REGIONAL COOPERATION IN SOUTH ASIA

A REVIEW OF BANGLADESH'S DEVELOPMENT 2004

CENTRE FOR POLICY DIALOGUE

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The Centre for Policy Dialogue (CPD), established in 1993, is mandated by its Deed of Trust to service the growing demand originating from the emerging civil society of Bangladesh for a more participatory and accountable development process. CPD seeks to address this felt need through organisation of multistakeholder consultations and dialogues, by conducting research on issues of critical national and regional interests, through dissemination of knowledge and information on key developmental issues, and by influencing the policymaking process in the country. At the core of CPD's activities lies its dialogue programme. The dialogues are designed to provide a forum for constructive engagement and discussion on key relevant issues, and to come up with specific recommendations to redefine the policies and for ensuring their effective implementation. The recommendations are then placed before current and prospective policymakers of the country as inputs to the decision making process. CPD's flagship research activity is the preparation of an annual *Independent Review of Bangladesh's Development (IRBD)*.The present IRBD2004 is the tenth volume prepared under the IRBD programme. Other CPD programmes include *Trade Related Research and Policy Development (TRRPD), Investment Promotion and Enterprise Development, Agriculture and Rural Development, Ecosystem and Environmental Studies, Human Resource Development, Gender Issues and Social Protection, Governance and Policy Reforms*. CPD actively networks with other institutions within and outside Bangladesh which have similar interests and also regularly participates in various regional and international fora where interests and concerns of developing and least developed countries are discussed. CPD's current publication list includes more than 220 titles including Books, Monographs, Occasional Papers, Dialogue Reports and Policy Briefs. CPD outputs are available for sale at the Centre and also in selected bookstores in Bangladesh. CPD publications and other relevant information are also regularly posted on CPD's website <www.cpd-bangladesh.org>.

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Acronyms

AADCP	ASEAN-Australia Development and Cooperation Programme
ABB	Association of Bankers Bangladesh
ACBF	ASEAN Cooperatives Business Forum
ACEDAC	ASEAN Centre for the Development of Agricultural Cooperatives
ADB	Asian Development Bank
ADD	Anti-Dumping Duty
ADF	Augmented Dickey-Fuller
ADP	Annual Development Programme
ADR	Alternative Dispute Resolution
AER	Agro-Ecoregion
AFF	ASEAN Fisheries Federation
AFPIC	ASEAN Forest Products Industry Club
AFTA	ASEAN Free Trade Area
AGM	Annual General Meeting
AH	Asian Highway
AIT	Advance Income Tax
ALTID	Asian Land Transport Infrastructure Development
AMAF	ASEAN Ministers on Agriculture and Forestry
APM	Administered Pricing Mechanism
APRTC	ASEAN Poultry Research and Training Centre
ASA	ASEAN Swap Arrangement
ASEAN	Association of South East Asian Nations
ASK	Ain-o-Shalish Kendra
ATTC	ASEAN Timber Technology Centre
AUPIDE	Arab Union of Producer, Transporters and Distributors of Electricity
AV	Ad-Valorem
AVOC	ASEAN Vegetable Oils Club
AVRDC	Asian Vegetable Research Development Centre
BAC	Bureau of Anti-Corruption
BATEXPO	Bangladesh Apparel and Textile Exposition
BB	Bangladesh Bank
BBINGQ	Bangladesh, Bhutan, India, Nepal Growth Quadrangle

BBS	Bangladesh Bureau of Statistics
BCE	Bovine Spongiform Encephalopathy
BCIC	Bangladesh Chemical Industries Corporation
BCX	Extra Large-Box Car
BDF	Bangladesh Development Forum
BEI	Bangladesh Enterprise Institute
BEPZA	Bangladesh Export Processing Zones Authority
BFTA	Bilateral FTA
BG	Broad Gauge
BIMSTEC	Bangladesh, India, Myanmar, Sri Lanka and Thailand (Now Bhutan and Nepal) Economic Cooperation
BINA	Bangladesh Institute of Nuclear Agriculture
BIT	Bilateral Investment Treaty
BIWTA	Bangladesh Inland Water Transport Authority
BKB	Bangladesh Krishi Bank
BoI	Board of Investment
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BoP	Balance of Payments
BPC	Bangladesh Petroleum Corporation
BR	Bangladesh Railways
BRRI	Bangladesh Rice Research Institute
BSA	Bilateral Swap Arrangement
BSM	Buyer-Seller Meet ()
BTA	Bilateral Trade Agreement
BTTB	Bangladesh Telegraph and Telephone Board
BW	Bretton Woods
C&F	Clearing and Forwarding
CASAC	Coalition for South Asian Cooperation
CBM	Coal Bed Methane
CBO	Community Based Organisation
CCB	Citizens Community Board
CCCL	Chittagong Chemical Complex Limited
CDS	Central Depository System
CEMS	Conference and Exhibition Management Services
CEPZ	Chittagong Export Processing Zone
CERC	Central Electricity Regulatory Commission
CETP	Common Effluent Treatment Plants
CHM	Clearing House Mechanisms

CIArb	Chartered Institute of Arbitrators
CIER	Commission of Regional Power Integration
CIMMYT	International Maize and Wheat Improvement Center
CIS	Commonwealth of Independent States
CMI	Chiang-Mai Initiative
CNI	Confederation of Nepalese Industries
CoE	Committee of Experts
COLA	Cost of Living Adjustment
COMESA	Common Market for Eastern and Southern Africa
CPD	Centre for Policy Dialogue
CPI	Consumer Price Index
CRTA	Committee on Regional Trade Agreements
CSE	Chittagong Stock Exchange
CSO	Civil Society Organisation
CSP	Country Strategy and Programme
CTH	Change of Tariff Heading
CTSH	Change of Tariff Sub-Heading
DA	Dearness Allowance
DAC	Development Assistance Committee
DCC	Dhaka City Corporation
DCCI	Dhaka Chamber of Commerce and Industries
DITF	Dhaka International Trade Fair
DSE	Dhaka Stock Exchange
DSL	Debt Servicing Liability
DTT	Double Taxation Treaty
DWRP	Displaced Workers' Rehabilitation Programme
ECA-95	Environment Conservation Act 1995
ECNEC	Executive Committee of National Economic Council
ECO	Economic Cooperation Organization
ECOSOC	Economic and Social Council
EEC	European Economic Community
EEF	Equity and Entrepreneurship Fund
EGBMP	Enterprise Growth and Bank Modernisation Project
EIA	Energy Information Administration
EIA	Environmental Impact Assessment
EMS	Environment Management System
EOAB	Employees Old Age Benefit
EPB	Export Promotion Bureau
EPZ	Export Processing Zone

ERC	Energy Regulatory Commission
ERD	Economic Relations Division
ESAF	Enhanced Structural Adjustment Facility
ESSI	Employees Social Security Institutions
ETFC	Electricity Tariff Fixation Commission
ETP	Effluent Treatment Plants
EU	European Union
FAO	Food and Agriculture Organisation
FAP	Flood Action Plan
FBCCI	Federation of Bangladesh Chambers of Commerce and Industry
FCB	Foreign Commercial Bank
FDI	Foreign Direct Investment
FFE	Food for Education
FFW	Food for Work
FI	Foreign Investments
FICCI	Foreign Investors Chamber of Commerce and Industry
FMGP	Financial Markets Governance Programme
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
FSA	Fuel Supply Agreement
FTA	Free Trade Agreement
FTAA	Free Trade Area of the Americas
G15	Group of Fifteen Developing Countries
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GDPGR	GDP Growth Rate
GEP	Group of Eminent Persons
GFCF	Gross Fixed Capital Formation
GMO	Genetically Modified Organism
GMS	Greater Mekong Sub-Region
GNP	Gross National Product
GoB	Government of Bangladesh
GoJ	Government of Japan
GoM	Government of Maldives
GoP	Government of Pakistan
GPS	General Public Service
HCR	Head Count Ratio
HDI	Human Development Index
HIES	Household Income and Expenditure Survey
HIPC	Heavily Indebted Poor Countries

HPAI	Highly Pathogenic Avian Influenza
IA	Implementation Agreement
IARC	International Agricultural Research Centre
IAS	Indian Administrative Service
ICC,B	International Chamber of Commerce, Bangladesh
ICD	Inland Container Depot
ICRISAT	International Crops Research Institute for the Semi-Arid Tropics
ICSID	International Centre for Settlement of Investment Disputes
IDB	Integrated Database
IDSC	Infrastructure Development Surcharge
IFAD	International Fund for Agricultural Development
IFI	International Financial Institutions
IFPRI	International Food Policy Research Institute
IGCC	Integrated Gas Combined Cycle
ILFTA	Indo-Lanka Free Trade Agreement
IMF	International Monetary Fund
IOC	International Oil Company
IPA	Integrated Programme of Action
IPGRI	International Plant Genetic Resources Institute
IPM	Integrated Pest Management
IPO	Initial Public Offerings
IPP	Independent Power Producer
IPRSP	Interim Poverty Reduction Strategy Paper
IR	Indian Railways
IRBD	Independent Review of Bangladesh's Development
IRRI	International Rice Research Institute
ISACPA	Independent South Asian Commission for Poverty Alleviation
ISCO	International Standard Classification of Occupation
ISPM	International Standards on Phytosanitary Measures
ITS	Internet Trading System
IUCN	International Union for Conservation of Nature and Natural Resources
IWT	Inland Water Transport
JETRO	Japan External Trade Organisation
KN	Kilo-Newton
KSB	Karma Sangsthan Bank
L/C	Letter of Credit
LCB	Local Commercial Bank
LECO	Lanka Electric Company Ltd
LGED	Local Government Engineering Department

LGO	Local Government Organisation
LNG	Liquefied Natural Gas
MCA	Millennium Challenge Account
MCCI	Metropolitan Chamber of Commerce and Industry
MDG	Millennium Development Goal
MFA	Multi-Fibre Arrangement
MFN	Most Favoured Nation
MFRD	Marine Fisheries Research Department
MG	Meter Gauge
MMT	Multimodal Transport
MoU	Memorandum of Understanding
MRL	Maximum Residue Limit
MTMF	Mid-Term Macroeconomic Framework
NAFTA	North American Free Trade Agreement
NBFI	Non-Banking Financial Institutions
NBR	National Board of Revenue
NCB	Nationalised Commercial Bank
NCC	National Coordination Council
NEC	National Economic Council
NELP	New Exploration and Licensing Policy
NEMAP	National Environmental Management Action Plan
NEP	National Environmental Policy
NEPRA	National Electric Power Regulatory Authority
NERC	North American Electric Reliability Council
NGO	Non Government Organisation
NPFP	National Poverty Focal Point
NSD	National Saving Deposit
NSGPRSD	National Strategy for Economic Growth, Poverty Reduction and Social Development
NTB	Non-Tariff Barrier
OCA	Optimum Currency Area
OECD	Organization of Economic Cooperation and Development
OGRA	Oil and Gas Regulatory Authority
OLS	Ordinary Least Square
ONGC	Oil and Natural Gas Corporation Ltd
PARC	Public Administration Reform Commission
PBM	Pakistan Bait-Ul-Mal
PCGDPGR	Per Capita GDP Growth Rate
PEDP-II	Second Primary Education Development Programme

PERC	Public Expenditure Review Commission
PGCB	Power Grid Company, Bangladesh
PKSF	Palli Karmasahayak Foundation
PLC	Public Limited Companies
PMA	Post–MFA Action Programme
PP	Phillips-Perron
PPA	Power Purchase Agreement
PPIB	Private Power and Infrastructure Board
PPP	Purchasing Power Parity
PPR	Peste Des Petite Ruminant
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSD	Private Sector Develoment Programme (Danida)
PSI	Pre-Shipment Inspection
PTA	Preferential Trading Arrangement
PTB	Para-Tariff Barrier
QIP	Quantum Index of Production
RAB	Rapid Action Battalion
RAKUB	Rajshahi Krishi Unnayan Bank
RER	Real Exchange Rate
RIT	Regional Investment Treaty
RLCM	Revenue Loss Compensation Mechanism
RoO	Rules of Origin
RTA	Regional Trading Arrangement
SAARC	South Asian Association for Regional Cooperation
SACEPS	South Asia Centre for Policy Studies
SADC	Southern African Development Community
SADF	South Asian Development Fund
SAFTA	South Asia Free Trade Agreement
SAGQ	South Asia Growth Quadrangle
SAIC	SAARC Agricultural Information Centre
SAP	Structural Adjustment Programme
SAPAP	South Asia Poverty Alleviation Programme
SAPP	Southern African Power Pool
SAPTA	SAARC Preferential Trading Arrangement
SCB	Shippers' Council of Bangladesh
SDF	SAARC Development Fund

SDR	Supplementary Drawing Rights
SEAFDEC	Southeast Asia Fisheries Development Centre
SEC	Securities and Exchange Commission
SECEP	Small Enterprise Capacity Enhancement Programme
SEDF	South Asia Enterprise Development Facility
SEI	Socio Economic Infrastructure
SEMP	Sustainable Environmental Management Plan
SERC	State Electricity Regulatory Commission
SFLI	Support to Forward Linkage Industries
SFM	Sustainable Forest Management
SFSRB	SAARC Food Security Reserve Board
SHS	Support to Handloom Sector
SID	Simpson Index of Diversity
SIDA	Swedish International Development Cooperation Agency
SLR	Statutory Liquidity Requirement
SME	Small and Medium Enterprises
SNMO	Support to New Market Opportunities
SOE	State-Owned Enterprise
SOM	Senior Officials Meeting
SPA	Strategic Plan of Action
SPP	Small Power Plant
SPS	Sanitary and Phytosanitary
SPTS	Support of Primary Textile Sector
SQDP	Skill and Quality Development Programme
SUPRO	Shusasan-Er Jonno Prochar Ovijan
TA	Technical Assistance
TAR	Trans Asian Railway
TB	Treasury Bill
TCB	Trading Corporation of Bangladesh
TCD	Technical Capacity Development of SME
TE	Triennium Ending
TIB	Transparency International Bangladesh
TIFA	Trade and Investment Framework Agreement
TIN	Taxpayee Identification Number
TLP	Trade Liberalisation Plan
TNC	Transnational Corporation
TOR	Terms of Reference
TR	Test Relief
TRIPS	Trades Related Aspect of Intellectual Property Rights

TRTA	Trade Related Technical Assistance
TTFA	Transit Transport Framework Agreements
TU	Trade Union
UIC	International Union of Railways
UNCED	United Nations Conference on Environment and Development
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UN-ECA	United Nations Economic Commission for Africa
UN-ECE	United Nations Economic Commission for Europe
UN-ESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UN-HABITAT	UN Human Settlements Programme
UNPAN	The United Nations Online Network in Public Administration and Finance
UTCE	Union for the Coordination of Transmission of Electricity
VAT	Value Added Tax
VGD	Vulnerable Group Development
VGF	Vulnerable Group Feeding
WB	World Bank
WDI	World Development Indicators
WEC	Water and Energy Commission
WTO	World Trade Organisation
WWF	Workers Welfare Fund

Contributors

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Preface

The objective of CPD's Independent Review of Bangladesh's Development (IRBD) exercise, of which the present volume *Regional Cooperation in South Asia: A Review of Bangladesh's Development 2004* is the ninth in the series, is to provide an annual home grown assessment of Bangladesh's development process. Launched in 1995, the IRBD initiative of the CPD has continued to play a defining role by way of providing an annual report card on the performance of the economy which is prepared through an interactive process with participation of major stakeholders, and also by thanks to the quality of the indepth analysis of key emerging strategic issues that are likely to define the country's development process in the coming years.

In continuation of the IRBD tradition, the IRBD2004 focuses on two major themes – in Part A titled *State of the Bangladesh Economy in FY2004* an assessment of the key trends and events concerning the Bangladesh economy over the fiscal year 2003-04 and also during the early months of FY2005 is presented; in Part B titled *Regional Cooperation in South Asia* the opportunities and challenges of economic cooperation among the SAARC member countries are examined by undertaking an indepth analysis of some of the most critically important issues involved.

Part A: State of the Bangladesh Economy in FY2004

Part A of IRBD2004 has three Chapters and includes three annexes. This part of the IRBD provides an indepth analysis of the state of the Bangladesh economy in FY2004, presents an assessment of Bangladesh Development Forum (BDF) held in 2004 in Dhaka and also presents CPD's assessment of the national budget for FY2005.

The first chapter on *Macroeconomic Overview* puts a number of key recent macroeconomic variables under scrutiny. This particularly concerns such areas as growth parameters, public finance, monetary policy, real economy and the external sector. This part of the review argues that most of the key variables (GDP growth, savings-investment, monetary aggregates, credit expansion, inflation, agricultural and industrial production, export and import, remittance, foreign exchange reserve, etc.) that had a bearing on Bangladesh's macroeconomic performance in FY2004 started off on a relatively strong footing. The attendant indicators were further strengthened during the second quarter of the fiscal year (October-December). However, the economy started to transmit mixed signals as it entered into the third and fourth quarters (January-June). Thus, the initial promise in terms of macroeconomic performance evidenced in the first half of the fiscal year 2003-04 somewhat tapered off and became less robust in the second half of FY2004. The review comes up with the observation that major distinguishing features of FY2004 were sustained export growth recovery, buoyant remittance flows and steady state of agriculture production. Positive movements were observed in case of import growth, industrial loans and agricultural credit disbursement. However, these reassuring trends were somewhat moderated by the marginal growth in the manufacturing sector, low level of FDI inflow, transitory bubbles in the capital market, and last but not the least, the perceptible price hike of essential commodities. The review states that fiscal balance in FY2004 remained sound mainly by default (largely due to low ADP implementation), and cautioned that the Balance of Payment (BoP) situation could be exposed to some pressure owing to an increasing trade gap and the expected pressure of import payments over the succeeding months.

The second chapter on *Perspectives on Bangladesh Development Forum 2004* deals with the evolving aid relationship of Bangladesh, and contextualises this with the holding of the BDF2004. In this context, the IRBD raises a number of concerns pertaining to the various themes that were put on the table for discussion during the five working sessions of the BDF2004 relating to macroeconomics, meso or sectoral issues, reforms, Governance and the PRSP. In this context, the IRBD contextualises BDF2004, by focusing on the background of the Forum and the agenda of discussion, analyses the evolving aid scenario, changing aid structure and the dynamics of donor-recipient relationship in the context of Bangladesh and highlights some of the important emerging issues which demand immediate attention of both Bangladesh's policymakers and development partners. The review takes a critical lore at some of the policies and their implementational aspects and goes on to make the point that without good governance and strong institutions and policies, however well meaning and justified, these will not result into real economic gains for the common people of Bangladesh.

