriented component as well as the export-oriented one. Despite these challenges manufacturing sector has been able to post at 7-9 per cent growth which was led particularly by the large and medium scale enterprises (Table 5.1). Over this same period small scale enterprises have also experienced a modest level of growth. Nonetheless there is an increasing concentration towards large and medium industries. Excepting a few sub-sectors of the manufacturing sector, major components of the sector are yet to attain the strength to compete globally in equal footing, or in the domestic market without tariff and incentive support. This had been mainly because of number of structural and operational constraints/weaknesses including narrow production base, lack of well-developed value chains, low productivity of capital (e.g. high incremental capital-output ratio), lack of access to adequate infrastructure facilities and in recent years and high interest rates on bank loan. In this backdrop, a detailed analysis of the recent

[20] The project of Northern Areas Reduction of Poverty Initiative (NARI) has been adopted in various northern areas for building dormitories and providing training facilities for women. The safety net programmes (SSNP) adopted by the government mostly has been taking place within the budgetary framework. Allocation in social safety net in the national budget for FY2013 has been reduced to 2.2 percent of GDP which was 2.51 percent in FY2012. The various programmes include the ones related to food security, Vulnerable Group Feeding (VGF), Test Relief (TR), Employment for Ultra-Poor in Northern Region etc. However, considering the prevailing high level of poverty allocation for this head needs to be raised. Moreover, most of the SSNP are related to food based programmes whereas little emphasis is given on cash transfer programs.

performance of the manufacturing sector is perceived to be important in view of the key role of the sector in ensuring structural transformation of the economy.

TABLE 5.1: SHARE AND GROWTH PRODUCTION OF MANUFACTURING ENTERPRISES: FY2008 TO FY2012

	FY08	FY09	FY10	FY11	FY12
Share in GDP (%)					
Manufacturing	17.8	17.9	17.9	18.4	19.0
Large & medium scale	*12.6*	*12.7*	*12.7*	*13.2*	*13.8*
Small scale	*5.2*	*5.2*	*5.2*	*5.2*	*5.2*
Share in Manufacturing GDP (%)					
Large & medium scale	70.8	70.9	70.9	71.7	72.6
Small scale	29.2	29.1	29.1	28.3	27.4
Growth (%)					
Manufacturing	7.2	6.7	6.5	9.4	9.8
Large & medium scale	*7.3*	*6.6*	*6.0*	*10.9*	*10.8*
Small scale	*7.1*	*6.9*	*7.8*	*5.8*	*7.2*

Source: Bangladesh Economic Review, MoF, GoB.

5.2 Structure of the Manufacturing Sector and Its Performance

According to the *Survey of Manufacturing Industries 2005-06*, BBS, there were a total of about 35,000 establishments in the country of which small scale manufacturing units (employing 20-99 workers) were about 41 per cent, and medium and large scale manufacturing units were about 15 per cent (Table 5.2). [21] Between 1998 and 2006, share of small scale enterprises has increased while that of large and medium scale enterprises has reduced (Table 2).[22] Over 99 per cent of the manufacturing units were privately-owned with the share of foreign-owned companies remaining insignificant (e.g. share of joint-venture enterprises was 0.6 per cent).

[21] On the other hand, there were over 50 per cent establishments which were micro and cottage industries (employed 1-19 workers).
[22] However the share of very large enterprises (above 1000 workers) has increased during this period.

TABLE 5.2: DISTRIBUTION OF MANUFACTURING ENTERPRISES

	1997-98	1999-2000	2001-2002	2005-06
No. of establishments	29,573	24,752	28,065	34,710
Share of total establishments (%)				
10-99 workers	63.8	79.9	81.0	85.0
100-999 workers	17.1	19.1	17.8	13.3
1000 and above workers	0.5	1.0	1.2	1.7
Average fixed assets per establishment (million Tk.)	7.3	9.8	11.9	26.7

Source: BBS.

Performance of large-medium scale manufacturing industries (LMI) and small scale manufacturing industries (SMI) varies for different sub-sectors (Table 5.3). Despite the global economic slowdown, Bangladesh was able to maintain moderately high level of growth in export of jute, cotton, wearing apparels and leather industries during FY2009-FY2012 in the backdrop of higher production of LMIs (average growth rate of 15.7 per cent). SMIs sub-sectors which attained high growth rates were basic metal products (19.8 per cent) and food, beverage and tobacco (14.1 per cent) mainly driven by higher demand in the local market. Other industries including non-metallic, fabricated products, wooden furniture etc., which largely cater to the domestic market did not show a significant variation in the performance of LMIs and SMIs. Compared to the corresponding period of the previous year, growth of LMIs in the first two months (Jul-Aug.) of FY2013 has slowed down mainly due to negative growth of jute, cotton, apparels and leather (-1.1 per cent) industries which catered mainly to the global market and had to confront slowdown in demand.

TABLE 5.3: GROWTH OF PRODUCTION OF LARGE, MEDIUM AND SMALL ENTERPRISES: FY2009-FY2013

		FY09	FY10	FY11	FY12	FY13 (Jul-Aug)	Average Growth Rate
General Index	LMMI	7.4	6.9	17.7	9.6	4.9	10.4
	SMI	7.8	10.7	3.3	5.1		6.7
Food, Beverage & Tobacco	LMMI	0.8	8.7	21.9	-6.9	15.1	6.1
	SMI	6.3	38.8	0.5	10.8		14.1
Jute, Cotton, W. Apparel, Leather	LMMI	10.6	3.2	30.1	18.9	-1.1	15.7
	SMI	6.2	4.3	-1.7	0.5		2.3
Wood Prod. /Furniture	LMMI	4.1	3.5	3.0	-4.2	-5.7	1.6
	SMI	10.3	-0.4	4.0	-20.8		-1.7
Paper and Paper Prod.	LMMI	4.2	1.6	-0.7	3.6	10.2	2.2
	SMI	5.1	4.6	-1.7	8.6		4.1
Chemical, Petroleum & Rubber	LMMI	4.4	22.3	-5.6	-0.9	13.3	5.1
	SMI	2.5	0.8	5.7	3.1		3.0
Non- Metallic product	LMMI	12.1	2.4	3.1	2.5	3.5	5.0
	SMI	10.7	5.0	1.9	-3.7		3.5
Basic Metal Product	LMMI	15.6	-41.3	32.3	-1.2	6.9	1.3
	SMI	21.0	1.4	3.1	53.7		19.8
Fabricated Metal Product	LMMI	6.1	8.6	1.8	8.6	30	6.3
	SMI	-2.3	4.2	17.0	8.4		6.8
Other Manufacturing	LMMI	--	--	--	--	--	--
	SMI	3.3	-19.9	-0.5	55.7	--	9.7

Source: Estimated based on QIP Advance Release (various years), BBS.

There was a high concentration in the value addition of the manufacturing sector (Table 5.4). Top ten manufacturing industries accounted for almost 62 per cent of total value addition in FY2006 which was, however, somewhat higher in FY2001 (67 per cent). Apart from the traditional manufacturing industries (such as woven, knit, textiles and pharmaceuticals) a number of non-traditional domestic market-oriented industries made significant contribution in the value addition in the manufacturing sector – these included bricks and tiles, cigarettes, iron steel and re-rolling mills (Table 4). To some extent, this relatively lower concentration in value added in the top ten industries in 2006 reflects some diversification in the manufacturing base.

TABLE 5.4: COMPARISON OF TOP TEN MANUFACTURING INDUSTRIES IN TERMS OF VALUE ADDED SHARE IN 2001-02 AND 2005-06

Industry (2001-02)	Value added share (%)	Industry (2005-06)	Value added share (%)
Readymade garment	22.0	Readymade garments (woven)	23.9
Pharmaceuticals	18.3	Knitwear	9.2
Cotton textile	6.9	Bricks & tiles	7.1
Silk and synthetic textiles	4.6	Cigarettes	6.3
Cigarettes	4.4	Pharmaceuticals	4.7
Wooden furniture	2.9	Iron & steel re-rolling mills	3.3
Jute textile	2.5	Cotton textile	2.0
Cement & other minerals	2.0	Mfg. of cement	1.9
Leather footwear	2.0	Processed fish & seafood	1.7
Soap & detergents	1.8	Handloom	1.5
Total	**67.3**	**Total**	**61.6**

Source: BBS Census of Manufacturing Industries 2001-02.
BBS Survey of Manufacturing Industries 2005-06.

5.3 Changes in Financing the Manufacturing Sector

Debt financing is the major form of resource mobilisation on the part of the manufacturing sector of Bangladesh about 30 per cent of required capital is raised through loans from banks and other financial institutions. However, share of loans and advances to the manufacturing sector (share in M_2) has declined over the years (from 27.0 per cent in FY2008 to 23.0 per cent in FY2012) indicating higher flow of money for non-manufacturing related activities.[23] Whilst between FY2009 and September, FY2013 disbursement of industrial term loan in nominal term has doubled, growth rate has experienced significant deceleration (from 30 per cent in FY2010 to 10 per cent in FY2012) (Table 5.5). Although large and small scale industries have seen a decline in growth in terms of disbursement of term loan, medium scale industries have seen a consistent rise in this period which resulted in a higher share for MSIs in the total disbursement of credit (from 23 per cent in FY2009 to 30 per cent in Jul-Sept, FY2013) whilst large scale enterprises experienced a decline in share. During the first quarter of FY2013, all categories of industries have experienced lower growth particularly due to tightening of credit growth as a result of the contractionary monetary policy pursued by the Central Bank to contain inflation (MPS, January-June, 2012 and July-December, 2012).

Rate of recovery of loan disbursed, particularly to large scale enterprises was found to be low. The amount of non-performing loan, particularly the doubtful loan component has been on the rise in recent years (Table 5.6). Moreover, net disbursement of term loan and working capital tends to vary

[23] Over 75 per cent loans and advances of M2 is used for advances and loans to different economic activities.

widely in relation to net advances (between June, FY2009 and June, 2012). This could be case due to rise in classified loan in this period or for some other reason. Several incidences of frauds and forgeries reported in the national dailies have given rise to concern about diversion of fund from specified activities. Thus, it is important to examine the issue of classified loan in some detail.

TABLE 5.5: DISTRIBUTION AND RECOVERY OF CREDIT: VALUE, SHARE AND GROWTH

Period	Disbursement				Recovery			
	LSI	MSI	SSI	Total (Tk. in Crore)	LSI	MSI	SSI	Total (Tk. in Crore)
Share (%)								
FY2008-09	73	23	4	19973	74	20	5	16302
FY2009-10	73	21	5	25876	68	26	6	18983
FY2010-11	68	25	7	32163	71	22	7	25016
FY2011-12	62	31	7	35278	59	33	8	30237
FY2012-13 (Jul-Sep)	64	30	6	9720	64	29	7	8191
Growth (%)								
FY2009-10	30	22	76	30	6	51	25	16
FY2010-11	16	45	63	24	37	12	62	32
FY2011-12	-0.2	38	7	10	2	77	33	21

Source: Estimated based on Bangladesh Bank data.

TABLE 5.6: STATE OF THE CLASSIFIED LOAN (CRORE TK.)

As of September	Sub-standard loans	Share % of total loan	Doubtful loans	Share % of total loan	Bad loans	Share % of total loan	Classified loans	Share % of total loan
2007	2954	1.8	2466	1.5	17834	10.8	23254	14.0
2008	2640	1.3	2830	1.4	19603	9.7	25072	12.3
2009	2770	1.2	2274	1.0	18365	8.1	23410	10.4
2010	2942	1.0	1955	0.7	19191	6.8	24088	8.5
2011	3748	1.1	2773	0.8	18552	5.3	25073	7.2
2012	8551	2.1	5179	1.3	22553	5.4	36283	8.8

Source: Bangladesh Bank.

Trends in the share of bank advances to various manufacturing activities help to appreciate performance of the related manufacturing sub-sectors (Annex Table 2). It is assumed here that any significant changes in advances in a particular period will be reflected in changes in the share of advances. It is found that a number of sub-sectors have higher shares in the increasing amount of advances; this would indicate that these sub-sectors have received significant amount of credit during the corresponding period. Among the LMIs, major rise in the share of advances was observed in case of rice and flour milling, milk and food processing, jute yarn, printing and publications, plastic products, bricks and tiles, electrical equipments, automobiles (including CNG conversion) etc. A number of these activities involve medium scale operation that target the domestic market.[24] Among the SMIs, major changes in terms of advances were observed in case of rice mills, leather, paper, wood products, cosmetics, livestock and poultry feed etc.

A large part of bank advances (other than working capital) was used for accumulating fixed assets particularly for procuring capital machineries. According to the SMI, 2005 this constituted about one-third of total fixed assets of manufacturing enterprises. Share of capital machineries in fixed assets, however, has declined over time while that of transport and other related equipments has registered significant rise (from about 8 per cent in 1997 to as high as 50 per cent in 2005). Because of limited domestic capacity, most of the manufacturing enterprises are overwhelmingly dependent on imported machineries.[25] In line with expected growth in demand for manufactured products, industries have added to their productive capacities by installing the needed capital machineries in this period (Table 5.7). However, the growth of import of machineries has slowed in FY2012 and was even negative in the first quarter of FY2013. This could perhaps because of slow pace of export growth as is evident in case of textiles and apparels industries which accounted for about 30 per cent of total import of machineries. Import of various kinds of other capital machineries such as motor vehicles and parts, iron and steel products, motor vehicle and motor cycle products and computer and accessories has significantly increased in recent years. Rise in investment for machineries and other equipments have contributed to capital deepening in the manufacturing sector; however it is also important to examine overall productivity and contribution of capital towards this. According to the SMI 2005-06, productivity of capital (measured in terms of ratio of gross value added with fixed assets, machinery or machinery, transport and other equipments) has improved over the previous years.

[24] Besides a number of activities have registered a lower share in advances such as jute mills, fertiliser, pharmaceuticals, soaps, detergents, cements and gas distribution which seem to be operated at large scale enterprises.

[25] Available domestic supply of machineries partly met the demand of engines and turbines (HS code: 3832), metal and wood working machines (3834), textiles machinery (3841), electrical machinery and apparatus, (3843), electric appliances, (3846), batteries, (3849), electric apparatus, (3851), shipbuilding and repairing and industrial machinery (Bakht et al., 2002).

TABLE 5.7: IMPORT OF MACHINERIES

Amount (million US$)	2009-10	2010-11	2011-12	2012-13 (July-Sep)
Capital Goods	5085.7	6563.6	7029.1	1958.9
Capital machinery	1594.5	2324.6	1997.7	546.5
Other capital goods	3491.2	4239	5031.4	1412.4
Growth (%)				
Capital Goods		29.1	7.1	-9.8
Capital machinery		45.8	-14.1	-13.6
Other capital goods		21.4	18.7	-8.3
Share (%)				
Capital Goods	100.0	100.0	100.0	100.0
Capital machinery	31.3	35.4	28.4	27.9
Other capital goods	68.7	64.6	71.6	72.1

Source: Estimated based on Bangladesh Bank data.

5.4 Foreign Direct Investment (FDI) in the Manufacturing Sector

Contribution of foreign direct investment (FDI) in private sector gross capital formation has not been significant in Bangladesh (only 5.5. per cent) as well as in GDP (1.0 per cent). In recent years, contribution of FDI has marginally improved in terms of both the indicators (Table 5.8). Despite the large number of FDI proposals registered with BOI in recent years (US$3.5 billion in FY2012), only a small share of these proposals was finally realised on the ground (US$1.1 billion in 2011). For most sectors, amount of local investment registered with the BOI are significantly high compared to that of FDI except in services sectors such as banking, telecommunication etc (Table 5.9). In case of manufacturing sector, foreign investment proposals generally tend to be associated with export-oriented industries such as leather and rubber, textile and clothing and engineering. According to BOI, more than 200 FDI proposals were registered in FY2012 and the majority of these are related to small scale investment (with an amount between US$1 million-US$125 million).

Despite the fact that FDI inflow has increased in recent years and it has crossed the US$1 billion mark in FY2012, its flow is still lower compared to the FDI in Bangladesh's major competing countries including India (US$32 billion), Indonesia (US$19 billion), Vietnam (US$7 billion) and even the war-torn Pakistan (US$1.3 billion).[26] About one-third of these investments generally tend to be in different manufacturing industries which are mostly located in the EPZs (Figure 5.1).[27] In other words, foreign investors usually look for a secure area such as in the EPZs to avoid risks and uncertainties. A large part of investment in EPZs is in the form of reinvested earnings and intra-company loans of existing companies. This is indicative of their preference for continuing investment in safe locations. Thus expansion of specialised, secured areas such as EPZs/SEZs is important to attract existing and new investors for investment.

[26] Average FDI flow during FY2006-2011 was US$860 million compared to US$470 million in FY2001-05. In 2011, Bangladesh received US$1.1 billion worth of FDI which was highest ever.

[27] Needless to mention, majority share of FDI in the country is particularly targeted to various kinds of services and other industries such as oil and gas exploration, telecommunication and banking sectors which are by and large located outside EPZ area (usually called domestic tariff area, DTAs).