The third chapter on *An Analysis of the National Budget for Fiscal Year 2004-2005* is an assessment of the national budget for FY2005. The review finds it paradoxical that the economy suffers from under-investment, and at the same time investible surplus remains unutilised. Thus, in the final analysis, it boils down to the question of effective and quality delivery of public resources to the disadvantaged groups. Analysing the budget for FY2005, the review points out that implementational prospects for the envisaged agendas appeared to be rather bleak in the absence of any cogent strategy. Significant shortfall in ADP implementation over the successive years was pointed out as a major cause for concern. The assessment points out further that without appropriate measures in the area of public administration reform, local government strengthening, improved utilisation of foreign aid, improvements in the quality of services in public health and education, the full potentials of the Bangladesh economy will remain underachieved. In the final analysis, full delivery of the resource package as well as faithful delivery of the development outlay will be the yardstick for judging the success of the FY2005 budget. Reviewing some of the key MTMF targets, the review makes the point that a number of key indicators such as domestic savings-investment (both public and private), revenue-GDP, and public expenditure-GDP ratios were performing below the target. In view of this the review cautions that protecting the integrity of the macro framework may emerge as problematic.

In addition, the three Annexes at the end of Part A present a report on the IRBD Dialogue titled *Bangladesh Development Forum 2004: Civil Society's Perspectives*, a review on *State of the Bangladesh Economy and Budget Responses 2004*, and a list of key economic events titled *Chronology of Major Economic Events (July 2003 – December 2004)*.

Part B: Regional Cooperation in South Asia

IRBD2004 opted for "Regional Cooperation" as a strategic policy issue for the thematic part of the Review in view of its emerging importance for Bangladesh's development in the coming years. Though multilateral institutions such as the WTO are setting the paced for globalisation, various regional initiatives are also gaining momentum at the same time. Although South Asian countries, under the aegis of the SAARC, have attempted to foster closer cooperation in the areas of trade, investment and some other areas, they do not have much to show as credit. More than two decades after establishment of the SAARC, South Asia continues to remain one of the least integrated regions of the world. In view of this, IRBD2004 was entrusted to undertake an indepth look at some of the key areas and issues that were critical to advancing regional cooperation among the countries of the South Asian region. Thus, IRBD2004 undertook an assessment of the policies and the progress in the area of regional cooperation in South Asia to explore potential avenues for strengthening further cooperation in the region. The review argues that the SAARC countries could draw important synergies through cooperation in areas such as agriculture, interindustry trade, sustainable energy use, integrated transport network, and investment.

Part B of IRBD2004 includes nine chapters. Chapter four on *Setting the Enhanced Agenda for Regional Cooperation for the Next Decade* examines the prospects for South Asian cooperation and presents road map towards a South Asian Economic Union. The paper looks at both economic and political economic issues and argues that constraints to cooperation in virtually all areas originate in the tendency of member governments to politicise issues for reasons of domestic expediency. The study takes the view that SAARC leaders need to demonstrate the statesmanship needed to resolve their short and long term conflicts, and goes on to argue that this can be more readily addressed within a framework of open regionalism where borders and nationality do not become constraints to the intercourse of people and commerce. The author observes that the felt needs for economic integration are already reflected in the commitment of the SAARC leaders to reduce poverty and to uphold the rights of the excluded through the SAARC Social Charter. But for these rights to be realised South Asia has to be transformed into zone of peace where its scare resources are not exhausted in building security establishments which themselves become obstacles to cooperation in the region. The civil societies of the SAARC countries have a major role to play in priority such cooperation. The author cautions that, unless the leadership takes the long view towards a South Asian Economic Union and moves by mutual agreement to eliminate the roadblocks to this destination, South Asia's bureaucracies retain the capacity to transform each hurdle into an insurmountable obstacle.

Chapter five on *Macroeconomic Performance of South Asian Economies: A Comparative Perspective on Bangladesh* examines the issue of macroeconomic stability and growth in the South Asian countries and situates Bangladesh in the context of the region. According to the authors, the reform measures initiated in the 1980s and the 1990s contributed towards achievement of stability of macroeconomic performance in the South Asian countries; however, such stability turned out to be inadequate for the purpose of unleashing the growth potentials of these countries. Based on empirical evidence, the paper observes that South Asian economies, at various points in time over the last two decades, have embarked on market oriented policy reforms (initiated often in the backdrop of macroeconomic crises) aimed at achieving macroeconomic stability leading to accelerated growth. All the South Asian economies during the 1990s and early 2000s (post-reform period) were indeed successful in improving their macroeconomic performance (with some exceptions). The paper shows that Bangladesh is currently the most stable country in the South Asian region in terms of macroeconomic performance. During the period under observation, Bangladesh and India managed to increase their real GDP growth rate and per capita GDP; whereas Nepal and Pakistan could not. The authors observe that the regional data do not reveal any systematic relationship between macro-stability variables and growth performance, which implied that apart from macro-stability there were other factors at play and that there were country specific variables that were important in terms of driving the growth dynamics forward. The authors go on to suggest that these factors are possibly captured by the currently reigning analytical concepts of good governance, institutional reforms and capacity building where most of the SAARC countries have serious lacking.

Chapter six on *SAFTA Accord: Salient Features, and Challenges of Realising the Potentials* presents a review of the theoretical underpinning of regional trading arrangements (RTAs) which are emerging as a major force in the global trading system, undertakes a critical examination of some of the key negotiating issues pertaining to the SAFTA Agreement, investigates implications of the SAFTA for Bangladesh and other least developed country (LDC) members of the SAARC, and puts forward a number of suggestions for realising the potential benefits of the SAFTA accord. The paper argues that it will be unrealistic to expect that there will be substantial change in terms of intra-regional trade if the SAFTA accord is only limited to implementation of the trade liberalisation plan. In this connection, the author observes that the pace of tariff liberalisation under SAFTA is rather slow and that the list of sensitive items (negative lists) is quite long. These need to be sharply reduced, particularly for the LDC products, on a priority basis. The author observes that greater volume of intra-regional trade and reduced bilateral trade deficits between SAARC partner countries will be critical to the success of SAFTA. In this connection, the author mentions that investment, both intra- and extra-regional, must follow the preferential trade regime within the region. This can only be possible if the move towards an FTA is complemented by initiatives to promote cooperation in the area of investment, removal of all types of NTBs, trade and customs facilitation, and cooperation in the area of trade related capacity building. The building blocs for these complementary steps are present in the Framework Agreement, albeit only in the form of best endeavour clauses. The paper goes on to argue that without building the appropriate supply-side capacities, given the current export structure, it will be very difficult for South Asian LDCs such as Bangladesh to take advantage of the potential benefits of the SAFTA.

Chapter seven on *South Asian Financial Cooperation: Long Way to Go* focuses on the importance of financial cooperation among the South Asian economies and proposes the modalities to foster such cooperation. The paper argues that at present South Asian countries are barely ready for an integrated financial market. However, it is expected that implementation of SAFTA and increased exchange of goods will create a conducive environment to move towards enhanced financial cooperation. The authors favour a reinvigorated emphasis on harmonisation of macroeconomic fundamentals and argue for cooperation among the SAARC member states in the area of trade related financing at the initial stage. At the time of the last summit of the SAARC, held in Dhaka in November 2005, member countries had expressed a desire to work towards monetary and economic unions encompassing all the countries of the SAARC. The authors opine that initiatives in various areas, however insignificant, will create an environment that will promote and foster a move towards a mere comprehensive cooperation in the area of finance and investment.

Chapter eight on *Opportunities and Challenges of Intra-regional Investment in South Asia: With Special Reference to Bangladesh* presents an analysis of the scope for intra-regional FDI in South Asia under different trade and investment agreements. The paper explores possible investment opportunities that are there in South Asia and examines the operational mechanisms to enhance intra-regional FDI flow. In this context, the paper also highlights the critical challenges that need to be addressed. The paper reviews FDI policies of South Asian countries, and analyses the composition and trend of FDI inflow in South Asia. The author takes note of the uneven distribution and concentration of the FDI and the poor performance of intra-regional FDI flow. The author observes that regional trade integration has led to a substantial increase in the flow of FDI in the EU, NAFTA and the ASEAN. The author argues that such positive outcomes could also emerge in South Asia if the SAFTA accord was successfully implemented and this was complemented by other initiatives in the areas of investment and monetary cooperation. However, the author points out that increase in FDI flow and investment potentials would require a common investment framework, improvement of infrastructure such as power, transport, utilities, and port facilities at the regional level, and strong political commitment of all the countries in the region.

Chapter nine on *Regional Cooperation for Agricultural Development in South Asia: A Perspective from Bangladesh* reviews performance of South Asian agriculture over the last two decades, discusses the commitments as well as existing level of cooperation in agriculture among South Asian countries and identifies potential areas for further cooperation. In this context, the author also highlights the challenges facing development of the agriculture sector in South Asia. The study also reviews the ASEAN experience, particularly evolution of plans, programmes and implementation mechanisms for agricultural development in countries of the South-East Asia region. Based on the analysis, the study comes up with possible strategies for developing agricultural sector in South Asia in a manner that could be built on cooperation, coordination and complementarities. The five major areas identified in the study in this context relate to: (i) Agricultural Research and Technology Development; (ii) Technology Exchange; (iii) Capacity Building through training and development of regional facilities; (iv) Harmonisation of Policies and Acts; and (v) Effective participation in WTO negotiations in agriculture. The author argues that effective cooperation for agricultural development in South Asia would essentially require establishment of working bodies and networks, detailed work programmes, series of Agreements on specific issues, regular monitoring and evaluation system, strengthening of existing organisations such as SAIC, and establishment of regional institutes (designate existing institutes with regional mandates). Most importantly, agricultural development strategy should be implemented through public-private-NGO partnership rather than through public agencies only.

Chapter ten on *Regional Cooperation in the Energy Sector of South Asia* focuses its attention on a number of important issues that are relevant to developing regional cooperation in the energy sector in South Asia including sustainable development, energy security, energy policy and regulatory framework, structure of energy sector, energy trade, energy cooperation and development of institutional framework. The author observes that the South Asia has all the potentials for forging cooperation in the energy sector if the member countries are ready to address political divide and power rivalry for in favour of economic growth, sustainable development and poverty alleviation. The South Asia region is a net importer of crude and oil products and a large segment of economic activities, such as transportation, manufacturing and power generation, are also tied to oil products. Strategies drawn by the SAARC countries independently have common features in many respects. Energy security for the region has emerged as an issue of common interest for all the SAARC countries. Now the task is to address and deal with this issue from a common platform. The author notes that the crude oil reserves in the region of about 650 million tons, which is highly limited considering current production and envisaged growth. The natural gas reserves of the region are also small (about 52 TCF) when compared to the projected growth of consumption. If the depleted reserves are not augmented through new discoveries and development, sustenance of natural gas based economy appears to be uncertain and doubtful. The hydropower potential of the region has remained unexploited and only 12.5 per cent of the potential has been tapped till now. The author argues that cooperation in the energy sector in South Asia is a prerequisite for implementing many of the suggested strategic projects, including those that involve trans boundary natural gas pipelines bringing natural gas from sources outside the region, cross-border intertransmission of power, developing hydro power projects in Nepal and Bhutan, and trade in petroleum products. The author suggests that the preparatory works that could stimulate regional cooperation include: (i) creation of a consensus among the major stakeholders; (ii) streamlining of policies, regulations, laws, legislations, and rules; (iii) harmonisation of technical matters; and (iv) supporting think-tanks to initiate confidence building works among stakeholders to win their approval for cooperation.

Chapter eleven on *Promoting Transport Cooperation in South Asia* deals with a number of practical issues to promote transport cooperation in the region with a view to facilitating trade and investment integration in South Asia. The paper highlights the present unsatisfactory state of transport integration in South Asia and draws attention to factors that act as stumbling blocs in this regard. In this context the paper presents a number of recommendations to address the attendant challenges. The author observes that an increasingly integrated transport system at regional/ subregional level is essential to creating and sustaining economic dynamism. The author notes that for various historical, political and economic reasons, transport network of South Asia, once part of a highly integrated system, is at present degenerated into a highly fragmented one. As a result, its potential as an engine of economic growth at the subregional and regional levels remains largely unrealised. The situation in South Asia is entirely out of step with the ongoing world-wide trends towards greater integration. The author highlights some of the costs and consequences of non-cooperation in South Asia, and indicates how the member countries of SAARC can mutually benefit from closer cooperation. The author underscores the importance of major stakeholders including the civil society actors to play a more proactive role in changing the mind-sets of political leaders.

Chapter twelve on *Poverty in South Asia: A Need for an Empowerment Approach* critically examines evolution of the ongoing discourse on poverty in South Asia, both collectively, on the platform of SAARC, and also in the individual countries within the framework of their respective Poverty Reduction Strategy Papers (PRSPs). The author takes a critical look at the PRSP, prepared by Bangladesh, Nepal, Pakistan and Sri Lanka, and makes a comparative study of the major elements in these strategies. The author argues that although the goals set in the country PRSPs are quite ambitious, policies and programmes that underwrite those strategies have rarely gone beyond the traditional market based paradigm of poverty eradication supplemented by programmes of human development and a few safety net projects. Such traditional strategies of poverty eradication are not immune from severe governance problems that continue to exist in each of these countries and thus their prospect for success continues to remain doubtful. Though decentralisation, local government, human resource development and empowerment of the poor are very much present in all the four PRSPs, the author argues that without appropriate and adequate institutions of the poor, these are likely to remain pious wishes. The author argues that without addressing the more fundamental issues that give rise to the abject and endemic poverty that is present and persistent in all the South Asian countries, it will hardly be possible to alleviate and eradicate poverty, however good the intentions are. The author observes that in the ultimate analysis the governance problem is a political problem and cannot be solved by producing written document such as the PRSPs.

Acknowledgement

IRBD 2004 bears the fruit collaboration and support of many individuals and institutions and on behalf of the IRBD 2004 Team Members I would like to express my sincere gratitude to all of them. My special word of appreciation goes to the authors of the various chapters of the IRBD 2004 whose high calibre of scholarship and professionalism has produced a volume of such excellent quality. Each IRBD chapter has benefited from discussion with relevant stakeholders and comments from the many dialogue participants at which the various IRBD drafts were presented. They included top level policymakers, experts, and representatives of various groups including grassroots and professional organisations, trade bodies, business and commerce and

development partners. Many of you have been with us for the entire duration of the IRBD exercise, now in its tenth year. To each of you I would like to express our sincere thanks for your support to CPD's IRBD initiative.

Taking this opportunity I would also like to express our sincere thanks to the various institutions and organisations which have extended their support to IRBD authors by giving them access to unpublished data and information and by responding to the surveys conducted by some of the IRBD authors to generate primary data. In this context, I would like to particularly mention the cooperation received from the BBS, Bangladesh Bank, ERD, Planning Commission, FPMU, DAE, DAM, SAARC Agricultural Information Centre (SAIC), EPB, NBR, BoI, and various chambers.

Over the years CPD has developed a group of highly qualified professionals who have brought their dedication, sincerity and perseverance and pursuit for excellence to the work of preparing and publishing the IRBDs. In continuance of this rich tradition, this team of CPD colleagues has worked tirelessly and with devotion to prepare the IRBD2004 for publication under the very able leadership of Dr Debapriya Bhattacharya, Executive Director of the CPD. Debapriya has led from the front in mobilising the IRBD team, organising the various brainstorming sessions and preparing and presenting the macroeconomic overview part of IRBD 2004. Professor Mustafizur Rahman, Research Director, CPD was ably assisted by Dr Uttam Kumar Deb and Dr Fahmida Khatun, both Senior Research Fellows, and other colleagues in the Research Division in the various stages of preparing the IRBD2004 manuscript. More particularly, during the absence of IRBD coordinator Professor Rahman, who was on sabbatical leave, Dr Deb has put in a lot of effort in seeing the publication of IRBD2004 through. Young colleagues involved in preparing the background materials for the various IRBD2004 chapters worked very hard to collect, tabulate and analyse the relevant data and information. Ms Anisatul Fatema Yousuf, Head of Dialogue and Communication Division and her colleagues in the Division have played a crucial role in the preparation of IRBD2004 by organising the various dialogues. Ms Nafisa Khaled and Mr Shafiqul Abedin have been instrumental in preparing the IRBD manuscripts for publication. The CPD staffs in the Administration and Accounts Divisions have been instrumental in facilitating the work of the IRBD team members many of whom worked in other institutions and organisations. To all of these colleagues, I owe a debt of gratitude.

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The IRBDs tend to be published under very tight time-line and IRBD2004 has not been an exception. I would like to congratulate the IRBD publisher, the University Press Limited (UPL), for bringing out IRBD 2004 in such presentable format. Mr Mohiuddin and his colleagues at the UPL deserve our deepest appreciation for their sincere efforts.

Dhaka, July, 2006

Rehman Sobhan
Chairman, CPD

Part-A

STATE OF THE BANGLADESH ECONOMY IN FY2004

Chapter 1

STATE OF THE BANGLADESH ECONOMY IN FY2004: A MACROECONOMIC OVERVIEW

1.1 INTRODUCTION

Towards the end of the 1990s, the macroeconomic balances of the Bangladesh economy were confronting the twin pressures emanating from the fiscal deficit and Balance of Payments (BoP). At the structural level, the economy had plateaued in terms of upward movement in the domestic savings rate and gross private investment rate (as per cent of GDP). In spite of robust growth of the agriculture sector, private investment, particularly in the manufacturing sector was decelerating. However, the price level continued to remain low and stable.

The incumbent government, which took office in October 2001, during the first two fiscal years (FY2001-02 and FY2002-03) of its tenure was thus engaged, on a priority basis, in strengthening the macroeconomic coordinates of the economy through fiscal consolidation and strengthening of the BoP. The government also appreciated the need to stimulate investment. The Independent Review of Bangladesh's Development (IRBD), prepared by the Centre for Policy Dialogue (CPD), in its latest edition noted that the fiscal balance experienced some consolidation in FY2003 and the country's BoP improved further; however, the signs of investment stagnation still remain evident (Bhattacharya, 2004).

In this context, CPD in its review of the National Budget for FY2004 (Bhattacharya, 2003b) pointed out in June 2003 that the economic performance in the current fiscal year would depend on four critical factors: (i) full and faithful implementation of the Annual Development Programme (ADP) – putting emphasis on the quality of the projects; (ii) resurgence of exports and gradual diversification of the commodity basket; (iii) higher inflow of private investment in manufacturing activities, particularly in import-competing sectors; and (iv) ability to provide supportive credit and monetary policy backup to fiscal measures by maintaining stability of the exchange rate and price index as well as reducing the cost of capital.

CPD's review of the National Budget for FY2004 in conclusion pointed out, "without significant alleviation of the micro-level impediments to investment, ranging from enhancing the efficiency of public utilities and the financial system, measures to improve the security of life and property, addressing the dysfunctional judicial process and tackling pervasive corruption, the anticipated supply-side response will be hardly forthcoming" (ibid).