TABLE 5.8: DOMESTIC PRIVATE INVESTMENT IN BANGLADESH (1972-2011): SHARE OF FDI

	2001	**2005**	**2008**	**2009**	**2010**	**2011**
GFC, Private Sector (mill US$)*	7170	10557.8	15319.3	17517.6	19338.2	20704
GFC, Private Sector (% of GDP)*	16	18.3	19.3	19.7	19.4	19.0
FDI (mill. US$)**	354.5	845.0	1086.0	700.0	913.0	1136.4
FDI (% of GFC private sector)	4.9	8.0	7.1	4.0	4.7	5.5
FDI (% of GDP)**	0.78	1.40	1.37	0.78	0.91	1.05

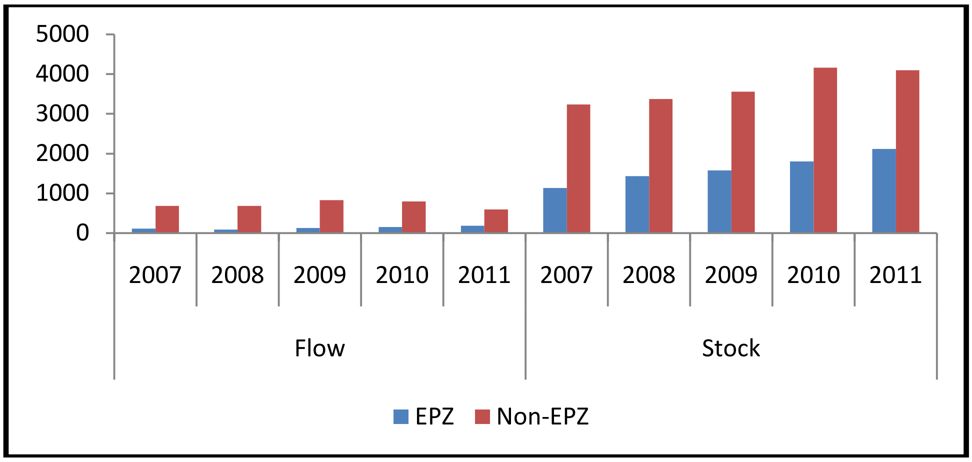
Source: *WDI and **UNCTAD.

TABLE 5.9: REGISTRATION FOR INVESTMENT: LOCAL INVESTMENT VS. FDI

	FY2009			**FY2010**			**FY2011**		
	Total (mil. US$)	Local companies (%)	Foreign companies (%)	Total (mil. US$)	Local companies (%)	Foreign companies (%)	Total (mil. US$)	Local companies (%)	Foreign companies (%)
Agriculture	322.5	93	7	896.7	97	3	280.2	44	56
Food	27.7	93	7	247.5	100	0	87.6	15	85
Clothing	799.2	95	5	923.7	92	8	425.7	38	62
Printing, Packaging and Publication	11.5	100	0	34.4	92	8	0.6	0	100
Leather and Rubber	4.2	49	51	40.8	64	36	83.4	6	94
Chemical	299.8	98	2	732.9	92	8	226.3	31	69
Engineering	349.9	65	35	261.1	93	7	3726.1	35	65
Service	2210.6	16	84	1125.6	42	58	3743.2	92	8
Glass and Ceramic	90.2	80	20	29.2	100	0	36.4	72	28
Miscellaneous	2.2	100		0.2	51	49	0.9	85	15
Total	**4117.6**			**4292.1**			**8610.3**		

Source: BOI, 2012.

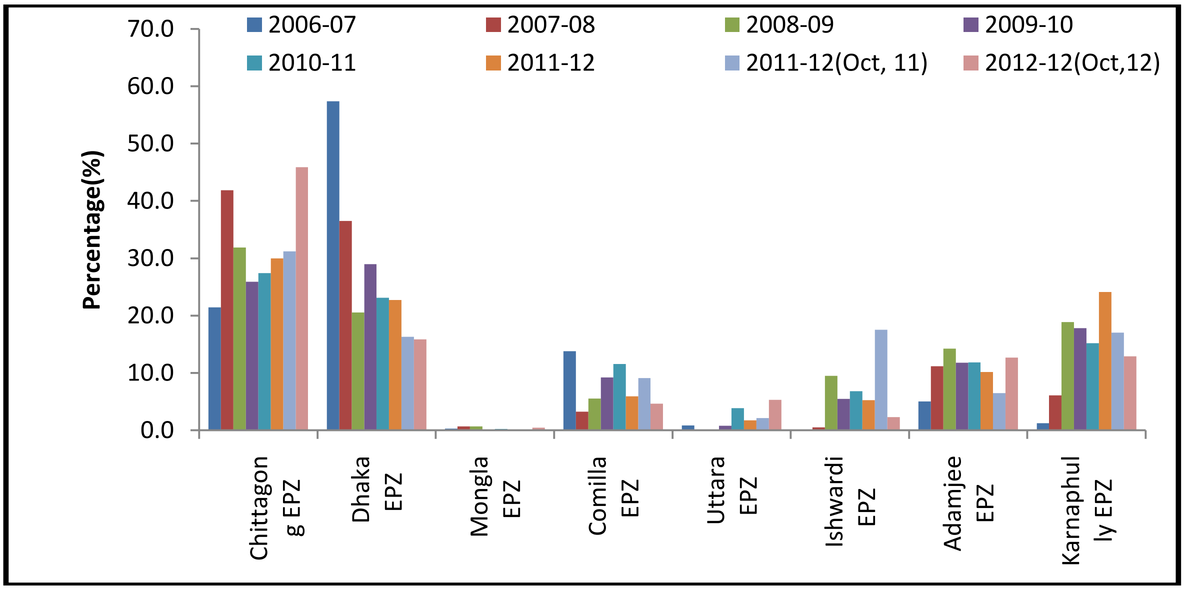
FIGURE 5.1: SHARE OF EPZ AND NON-EPZ IN FDI INFLOW



Source: Bangladesh Bank and BEPZA.

The overwhelming share of investment in EPZs is usually on account of two main EPZs of the country – Dhaka EPZ (DEPZ) and Chittagong EPZ (CEPZ) (Figure 5.2). These two EPZs accounted for US$1.8 billion worth of FDI stock till October, 2012. This is mainly because of their advantages in terms of location, infrastructure and logistics.[28] Since the capacity to absorb new investment has been exhausted both in DEPZ and CEPZ, new foreign investment has to be attracted to other EPZs which have available plots. However, infrastructure, logistics, housing for workers and other facilities have to be developed if FDI is to come to these locations.

FIGURE 5.2: DISTRIBUTION OF INVESTMENT IN DIFFERENT EPZS



Source: BEPZA.

[28] Growth of investment in Dhaka EPZ is slower than that of Chittagong EPZ which is reflected in the decline in the share of FDI flow to DEPZ.

FDI inflow in the manufacturing sector was only 14 per cent of the total FDI inflow of US$1.13 billion in 2011. There is a rising trend in FDI flow in the manufacturing sector both in absolute amount and relative share. Major share of FDI in the manufacturing sector comprised of reinvested earnings of existing companies. This is somewhat different compared to what is observed in other sectors. For example, FDI in power and energy sector is largely in the form of equity capital and reinvested earnings; in telecommunication sector this largely equity capital or intra-company loan; in banking sector this in the form of equity capital and reinvested earnings. In view of this scenario, it is important to encourage new investment in the manufacturing sector in the form of equity capital, particularly in the DTAs, by addressing the difficulties concerning such investment.

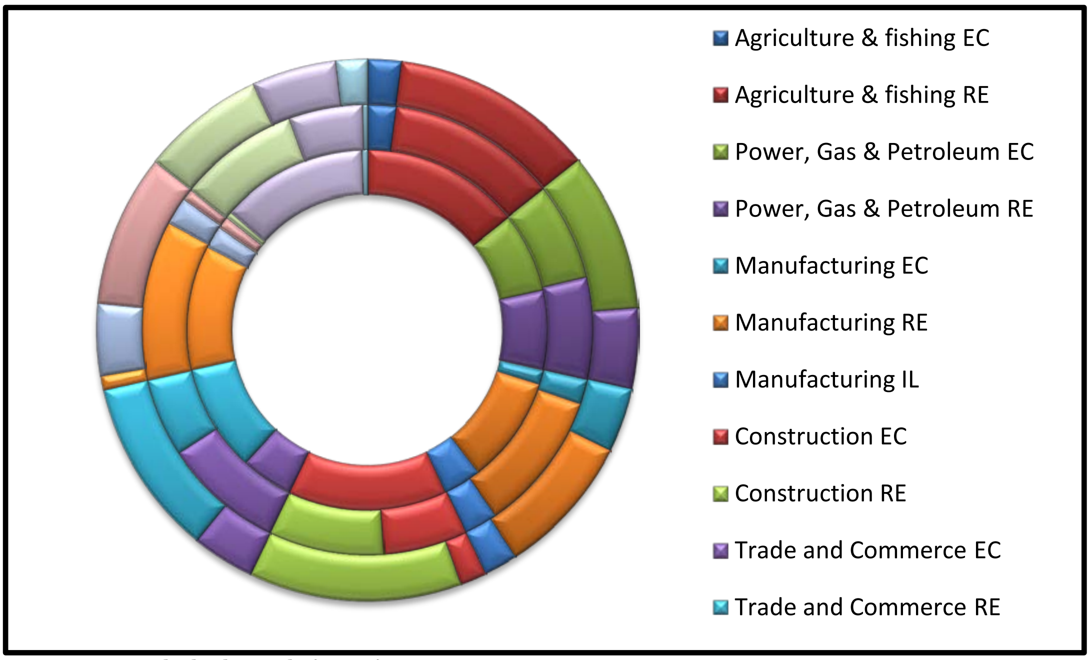
Major home countries for FDI in the manufacturing sector in Bangladesh are both developed and developing countries (Table 5.10). Developing countries were found to invest relatively large share of their respective FDI in manufacturing activities. The pattern of investment generally tends to follow their specialisation. The investment coming from developing countries to the manufacturing sector generally tends to be in the form of reinvested earnings and intracompany loan.

TABLE 5.10: SOURCES OF FDI IN BANGLADESH

	2009 (Total)			2011 (Total)		
	Total US$ 700 million	Manufacturing (%)	Non-Manufacturing (%)	Total US$1.13 billion	Manufacturing (%)	Non-Manufacturing (%)
Australia	0.0			72.8	0	100
China	2.2	93	7	18.7	60	40
Denmark	5.8	30	70	12.1	57	43
Egypt	72.7	0	100	152.3	0	100
Hong Kong	75.6	58	42	104.8	43	57
India	6.3	32	68	25.7	63	37
Japan	17.5	91	9	46.6	70	30
Malaysia	43.8	0	100			
Netherlands	49.6	36	64	116.8	31	69
Norway	45.6	0	100	24.3	0	100
Pakistan	30.1	1	99	70.5	85	15
Singapore	19.1	16	84	13.7	63	37
South Korea	46.0	87	13	113.1	69	31
Sri Lanka	7.4	0	100	31.6	67	33
Sweden	10.1	0	100			
Switzerland	29.1	64	36	10.8	92	8
Taiwan	8.6	85	15	6.5	93	7
U.A.E	67.1	0	100	10.1	11	89
UK	88.1	30	70	116.3	39	61
USA	42.9	6	94	117.7	5	95

Source: Bangladesh Bank (2012).

FIGURE 5.3: COMPONENT WISE DISTRIBUTION OF FDI IN DIFFERENT SECTORS



Source: Bangladesh Bank (2012).

5.5 Raising Equity from the Capital Market for Manufacturing Enterprises

Raising financial resources from the equity market faced a number of challenges in 2012. The artificial bubble created in the capital market in 2009 and 2010 came to an end in December, 2010 (the boom and bust story). Manufacturing sector IPOs were rather few till FY2011.[29] After the collapse of the market, a number of reform measures were undertaken to raise market efficiency particularly focusing on the primary market. As a result number of IPOs in FY2012, for setting up manufacturing enterprises, has increased significantly (Table 5.11). New IPOs included engineering, textiles and food and allied products which accounted for about 18 per cent of total IPOs in FY2012. However, number of IPOs for mutual funds in FY2012 and the amount to be raised by these through public offer were still high. In view of allegations about market manipulation, to ensure transparency and reduce malpractices, operations of the concerned companies should be properly audited.[30] To address some of the attendant concerns, it is important to implement the Financial Reporting Act on an urgent basis.

[29] Before the collapse of the market, even primary market was used by opening IPOs for mutual funds particularly for increasing transaction in the secondary market – there were as many as nine new mutual funds introduced in FY2010 with a public offer of Tk. 9225 million which constituted more than 60 per cent total public offer in that year.
[30] Auditing company should be equally responsible for any irregularity or misrepresentation in the audited report.

TABLE 5.11: IPOS IN THE CAPITAL MARKET

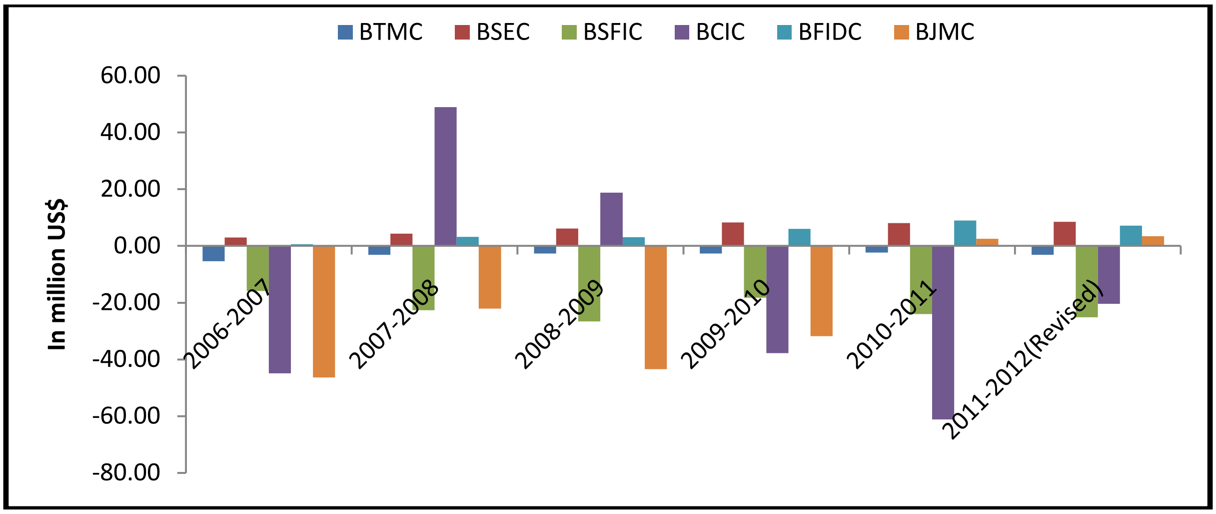
Sectors	FY09		FY10		FY11		FY12		FY13 (Jul.-Dec.)	
	Number	Public Offer (million Tk.)	Number	Public Offer (million Tk.)	Number	Public Offer (million Tk.)	Number	Public Offer (million Tk.)	Number	Public Offer (million Tk.)
Pharmaceuticals & Chemicals			2	834						
Engineering	1	200	2	185	4	780	2	700		
Textiles	1	80	2	700			1	475	2	600
Food & Allied							1	294		
Fuel & Power							1	205		
Financial institutions	3	1905					1	200		
Insurance	6	3735	3	288			1	120		
Corporate Bond					1	300				
IT							2	526		
Service	1	100	2	4961			1	260		
Mutual Fund	2	300	9	9225	10	6775	5	5508		
Total	14	6320	20	16193	15	7855	15	8287	2	600

Source: http://www.dsebd.org/

5.6 State Owned Manufacturing Enterprises

Despite the various initiatives taken to revitalise the state-owned manufacturing enterprises, particularly in light of the new Industrial Policy 2010, performance of most of the corporations did not significantly improve (Figure 5.4). This is observed from net profit/loss of various corporations and the amount of outstanding and classified loans. The majority of the corporations operated either at low levels of profit or at loss (for example, BTMC, BFIDC); indeed, some suffered significant losses (for example, BCIC, BSFIC). Few enterprises were able to make profit in recent years thanks primarily to freezing of their respective classified loan. BJMC is a case in point where huge public debt was partly responsible for making losses over the years (CPD, 2008). Outstanding and classified loans tend to vary across corporations. A number of corporations have very high outstanding loans – these include BCIC and BSFIC. Some of the others have reasonable amount of classified loan such as the BTMC. A number of corporations were able to reduce the amount of classified loan – e.g. BSEC, BSFIC and BJMC. Despite the support measures of the government, the majority of the manufacturing corporations could not operate profitably.

FIGURE 5.4: NET PROFIT/LOSS OF STATE OWNED MANUFACTURING ENTERPRISE



Source: Ministry of Finance.

In addition to running public sector corporations, government also provided support in the form of infrastructure and utilities facilities to attract investment in BSCIC 'Industrial Estates' (Table 5.12). Out of the over ten thousand plots belonging to BSCIC 9700 plots have already been allotted where 5700 industrial units have been established or were in different phases of establishment. Whilst some of the industrial estates were functioning well thanks to adequate infrastructural facilities and market linkages, many others were not found to be in good shape because of the lack of required facilities.