The present government has since then entered into the third and, possibly the most defining year of its tenure. Common wisdom about the political tradition of Bangladesh tells us that successive governments are more likely to undertake a series of energetic and bold reform measures during the first couple of years of the regime, which invariably run out of steam as the next national election approaches. From this perspective, FY2004 has to be "the year of the big push" for the government in order to avert the setting in of the *mid-term inertia*.

As one looks back to FY2004, one can identify a number of issues, which distinguish the period. These issues include energetic measures in the financial sector, intensive bilateral, regional and multilateral trade negotiations, and fresh movements (bubbles!) in the capital market.

But these positive movements were paralleled by such developments as the rise in the price of essential consumer goods, seasonal employment and income deprivation *(monga)* in the Northern districts and the emerging retardation in the privatisation process. "High" rate of interest charged by the banks, slack implementation of the ADP, low utilisation of foreign aid and the state of trade union rights in the Export Processing Zones (EPZs) are some of the issues, which dominated the public policy debate during FY2004.

In this context, in order to generate a proper understanding of the state of economic affairs during the elapsing fiscal year, this paper puts under scrutiny some recent trends in the Bangladesh economy, particularly in the areas of public finance, monetary policy, real economy and the external sector.

The information used in the analysis are primarily derived from official sources including Bangladesh Bank, Bangladesh Bureau of Statistics (BBS), Bangladesh Export Processing Zones Authority (BEPZA), Board of Investment (BoI), Economic Relations Division (ERD), Export Promotion Bureau (EPB), National Board of Revenue (NBR), etc. These were supplemented by primary data generated by CPD through focused field investigation (e.g. Rapid Appraisal of *monga* and Perception Survey on Investment Situation).

1.2 GROWTH, SAVINGS AND INVESTMENT

1.2.1 Growth Rate – Plateauing?

Bangladesh economy posted a growth of 5.5 per cent[1] in FY2004 in keeping with the I-PRSP target against the 5.3 per cent growth in FY2003. The real GDP stood at Tk 2,501.0 billion in FY2004, against the corresponding figure of Tk 2,371.0 billion in FY2003. However, the improved growth rate remains below the recent record figure of 5.9 per cent achieved in FY2000. Growth of nominal GDP during FY2004 was 10.6 per cent, as against that of 10.0 per cent in FY2003. The government has set the new target for real GDP growth at 6.0 per cent for FY2005 in line with the I-PRSP (Figure 1.1).

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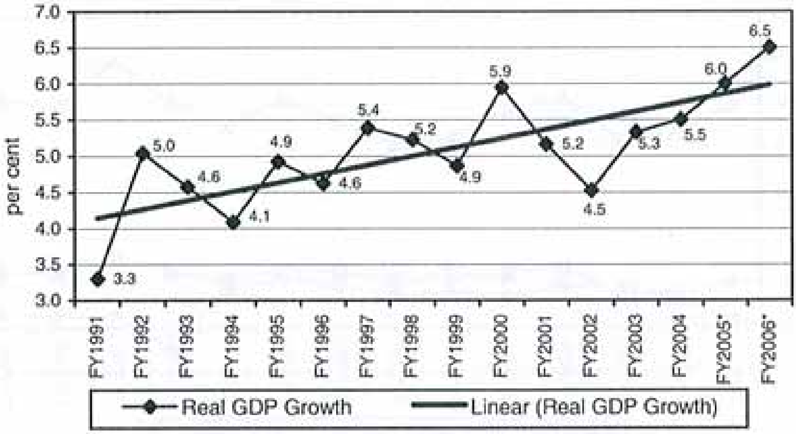
[1] BBS has recently revised the GDP growth rate for FY2004 from 5.5 per cent to 6.3 per cent. However, the present paper takes into account the earlier figure, as it was written before the revision.



Note: *I-PRSP Targets.

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

Figure 1.1: Trends in GDP Growth and I-PRSP Targets

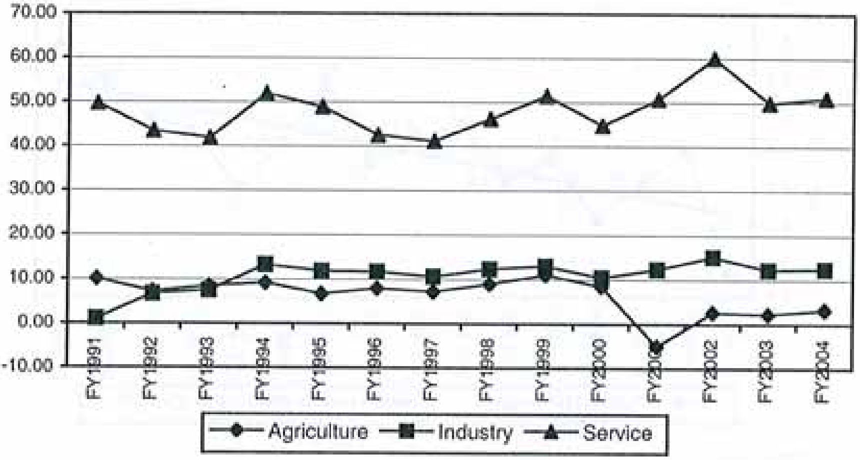
However, as was mentioned in IRBD2003, acceleration of the growth momentum is tapering off and the growth rate since 2000 has plateaued at 5.0 per cent-plus level (Bhattacharya, 2004). It may be recalled that economic growth experienced acceleration, from 3.7 per cent average growth in the 1980s to 4.8 per cent average growth in the 1990s. The growth momentum was higher during the second half of the decade in comparison to the first half: average growth rate for FY1991-FY1995 was 4.4 per cent while the same for FY1996-FY2000 was 5.2 per cent. Linear growth during this period rose from 4.0 per cent in FY1991-FY1995 to 4.8 per cent in FY1996-FY2000.

1.2.2 Sources of Growth – Service Sector Dominated

The contribution of the real economic sectors to incremental growth had declined to 33 per cent in FY2004 from 34.4 per cent in FY2003. The annual growth of the real economic sector stagnated at 4.6 per cent during the last couple of fiscal years (FY2003-FY2004). This was largely triggered by the decline in the incremental growth of agriculture sector, which plummeted from 13.3 per cent in FY2003 to 11.0 per cent in FY2004. The incremental growth of the service sector has increased to 51.0 per cent in FY2004 from 49.9 per cent in FY2003 (Figure 1.2).

The economy has experienced a major structural transformation in respect of the sectoral contribution to GDP during the last two decades. While the agricultural sector had more than 30.0 per cent share during the 1980s, the share came down to less than 23.0 per cent at the beginning of twentieth century. On the other hand, the share of industrial sector had increased from around 18.0 per cent in the 1980s to about 28.0 per cent at the beginning of this century.

During the FY2004, both the sectoral contribution (share) and incremental growth of agricultural sector declined from 23.5 per cent and 13.5 per cent in FY2003 to 22.8 per cent and 11.0 per cent in FY2004 respectively. Industrial sector, on the other hand,



Source: Computed from CPD (2004).

Figure 1.2: Incremental Growth of Sectors of GDP: FY1991-FY2004

experienced a marginal growth both in terms of sectoral contribution and incremental growth, increasing from 49.3 per cent and 48.6 per cent in FY2003 to 49.4 per cent and 49.1 per cent in FY2004 in that order. The share of service sector remained the top, which has also slightly increased from 49.3 per cent in FY2003 to 49.4 per cent in FY2004.

As may be observed, the GDP growth in FY2004 was spearheaded by manufacturing industries and various service sectors while the share of agriculture was relatively low. Does this mean that we are witnessing a more urban-biased growth? Will it deepen the disparity even further? One would need to do an indepth investigation in order to seek answers to these important questions.

1.2.3 Per Capita Income

The per capita GDP and GNI scenario are gradually improving after a decline in FY2002. In FY2003, the per capita GDP and GNI was recorded at US$389.0 and US$411.0 respectively. In FY2004, the corresponding figures were US$421.0 and US$444.0 respectively. The annual growth is of 8.2 per cent for per capita GDP and 8.0 per cent for per capita GNI in terms of US dollars. Once these figures are adjusted by the extent of devaluation of US Dollar, the per capita GDP growth comes down to 5.3 per cent.

It is well known that poverty trends are influenced by the changing faces of inequality. Income inequality at the national level has increased from 25.9 per cent in 1991/92 to 30.6 per cent in 2000. During the same period, urban inequality was rising at a higher pace (from 30.7 per cent in 1991/92 to 36.8 per cent in 2000) than rural inequality (from 24.3 per cent in 1991/92 to 27.1 per cent in 2000) (BBS, 2003).

Between 1995/96 and 2000, the income differential between the poorest and the richest increased from 35.7 times to 53.4 times during the second half of the 1990s. The sources of rising inequality are linked with the uneven spread of economic and social opportunities, unequal distribution of assets especially in respect of human capital and financial capital, growing disparity between urban and rural areas as well as between developed and underdeveloped areas. The IRBD2003 opined that the incremental growth does not automatically benefit the poor in Bangladesh (Bhattacharya, 2004). In this context and also in connection with the completion of the initial year of the I-PRSP, we have not been provided with any assessment on the poverty situation. There is no evidence, which suggests that this trend has reversed during the last couple of years. Absence of such an assessment also makes us unable to benchmark our programmes regarding Millennium Development Goals (MDGs).

1.2.4 Savings

Stagnating domestic savings may be accepted as a proxy indicator of the slow pace of poverty alleviation and rising inequality. Domestic savings increased marginally to 18.3 per cent[2] of the GDP in FY2004 while it was 18.2 per cent in FY2003. The share of national savings to GDP has also shown signs of stagnation in FY2004 at 24.5 per cent of GDP against 24.5 per cent in FY2003. Though the national savings rate projected at the I-PRSP document for FY2004 (23.8 per cent) was achieved, the projected domestic savings rate for FY2004 (19.2 per cent) was not attained (Table 1.1).

TABLE 1.1

Savings/Investment Scenario, FY2004-FY2005

	FY2004		Deviation from	PRSP
	I-PRSP	Actual	I-PRSP	FY2005
Gross Domestic Savings	19.2	18.3	- 0.9	20.0
Gross National Savings	24.3	24.5	+ 0.2	25.2
Gross Investment	25.4	23.6	- 1.8	27.0
Private	18.7	17.5	- 1.2	19.9
Public	6.7	6.1	-0.6	7.1

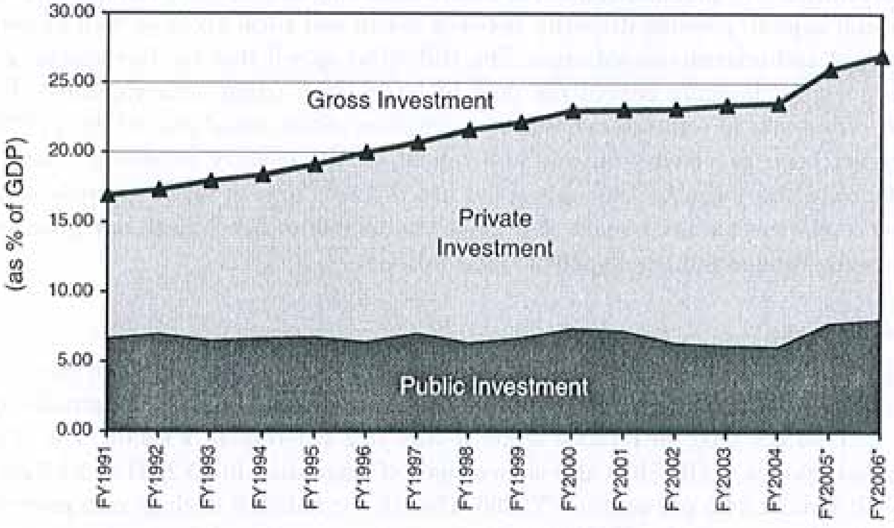
Source: Computed from Finance Division (2004c) and ERD (2003).

1.2.5 Investment

During the last five years (FY2000-FY2004), the gross investment ratio had increased by only 0.5 per cent of the GDP. For example, the ratio was 23.0 per cent in FY2000, while it inched only up to 23.6 per cent in FY2004. Increasing investment continues to remain one of the core challenges of Bangladesh's macroeconomy. In FY2004, the country recorded the lowest public investment ratio of the last 14 years at 6.1 per cent.[3] The sectors left behind by public investment were not adequately picked up by private

[2] Government has revised upward the savings figures of FY2003 and FY2004, gross national savings 24.5 per cent to 25.4 per cent of GDP; and gross domestic savings 18.3 per cent to 19.5 per cent of GDP. Given the fact that the GDP for FY2004 has been revised upward significantly, these proportions as per cent of GDP are remarkably higher. However, as was mentioned earlier, the present paper could not consider these delayed changes in the national income accounts.

[3] Figures on gross investment rates for FY2004 have also been revised upward from 23.6 per cent to 24.0 per cent of GDP. Similarly, the private and public investment figures have also been correspondingly revised after the finalisation of this paper.



Note: *I-PRSP Targets.
Source: Computed from Finance Division (2004c) and ERD (2003).

Figure 1.3: Investment Trend (as % of GDP)

investment. BBS has re-estimated the private investment values for FY2003 and the final figure for private investment rate has been revised upward from 16.5 per cent to 17.2 per cent of GDP (i.e. a change of 4.4 per cent). As a result, the difference between the final figure for FY2003 and the provisional figure for FY2004 with respect to private investment is as low as 0.1 per cent of GDP. This implies that, contrary to the official version, the magnitude of private investment acceleration during FY2004 was rather modest (Figure 1.3).

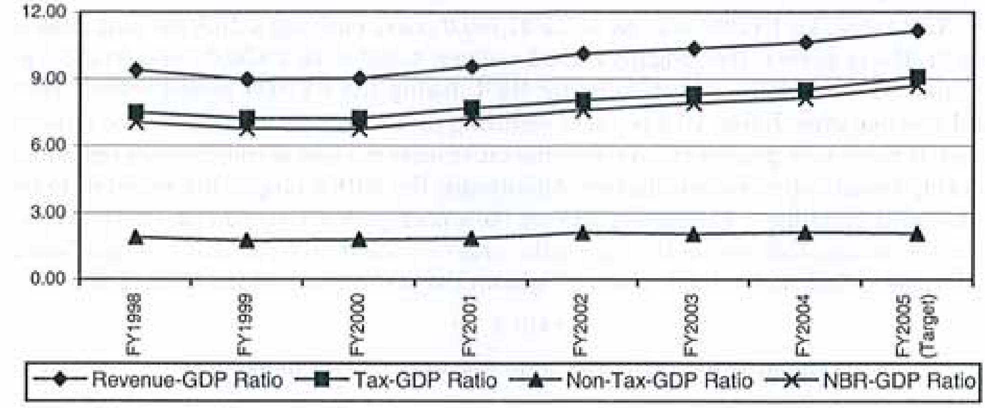
Paradoxically, Bangladesh continues to remain an under-invested country, while its national savings rate (24.5 per cent) supposes its gross investment rate (23.6 per cent). Bangladesh has been failing to convert all its savings into investment, as it continues to borrow from foreign sources. Private savings rate is marginally lower than projected in I-PRSP for FY2004 (17.5 per cent), but public investment is much below the projected figure for FY2004 (7.2 per cent) in I-PRSP (Table 1.1).

1.3 PUBLIC FINANCE

In the area of public finance it will be important to analyse the current trends in revenue generation, public expenditure including the ADP and financing of the budget deficit. Development expenditure of the government – both its size and quality – was the major issue on part of public finance, which attracted maximum attention in FY2004.

1.3.1 Revenue Earning

The National Board of Revenue (NBR) commands about three-fourths of total revenue generation in Bangladesh. The non-NBR taxes account for another 4.0 per cent of the



Source: Computed from CPD (2004).

Figure 1.4: Revenue as % of GDP

total revenue, while the remainder (20.0 per cent) comes from non-tax revenues. In recent years, the NBR has been more or less fulfilling its budgetary targets, whereas the non-NBR revenue and non-tax collection have systematically lagged behind (Table 1.2).

Actual revenue collection in FY2003 was equivalent to about 10.0 per cent of the GDP, and in FY2004, the ratio increased to about 11.2 per cent, which is still fairly low by all cross-country standards (Figure 1.4).[4]

TABLE 1.2

Trends in Total Revenue Receipts: FY2001-FY2005

(in billion Tk)

	Tax Revenue				Non-tax Revenue				Total Revenue				Total
	Budget	Revised	Actual	Actual as % of budget	Budget	Revised	Actual	Actual as % of budget	Budget	Revised	Actual	Actual as % of budget	Revenue as % of GDP
FY2001	19278.0	19490.0	19132.0	-0.76	4920.0	4683.0	4563.0	-7.26	24198.0	24173.0	23695.0	-2.1	9.3
FY2002	22024.0	21932.0	21029.0	-4.52	6433.0	5740.0	6652.0	3.40	28457.0	27672.0	27681.0	-2.7	10.1
	(14.2)	(12.5)	(9.9)		(30.7)	(22.6)	(45.9)		(17.6)	(14.5)	(16.8)		
FY2003	25500.0	24950.0	24261.0	-4.86	7067.0	6099.0	6094.0	-13.77	32567.0	31049.0	30355.0	-6.8	10.1
	(15.8)	(13.8)	(15.4)		(9.9)	(6.2)	(-8.4)		(14.4)	(12.2)	(9.6)		
FY2004	29071.0	28300.0	27009.0	-7.09	7000.0	6989.0	6249.0	-10.73	36071.0	35289.0	33258.0	-7.8	10.0
	(14.0)	(13.4)	(11.3)		(-0.9)	(14.6)	(2.5)		(10.7)	(13.7)	(9.6)		
FY2005	33640.0				7660.0				41300.0				11.1[a]
	(15.7)		n.a.		(9.4)		n.a.		(14.5)		n.a.		

Notes: Figures in the parentheses depict annual growth rates.

[a] Based on target. GDP for FY2005 has been estimated by the government at Tk 3,701.2 billion.

n.a. not available/not applicable.

Source: Computed from CPD (2004) and Finance Division (2003b).

[4] In India and Pakistan, central government revenues as percentage of GDP (2002) were 20.0 per cent and 17.0 per cent respectively. In transitional economies and in developing countries (1997) the rates were 27.3 and 16.8 per cent, while in Asia (1997) the overall rate was 14.0 per cent (UNPAN, 2004).