TABLE 5.12: BSCIC INDUSTRIAL ESTATES

Division	Land area (in acre)	Allocable plots	Allotted plots	Particulars of allotted units					Plots waiting for allotment
				Total	On production	Under implementation	Construction not started	Sick/ inactive	
Dhaka	713.63	3738	3645	2752	1894	403	369	86	93
Chittagong	440.72	2440	2231	1270	920	143	126	81	209
Rajshahi	456.26	2378	2298	974	808	85	46	35	80
Khulna	358.6	1791	1583	692	415	76	129	72	208
Total	1969.21	10347	9757	5688	4037	707	670	274	590

Source: http://www.bscic.gov.bd/

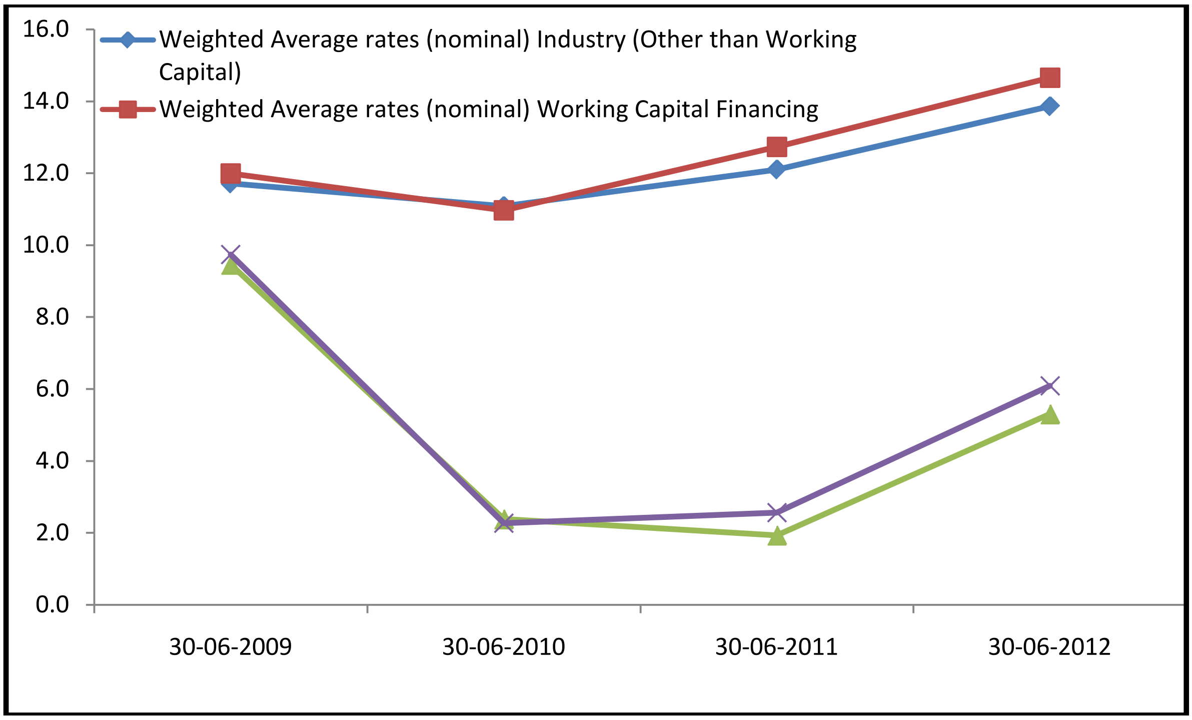
5.7 Changes in the Business Enabling Environment

Growth of manufacturing sector in recent years was adversely affected because of absence of appropriate business enabling environment in the country. Rising interest rate for bank loans, lack of adequate supply of gas and electricity, weak infrastructure support, changes in effective rates of protection and weak development of supply chains, added to the difficulties faced by the manufacturing industries. As a consequence, barring few, many of Bangladesh's manufacturing units lack the capacity to compete in the domestic and international markets.

5.7.1 Rise in Interest Rate for Bank Loan

High rate of interest for bank loan is a key concern for entrepreneurs operating in the manufacturing sector. Since FY2010, interest rate has significantly gone up both in nominal and real terms (Figure 5.5). Weighted average interest rates applied for term loan and working capital has significantly increased since June, 2010; this was relatively high in case of working capital (compared to that in term loan). Besides, removal of cap over interest rate in June, 2012, ostensibly to infuse competitiveness in the market has contributed to the rise in interest rates both for deposit collection as well as advances and loans. This has adversely affected the growth of working capital, both for LMIs and SMIs.

FIGURE 5.5: RISE IN INTEREST RATES: NOMINAL AND REAL



Source: Estimated based on Bangladesh Bank data.

5.7.2 Lack of Adequate Supply of Energy and Power

Despite the rise in generation and supply of electricity and gas over the last three years, industrial sector still faces significantly high unmet demand for these. While the second highest recipient of electricity was industrial sector, after the household sector with increased share between FY2010 and FY2012 (till March), the supply has not been able to match the required need of the sector. There is a large gap between installed capacity for generation of electricity and usable load available for consumption; this has widened over the years (Table 5.13). This would indicate that the supply of electricity could be much higher if existing power plants could generate electricity as per their installed capacity. On the other hand, industrial sector was deprived of adequate supply of gas since a large part of the gas resources had to be used for electricity generation (Table 5.14). As a result, gas supply for industrial usages has significantly declined both in amount and share over the recent years (from 12.0 per cent in 2008 to 2.0 per cent in August, 2012).[31] Unless gas supply can be increased for industrial usage, growth prospects of gas-based industries (e.g. knitwear industries, textiles etc.) will continue to suffer.

TABLE 5.13: SECTOR WISE ELECTRICITY CONSUMPTION

	2009-2010	2010-2011	2011-2012 (up to March)
Domestic (MkWh)	11628	12760	11598
Share (% of total electricity consumption)			
Domestic	48.2	46.1	51.8
Commercial	9.7	9.3	8.9
Irrigation	5.1	4.6	5.5
Industrial	27.1	34.4	32.2
Others	9.9	5.6	1.6
Total	100.0	100.0	100.0

Source: BPDB.

TABLE 5.14: SECTORWISE DISTRIBUTION OF GAS

	Total (mmcm)	Sectorwise Distribution (%)						
		Electricity	Fertilizer Industry	Captive Power	Industry	Commercial	Domestic	CNG
2007-08	2827	20.6	34.2	10.2	11.9	1.9	16.4	4.9
2008-09	2881	15.2	33.1	11.8	13.1	2.0	17.2	7.6
2009-10	3035	21.3	22.6	12.9	14.4	2.1	18.3	8.6
2010-11	664	26.2	1.0	11.7	6.5	4.8	29.9	19.9
2011-12	2999	70.0	12.1	2.5	1.7	1.2	7.7	4.9
2012-13(up to August)	536	76.1	6.7	2.6	1.7	1.2	7.2	4.5

Source: Petro Bangla MIS Report.

5.7.3 Changes in Effective Tariff Rates

Import liberalisation has multiple impacts. Import duty on raw materials, capital machineries, and intermediate products has come down significantly in the past; this has helped reduce cost of production for industries.

[31] Even supply of gas to captive power plants run by industrial units has significantly declined.

5.7.4 Lack Development of Value Chain

Most of the value chains relating to local manufacturing industries are underdeveloped. This undermines their competitiveness in the global and local markets. However, in recent years a gradual rise in the quality of various indicators related to the supply chain is becoming visible. According to the Global Competitiveness Report, positive changes has been observed (in terms of higher score in recent years) in case of quality of local suppliers, state of cluster development, control of international distribution and production process sophistication (Table 5.15). On the other hand, changes in terms of other indicators were either negative or insignificant – these included sophistication of buyer, availability of local suppliers, value chain breadth and extent of marketing etc. Over all, most of the attributes related to value chain need significant improvement for raising the competitiveness of Bangladesh's manufacturing sector in local and global markets.

Table 5.15: Score of Selected Indicators of the Value Chain (Out of 7)

Perception on	2005	2006	2007	2008	2009	2010	2011	2012
Buyer Sophistication	3.3	3.5	3.2	3.2	3.2	3.0	3.1	3.1
Local Supplier Availability	4.7	4.4	4.3	4.4	4.5	4.5	4.6	4.6
Local Supplier Quality	3.9	3.5	3.8	4.0	4.1	4.2	4.4	4.3
State of Cluster Development			3.4	3.4	3.5	3.7	3.9	3.9
Value Chain Breadth	3.0	3.1	3.0	2.9	3.0	3.4	3.4	3.3
Control of International Distribution	3.5	3.4	3.5	3.3	3.2	3.5	3.6	3.8
Production Process Sophistication	2.6	2.4	2.4	2.3	2.5	2.9	2.9	2.9
Extent of Marketing	3.3	3.4	3.4	3.4	3.2	3.3	3.4	3.3

Source: World Economic Forum, Different Issues.