NBR Components

The NBR target for FY2004 was set at Tk 27,750.0 crore, implying a 16.8 per cent annual growth. The target was then slightly revised and new target is Tk 27050.0 crore. Analysis of information on revenue collection under NBR during the FY2004 period reveals that total revenue growth was 10.3 per cent resulting in 3.5 per cent shortfall of the annual target. It needs to be pointed out in this context that there is a lack of transparency regarding monthly targets of revenue collection. Admittedly, the NBR's targets are reported to be back-loaded, resulting in a mismatch between the annual growth target and monthly targets. However, accomplishment of the aggregate target by about 96.5 per cent is a significant achievement that throws some positive light on the performance of the NBR (Table 1.3).

TABLE 1.3

Composition of Tax Revenue Receipts (NBR Component)

(in crore Tk)

No.	Source of Revenue	FY2004				FY2003				Growth
		Revised Target	Achieved	Difference	Collection as % of Target	Revised Target	Achieved	Difference	Collection as % of Target	(FY2004 over FY2003)
1	Customs Duty	7300.0	7084.9	-215.1	97.0	5890.0	6679.4	789.4	113.4	6.1
2	Value Added Tax (Import)	4325.0	4397.7	72.7	101.7	4375.0	4121.2	-253.8	94.2	6.7
3	Supplementary Duty (Import)	1830.0	1689.9	-140.1	92.3	1550.0	1271.0	-278.9	82.0	32.9
	Total Import Related Revenue	13455.0	13172.6	-282.4	97.9	11815.0	12071.7	256.6	102.1	9.1
4	Excise Duty	170.0	158.4	-11.5	93.2	310.0	318.3	8.2	102.6	-50.2
5	Value Added Tax (Domestic)	4250.0	4316.4	66.4	101.5	3696.0	3660.2	-35.7	99.0	17.9
6	Supplementary Duty (Domestic)	3600.0	3545.1	-54.9	98.5	2825.0	3138.9	313.9	111.1	12.9
	Total Internal Trade Related Revenue	8020.0	8020.0	0.0	100.0	6831.0	7117.4	286.4	104.2	12.7
7	Income Tax	5270.0	4610.0	-660.0	87.5	4788.0	4235.6	-552.4	88.4	8.8
8	Other Taxes & Duties	305.0	295.0	-10.0	96.7	316.0	229.8	-86.2	72.7	28.3
	Total	27050.0	26097.6	-952.3	96.5	23750.0	23654.5	-95.5	99.6	10.3

Note: Based on NBR data, which have some discrepancy with the CGA system data provided by the Finance Division (in Table 1.2).

Source: Computed from National Board of Revenue (2003-04).

A disaggregated analysis of the revenue collection by the NBR for the FY2004 reveals that the growth of total *internal trade-related revenue* was higher (12.7 per cent) than that of total *import-related revenue* (9.1 per cent). Against the backdrop of high import growth in the recent months (discussed later), non-fulfilment of target (around 3.0 per cent shortfall) for collection of customs duty comes as a surprise. It is further contradictory that the supplementary duty (Import) collection recorded the highest growth (33.0 per cent), which is tagged with core duty collection. A decomposition of imports and the tariff structure analysis may put some light on the matter and confusion may be removed. On the other hand, the revenue collections through VAT (local) and supplementary duty (local) have been 17.9 per cent and 12.9 per cent higher than that of the preceding year (NBR, 2003-2004).

As a whole, collection by the NBR depicts a business-as-usual scenario, since a 10.0 per cent annual growth usually comes from the normal expansion of economic activities. Reorientation of the tax base from preponderance of foreign trade-related taxes to higher expansion of VAT (local) is a welcome trend. However, the relatively modest growth (8.8 per cent) in income tax collections, in spite of various potential payee identification initiatives, suggests that efforts to increase the role of mean-tested direct taxes in total revenue are yet to show any sign of improvement. Instead, the incremental revenues are coming from indirect taxes, which are borne by the consumers irrespective of their paying capacity. These emerging trends in revenue composition indicate that Bangladesh's tax structure is becoming increasingly anti-equity.

Box 1.1: Failure to Raise Revenue through Income Tax

Bangladesh has one of the lowest revenue-GDP ratios among the low-income countries. In its effort to raise revenue earnings, the government in the recent past has sought to move away from its dependence on import-related taxes and increasingly expand the base of VAT (local) and income tax. It is well recognised that VAT, as an indirect tax, is borne by all consumers irrespective of their level of earnings; thus, it tends to be anti-equity. A modern and progressive tax structure is supposed to increasingly base itself on direct taxes, particularly on income tax.

Records reveal that the annual targets of income tax have remained systematically underachieved. Consequently, the contribution of income tax in the total in-take of the NBR has stagnated at 20.0 per cent between FY1993 and FY2003. In fact, quite often the share has dipped to less than 15.0 per cent (e.g. in FY1998).

The *Taxpayee Identification Number* (TIN) system was launched on 30 June 1994. As of March 31, 2004, the TIN had a total cumulative number of 15,41,269 subscribers, registering a trend growth of 10.9 per cent over almost a 10-year period (FY1994-FY2004). About 95.5 per cent of the subscribers belong to the individual person category, whereas 2.6 per cent are in the company category (the rest in the "others" category). However, it is suspected that a significant portion of these subscribers is "dead".

The total number of tax returns submitted in FY2003 was 9,37,483. This number has experienced a growth of about 9.0 per cent between FY1992 and FY2004. About 97.3 per cent of those who submitted tax returns in FY2003 belonged to the individual person category. But it is important to note that about 40.0 per cent of those who have a registered TIN did not submit a tax return. Incidentally, it seems that the composition of the tax returnees closely proximate the TIN subscribers' break up.

The number of effective tax payees was 10,47,680 in FY2003. This number was also achieved due to a trend growth of about 9.0 per cent per year since FY1992. The split between the individual and company category once again by and large reflects the composition of the TIN subscribers. The number of effective tax payees is more than the number of tax returnees as the former group includes those from whom income tax was withheld at source of payment, but they preferred not to seek adjustment through filing tax returns. In this sense, this number is also partly flawed by double counting on the one hand and evasion on the other.

It is really provokes curiosity that the cumulative number of TIN issued is less than 3.0 per cent of the labour force of the country, while the number of tax returnees is less than 2.0 per cent of the same.

Therefore, the NBR faces a daunting challenge of collecting about a quarter of its total target within the couple of months of every fiscal year. More importantly, as the targets of the non-NBR and non-tax components of the revenue baskets remain regularly underachieved, the NBR has to collect much more than its allocated share to fulfil the aggregate target of revenue collection. Thus, the aggregate revenue target looks vulnerable or even fanciful as the fiscal year enters its last quarter.

Initial assessment suggests that the Revenue-GDP ratio will not be able to cross the 11.0 per cent mark in FY2004. Understandably, the evolving revenue mobilisation scenario will have concomitant implications for financing the ADP and, consequently, financing the fiscal deficit, particularly in the face of low off-take of foreign aid (discussed later).

The government has set a revenue collection target of Tk 32,190.0 crore for the NBR for the next fiscal year (FY2005). This implies a target growth of 19.0 per cent over the revised target (Tk 27050.0 crore) of the preceding year. Given the devastating flood at the end of FY2004, it is very likely that the revenue collection during the FY2005 will experience a sluggish run.

Non-NBR Components

Though the motivated NBR-target was more or less achieved, tax revenue collection of the non-NBR portion experienced a major jolt in FY2004. Against Tk 1,321.0 crore target, the realisation stood at Tk 1,236.0 crore in FY2004. Though the realised figure was 16.0 per cent higher than a lower benchmark of the previous year (FY2003), it was (-) 6.4 per cent less than the annual target. Only taxes on vehicles crossed the target by 5.0 per cent, while other non-NBR components, i.e. taxes on narcotics and liquor, taxes on land and taxes on stamps have fallen short of target in FY2004, though their growths over FY2003 were 6.7 per cent, 5.0 per cent and 22.1 per cent higher respectively (Table 1.4). However, the government has set a new ambitious target for the FY2005 at

TABLE 1.4

Non-NBR and Non-Tax Revenue During FY2003-FY2004

(in crore Tk)

	FY2003		FY2004			Growth of Actual FY2004 (per cent)	
	Budget	Actual	Budget	Revised Budget	Actual	over Budget 04	over Actual 03
Narcotics and Liquor	40.0	30.0	50.0	40.0	32.0	-36.0	6.8
Vehicles	270.0	228.0	240.0	241.0	252.0	5.0	10.5
Land	326.0	202.0	213.0	259.0	212.0	-0.4	4.9
Stamp	1114.0	606.0	818.0	710.0	740.0	-9.5	22.1
Total Non-NBR Revenue	1750.0	1066.0	1321.0	1250.0	1236.0	-6.4	15.9
Dividend & Profit	1230.0	677.0	924.0	1054.0	967.0	4.6	42.8
Post Office & Railway	538.0	540.0	594.0	600.0	373.0	-37.2	-30.9
T&T	1602.0	1545.0	1700.0	1702.0	1409.0	-17.1	-8.8
Others	3697.0	3332.0	3782.0	3633.0	3500.0	-7.4	5.0
Total Non-tax Revenue	7067.0	6094.0	7000.0	6989.0	6249.0	-10.7	2.5

Source: Computed from CPD (2004) and Finance Division (2003b).

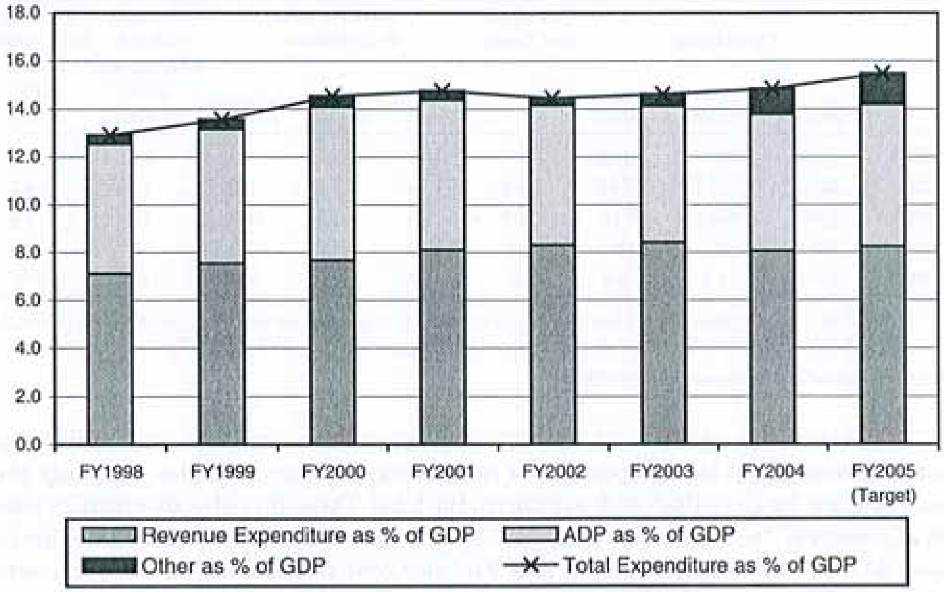
Tk 1,450.0 crore; targeting a higher growth in *land developments taxes* and *non-judicial stamp duties*. If the FY2005 target is achieved, it would be a 17.3 per cent growth over the realised figure of FY2004.

Non-Tax Revenue

The collection of non-tax revenue also faced a target deficit even after fixing a humble target for FY2004. As against the target of Tk 7,000.0 crore, actual revenue earnings from non-tax sources stood at Tk 6,249.0 crore in FY2004, accounting for a (-) 10.7 per cent negative growth over the previous year (FY2003). Unlike the huge under-achievement in most of the duty areas (post office and railway duties on dividend and profit by -37.2 per cent and T&T by -17.1 per cent and others by -7.5 per cent), duties on dividend and profit showed an over-achievement of the target by 4.7 per cent in FY2004. The growth of duties on dividend and profit was 42.9 per cent over the corresponding figure of FY2003. Total non-tax revenue experienced a marginal growth in FY2004 by about 2.5 per cent over the corresponding figure of the previous year (FY2003) (Table 1.4). However, the government has set a target for the FY2005 at Tk 7,660.0 crore, which is about 22.6 per cent higher than the figure realised in FY2004.

1.3.2 Public Expenditure

The revised total public expenditure in FY2004 stood at Tk 4,9367.0 crore, which is about 5.0 per cent less than the budgeted figure. The revised public expenditure accounted for about 14.8 per cent of GDP, of which ADP accounted for about 38.0 per cent and



Source: Computed from CPD (2004) and Finance Division (2004c).

Figure 1.5: Public Expenditure (as % of GDP)

revenue and other expenditures for about 62.0 per cent. However, latest available figure shows that the actual public expenditure for FY2004 would be about 13.4 per cent of the GDP, as there were under-achievements both in ADP and revenue expenditure in FY2004.

The government has set a higher target for the FY2005 at Tk 57,248.0 crore, which is about 16.0 per cent higher than the revised figure of FY2004. If the targeted volume of public expenditure is realised in FY2005, then the share in GDP will increase to about 15.5 per cent, keeping the ADP and non-ADP ratio at 40:60 (Figure 1.5).

1.3.3 Revenue Expenditure

The targeted amount of revenue expenditure for FY2004 was Tk 28,996.0 crore, which has been revised at Tk 28,390.0 crore.[5] While the actual revenue expenditure for the FY2003 was 10.7 per cent higher than the corresponding figure of the previous year, revenue budget for the FY2004 was 21.4 per cent higher than the actual figure of FY2003. However, latest available figure shows that the actual revenue expenditure for FY2004 has been 5.6 per cent higher than the corresponding figure of FY2003. Thus, the actual spending in FY2004 has fallen short of budget target by (-) 8.5 per cent (Table 1.5). The actual revenue earnings-expenditure ratio has increased marginally from 1.21 per cent in FY2003 to 1.3 per cent in FY2005 and the revenue expenditure-GDP ratio during the FY2004 stood at about 8.0 per cent.

TABLE 1.5

Trend in Revenue Expenditure (FY2001-FY2005)

(in billion Tk)

Year	Expenditure[a]			Actual as % of Target	Annual Growth of Expenditure			Revenue Earning-Expenditure Ratio (Actual)	Revenue Expenditure as % of GDP
	Target	Revised	Actual		Target	Revised	Actual		
FY2001	196.3	206.6	212.9	8.5	10.3	12.0	–	1.1	8.4
FY2002	220.4	226.9	226.9	2.9	12.2	9.8	6.6	1.2	8.3
FY2003	239.7	253.1	251.2	4.8	8.8	11.5	10.7	1.2	8.4
FY2004	289.9	283.9	265.2	-8.5	20.9	5.9	5.6	1.2	7.9
FY2005	321.9	n.a.	n.a.	n.a.	11.0	n.a.	n.a.	1.3[b]	8.7[c]

Note: [a]Including non-development expenditures like accusation of assets and works. [b]Based on target expenditure for FY2005. [c]GDP for FY2005 has been estimated by the government at Tk 3701.2 billion.

Source: Computed from Finance Division (2004a).

The structural rigidities of the revenue expenditure portfolio are well known. Economic analysis of the composition of revenue expenditure indicates that only three heads account for more than 80.0 per cent of the total. These three heads include: "salary and allowances," "subsidies and transfers" and "interest payments," which accounted for about 30.8 per cent, 30.7 per cent and 21.7 per cent respectively in the total actual revenue expenditure of FY2004 (Table 1.6). For all practical purposes, allocation and spending target for FY2005 did not significantly deviate from this trend.

[5] Excluding requisition of assets and works, revised revenue expenditure for FY2004 is Tk 26,807.0 crore.

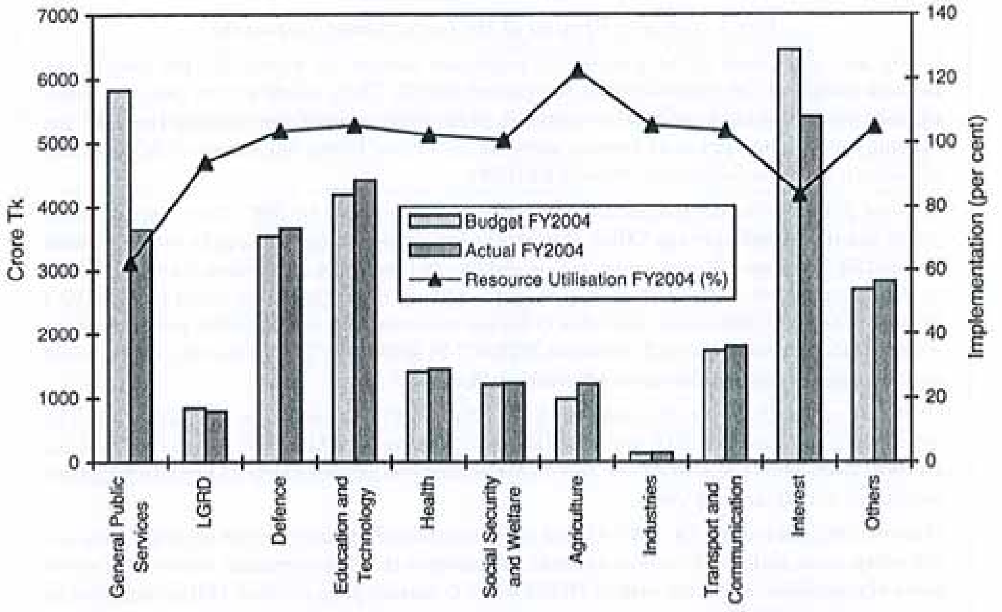


Figure 1.6: Revenue Expenditure by Sector in FY2004

It may be noted that expenditure on account of defence services as a share of total revenue spending had made a welcome decline from its peak 18.2 per cent in FY1998 to 13.5 per cent in FY2003. In FY2004, the targeted amount for defence services amount to 14.2 per cent of the total revenue expenditure.

A sectoral analysis of budget expenditure during the FY2004 reveals that the general public services used the least of its revenue budget spending only 62.6 per cent, while agriculture sector used the most by spending 122.4 per cent. Among others, education, health, industries and transport utilised 105.4 per cent, 102.4 per cent, 105.3 per cent and 103.8 per cent of their respective revenue budget during the FY2004 (Figure 1.6).

In FY2004, actual revenue expenditure growth (5.6 per cent) has been kept below the actual revenue earning growth (9.6 per cent). But past experience suggests that while revenue expenditure routinely exceeds the budgetary limit, the target of total revenue earning is often missed.

One of the positive aspects of the revenue expenditure portfolio for FY2004 has been the higher allocation (more than 28.0 per cent increase) for operation and maintenance – a usually neglected area. This makes room for the government to reallocate budgetary resources for any sudden maintenance need during natural disasters like flood and cyclone. On the other hand, in FY2004 about 7.2 per cent of the revenue budget was kept as a "Block Allocation" (an increase of Tk 100.0 crore to Tk 1,967.0 crore) possibly for meeting an anticipated pay rise of government employees. The recent decision of the government to transfer a number of projects to the revenue budget may also be underwritten by these unallocated resources.