5.8 Conclusion

Bangladesh's manufacturing sector has witnessed considerable growth over the past decade. However, in view of increasing competitiveness in the local (vis-à-vis imported goods) and global (vis-à-vis other countries and domestic producers in the importing countries) markets, there is a need to ensure structural changes in the country's manufacturing sector. This challenge is further accentuated because of rising intensity of competition. All categories of industries are having to operate in an environment which is by and are not investment friendly – high interest rate, high inflation, lack of the needed supply of power and gas, weak infrastructure, absence of well developed supply chain etc. Low capital and labour productivity can only be addressed through capital infusion, technology adoption and skill development. A major policy choice for Bangladesh will be to put emphasis on the development of domestic market oriented industries to cater to growing domestic demand. There is a need to take strategic approach that looks at industrial development from a holistic approach combine trade, investment and regulatory regime that could promote industrialisation of Bangladesh.

6. State of Governance in the Banking Sector: Dealing with Shocks[32]

6.1 Introduction

Banking sector is one of the most important components of the financial system that mobilizes resources for productive investments in a country which in turn contributes to economic development. The relationship between financial sector development and economic growth has been explored in several studies in the recent past. Cross-country empirical evidence suggests a positive association between financial development and economic growth (Ahmed and Ansari 1998; CPD 2011; Monnin and Jokipii 2010; McKinnon, 1973; Shaw, 1973; Calderón and Liu, 1999; Rahman, 2004; Chakraborty, 2008; Khan 2011; Khan 2002; Khan and Senhadji 2000). On the other hand crisis, volatility and corruption in the banking sector have been found to have negative implications for the growth of the banking industry (Park 2012; Moshirian and Wu 2012; Lin and Huang 2012; Serwa 2010).

In Bangladesh, financial sector is dominated by banks. In 2011 total asset of the banking sector was 74.6 percent and of non-bank financial institutions 3.4 percent of GDP (GoB 2012; Bangladesh Bank 2012). The banking sector has flourished during the last three decades or so as a result of increased demand of the growing economy. During this period the banking sector has also undergone several reforms and fallen under the jurisdiction of a number of acts in a bid to improve the efficiency of the sector. Nevertheless, the sector is yet to improve its performance in terms of trust and confidence of people as shocks hit the sector from time to time in a major way. Among these, the issue of governance in the banking sector has been under the spotlight in 2012 in the context of the Hall Mark scam which was the biggest financial crime in the history of Bangladesh's banking sector. Given the contribution of the banking sector in the overall development of the country, such processes of misappropriating public resources can have serious implications for economic growth of the country.

In this section some of the key challenges confronting the state owned commercial banks (SCBs) of Bangladesh will be discussed. In doing so this section examines the credibility of the exposed performance indicators of the SCBs and suggests a few policy measures as to how the situation can be improved.

6.2 Brief Overview of the Performance of the Banking Sector

The pace of development in the banking industry has been significant over the past decades. In calendar year (CY) 2011 total asset of 47 commercial banks stood at Tk 5874.9 billion and deposit at Tk 4509.8 billion (Bangladesh Bank 2012) which were 74.6 percent and 57.2 percent respectively. During the last ten years (2001-2011) total asset has grown by 324.2 percent while deposit has increased by 326.9 percent (Bangladesh Bank Annual Report 2010-11). The ratios of money supply (M2) to GDP, total deposits to GDP and total domestic credit to GDP have shown steady increase over the years indicating an increased financial depth (Annual Reports of Bangladesh Bank).

[32] This section is adopted from the keynote presentation made at the CPD Dialogue on *State of Governance in the Banking Sector: Dealing with the Recent Shocks*, held on 5 November 2012, in Dhaka, Bangladesh.

Financial inclusion, though still low compared to developing countries[33], have increased significantly since independence. Population per bank branch has improved from 57,700 in 1972 to 17,660 in June 2011 indicating that a large number of people are under the coverage of banking services.

In terms of soundness of the banking sector, which is measured by indicators such as capital adequacy, asset quality, management quality, earnings, liquidity and sensitivity to market risks (CAMELS), the banking sector of Bangladesh has exhibited significant progress (Table 1). As shown in Table 2, in the recent past the situation of banks in terms of capital adequacy has improved and banks in Bangladesh have been able to maintain adequate RWA capital. The percentage share of non-performing loans (NPL) to total loans has reduced dramatically during 1997 to 2011. Similarly there were improvements in the case of bank management, profitability and liquidity. However, a disaggregated performance of these indicators for different categories of banks shows that the SCBs are lagging behind compared to other categories of banks (Table 2). The SCBs continue to be grappled with problems of inefficiency and mismanagement even after several reform measures undertaken for the sector since the 1980s. In fact reform has been a continuous process in the SCBs which gained further momentum in the 1990s and continued till 2007. However, the poor performance of the SCBs suggests that reform is still an unfinished agenda in the banking sector of Bangladesh.

TABLE 6.1: BANKING SECTOR PERFORMANCE

Soundness Indicators	CY2004	CY2006	CY2008	CY2010	CY2011	2012 (June)
Capital to Risk Weighted Asset (%)	8.7	6.7	10.1	9.3	11.3	
NPL to Total Loans (%)	17.6	13.2	10.8	7.3	6.2	7.17
Expenditure-Income Ratio (%)	90.9	91.4	87.9	70.9		
Return on Asset (%)	0.7	0.8	1.2	1.8	1.3	1.16
Return on Equity (%)	13.0	14.1	15.6	21.0	14.3	13.49
Liquid Asset (%)	23.4	21.5	24.8	23.0	21.0	
Excess Liquidity (%)	8.7	5.1	8.4	6.0		
Sensitivity to Risks	20.3	31.5	9.9			

Source: Bangladesh Bank.

[33] In India, for example, population per bank branch was 13466 in FY 2010-11 (Reserve Bank of India; http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?id=669 accessed 02/11/2012).

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TABLE 6.2: CAPITAL TO RISK WEIGHTED ASSETS RATIO BY TYPE OF BANKS

	Bank Type	2004	2006	2008	2010	2011 (June)	2012 (June)
Capital Adequacy	**Capital to Risk Weighted Asset (%)**						
	SCBs	4.1	1.1	6.9	8.9	9.5	
	DFIs	9.1	-6.7	-5.3	-7.3	-7.0	
	PCBs	10.3	9.8	11.4	10.1	10.4	
	FCBs	24.2	22.7	24.0	15.6	17.1	
Asset Quality	**NPL to Total Loans (%)**						
	SCBs	25.3	22.9	25.4	15.7	14.1	
	DFIs	42.9	33.7	25.5	24.2	21.8	
	PCBs	8.5	5.5	4.4	3.2	3.5	
	FCBs	1.5	0.8	1.9	3.0	3.1	
Management	**Expenditure-Income Ratio (%)**						
	SCBs	102.3	100	89.6	80.7	65.9	
	DFIs	104	103.5	103.7	87.8	101.7	
	PCBs	87.1	90.2	88.4	67.6	69.1	
	FCBs	76.3	71.1	75.8	64.7	45.4	
Profitability	**Return on Asset (%)**						
	SCBs	-0.1	0.0	0.7	1.1	0.6	0.75
	DFIs	-0.2	-0.2	-0.6	0.2	-0.3	-0.04
	PCBs	1.2	1.1	1.4	2.1	1.6	1.19
	FCBs	3.2	2.2	2.9	2.9	3.6	3.78
	Return on Equity (%)						
	SCBs	-5.3	0.0	22.5	18.4	10.0	11.72
	DFIs	-2.1	-2.0	-6.9	-3.2	-5.2	1.39
	PCBs	19.5	15.2	16.4	20.9	15.6	12.39
	FCBs	22.5	21.5	17.8	17.0	20.2	19.43
Liquidity	**Liquid Asset (%)**						
	SCBs	22.8	20.1	32.9	27.2	27.0	
	DFIs	11.2	11.9	13.7	21.3	22.1	
	PCBs	23.1	21.4	20.7	21.5	24.5	
	FCBs	37.8	34.4	31.3	32.1	31.1	
	Excess Liquidity (%)						
	SCBs	6.8	2.1	14.9	8.2	8.1	
	DFIs	4.7	3.8	4.9	2.3	3.1	
	PCBs	8.8	5.6	4.7	4.6	8.0	
	FCBs	21.9	16.4	13.3	13.2	12.2	

Source: Bangladesh Bank.