Box 1.2: Income Erosion of the Government Employees

Salary and allowances of the government employees account for about 28.0 per cent of the revenue budget of the Government of Bangladesh (GOB). There exists a view that the public expenditure on this head needs to be controlled, particularly to avoid over-staffing. However, the existing government's pay scale does not allow for any Cost of Living Adjustment (COLA) by way of taking note of the Consumers' Price Index (CPI).

The last pay scale for the government employees was announced in 1997. Over the last seven years, due to an absence of any COLA, the government employees experienced an income erosion of about 39.4 per cent. Thus, a person who joined the civil service as a first class Gazetted Officer in 1997 with a gross salary of Tk 6,525.0 should have been receiving a gross salary of Tk 9,100.0 in 2004 in order to protect the real value of his/her emolument in terms of 1997 prices. In other words, anybody joining the civil service in 2004 will be getting Tk 2,573.0 less in current prices in comparison to his/her colleagues who started off in 1997.

CPD first raised this issue of income erosion of the government employees in May 2003. The government announced a 10.0 per cent Dearness Allowance (DA) in the national budget for FY2004. Even when one accounts for this *ad hoc* benefit, the said income level remained 30.8 per cent lower in real terms in 2004.

Once we take note of the Tk 185.0 annual increment allowed to government employees (as per the entry point scale of the officer category), it emerges that a government officer with seven years of experience is actually getting Tk 850.0 less in current price or about 13.0 per cent less in constant prices of 1997.

It may be mentioned that in US Dollar terms, an entry level officer in Bangladesh gets about 45.0 per cent less than what is paid to a comparable Indian Administrative Service (IAS) officer.

It goes without saying that one cannot expect the government officers to service the new demands of managing a market economy without being paid an adequate compensation that ensures standard living conditions as well as provides for higher incentives in comparison to other jobs including those in the private sector. In place of *ad hoc* and arbitrary benefits, pay adjustment needs to be implemented through the awards of a Permanent Pay Commission for government employees. In fact, the present government did promise setting up such a Commission in its Election Manifesto of 2001.

However, the issue of compensation adjustment of the government employees needs to be considered within the broader context of public administration reform. This needs to address such issues as workforce rationalisation, skill development, predictability of career path, etc.

Although the volume of domestic debt (currently 16.0 per cent of the GDP) remains moderate, trends in revenue expenditure composition reveal a continuous rise in Debt Servicing Liability (DSL) on account of domestic debt, while the DSL for foreign loans may be expected to rise in the coming years, given the composition of the recent aid inflow. It may be recalled that the interest payment on account of domestic debt has steadily increased from about 11 per cent of revenue expenditure in FY1998 to more than 17.2 per cent in FY2004. The target figure for the same in FY2005 is about 19.7 per cent. The recent increase in domestic DSL may be explained in terms of the government's attempt to finance its deficit through borrowing from non-banking sources, which though is costlier than the money from banking sources, is non-inflationary. On the other hand, the debt servicing liability on account of foreign debt decreased from 5.0 per cent of revenue expenditure in FY1998 to about 3.7 per cent in FY2004. The projected figure for this in FY2005 is about 3.5 per cent (Table 1.6).

TABLE 1.6

Economic Analysis of Revenue Expenditures in FY2004-FY2005

(per cent)

	Revenue Expenditure[a] (crore Tk)		Share (per cent)		Growth	
	FY2004 (Act)	FY2005 (Bud)	FY2004 (Act)	FY2005 (Bud)	Act04 over Bud04	Bud05 over Act04
Pay and Allowance	7667.0	8218.0	30.8	26.9	2.2	7.2
Goods and Services	4418.0	5171.0	17.7	16.9	-1.1	17.0
Interest Payment	5400.0	6533.0	21.7	21.4	-16.1	20.9
Interest Payment (Domestic)	4283.0	5380.0	17.2	17.6	-21.6	25.6
Interest Payment (Foreign)	1117.0	1153.0	4.5	3.8	14.4	3.2
Subsidies and Current Transfer	7641.0	9477.0	30.7	31.0	-2.1	24.0
Block Allocation	226.0	1665.0	0.9	5.5	-88.5	637.4
Recoveries	-455.0	-546.0	-1.8	-1.8	-0.4	20.0
Total	24897.0	30518.0	100.0	100.0	-10.2	22.6

Note: [a]Excluding non-development expenditures like accusation of assets and works.

Source: Computed from Finance Division (2004b).

1.3.4 Annual Development Programme

The ADP for FY2003 was Tk 19,200.0 crore which was later slashed down to Tk 17,100.0 crore. In reality, the realised size of the ADP was Tk 15,434.0 crore last year, i.e. about 80.0 per cent of the budget target. The realised ADP figure for FY2003 was only about 61.3 per cent of the actual revenue expenditure (Finance Division, 2004a). The ADP target for FY2004 was originally fixed at Tk 20,300.0 crore, i.e. an additional amount of Tk 5,000.0 crore was to be spent during the current fiscal year over its preceding benchmark. In the wake of the National Budget for FY2004, questions have been raised at various discussions on the viability of this "ambitious target." Others have maintained that Bangladesh remains an under-invested economy, and as such, a large ADP target is worth chasing.

It needs to be pointed out here that in the recent past the gross investment rate remained stable in spite of the deceleration of private investment thanks to moderate ADP growth. In FY2003, private investment as a share of GDP actually declined from 16.8 per cent to 16.5 per cent, whereas the corresponding share of public investment increased from 6.4 per cent to 6.7 per cent (ibid). However, in a recent speech before the Economic Cadre officers, the Finance Minister pointed to the proliferation of useless projects and the padding of many projects with wasteful expenditure.[6] It is thus not the overall size, but the quality of the projects included in the ADP, which matters. Furthermore, the capacity of the line ministries to absorb such incremental allocation of resources remains open to doubt. Thus, the operative issue that needs to be investigated is whether this increase in ADP expenditure actually constitutes growth-generating investment or not (Table 1.7).

[6] "There are many projects which seek funds double or even triple the actual cost. During the revision of a project, the cost multiplies progressively." – M. Saifur Rahman, Minister for Finance and Planning, *The Daily Star*, 21 December 2003.

TABLE 1.7

Annual Development Programme

(in billion Tk)

Year	Annual Development Programme			Actual as % of Original	Actual as % of Revised	Actual ADP as % of Revenue Expenditure	Actual ADP as % GDP
	Original	Revised	Actual				
FY1998	128.0 (2.4)	122.0 (4.3)	110.4 (0.0)	86.2	90.5	76.1	5.5
FY1999	136.0 (6.3)	140.0 (14.8)	125.1 (13.3)	92.0	89.4	74.6	5.7
FY2000	155.0 (14.0)	165.0 (17.9)	154.7 (23.7)	99.8	93.8	83.9	6.5
FY2001	175.0 (12.9)	182.0 (10.3)	161.5 (4.4)	92.3	88.7	78.2	6.4
FY2002	190.0 (8.6)	160.0 (-12.1)	140.9 (-12.8)	74.1	88.0	62.0	5.2
FY2003	192.0 (1.1)	171.0 (6.9)	154.3 (9.5)	80.4	90.3	61.0	5.1
FY2004	203.0 (5.7)	190.0 (11.8)	168.8 (9.4)	83.2	88.9	63.6	5.1

Note: Figures in the parentheses depict annual growth rates over preceding year.
Source: Computed from CPD (2004) and Finance Division (2003a).

The National Budget for FY2004 stated that a total number of 1,163 projects will be brought under the ADP, including 174 unapproved projects. During FY2004, a total of 1,109 projects were included in the ADP, of which 79 were new. It may be recalled that Tk 2,346.0 crore (about 12.0 per cent of ADP) was allocated under different ministries as "Block Allocation" in the current fiscal year's budget. It was not immediately clear whether such flexibility in decisions pertaining to allocation will breed indiscipline in course of time or whether these projects will be purposefully designed and resources used more efficiently. Foreign resources are expected to underwrite about 51.0 per cent of the ADP outlay in FY2004, while the balance is to come from domestic sources – revenue surplus (36.0 per cent) and bank borrowing (13.0 per cent). Such a contribution of bank borrowing may be compared with the 20.7 per cent contributed by bank borrowing in FY2001 when the issue of rising dependence on bank financing was exposed to intense public debate.

Latest information on ADP implementation suggests that a total amount of Tk 16,883.0 crore, i.e. about 89.0 per cent of the total allocation was spent during the FY2004. Out of this, Tk 11,155.0 crore is government expenditure and Tk 5,728.0 crore is project aid expenditure, indicating that 93.0 per cent and 82.0 per cent of their respective allocations have been implemented. It can be mentioned that while in FY2003 the actual government expenditure as per cent of taka release showed (-) 1.4 per cent shortfall in FY2004, Tk 11,155.0 crore of government expenditure is, in fact, 3.2 per cent higher than the amount released for expenditure, as against a 90.0 per cent release of total taka allocation, taka expenditure was about 93.0 per cent. This suggests that timely release of development expenditure is also responsible for holding back the fuller implementation of development budget. Another dynamics of ADP implementation is that the performance of project aid is always lower than that of the government expenditure (taka). It is now becoming increasingly obvious that one of the prime reasons for under-achievement of the ADP relates to low utilisation of foreign project aid available in the pipeline. However, the aggregate ratio of ADP implementation compares almost equally with the same for the last three fiscal years with respect to actual ADP size. The rates of ADP implementation for FY2001, FY2002 and FY2003 were 89.0 per cent, 88.0 per cent and 90.0 per cent respectively.

Among the major aid utilising ministries and divisions, the power division utilised most of its allocation (96.0 per cent), followed by the Local Government Division (94.0 per cent), Ministry of Education (89.0 per cent) and Ministry of Communication (88.0 per cent); while the Ministry of Health and Family Welfare utilised only 71.0 per cent of its allocated resources. Among other line ministries and divisions, Ministry of Home Affairs (99 per cent), Ministry of Religious Affairs (98.0 per cent), Ministry of Industries (99.0 per cent) and Energy and Mineral Resources Division (98.0 per cent) are among the top performers in ADP implementation. On the other hand, Internal Resource Division, the Ministry of Liberation War Affairs and the Planning Division are among the low ADP implementing ministries/divisions, utilising 24.0 per cent, 36.0 per cent and 36.0 per cent of their corresponding ADP allocations during the FY2004.

In the ADP of FY2004, a number of projects were identified as "poverty alleviation projects," although there remains a doubt about the content of those projects and their relationship with poverty alleviation. Out of Tk 1,175.0 crore earmarked for "poverty alleviation projects," Tk 600.0 crore (51.0 per cent) has been utilised till March 2004. It was not immediately evident how these projects fit into the sectoral strategy enunciated by the I-PRSP and PRSP. As the implementation information for the full fiscal year and list of these projects were not available, it was not possible to take a closer look at their profile.

In the past years, one of the primary criticisms of the ADP budget management was related to the tardy use of ADP allocations in the first three quarters of the fiscal year and the subsequent rush by the line ministries to spend their remaining budget allocations in the last quarter. This approach to project management directly contributes to the process of waste, leakage and corruption in the public expenditure process. There is a concern that the ADP management quality has further deteriorated, which might increase the incidence of wastage of resources. Thus, acceleration of the ADP implementation from the second rather than the fourth quarter of the fiscal year had been one of the major tasks for FY2004, particularly for crowding-in of private investment and improving quality of public utilities and social services. It seems that the ADP implementation process in FY2004 has failed in this task. According to its original target, the government had to spend about 55.0 per cent of the total allocation within the last three months (April-June) of FY2004.

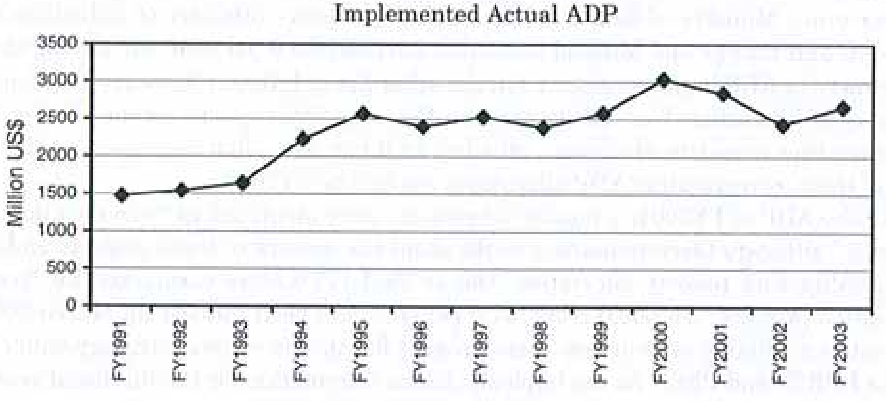
It can be mentioned that in the first interim report of the IRBD2004 (covering the period July-December 2003), it was mentioned, "from the experience of earlier periods, it is anticipated that the overall size of the ADP will be reduced. It is fully conceivable that the final figures of the ADP will be less than Tk 17,000.0 crore, resulting in a shortfall of more than Tk 4,000.0 crore from the original budget" (Bhattacharya, 2003c).

Interestingly, the Planning Ministry reduced the ADP by Tk 1,300.0 crore, re-fixing the revised size at Tk 1,900.0 crore and the actual ADP of Tk 16,883.0 crore was well below the predicted figure of interim IRBD.

Box 1.3: Annual Development Programme Stagnates

In the face of the increasing development needs of the country, Bangladesh remains an under-invested economy. Gross investment – GDP ratio has been stagnating at around 23.0 per cent for the last four-five years. In this context public investment is expected to play a greater role in creating an enabling physical and social infrastructure for promoting private investment.

However, the realised size of the ADP has stagnated in real term and has hovered between US$3,000.0 million and US$2,500.0 million during the last five-six years. The largest ever ADP was implemented in FY2000 (US$3,033.5 million), followed by FY2001 (US$2,850.0 million). From all indications it seems that FY2004 will not be able to break these records.



One can identify at least four factors, which have contributed to the dismal implementation of the ADP. First, introduction of the new public procurement policy limited the scope for indulging in corruption while implementing foreign aided projects, creating some disincentive to spend. Second, inability to undertake "prior actions" as agreed with the development partners under the project documents seriously constrained the country's access to pipeline foreign aid. Third, over-centralisation of the project planning and approval process coupled with the confusion relating to the state of the sector-wide programme approach made the utilisation of resources more time-killing. Finally, the state of uncertainty pervading the public administration in the backdrop of growing political confrontation encouraged many of the key persons in various government agencies to be indecisive or free sitters. It is also getting abundantly clear that without effective devolution of power and decentralisation of development administration through setting up of a strong upazila system, Bangladesh will not be able to effectively handle a larger ADP.

Box 1.4: Declining Public Expenditure in Agriculture

Total public expenditure (revenue + development) for agriculture (including fisheries and livestock) has been declining both in absolute and relative terms. Total expenditure for agriculture (as per revised budget) was Tk 3,053.0 crore (7.8 per cent of total budget) in FY2001, which dropped to Tk 2,596.0 crore (6.0 per cent of total budget) in FY2003. Budgeted allocation in FY2004 is Tk 2,838.0 crore (5.7 per cent of total budget). In terms of development expenditure, the amount was Tk 2205.0 crore in FY2001, Tk 1,629.0 crore in FY2003 and Tk 1,855.0 crore in FY2004. In agriculture, 46.1 per cent of total allocation comes from project aid. Bangladesh must have to increase its total public expenditure for agriculture. Though the total public expenditure has declined, agricultural subsidy has increased. This year (FY2004), budgetary allocation for agricultural subsidy is Tk 300.0 crore against Tk 100.0 crore as agricultural subsidy in FY2002. In addition, there is an allocation of Tk 50.0 crore in FY2004 for development of agro-based industries. Subsidy is mostly used for financing the deficit of imported urea fertiliser. In Barind areas (Rajshahi, Chapainawabganj and adjacent districts), electricity for irrigation is provided at 20.0 per cent lower tariff rate.

The government must increase total public expenditure for agriculture as well as subsidy for agriculture. Subsidy may be provided for following activities:

- Provision of quality rice seed can increase rice production by 2.2 million tons. For this, special projects for breeder's seed production and strengthening of infrastructure (modern processing and storage) and additional manpower for breeder seed production at BRRI and BINA is needed to meet the growing demand of breeder's seed by NGOs and private companies who are producing seed for farmers. Subsidies for production of seeds of potato, oilseeds, vegetables, pulses and maize would also be helpful.
- Subsidies for diesel used for irrigation is required. However, considering multiple use of diesel, the government must ensure its proper application. It may be noted that 83 per cent of the total irrigated area in Bangladesh is under diesel-operated engines. Two districts (Munshiganj and Borguna) are irrigated only through diesel-operated engines and in 18 other districts, more than 95.0 per cent of the irrigated area is irrigated by diesel engines.
- Poultry farmers are facing problem of quality chicks, feed, vaccines and financing. Subsidy for "parent stock", poultry vaccines and feed production would be helpful for further growth in this sector. Budgetary allocation for monitoring these and timely actions are also needed for the proper functioning of private sector in these areas. Number of veterinary doctors in poultry growing zones such as Daudkandi, Gazipur, Narsingdi has to be increased to ensure professional support.

Fish farmers are facing the problem of quality fingerlings, feed and professional advice of fisheries specialists. To overcome the problem of quality fingerlings, subsidies for development and maintenance of "broodstock" of *ruhi*, *katla*, shrimp and tilapia are needed. Present manpower strength is inadequate to cater to the professional advice need of fish farmers in intensive fish growing areas, such as Mymensingh and Comilla. The number of fisheries extension service personnel in these areas needs to be increased and special projects to ensure quality service delivery cold storage facility to minimise risks of price fall is essential.

Notwithstanding the continuous failure to implement the full amount of the development budget, the government has targeted an ambitious ADP to the extent of Tk 22,800.0 crore for the next fiscal year (FY2005). In the context of the growing demand for reforming the power sector, available figures show that in the ADP 2005, the power sector received the highest allocation of Tk 3.243.4 crore (14.7 per cent of total development outlay). Education and Religion (14.3 per cent) and local government (10.6 per cent) became the second and third largest recipients from the ADP, followed by road transport[7]

[7] If air, rail and water transport are included with road transport, transport sector will receive the second highest allocation by the amount of Tk 3,237.8 crore or 14.7 per cent of the development outlay.

(10.5 per cent) and health, population and family welfare (9.8 per cent). Despite the government promises to allocate more resources to agriculture, this sector received a development allocation of only Tk 872.7 crore (4.0 per cent), which is around Tk 50.0 crore less than that of the previous year (Planning Commission, 2004).