6.3 Anatomy of the Hall Mark Incidence

The Hall Mark forgery, the biggest in the banking history of Bangladesh[34], will not only hamper the growth of the banking industry but can risk the economic growth of the country. In a resource constraint country such as Bangladesh where the government has to struggle for allocating limited resources among competing priorities, Tk 3606.48 crores have significant implications for public investment. It may be mentioned that the forged amount is 6.6 per cent of the ADP and 15.9 percent of the allocation for social safety net programmes in FY2012-13.

The called Hall Mark case of forgery through inland bills trade involving the largest SCB of the country Sonali Bank Limited (SBL), has been a testimony to poor management, weak internal control and risk management, and above all, total lack of governance on the part of the bank. Information provided in Box 1 supports such claim.

BOX 6.1: UNAUTHORISED LOANS AND ADVANCES: A RECORD OF SONALI BANK /RUPOSHI BANGLA BRANCH

The incidence of financial irregularities in the Ruposhi Bangla branch of Sonali Bank Limited reveals that as on 31 May 2012 total outstanding loans and advances related to international trade was Tk 3,699.53 crores, of which funded and non-funded unauthorized loans and advances was Tk 3606.48 crores. These unauthorized bank loan facilities were given by the General Manager and Assistant Manager of the branch to Hall Mark Group (Tk 2,667.45 crores), T and Brothers Group (Tk 685.63 crores), Paragon Group (Tk 144.44 crores), DN Sports Group (Tk 28.54 crores), Nakshi Knit Group (Tk 65.30 crores) and others (Tk 15.12 crores).

These loans and advances were given by disregarding the rules and regulations of the bank. Besides branch officials did not maintain relevant documentation properly on purpose. A significant fund was misappropriated through the inland bills trading. The branch opened inland letters of credit (L/Cs) in favour of three fictitious spinning mills which were customers of the said branch on account of another company, a concern of the Hall Mark Group. The branch transferred the money to the accounts of the three companies which after a few days advised the bank to transfer the money to the account of Hall Mark Group.

The branch manager resorted to a number of unauthorized ways to disburse huge amount of money to Hall Mark Group and other customers. Some of these are as follows:

Provided credit facilities without any sanction;
Allowed credit facilities after the expiry of sanctioned period;
Illegally opened local back to back L/Cs and provided acceptance to documents raised by different banks in favour of non-existent spinning and textile mill on account of Hall Mark Group, T and Brothers Group, Paragon Group, DN Sports Group and Nakshi Knit Group;
Illegally opened local back to back L/Cs and provided acceptance to documents raised by inter/intra branch customers namely Star Spinning Mills, Max Spinning Mills, Anwara Spinning Mills and Master Cotton Yarn Ltd on account of Hall Mark Group and T and Brothers Group;
Created unauthorized fresh loans to adjust unauthorized overdue loans;
Provided loan against fake export documents of Hall Mark Group, T and Brothers Group, Paragon Knit

[34] Some of the previous cases of bank frauds include Tk 300 crores by Om Prakash Agarwal in 2002 through transfer from five banks, Tk 596 crores through withdrawal without cheques by the owners of the Oriental Bank in 2006 and Tk 622 crores by Nurunnabi in 2007 through fake L/Cs.

Composite Ltd, and Nakshi Knit Composite Ltd;
Provided excess pre-shipment credits (PSC) over approved limit;
Allowed PSC without L/Cs;
Allowed PSC after shipment date;
Opened cash L/Cs without customers' existing liabilities and limits;
Opened cash L/Cs for capital machinery at zero margin without the approval of the head office of the bank;
FCMD debited head office NOSTRO account without obtaining reimbursement from the branch;
Reported irregular payment against documents (PAD) loans as regular in classified loan report;
Opened foreign back to back L/Cs without office note and realizing commission;
Transferred fund illegally by debiting sundry deposit accounts;
Purchased export bills before completion of exports;
Applied incorrect exchange rates for purchasing deferred payment export bills;
Overdue export bills were not reported to the central bank; and
Allowed temporary overdraft illegally against cash incentives.

Source: Report on Financial Audit of Ruposhi Bangla Branch of Sonali Bank Limited, August 2012.

As is shown in Box 1, irregularities regarding Hall Mark were of various natures. This cannot be performed by a sole manager of a small branch. Weak risk management, pressure exerted by powerful sections, connivance and unholy alliance between senior managers of the bank and the client, lack of supervision from the head office of the bank, oversight of the Board and lack of regulatory hindsight had been the reasons behind the embezzlement of this huge amount of money from a small branch of SBL. A number of specific reasons were identified by the audit team which helped this forgery to happen. These are summarized below:

a. The branch manager was posted in the same branch for five years exceeding the limit of three years at one branch. The principal office of the bank warned the manager back in 2007 about some irregularities. Again in 2010, serious irregularities relating to international trade were found by the GM office and International Trade Finance Division (ITFD) of the Head office. However, no steps were taken by the ITFD to regularise the irregularities of the said branch of the bank.

b. Neither the budgeting and monitoring department nor the ITFD of the bank did inquire about the huge growth of loans and advances of the branch. No detailed inspection was carried out to investigate abnormal increase of loans and advances. On the contrary, Inspection and Audit Division (IAD) -2 of the head office graded the branch as 'Low Risk' branch in February 2011 and they did not mention any irregularities. More shocking is that the IAD-2 commended the branch manager saying that he was "managing the branch efficiently with his extraordinary talent, foresight and banking knowledge". One can easily understand how the branch manager was encouraged to continue unethical activities!

c. Since June 2010 the management of the bank introduced a detailed monthly report on branches containing 85 columns. A close scrutiny of this factsheet can reveal the status of branches. However, it seems these reports were not reviewed properly by the GM office and the CEO also overlooked these reports.

d. There was a general reluctance towards inspection and audit of the Ruposhi Bangla branch even after complains of irregularities were made. Principal office requested the DGM of IFTD and IAD-2 to carry out inspection of the branch on its irregularities. But none of the bodies acted on this. The branch was brought under the supervision of the GM office since July 2011. No quarterly inspection was undertaken till 31 January 2012. On 26 January 2012 the ITFD finally put up a note for inspection of the branch. However, the inspection began after two months.

6.4 Lessons Learnt and Recommendations

Irregularities of such nature and volume call for a revisit of the practices and policies in the banking sector. This should not only be dealt through stern measures against the criminals involved, but also through short and medium term policies for improved performance of the sector on a sustainable basis. Some key recommendations are presented below:

Implement Risk Management Policy

The absence of a comprehensive risk management policy in many banks makes it difficult to handle fraud and other extra-ordinary cases. Core risk management guidelines of Bangladesh Bank are hardly followed by SCBs. The manual for loans and advances containing policies, procedures, processing and reporting transactions, review of security and collateral and responsibilities at different levels is not followed by many banks due to which it becomes difficult for banks to handle and manage clients with various levels of exposures.

Strengthen Internal Control

The internal control department which is a critically important department is weak in the SCBs. This is partly due to incentive failure which prevents hiring of qualified persons for this department. As the nature of the job involves patient scrutiny of compliance, people are reluctant to work here, and those who do, are often in a way dumped in this department.

Remove Political Baggage of the Board of Directors

The practice of appointing Directors of the Board of the SCBs based on the political loyalty and affiliation has to be changed. The 'Fit and Proper Test Criteria' of the 'Bangladesh Bank Guidelines 2010' for the nomination of Directors should be implemented fully. Due to political baggage, Directors of SCBs cannot perform their duties independently and remain morally obliged to listen to political instructions. The accountability of the Directors should also be determined clearly. In case of the Hall Mark scam it was reported that the Board was not informed of the unscrupulous inland bill trading. However, the fact that the responsible branch was not audited and the accused branch manager was not transferred even after completion of his three years tenure are some of the issues which the Board cannot shrug off its oversight responsibility.

Evaluate Performance of CEOs and Senior Officials

The Hall Mark scam has also exposed total failure of the senior managers of the bank in discharging their duties. In the SCBs, major preoccupation of the Chief Executive Officer (CEO) is to 'manage' the Board to keep their jobs. Unfortunately, it is also difficult for them to do otherwise in a setting where many decisions are influenced by political instructions. As a result, these officials lack creativity and initiatives for good business plan, effective people management programme, regulatory compliance practice and effort towards clients' satisfaction. The Board should only guide and support the CEO to achieve bank's targets and evaluate his performance on the basis of Key Performance Indicators. The general managers should be transferred from one SCB to another in order to not only help transfer of good practices, but also to reduce the possibility of fraudulent and unethical practices.

Improve Human Resource Policy

The human resource (HR) department of the SCBs remains weak and powerless to take decisions on recruitment and promotion, due to lack of capacity and presence of external influence. The HR policy of banks should not only arrange for appropriate training but should also involve the reward and punishment practices.