1.3.5 Budget Deficit and Financing

The budget deficit has shown a chronological deceleration during the previous years from (-) 5.1 per cent in FY2001 to (-) 4.2 per cent in FY2003 (revised). In the FY2004 budget, the targeted balance was set at (-) 4.8 per cent of the GDP. While the actual budget deficit[8] for FY2003 was (-) 3.5 per cent, the overall balance during FY2004 accounted for (-) 3.4 per cent of the GDP, of which foreign financing contributed to 41.0 per cent and the remaining 59.0 per cent was derived from domestic sources. Within the domestic component, non-bank borrowing accounts a larger share of 65.0 per cent of the domestic resources, i.e. 1.3 per cent of GDP. In FY2003, the financing ratio of actual budget deficit from foreign and domestic sources was 60.0 per cent and 30.0 per cent respectively. The target for the budget deficit has been fixed at a higher level in FY2005 – about 4.3 per cent. It is expected that the incremental deficit will be largely financed by the domestic sources (Table 1.8).

TABLE 1.8

Actual Budget Deficit and Financing

(in billion Tk)

Year	Budget Deficit			Actual Budget	Financing Deficit (as % of GDP)	
	Target	Actual	Difference as % of Target	Deficit as % of GDP	Domestic Financing	Foreign Financing
FY2001	168.6	116.6	-30.8	4.6	2.7	1.9
FY2002	149.1	120.2	-19.4	4.4	2.6	1.7
FY2003	117.7	105.2	-10.6	3.5	1.4	2.1
FY2004	158.1	113.1	-28.5	3.4	2.0	1.4
FY2005	159.5	n.a.	n.a.	4.3[a]	2.4	1.9[b]

Notes: [a]Based on target figures; [b]GDP for FY2005 has been estimated by the government at Tk 3,701.0 billion (Finance Division, 2004).

Source: Computed from CPD (2004).

Figures for FY2004 indicate that the government had to mobilise about Tk 11,316.0 crore to finance the fiscal deficit, which is about 28.0 per cent lower than the comparable figure for the preceding year. During FY2004, an amount of Tk 1,813.9 crore came as foreign grants while another Tk 5339.4 crore came as foreign loan. After amortisation of Tk 2,471.1 crore, a net amount of Tk 4,682.2 crore was used to fill the 41.0 per cent of the total budget deficit. Thus, within the foreign financing component, foreign grants contributed to 25.4 per cent while foreign loan added 74.6 per cent to the total foreign financing. Within the domestic resources part – the exclusive source being net borrowing through non-bank instruments accounted for Tk 4,327.2 crore, while another Tk 2,273.7

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

crore was borrowed from the banking system. The remaining Tk 32.9 crore was received from the privatisation process (Finance Division, 2004b). However, when compared with the targeted budget deficit, the relatively low level of actual fiscal deficit during FY2004 reinforces the failure of a fuller implementation of ADP. It seems that in FY2004 the government would end up with a lower budget deficit as a result of the smaller target level of ADP spending.

It should be borne in mind that the concept of the fiscal deficit in aid dependent countries, such as Bangladesh, is a synthetic issue. The aggregate deficit in public expenditure is a structural aspect of aid dependence, which accommodates the volume of foreign aid disbursed in a given year. The rise and fall in the fiscal deficit in any year reflects the efficacy and timing of aid disbursements rather than some significant improvement in macroeconomic management. Thus, it is important to bear in mind how far an inefficient aid utilisation is being falsely interpreted as an improvement in the fiscal deficit situation.

1.4 MONETARY AGGREGATES, CREDIT EXPANSION AND INFLATION

In response to recessionary business conditions and downtrend in private investment, the government was currently pursuing an accommodative monetary policy in the recent past through a number of measures: reduction in bank rate, curb in interest rates on government bonds, and minimising of Statutory Liquidity Requirement (SLR).

Financial sector reforms are also being pursued through strengthening of the oversight functions of the central bank, improving the corporate governance of the private commercial banks through higher transparency and accountability, contracting out management of a number of nationalised commercial banks (NCBs), amending the legal framework for loan recovery, improving prudential guidelines and their enforcement.

It is well recognised that currently an inefficient financial sector in Bangladesh is imposing a heavy structural constraint on the country's investment situation. How far these financial sector reform measures may actually stimulate investment without addressing the other structural constraints to investment (e.g. underdeveloped infrastructure) remains to be observed.

1.4.1 Domestic Credit Expansion

Domestic credit recorded a larger increase of Tk 15,581.2 crore or 15.0 per cent during FY2004 against the increase of Tk 9,126.1 crore or 9.5 per cent during FY2003. Though government borrowing increased by Tk 1,521.2 crore or 8.0 per cent (on a point-to-point basis) against the decline of Tk 982.6 crore or (-) 5.5 per cent during the preceding year, the high credit expansion rate was mainly resulted by the increase of Tk 12,562.9 crore or 16.2 per cent in credit to the private sector. Credit to the other public bodies also contributed to the rise in domestic credit by Tk 1497.1 crore or 20.6 per cent during FY2004, as against a 0.2 per cent growth as of June 2003 (Table 1.9).

This moderation, positive in monetary expansion of public sector credit, resulted in the growth of the private sector's share in total domestic credit flow to 75.5 per cent, which is one of the highest shares recorded in recent years.

TABLE 1.9

Domestic Credit Expansion

(in billion Tk)

Year	Government		Other Public		Private Sector		Total		Share of Private Sector in Total Credit
	Amount	Annual Growth Rate (%)	Amount	Annual Growth Rate (%)	Amount	Annual Growth Rate (%)	Amount	Annual Growth Rate (%)	
FY1998	92.7	15.7	62.5	6.4	401.2	13.0	556.4	12.6	72.1
FY1999	112.5	21.3	60.2	-3.7	456.4	13.8	629.1	13.1	72.5
FY2000	147.7	31.3	61.7	2.5	505.4	10.7	714.9	13.6	70.7
FY2001	176.8	19.7	73.6	19.2	590.7	16.9	841.1	17.7	70.2
FY2002	201.6	14.1	72.4	-1.6	675.7	14.4	949.8	12.9	71.1
FY2003	190.6	-5.5	72.6	0.2	776.6	14.9	1039.8	9.5	74.7
FY2004	205.8	7.9	87.6	20.6	902.3	16.2	1195.7	14.9	75.5

Source: Computed from Bangladesh Bank (1991-2003).

However, during the first 10 months of the FY2004, the economy experienced a relatively moderate aggregate growth in the domestic credit flow due to the negative balance (-4.0 per cent) in the case of government borrowing and relatively low growth (7.5 per cent) in the case of "other public bodies." On a point-to-point basis, credit growth in the private sector, as of April 2004, was 12.6 per cent. However, credit flow in other public bodies and private sector took a sharp upturn in May 2004, accounting a point-to-point growth of about 23.1 per cent and 25.8 per cent respectively, which resulted in an overall year-end positive growth rate in the domestic credit flow (Bangladesh Bank, 2004). It seems that after an early pick-up till September 2003, some restraint was again imposed on monetary growth in October 2003. It is not immediately apparent whether this is the result of a conscious restriction imposed by the central bank in the face of the rising price level or merely a reflection of poor response from an effective investment demand. This may also well reflect the monthly trend projected under the Bangladesh Bank's monetary programme.

1.4.2 Reserve Money and Liquidity Position

During FY2004, reserve money stood at Tk.1843.9 crore, marking a large increase of 7.6 per cent against that of FY2003 (Tk 779.5 crore or 3.3 per cent during FY2003). According to the Bangladesh Bank sources, the increase in reserve money occurred due to increase in net foreign assets of Tk 1649.2 crore or 13.4 per cent as well as claims on Government (net) of Tk 1585.6 crore or 15.5 per cent during the year under report. Reserve money multiplier increased from 4.7 at the end of June 2003 to 5.0 at the end of June 2004, mainly due to lower reserve-deposit ratio than that of June 2003 (Bangladesh Bank, 2004a).

Total liquid assets of scheduled banks stood at Tk 28689.6 crore at the end of FY2004 (on 30 June 2004), while the comparable figure for the previous year was Tk 26,656.3 crore. Excess liquidity of scheduled banks also stood higher at Tk 11,754.0 crore as on 30 June 2004 compared to Tk 7,971.2 crore at the end of June 2003.

Box 1.5: Did Interest Rate Spread Decline?

In the absence of real time data from the Bangladesh Bank on interest rate spreads, CPD collected data from seven local commercial banks (LCBs) and two foreign commercial banks (FCBs) to generate average weighted interest rates for both deposits and advances.

The sample data revealed that during 2003, the local private banks reduced their spreads from 7.05 per cent to 6.2 per cent. In the case of foreign banks, the spread increased to 7.7 per cent from 7.4 per cent.

The sample local private banks decreased their lending rate by (-) 12.6 per cent (i.e. from 14.1 per cent to 12.3 per cent) during 2003, while the deposit rate declined by (-) 13.4 per cent (i.e. from 7.1 per cent to 6.1 per cent). This implies that the lending rate has been reduced at the cost of the depositors, while the efficiency level remained more or less unchanged.

Thus, there is hardly any conclusive evidence to show that the recent initiatives of the government to decrease interest rate have had any fundamental effect on the interest rate charging behaviour of the private banks, both local and foreign.

However, it will be enlightening to take a closer look at the composition of this amount to assess the extent of an effective liquidity. As mentioned in the first interim IRBD, the excess liquidity of the scheduled banks, as of end-November 2003, stood at Tk 7,204.0 crore. Of the amount, Tk 2,118.0 crore (29.4 per cent) remains in the foreign currency clearing account, which is not readily available for local lending. In addition, excess liquidity in the Islamic banks was about Tk 1,000.0 crore (13.9 per cent). If these two amounts are excluded, effective excess liquidity is about Tk 4,086.0 crore, which is less than 4.0 per cent of an average daily balance of Tk 110,520.0 crore (ibid).

Burdened with such excess liquidity, it is to be seen whether the commercial banks will be able to escape "moral hazard" and avoid financing bad projects. The Bangladesh Bank needs to make its prudential guidelines for corporate governance more effective in this respect.

Curiously, one finds that the banking system flushed with excess liquidity is on the lookout for viable business opportunities – a baseline estimate would put the figure at least Tk 10,000.0 crore (almost US$2.0 billion) at any point in time. These numbers, of course, do not include the savings of the lower income groups, which remain under-utilised due to dearth of investment opportunities or appropriate financial instruments to put into productive use such savings. One wonders what would happen with this excess liquidity if investment does not accelerate further – growth in conspicuous consumption or flight of capital? Our survey reveals that overseas investment by the entrepreneurs of this investment-starved country is increasingly becoming a reality, while Non-Resident Bangladeshis (NRBs) are not investing as much in the country as we expect them to.

1.4.3 Government Borrowing

Following the reduction of the interest rates on the National Saving Deposit (NSD) certificates, the growth (on point-to-point basis) of their sales gradually declined from 15.1 per cent in July 2003 to (-) 23.6 per cent in April 2004. However, prior to the implementation of the much-anticipated lower interest rate on 1 January 2004, very high rates in the sale of NSD certificates were observed during the previous three months. Monthly NSD sale during November-December 2003 recorded as high a growth as 46.6 per cent and 70.4 per cent (point-to-point basis) respectively. This has pushed the average NSD sales growth for FY2004 to 2.8 per cent, with the total amount purchased surpassing Tk 9,678.2 crore. Outstanding sales of certificates at the end of June 2004 stood at Tk 33,488.4 crore, recording an increase of Tk 3,905.6 crore or 13.2 per cent over the preceding year (Bangladesh Bank, 2004a) (see Table 1.10 and Figure 1.7).

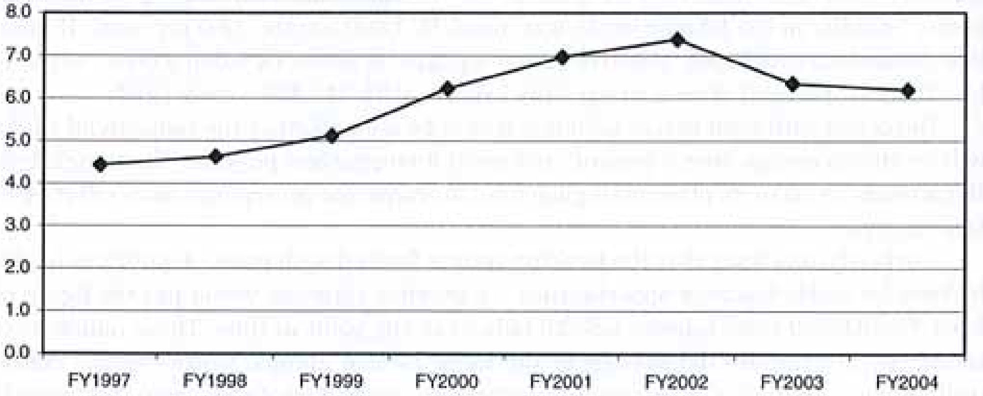
TABLE 1.10

Net Government Borrowing

(in billion Tk)

Sources	FY2003	FY2004	Growth Rate (FY2004 over FY2003)
Net Government Borrowing from the Banking Sector	190.6	205.8	8.0
Net Non-bank Borrowing of the Government from the Public	48.6	46.0	-5.3
Of which: NSD Instruments	43.8	41.3	
Treasury Bills/Bonds	4.8	4.7	
Total Government Borrowing (Net)	239.2	251.8	5.3

Source: Computed from CPD (2004), BB (1991-2003) and National Savings Directorate data.



Source: Computed from CPD (2004) and Bangladesh Bank (2004a).

Figure 1.7: Outstanding Government Borrowing from the Banking Sector as a Share of GDP

It is evident that the fall in yield rate has partly dampened the demand for NSD, although more than Tk 800.0 crore worth of NSDs continue to be purchased by the public every month on an average till date. However, as the monthly sales figures of NSD certificates are declining since January 2004 in the face of maturity of a larger amount of the certificates, the net monthly sales figures have come down to about one-quarter of the total sale between July 2003 and June 2004. The debate on the implications of the so-called high interest rates offered on NSD certificates for lowering interest rates in the commercial banks is worth pursuing, but possibly on a different occasion. But it needs to be pointed out that one of the major reasons, which has depressed the demand for NSD certificates correspond to discontinuation of the practice of accepting these certificates by commercial banks as second collateral for the purpose of granting loans.

In addition to the banking sector holdings of NSDs (Tk 2,230.0 crore), net government borrowing from the NSD certificates stood at Tk 4,129.0 crore and including Tk 471.0 crore of government treasury bills and bonds, the total non-bank borrowing of the government stood at Tk 4,600.0 crore, which is (-) 5.3 per cent less than the previous year. Thus, together with Tk 205.8 crore borrowing from the banking sector, total government borrowing from the domestic sources stood at Tk 25,180.0 crore, which is 5.3 per cent higher than that of the year just gone by.

1.4.4 Agricultural Credit

During the FY2004, a total amount of Tk 4,048.4 crore was disbursed as agriculture credit, recording an annual increase in disbursement by 23.5 per cent. Due to lower recovery (Tk 3,135.3 crore), the sector experienced a net gain of Tk 913.1 crore during the FY2004 against a net outflow of Tk 237.9 crore from the rural economy during the FY2003.

Available figure shows that the position of overdue agricultural loans as a percentage of total outstanding loans improved significantly, decreasing from 54.8 per cent in FY2003 to 50.5 per cent in FY2004. Collection of overdue loans should be seen as a healthy initiative, leading to better loan discipline. Some improvements in the classification rate may also have occurred due to writing off of "bad loans."

However, if the recovery rate increases in the backdrop of such a modest growth in fresh loans, the agricultural credit delivery system will remain as the main conduit of transfer of resources from rural to urban areas. Although a refinance facility and specialised delivery of agriculture credit from the Bangladesh Bank has been made available to the scheduled banks, it appears that the banks are not so much enthusiastic about giving credit to the farmers. It, therefore, needs to be explained to what extent the financial sector reforms have failed to address the importance of channelling credit to the poorer sections of society and may even be responsible for slowing down credit flows to the rural areas (Table 1.11).

TABLE 1.11

Agricultural Credit Expansion

(in billion Tk)

Year	Disbursement	Recovery	Net Flow
FY1998	18.1	17.8	0.4
FY1999	30.2	19.2	11.0
FY2000	28.5	29.9	-1.4
FY2001	30.2	28.8	1.4
FY2002	29.5	32.6	-3.1
FY2003	32.8	35.1	-2.8
FY2004	40.5	31.3	9.1

Source: Computed from CPD (2004) and BB (2002-2004).

Recently (on 29 March 2004), the government has decided to waive all interest and penal interest on agricultural loans up to Tk 5,000.0. This decision is supposed to help about 15.0 lakh marginal farmers and the government would have to reimburse an amount of about Tk 500.0 crore to different public commercial and specialised banks to underwrite the losses in this connection. It was also decided earlier that the certificate cases against dues below Tk 5.0 lakh would not be tried in the financial courts. These measures, if implemented effectively, are expected to directly benefit a significant section of the rural poor.

1.4.5 Industrial Loans

Given the slowdown in the growth of industrial term loans in recent years (since FY2001), the disbursement record for FY2004 is quite impressive at Tk 6,619.6 crore, i.e. 67.1 per cent growth. After a recovery of Tk 4,954.2 crore, the net flow to the sector is Tk 1,305.0 crore, which compares favourably with the outflow of (-) Tk 40.9 crore during the comparable period in FY2003 (Bangladesh Bank, 2004a). The rapid growth in disbursement can be partially explained by the carry-over of sanctioned (but not disbursed) loans from FY2003. But the incremental off-take of industrial loans may very well be due to an increase in investment demand (Tables 1.12 and 1.13).

TABLE 1.12

Disbursement and Recovery of Term Loan

(in billion Tk)

Year	Disbursement	Growth of Disbursement	Recovery	Growth of Recovery
FY1998	11.2	-6.7	8.6	-3.4
FY1999	13.3	18.8	10.9	26.7
FY2000	16.3	22.3	16.5	51.4
FY2001	30.6	87.9	27.9	69.1
FY2002	35.1	14.7	32.1	15.1
FY2003	39.6	13.0	38.4	19.5
FY2004	66.7	68.4	49.6	29.2

Source: Computed from CPD (2004) and BB (2002-2003).

TABLE 1.13

Sanction and Disbursement of Term Loan

(in billion Tk)

Year	NCB		DFI		PCB (D)		PCB (F)		NBFI		Total	
	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed
FY1998	3.9	2.5	0.8	1.5	2.5	2.3	6.3	2.4	2.4	2.4	16.1	11.2
FY1999	5.9	3.5	0.3	0.6	2.9	2.9	3.7	2.7	4.4	3.5	17.4	13.3
FY2000	5.6	3.3	0.6	0.8	9.3	5.3	4.4	2.6	5.3	4.3	25.2	16.3
FY2001	7.8	5.2	1.4	1.2	16.6	12.5	3.3	4.5	8.4	7.0	37.7	30.6
FY2002	9.4	4.9	0.9	0.5	16.0	16.6	4.4	5.4	8.4	7.6	39.2	35.0
FY2003	13.9	6.7	2.4	1.3	20.6	16.0	5.6	6.1	11.5	9.5	54.1	39.6
FY2004	5.7	7.4	1.9	1.6	35.8	32.4	4.6	10.6	19.1	14.5	67.1	66.7

Source: Computed from CPD (2004) and BB (2002-2003).

It needs to be pointed out that the central bank's measures relating to reduction of bank rate and SLR came in November 2003, and thus, could not be responsible for the relatively higher disbursement of term loans during FY2003. Moreover, whatever decline in interest rate has taken place, it did not take effect in the second half of FY2003 and this was the period when most of the investment decisions took place, resulting in disbursement during the early periods of FY2004.

It needs to be recalled here that the share of overdue credit as a share of outstanding industrial term loans declined from 28.0 per cent in FY2003 to 25.8 per cent in FY2004. This decline took place largely due to write-off decisions by the commercial banks. The NCBs have written-off Tk 1,984.0 crore, which is 2.7 per cent of the NCBs classified loans. Five specialised banks have written off Tk 779.0 crore worth of bad loans, reducing their default loans by 8.0 per cent. The private commercial banks and foreign banks have written-off Tk 1,079.0 crore and Tk 125.0 crore respectively (ibid).

The disbursement of working capital recorded a significant growth in FY2004. While the sanction of working capital increased from Tk 137.7 billion in FY2003 to Tk 156.1 billion in FY2004, witnessing a 13.4 per cent growth; the disbursement of working capital was even higher with a 22.7 per cent growth, increasing from Tk 156.7 billion in FY2003 to Tk 192.3 billion in FY2004. Interestingly, the NCBs recorded a negative growth both in sanction (-33.4 per cent) and disbursement (-28.3 per cent). Unlikely, the DFIs registered a significant growth (more than 500 times) in working capital flow in FY2004. Disbursement of working capital by DFIs increased from only Tk 2.7 billion in FY2003 to Tk 16.5 billion in FY2004, which is the largest amount disbursed by DFIs in recent years. Meanwhile, the PCBs also showed a negative growth in FY2004 both in terms of sanction and disbursement of working capital by (-) 40.1 per cent and (-) 30.4 per cent respectively (Table 1.14).

Box 1.6: Effect of Declining Interest Rate

The government resorted to vigorous "moral suasion" in FY2004 in order to bring down the lending rate of bank loans. CPD undertook a rapid perception survey regarding the realised benefits of the declining rate of interest (lending) in the banks in terms of production cost. This was implemented during 22 April 2004-17 May 2004 among a group of more than 70 entrepreneurs with fixed assets ranging above Tk 10.0 crore.

Analysis of the responses revealed that 38.0 per cent of the respondents acknowledged that during FY2003 the reduction in the rate of interest (lending) has benefited their companies in terms of reduced production costs. This trend in responses sharply increases in FY2004 (July 2003-March 2004) to 60.3 per cent. This implies that in FY2004 an overwhelming majority of the enterprises enjoyed the benefits of a fall in interest rates. However, it is also true, as suggested by the survey, that a significant section of the entrepreneurs (about 40.0 per cent) are yet to receive such benefits.

Effect of Declining Interest Rate	Yes		No	
	July 2002 - June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004
	(In per cent)		(In per cent)	
Declining rate on interest (lending) in the banks benefit you in terms of production cost	38.0 (R-73)	60.3 (R-75)	62.0 (R-71)	39.7 (R-78)

Note: Figures in the parentheses indicate the number of respondents.

TABLE 1.14

Sanction and Disbursement of Working Capital

(in billion Tk)

Year	NCB		DFI		PCB (D)		PCB (F)		NBFI		Total	
	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed	Sanctioned	Disbursed
FY1998	39.6	35.4	0.7	1.0	11.3	16.3	27.3	13.0	0.1	0.1	79.1	65.9
FY1999	40.6	37.5	1.3	1.3	15.9	22.8	27.7	17.1	0.2	0.2	85.9	79.0
FY2000	43.8	43.4	1.5	1.4	24.5	32.2	28.1	28.5	0.8	1.2	98.8	106.8
FY2001	39.8	39.8	2.7	3.6	35.4	51.2	25.2	33.5	2.1	5.6	105.3	133.8
FY2002	40.4	39.2	2.9	4.0	49.1	68.2	21.8	23.4	0.8	2.7	115.1	137.6
FY2003	37.7	34.3	2.2	2.7	67.8	87.3	29.3	29.7	0.6	2.6	137.6	156.7
FY2004	25.1	24.6	6.4	16.5	106.4	127.9	17.5	20.7	0.6	2.6	156.1	192.3

Source: Computed from CPD (2004) and BB (2002-2003).

Loan Classification

The outstanding amount of classified loan declined from Tk 219.7 billion (as of 30 June 2003) to Tk 212.5 billion (as of 30 June 2004), registering a negative growth of (-) 3.3 per cent. The share of classified loan as percentage of total outstanding dropped from 25.3 per cent at the end of FY2003 to 21.5 per cent at the end of FY2004. The decline of classified loan was contributed by all types of banks where NCBs, DFIs, PCB (D)s and PCB (F)s showed negative growth rates of (-) 1.8 per cent, (-) 8.0 per cent, (-) 18.7 per cent and (-) 1.5 per cent respectively in loan classification status (Table 1.15).

TABLE 1.15

Classified Loan

(in billion Tk)

Type of Banks	As of June 30, 2003						As of June 30, 2003			Growth Rate of Classified Loan
		Classification Status				CL as %			CL as %	
	Total Outstanding	Sub-standard	Doubtful	Bad/Loss	Total Classified	of Total Outstanding	Total Outstanding	Total Classified	of Total Outstanding	
NCBs	388.3	9.9	6.6	99.3	115.8	29.8	359.2	117.9	32.8	1.8
PCBs	427.2	3.7	4.9	39.4	48.1	11.2	351.2	52.3	14.9	-8.0
FBs	71.4	0.0	0.0	0.9	1.0	1.4	59.3	1.3	2.1	-18.7
DFIs	100.6	6.6	6.3	34.6	47.5	47.2	100.0	48.2	48.2	-1.4
All Banks	987.5	20.3	17.8	174.3	212.4	21.5	869.7	219.7	25.2	-3.3

Source: Computed from CPD (2004) and BB (2002-2003).

However, in entirety, the reduction of classified loans largely occurs as a result of window-dressing through rescheduling and write-off, but not due to improvement in recovery. It should be kept in mind that the policy of debt rescheduling, practised by successive political regimes in Bangladesh, has contributed to a serious moral hazard problem in the banking system, which may actually have contributed to the perpetuation of the default culture in Bangladesh.

1.4.6 Price and Wage Inflation

The latest available figures from the BBS show that the national inflation rate (moving average, base year 1995/96) was 5.8 per cent in June 2004. On a point-to-point basis, the rate was about 5.6 per cent. It may be recalled here that the inflation rate (moving average) was 2.8 per cent and 4.4 per cent in June 2002 and June 2003 respectively.

After the steady rise in the consumer price level during October-November (Ramadan months) and December 2003, the inflation rate had shown some signs of slowdown on a point-to-point basis. However, when estimated as a moving average, the inflation rate seems to have risen further, due to its momentum, to 5.8 per cent from 5.4 per cent between December 2003 and June 2004. In fact, even on a point-to-point basis, the food prices have continued to rise throughout January-June 2004 (CPD, 2004) (Table 1.16).

Box 1.7: Effect of Rising Inflation

With a view to assess the perception of the enterprises regarding the effect of the rising trend of inflation on production cost, a questionnaire-based survey was carried out by CPD among a group of entrepreneurs with fixed assets ranging above Tk 10.0 crore. The survey was implemented during 22 April 2004-17 May 2004 with more than 70.0 valid respondents.

Analysis of the responses revealed that almost half of the respondents (49.3 per cent) felt that the rising trend of inflation affected their companies' production cost during FY2003. This trend in responses increased further in FY2004 (July 2003-March 2004), as 56.0 per cent of the respondents maintained that the present rate of inflation is affecting their production costs. This increasing trend between the two periods of time coincides with the matching rise in the inflation rate. The respondents who reported that they are immune from the impact of the price rise largely belonged to the export-oriented clothing sector.

Effect of Declining Interest Rate	Yes		No	
	July 2002 - June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004
	(In per cent)		(In per cent)	
Did rising trend of inflation affect your production cost during the following periods?	49.3 (R-73)	56.0 (R-75)	51.7 (R-71)	44.0 (R-78)

Note: Figures in the parentheses indicate the number of respondents.

TABLE 1.16

Inflation Rate (Base: FY1996=100)

Year	National		Rural		Urban	
	12 Month Moving Average	Point-to-Point (as of June)	12 Month Moving Average	Point-to-Point (as of June)	12 Month Moving Average	Point-to-Point (as of June)
FY2001	1.9	1.6	2.1	1.5	1.5	1.9
FY2002	2.8	3.6	2.6	3.4	3.3	4.0
FY2003	4.4	5.0	4.7	5.3	3.5	4.3
FY2004	5.8	5.6	5.7	5.7	5.9	5.5

Source: Computed from CPD (2004) and BBS (1995-2004a).

The inflation rate (moving average) for food prices has been higher (6.6 per cent) compared to non-food prices (4.4 per cent). However, very surprisingly, one finds that both the food and non-food prices increase had been higher in the rural areas than in the urban areas. The inflation rate (moving average) as of June 2004 for food and non-food prices in the rural areas has been 8.7 per cent and 4.5 per cent respectively in comparison with the corresponding inflation rates of 7.8 per cent and 4.1 per cent in the urban areas. Thus, it is evident that the recent price hike will hit the poor more (those who spend relatively more on food), particularly those living in the rural areas. The higher inflation in the rural areas is also a pointer to the evolving structural shift of the rural economy through increasing monetisation and growth of the non-farm sectors.

Box 1.8: Price Trend of Some Imported Commodities

Facing the rising price of rice and wheat, the government reduced tariffs and duties on rice and wheat imports in FY2003 and continued these reduced rates in FY2004. Government policies on lower tariff for rice and wheat imports in FY2003 enabled gradual convergence of wholesale price of wheat in Bangladesh (Dhaka) and India (Delhi). It may be noted that India is the largest exporter of rice and wheat to the Bangladesh market. Indian government policy of exporting subsidised rice and wheat and transport subsidy for export also contributed to this convergence. In October 2003, Indian government increased the administered price of rice and wheat. Since January 2004, the rice price in Bangladesh as well as in India has been showing an upward trend. Increase in the rice price in recent months is mainly due to the bull run in the international price. In the case of the increase of wheat price, a sharp upward trend in Bangladesh was observed since October 2003. The wheat price in Bangladesh (Dhaka) was slightly higher than that of India (Delhi) up to January 2004. After that, the wheat price has been consistently going up in Bangladesh (data is available up to 19 May 2004) but is declining in India (Delhi; data is available up to 14 April 2004).

Bangladesh imports crude soyabean oil and the refined oil is marketed by the domestic companies. Price of soyabean oil is also consistently going up. The wholesale price of refined soyabean oil in Bangladesh increased from Tk 39.9 per litre in July 2003 to Tk 47.1 per litre in May 2004. An analysis of differences between the crude oil price of soyabean in the international market and refined oil price of the same in the domestic market indicates that the gap is widening. In other words, the price of soyabean oil in Bangladesh has been increasing at a faster pace than in the international market.

Price of sugar has increased from Tk 27.5 per kilo in July 2003 to Tk 31.5 in May 2004. A comparison of the wholesale price of sugar in India (Delhi) and Bangladesh (Dhaka) indicates that wholesale price of sugar in Bangladesh (Tk 35.6 per kg or US$0.6) during September 2003 was much higher than that of India (Rs 14.3 per kg or US$0.3). After that the sugar price in Bangladesh remained higher but stable while sugar prices in India were gradually increasing. It may be noted that per kg wholesale price of sugar in Dhaka in April 2004 was Tk 28.3 (US$0.5), while it was Rs 15.1 (US$0.3) in Delhi.

The price of construction materials, particularly iron rods, was high. According to the *Daily Star* (28 February 2004), "MS (mild steel) rod price has shot up by 50.0 to 80.0 per cent during the last one year. Price of each ton of 60 grade MS rod was Tk 21,500.0 while 40.0 grade MS rod price was Tk 23,500.0 in January 2003. Now (February 2004), the prices are Tk 35,500.0 and Tk 42,000.0 respectively."

It needs to be observed how the food price index behaves once the *boro* crop is harvested. But it is imperative that the inflation rate is closely monitored in the coming months, particularly when the government is pursuing a moderately expansionary policy.

This concern for price inflation becomes quite serious when we consider the recent trend in wage inflation. The wage index grew by more than 11.0 per cent throughout FY2003, and during the FY2004 period this has remained about 5.0-6.0 per cent. It goes without saying that such wage inflation is often driven by the wage-goods price inflation, which in turn erodes the economy's export competitiveness. On the other hand, increase in real wages (around 5.3 per cent) may be an expression of higher labour demand and growth in productivity. Thus, it needs further examination to explain the growth in real wages during a period in a country where one-third of its workforce in unemployed or underemployed and it has experienced a large retrenchment of manufacturing labour (more than 51,000) through closure of some state-owned enterprises (SOEs).

In assessing inflationary trends in the economy, we need to recognise that very little research evidence is at hand to explain the dynamics of price inflation in Bangladesh that would enable us to differentiate between the contribution of monetary and structural factors. The sudden escalation of price levels during *Ramadan* appeared to be at variance with supply and demand trends for certain key items of consumption. This suggests that the structural components of price and wage inflation and their institutional foundations merit investigation if appropriate policy responses are to be designed to cope with the problem.

However, there is hardly any doubt that the recent inflationary trend observed in the Bangladesh economy is a "cost-push" one. The major factors, that have contributed to this trend include upward adjustment of utility tariffs, rise in global prices of some consumer goods, and the downward adjustment in exchange rate of the national currency. One should also remain open to the possibility of a warming up of the economy expressed by the rise in CPI in the face of increased investment demand. Similarly, the extent to which the present price hike relates to inefficient market intermediation underpinned by corrupt practices and extortion also needs to be probed.

Latest available figure shows that the general wage index grew only by about 3.9 per cent in June 2004, as against 11.8 per cent growth in June 2003. Sectoral analysis shows that wage index of manufacturing and construction workers had grown only 5.9 per cent and 0.2 per cent in June 2004, as against 16.1 per cent and 5.8 per cent in 2003 respectively. The wage index of agricultural workers remained stagnated at zero per cent growth in June 2004, as against 10.6 per cent growth in June 2003.

1.5 REAL ECONOMY

1.5.1 Agricultural Production

Agricultural and forestry achieved a moderate 2.4 per cent growth in FY2004, while the rate of overall agricultural growth has been 2.7 per cent in FY2004, which is lower than the growth achieved in the previous year (3.1 per cent). The annual growth of both forest and livestock in FY2004 was 4.5 per cent, which was about the same in FY2003. In contrary, crops and horticulture registered only a 1.7 per cent growth in FY2004, compared with the 2.9 per cent growth in FY2003. Fisheries, however, made 3.6 per cent growth in FY2004, in comparison with 2.3 per cent growth in FY2003 (Table 1.17).

Foodgrain production has increased in FY2003 after a decline in FY2002. According to the final estimate of the BBS, actual foodgrain production for FY2003 was 26.7 million metric tons (*aus* 1.8 million metric tons, *aman* 11.1 million metric tons, *boro* 12.2 million metric tons, and wheat 1.5 million metric tons), which was about 3.0 per cent higher than that of FY2002. Total rice production in FY2003 was 3.6 per cent higher than that of FY2002. It may be mentioned here that though the production of foodgrains had increased in FY2003, it was below the production level (26.8 million metric tons) of FY2001 (Table 1.18).

TABLE 1.17

Annual Growth of Agricultural Output (Base FY1996=100)

(per cent)

Year	Agriculture	Crops and Horticulture	Forest	Livestock	Fisheries
FY1998	3.2	1.1	4.5	2.6	8.9
FY1999	4.7	3.1	5.2	2.7	9.9
FY2000	7.4	8.1	4.9	2.7	8.9
FY2001	3.1	6.2	4.8	2.8	-4.5
FY2002	0.0	-2.4	4.9	4.7	2.2
FY2003	3.1	2.9	4.4	4.5	2.3
FY2004p	2.7	1.7	4.5	4.5	3.6

Note: p = Provisional.

Source: Computed from CPD (2004).

TABLE 1.18

Foodgrain Production

(in million M Ton)

Year	Rice				Annual Growth of Rice Production (%)	Wheat	Total Foodgrain	Annual Growth of Foodgrain Production (%)
	Aus	*Aman*	*Boro*	Total				
FY1997	1.9	9.5	7.5	18.9	6.7	1.4	20.3	6.7
FY1998	1.9	8.8	8.1	18.8	-0.1	1.8	20.6	1.6
FY1999	1.6	7.7	10.0	19.4	2.8	1.9	21.3	3.1
FY2000	1.7	10.3	11.0	23.0	18.9	1.8	24.9	16.8
FY2001	1.9	11.2	11.9	25.1	8.8	1.6	26.7	7.5
FY2002	1.8	10.7	11.8	24.3	-3.1	1.6	25.9	-3.1
FY2003	1.8	11.1	12.2	25.2	3.6	1.5	26.7	2.9
FY2004	1.8	11.5	12.6	25.9	3.0	1.2	27.2	1.9

Source: Computed from CPD (2004) and BBS – Agricultural Division data.

The foodgrain production target for FY2004 was set at 28.1 million metric tons, which is 5.4 per cent higher than the actual production in FY2003. Initial estimates show that areas under *aus* and *aman* cropping marginally declined during FY2004. While production of *aus* experienced a slight decline, *aman* registered an increase. Flash flood caused by onrush of hilly waters from upper reaches across the border and heavy rains during the third week of April have damaged *boro* rice in Sylhet, Sunamganj, Moulvibazar, Kishoregonj and Netrakona districts. Total production of *boro* rice in FY2004 is just above the production level of the last year.