Implement Automation and Management Information System

An issue related to the HR development is the automation and management information system in banks. It is apprehended by experts with fair amount of certainty that there may be many more Hall Mark cases that wait to be uncovered in other banks. Unless these are dug out through transparent and automated transaction system with central control and monitoring facilities, the mess may be piled up and reach an unmanageable stage. Due to lack of MIS, the Hall Mark case was not detected in time even though clearing was going against SBL continuously for many months due to loan increase in a branch of the bank.

Remove Dualism in the Regulatory Mechanism and Improve Regulator's Oversight

For smooth functioning of the banking sector the supervisory and monitoring role of the central bank needs to be strengthened and the Banking and Financial Institutions Division should be dismantled in order to get rid of dualism in the regulatory mechanism. However, the oversight role of Bangladesh has to be stronger and stricter. Unfortunately, as in the previous financial chaos in the country such as the capital market debacle, Bangladesh Bank played a reactive role long after the irregularities have actually been in place. Firm supervision and effective monitoring could have reduced the damage suffered by SBL. The fact that clearing of SBL was going against the bank, the amount of loan was increasing, and finally the bank became a borrower from a lender in the interbank market, indicates the weak off-site supervision mechanism of Bangladesh Bank.

Form a Commission for the Financial Sector

In view of shocks and emerging challenges in the banking sector a Commission should be formed which will scrutinize the overall performance of the sector, assess the need of customers and the economy, identify the current problems and emerging challenges and suggest concrete recommendations for prudential banking. Considering the emerging need and in order to build up more transparent and responsible banking sector the commission should also include non-bank financial institutions, such as insurance companies and capital market under its jurisdiction as they are interconnected.

6.5 Concluding Remarks

The Hall Mark incident is not only a case of financial loss but also a deep dent on the confidence and trust of the customers of the bank. It is also not the loss of good will of the particular bank only, but of the total banking industry. While the investigation of the Hall Mark case goes on and efforts to clean the mess continues, the banking sector of Bangladesh has to prepare for the next generation global regulatory framework and meet emerging clients' needs as well. In the coming days the banking industry will have to achieve the ability to absorb shocks arising from financial and economic stress, improve risk management and governance, and strengthen transparency and disclosures through complying with Basel III requirements which is scheduled to be introduced from 2013 until 2018. Without radical changes in the banking practices in the country such commitments may remain largely unfulfilled.

ANNEX TABLE 1: STATUS OF A NUMBER OF LARGE PROJECTS IN ADP

Project Name	Duration	Project Cost		Cumulative Expenditure upto Nov'11	Cumulative Expenditure upto Oct'12	FY13 Allocation	FY13 (Jul-Oct) Expenditure % of Allocation
		Total	Aid share				
Construction of Padma Multipurpose Bridge (rev)	2009-2015	2,050,720.0	79%	4.3%	6.1%	80,400.0	5.3%
Bheramara Combined cycle plant (360MW) development	2010-2014	414,048.0	78%	1.1%	1.7%	2,800.0	12.2%
Revitalisation of community health care initiatives in Bangladesh	2009-2014	267,749.0	19%	0.0%	11.5%	32,500.0	17.8%
Construction of Shiddhirganj 335MW peaking combined cycle power plant (rev)	2009-2015	423,947.0	43%	0.0%	6.4%	14,500.0	0.1%
3G network technology establishment and extension of 2.5G network	2011-2012	190,099.0	78%	0.0%	47.4%	101,779.0	12.6%
Construction of meter gauge line at Dohajari-Coxsbazar and Ramu-Gungdum	2010-2013	185,235.0	64%	0.5%	0.6%	100.0	0.0%
Feasibility study and railway construction from Khulna to Mongla port	2010-2013	172,139.0	70%	0.0%	0.0%	4,800.0	0.0%
Bibiana-Kaliakoir 400KV and Fenchuganj-Bibiana 230KV transmission line	2010-2013	171,435.0	37%	9.0%	13.6%	9,400.0	13.3%
South-West rural infrastructure development	2010-2013	148,072.0	72%	3.9%	20.4%	25,000.0	24.9%
Rural electrification upgradation project(Rajshahi, Rangpur, Khulna, Barisal division)	2010-2015	132,218.0	75%	0.1%	18.4%	46,195.0	24.8%
Construction of 820MW peaking power plant (rev)	2009-2012	695,986.0	0%	52.5%	67.8%	105,400.0	5.0%
Priority based important rural infrastructure development project	2010-2013	469,113.0	0%	11.9%	30.7%	119,823.0	49.8%
Development of physical infrastructure of selected non-government high schools	2011-2014	211,480.0	0%	0.0%	13.0%	21,200.0	49.3%
Ekti bari, ekti khamar project (rev)	2009-2013	149,292.0	0%	14.9%	49.8%	47,000.0	24.3%
Dredger and related machinery procurement for Capital dredging of rivers of Bangladesh	2010-2012	130,988.0	0%	0.0%	1.1%	7,000.0	19.0%
Asrayan-2	2010-2015	116,918.0	0%	0.0%	13.7%	18,000.0	9.7%
Important urban infrastructure development project	2011-2014	115,099.0	0%	0.7%	5.8%	4,500.0	46.9%
Total 17 Largest Projects		**6,044,538.0**	**47%**	**9.3%**	**18.2%**	**640,397.0 (11.6%)**	**20.9%**
ADP FY13						**5,500,000.0**	**19.5%**

Source: IMED.

ANNEX TABLE 2: STATUS OF ADVANCES OF SELECTED MANUFACTURING ENTERPRISES: FY08-FY12

	Advances as of June2008		Advances as of June2012		Changes in share between 2008 and 2012
	Amount (lakh Tk.)	% of total advances	Amount (lakh Tk.)	% of total advances	
A. Other Than Working Capital Financing					
Large and Medium Manufacturing					
Rice, Flour, Oil & Pulse Mills	699,32	0.39	262975	0.68	Increased
Milk & Milk Foods Processing	59,07	0.03	28481	0.07	Increased
Jute (Pressing, Baling & Yarn)	146,24	0.08	81419	0.21	Increased
Jute Mills (Carpet, Bags & Textiles)	563,74	0.31	74092	0.19	Decreased
Printing, Publishing & Allied	94,11	0.05	49182	0.13	Increased
Newspapers & Periodical Pub.	23,09	0.01	17156	0.04	Increased
Fertilizer Factories	171,54	0.09	24170	0.06	Decreased
Drugs & Pharmaceuticals	1,216,65	0.67	211501	0.55	Decreased
Plastic & Plastic Products	348,27	0.19	101535	0.26	Increased
Soaps & Detergents	132,84	0.07	2211	0.01	Decreased
Other Chemicals & Chemical Products	647,52	0.36	72089	0.19	Decreased
Cement & Asbestos	918,41	0.51	155174	0.4	Decreased
Bricks & Tiles	224,91	0.12	95721	0.25	Increased
Others	422,69	0.23	22157	0.06	Decreased
Electrical Equipments & spares	307,76	0.17	115002	0.3	Increased
Automobiles	125,53	0.07	41586	0.11	Increased
Electricity	724,36	0.4	287504	0.74	Increased
Petroleum (Refine & Supply)	41,64	0.02	24008	0.06	Increased
Gas (Elevation, Supply & Distribution)	190,95	0.11	16830	0.04	Decreased
Oxygen Gas	7	0	3462	0.01	Increased
Others	128,56	0.07	36228	0.09	Increased
Small Scale Manufacturing & Cottage Industries					
Rice, Flour, Oil & Pulse Mills	185,40	0.1	83769	0.22	Increased
Leather & leather Products	5,41	0	58852	0.15	Increased
Paper & Paper Products	54,86	0.03	22069	0.06	Increased
Wood & Wood Products	25,48	0.01	16572	0.04	Increased
Saw Mills	6,52	0	5852	0.02	Increased
Cosmetics	4,71	0	4147	0.01	Increased
Jute & Jute Goods	5,65	0	18372	0.05	Increased
Livestock & Poultry Feed	46,31	0.03	19080	0.05	Increased
Other Industries	556,41	0.31	86131	0.22	Decreased
Cottage Industries	77,23	0.04	8658	0.02	Decreased
B. Working Capital Financing					
Large & Medium Scale Industries	30,846,44	16.99	4513305	11.69	Decreased
Small Scale & Cottage Industries	1,291,69	0.71	214888	0.56	Decreased
Small Scale Industries	1,152,41	0.63	195597	0.51	Decreased
Cottage Industries	139,28	0.08	19291	0.05	Decreased

Source: Bangladesh Bank.