Latest available data show that the overall foodgrain production in FY2004 has crossed the recent peak of FY2001, with a total production of 27.2 million metric tons, registering a 1.9 per cent growth over the previous year. Total production of rice in

FY2004 has been 26.0 million metric tons (*aus* 1.8 million metric tons, *aman* 11.5 million metric tons and *boro* 12.6 million metric tons), which accounts for a 3.1 per cent growth over the FY2003. However, production of wheat dropped by (-) 17.2 per cent or 0.3 million metric tons in FY2004 than that of FY2003 (CPD, 2004).

In FY2004, the government fixed the rice procurement target at 200,000 metric tons of *aman* rice. About 150,000 metric tons of rice and about 73,000 metric tons of paddy (equivalent to 50,000 metric tons of rice) are to be directly purchased from the farmers. Procurement of *aman* paddy started from 15 November 2003 and continued up to 28 February 2004. Procurement price of *aman* paddy and rice was set at Tk 8.4 and Tk 12.8 per kg respectively. During this period, more than 131,000 tonnes of rice and 16,000 tonnes of paddy were procured.[9] This indicated a shortfall of 12.7 per cent and 78.1 per cent in procurement for *aman* rice and paddy respectively (ibid). This shortfall took place because the farmers were getting better prices for their harvests in the open market and the procurement price operated as a market supportive lever.

In a recent meeting of the interministerial committee on Food Planning and Management (FPMC), held in April 2004, decision was taken to procure 600,000 tonnes of rice and 154,000 tonnes of paddy during the *boro* season. The committee also set procurement prices of *boro* paddy and rice at Tk 8.4 and Tk 13.3 per kg respectively.[10] The procurement is scheduled to begin from 25 April and end on 31 August 2004 (ibid). The procurement regime will need to ensure that the experience of last year is not repeated when poor quality foodgrains imported from India ended up in the silos of the Food Directorate.

1.5.2 *Monga* Situation

The relatively good performance of the foodgrain production has been foreshadowed by the *monga* situation in FY2004 prevailing in some Northern districts of Bangladesh. *Monga* is a local term used to indicate acute deprivation caused by the erosion of purchasing power due to lack of gainful employment opportunities. Although this happens every year during September-November (*Aswin* and *Kartik*) in the country's Northern districts, this year the situation was more severe than in the recent past. A CPD research team visited two upazilas of Rangpur and Gaibandha districts (one from an "affected" area and another from a "severely affected" area) to assess the reasons for the dire distress experienced this year. Stakeholder consultation and desk level research revealed a number of factors responsible for the severity of the hardship this year.

A major reason was the reduced production of foodgrain in FY2002 and FY2003. According to the data obtained from the BBS, total foodgrain (rice and wheat) production in the greater Rangpur region in FY2002 was 11.6 per cent lower than that of FY2001. On the other hand, total foodgrain production in FY2003 was 5.9 per cent lower than that of FY2001. This reduced foodgrain production has resulted in reduction of employment opportunities for harvesting and processing of agricultural commodities. Besides, loss of crops due to floods in 2003 had also aggravated the situation by delaying the transplanting time, thereby reducing employment opportunities for land preparation,

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9 *The Bangladesh Observer*, March 1, 2004.

10 *The Bangladesh Observer*, April 9, 2004.

transplanting and weeding of *aman* rice. The worst affected people were also victims of riverbank erosion. The traditional instruments for disaster relief such as Test Relief (TR), Food for Work and Vulnerable Group Feeding (VGF) programmes have been reduced this year resulting in lower entitlement opportunities during the lean period. Outflow of money from the rural areas due to greater loan recovery compared to disbursement by both government banks and NGOs also contributed to worsening the situation. On the other hand, lack of participation by NGOs to help the vulnerable to cope with hardship has further aggravated the situation. Some NGO workers indicated that since the government was not acknowledging the prevalence of *monga*, they did not dare initiate any targeted programme.

Box 1.9: Poverty Trends and Spatial Variation in Poverty

Bangladesh made notable progress in income-poverty reduction during the 1990s. I-PRSP reported that the income-poverty at the national level had declined from 58.8 per cent in 1991/92 to 49.8 per cent in 2000. In other words, rate of poverty reduction in the 1990s was 1 percentage point per year. The progress was faster during the 1990s compared with the previous decade. The faster pace of poverty reduction in the 1990s is attributable to the accelerated growth in income. The pace of rural poverty reduction was slow in the 1980s, but became faster in the 1990s. The reverse was true for the urban areas. It is well known that poverty trends are influenced by the changes in inequality. Income inequality at the national level has increased from 25.9 per cent in 1991/92 to 30.6 per cent in 2000. During the same period, urban inequality rose much faster (from 30.7 to 36.8 per cent) than rural inequality (from 24.3 to 27.1 per cent). The sources of rising inequality are linked with the uneven spread of economic and social opportunities, unequal distribution of assets especially in respect of human capital and financial capital, growing disparity between urban and rural areas as well as between developed and underdeveloped areas (I-PRSP, 2003).

Kam et al. (2004) reported geographical concentration of rural poverty in Bangladesh for 425 upazilas in 2000-01.[11] The study measured and mapped incidence of poverty (using Head-count Index) and severity of poverty (using Squared Poverty Gap Index). The Head-count Index varied from 15.0 per cent to 79.9 per cent of the rural households across the 425 upazilas. According to the study, the areas with highest incidence of poverty (greater than 47.0 per cent) are the depressed basins in Sunamganj, Habiganj and Netrakona districts; the northwestern districts of Kurigram, Nilphamari and Nawabganj; and Cox's Bazar and coastal islands of Bhola, Hatia and Sandeep. The areas with low levels of poverty are the greater Dhaka and Barisal regions, and Bogra, Pabna, and Jessore regions. The picture appears to be similar with regard to the severity of poverty. One implication of the findings of the study is that safety-net programmes such as Food for Work (FFW), Food for Education (FFE), Vulnerable Group Feeding (VGF), Vulnerable Group Development (VGD), etc. be targeted with greater intensity in the upazilas with higher intensity of poverty. Another implication is that strengthening special and targeted employment programmes for the vulnerable poor should get priority in the upazilas with high poverty incidence.

CPD fieldwork further unveiled that, for their survival, *monga* affected people tried to cope with the situation in their own ways. A common strategy was the forward sale of their labour at reduced wages – Tk 20.0-25.0 per day with food or Tk 35.0-40.0 per day without food. This may be compared with the potential wage rate of Tk 35.0-40.0 with food and Tk 55.0-60.0 without food during the crop harvest and planting season. Another desperate approach is the selling of crops (paddy) in advance at a lower price. For

[11] Most of the upazilas of the Chittagong Hill Tracts and the metropolitan thanas were not included in the study.

example, Tk 150.0-200.0 per maund of paddy against a potential post-harvesting price of Tk 300.0-350.0 per maund. Another practice is to obtain informal loans from money lenders. For example, an amount of Tk 100.0 obtained in *Aswin-Kartik* has to be paid with 50.0 per cent interest after 2-3 months. Temporary migration in search of work to other districts such as Comilla, Kishoreganj (Bhairab), Chittagong is also common among the *monga*-hit people. Even as a desperate measure, people eat *banana thors, kachu-ghechu,* which are not naturally consumed even by the poor during the normal period.

In the final analysis, the *monga* situation of FY2004 reflected weak monitoring on the part of the government and its slow response to the emerging situation. However, it would be a mistake to view this problem as a mere weakness in governance. The more fundamental problem highlighted by the recent *monga* crisis arises from the failure of successive governments to develop a long-term solution to the problem, which has been affecting certain Northern districts of Bangladesh, with varying degrees of severity, at least since independence of the country or possibly before that. The root causes of the problem, associated with entitlement deprivation, with its territorial location, are well known. Given the local dimensions of the crisis, it should have been possible to provide structural as well as programmatic solutions to this problem in all these years. Failure to do so indicates that the problem will remain.

1.5.3 Industrial Production

The lowest growth rate (3.2 per cent) in the manufacturing sector was recorded in the recent past during the 1990s in the year of severe floods, i.e. in FY1999. Since then, the sector has gradually recovered. In FY2003, the sector recorded 6.6 per cent growth with its medium and large components expanding at a rate slightly lower than the average (6.0 per cent) (Table 1.19).

TABLE 1.19

Growth of Industrial Production (1995-96=100)

Year	Overall Industry	Mining and Quarrying	Manufacturing: Large and Medium	Manufacturing: Small	Manufacturing: Total	Power, Gas, Water Supply	Construction
FY1998	8.3	5.8	9.3	6.7	8.5	2.0	9.5
FY1999	4.9	1.1	4.2	0.7	3.2	6.0	8.9
FY2000	6.2	9.6	4.4	5.8	4.8	6.8	8.5
FY2001	7.4	9.8	6.5	7.0	6.7	7.2	8.7
FY2002	6.5	4.5	4.6	7.7	5.5	7.7	8.6
FY2003	7.3	7.1	6.6	7.2	6.7	8.0	8.1
FY2004	7.7	6.8	7.3	7.6	7.4	7.9	8.3

Source: Computed from CPD (2004) and BBS (1995-2004b).

For an assessment of the performance of the manufacturing sector in FY2004, one has to fall back on the series of Quantum Index of Production (QIP). On a point-to-point basis, industrial production has increased remarkably by about 13.3 per cent between June 2003 and 2004. Conversely, average QIP for FY2004 is only 4.9 per cent higher than the same in FY2003 (BBS, 2004).

Box 1.10: Assessing the Investment, Employment, Production and Export Situation

In view of the conflicting signals emanating from the investment and employment scenario, CPD undertook a limited survey of large-scale entrepreneurs to assess their production performance.

The findings of the survey reveal that the investment, employment, production and export situation had been better in the first three quarters of FY2004, in comparison to FY2003.

On investment, about half of the respondents (50.6 per cent) mentioned that they have expanded their base in FY2003, while this share increased to 53.7 per cent in FY2004. More importantly, a little over 20.0 per cent of the respondents admitted to investing in new businesses during FY2003 and FY2004.

Investment Situation	Expanded Existing Business		No New Investment		Invested in New Business	
	July 2002-June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004
	(In per cent)		(In per cent)		(In per cent)	
Investment situation of your company	50.6 (R-79)	53.7 (R-82)	24.1 (R-79)	25.6 (R-82)	21.5 (R-79)	20.7 (R-82)

Note: Figures in the parentheses indicate the number of respondents.

In the case of employment, about 56.3 per cent of the respondents reported that they have hired more people in FY2003. The matching share was 63.0 per cent in FY2004. The share of enterprises experiencing labour retrenchment was less than 10.0 per cent in both the years.

In the same survey, 64.0 per cent of the respondents in FY2003 and about 67.5 per cent of respondents in FY2004 mentioned that they have increased their volume of production.

Finally, about 56.3 per cent of export-oriented respondent entrepreneurs in FY2003 and FY2004 respectively achieved higher export growth.

Volume of Production, Export Situation and Employee Situation	Increased		Decreased		Unchanged	
	July 2002-June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004	July 2002-June 2003	July 2003-March 2004
	(In per cent)		(In per cent)		(In per cent)	
State of volume of production of your company	64.1 (R- 78)	67.5 (R- 80)	5.1 (R- 78)	7.5 (R- 80)	30.8 (R- 78)	25.0 (R- 80)
Export situation of your company	65.1 (R- 43)	72.7 (R- 44)	16.3 (R- 43)	11.4 (R- 44)	18.6 (R- 43)	15.9 (R-44)
Total number of employees	56.3 (R-80)	63.0 (R-81)	6.3 (R-80)	8.6 (R-81)	37.5 (R-80)	28.4 (R-81)

Note: Figures in the parentheses indicate the number of respondents.

However, what is to be noted is that the QIP in February 2004 fell to 238.6 in comparison with 284.9 of the preceding month (January 2004) by more than 16.0 per cent. In June 2004 the QIP stood at 302.0, the highest in the last five years, recording a surprising 13.3 per cent growth (point to point). This was largely due to the incremental contribution of the garments and cotton textiles sector, which account for about 17.0 per cent weight in the total manufacturing industries.

The faltering growth of the manufacturing sector is largely attributable to the visible withering away of the jute industry in Bangladesh. During the first two quarters of FY2004, production fell in all categories of jute products (i.e. Hessian 19.3 per cent, sacking 7.9 per cent, carpet backing 20.4 per cent and others 36.2 per cent) – both in the public and private sector enterprises (ibid). This process has been accelerated by the liquidation of the Adamjee Jute Mills. The weight of the jute textiles in the QIP is still as high as 14.1 per cent. Along with the jute sector, among the major industries, the fall in production of paper and petroleum products is also discernible.

The most encouraging feature of the manufacturing production during July-December 2004 had been the robust growth of yarn (34.3 per cent) and fabric (48.1 per cent) production, which generates confidence about Bangladesh's growing capacity to meet the challenges of the post-Multi-Fibre Arrangement (MFA) era. During the first six months of the FY2004, the major industries (among others which include jute, textile, fertiliser, pharmaceuticals and tea and carries 68.2 per cent weight in the total manufacturing industry) recorded a 1.6 per cent growth over the same period of the previous year.

On the other hand, the QIP for the small scale manufacturing industries showed a 5.4 per cent growth during July-December 2003 in comparison with the comparable period of the preceding year. The substantive sub-sectors (at 2-digit level), which demonstrated fastest growth, are food, beverage and tobacco (8.7 per cent), and textiles, leather and apparels (8.6 per cent).

Such a low manufacturing growth rate does not trigger optimism, particularly when it rests on a very narrow base. The issue of industrial and export diversification has been part of the policy discourse for at least two decades. This debate has acquired acute relevance with the advent of the total phase-out of the MFA in 2005. Unless a new generation of industries, which can be either globally competitive or can provide efficient import substitution, the promise associated with Bangladesh's export gains and industrial change registered in the last decade may leave us with severe social as well as economic problems.

At the same time, it needs to be recognised that a structural transformation is going on in the country's manufacturing sector and there is a great deficiency in enterprise level data, which are quite often not consistent with macroeconomic aggregates. The current weak manufacturing growth does not match the higher flow of term loans to the industrial sector, mentioned earlier, or the rise in capital machinery import discussed later. There is a need to revisit the estimation procedure of the QIP. It is suspected that the current methodology of calculating QIP neither adequately covers the population of the manufacturing sector, nor does it incorporate a proper representative sample of the sector.

1.5.4 Privatisation

At present, the total number of state-owned enterprises (SOEs) approved by the government for privatisation is 97. Around 10 SOEs have been closed down during the last two and a half years, while only 14[12] were privatised, i.e. handed over to the buyers. Sale proceeds from these 14 enterprises amounted to around Tk 110.5 crore.

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12 These were: Nishat Jute Mills Ltd., Tongi; Mymensingh Jute Mills Ltd., Shambhugonj; Deshbandhu Sugar Mills Ltd., Narshingdi; Corn Flour Mills Ltd., Narayanganj; Cabinet Manufacturing Plant, Mirerdanga, Daulatpur, Khulna Wood Treating Plant, Mirerdanga, Daulatpur, Khulna; Mangrove Tannin Plant, Mirerdanga, Daulatpur, Khulna; Bangladesh Oil Mills, Khulna; Kaliachapra Sugar Mills Ltd., Kishoreganj; Fish Export, Khulna; Bawa Jute Mills, Narayanganj; Lira Industrial Enterprise, Tongi; Bangladesh Monospol Paper Manufacturing Co. Ltd and Service Facilities Centre (SFC), Sirajganj.

Currently, Letters of Intent (LoI) for privatisation have been issued for seven enterprises and these units are yet to be handed over to the private takers. The expected receipt from these sales is around Tk 71.6 crore. However, the Privatisation Commission is facing problems regarding handing over of a number of enterprises scheduled for privatisation.

Incidentally, the Textile Ministry has recently taken back three of its big textile mills from the Privatisation Commission list and has planned to liquidate them on its own.[13] The Ministry of Industry is trying to reopen four of its enterprises sent to the Privatisation Commission years ago. The ministry has sent a letter to the Privatisation Commission expressing its intent to reopen the North Bengal Paper Mills in Pakshey. It had already asked the Bangladesh Chemical Industries Corporation (BCIC) to initiate plans to run three other SOEs. A plan is afoot to start production of the Dhaka Leather Company, which was shut down way back in 1998 and since then, all its employees have been transferred to other enterprises of the Corporation. Several ministries are also keen to take back their enterprises and to liquidate them on their own in spite of the fact that no ministry has such cell, nor do these ministries have any expertise to conduct the liquidation process on their own. Citing ambiguous reasons, a Cabinet committee decided on 27 December 2003 that instead of the Privatisation Commission, ministries would liquidate the laid-off mills and factories.

The Ministry of Civil Aviation and Tourism decided not to privatise the enterprises under the Bangladesh Tourism Corporation that had been approved by the government for privatisation earlier.

It is apparent from the above evidence that the privatisation process faces retardation due to lack of a coherent policy within the government. Nor is it clear how the sales proceeds from the privatisation of the SOEs will be reinvested, if at all. On the other hand, the Privatisation Commission is yet to come up with its annual report, which is mandated under its Act. Little is known of the fate of the approximately 554 enterprises privatised over the last 30 years except for a few episodic studies. Nor is there any indication that the Privatisation Commission is taking any measure to keep the people of Bangladesh or even the Parliament informed of the fruits yielded by the privatisation process. This lack of transparency relating both to the privatisation process and its outcomes may have contributed to the problems faced by the Privatisation Commission.

1.5.5 Foreign Investment

A new round of debate on estimates of Foreign Direct Investment (FDI) has once again resurfaced following publication of FDI inflow data for the first half of the calendar year 2003 by the Board of Investment (BoI). There is no scope for an elaborate discussion here on whether internationally accepted accounting methods of FDI, in the context of practices in Bangladesh, have been used by the BoI. Although there is a high probability that FDI flow remains under-reported in the BoP statement in Bangladesh as it often does not fully capture capital machinery brought in, reinvested earning or inter-company loans under appropriate heads. However, the Bangladesh Bank has recently taken the initiative to incorporate survey data (instead of banking data) to measure the foreign investment flow.

13 The Ministry of Jute has also taken back three of its mills from the Privatisation Commission list recently and planned to run these enterprises by itself.

CPD estimate based on Bangladesh Bank's survey data on FDI and portfolio investment including foreign investments (FIs) in EPZs indicates that a net total of US$391.0 million[14] of foreign investment came to Bangladesh during FY2004. About 29.3 per cent of it was invested in the EPZs. A net total of US$6.0 million in portfolio transactions was reported during this period. The foreign investment figure for the FY2004 compares favourably with that for FY2003, with a 3.5 per cent increase. Net flow of FDI increased by 2.4 per cent, while EPZs recorded around 11.0 per cent growth during the FY2004.

However, one should not lose sight of the fact that all these growth trends are projected from an insignificant base. After a (-) 30.0 per cent fall in foreign investment in FY2002 from about US$385.0 million in FY2001 (peak after FY1998 when high FDI flew into the energy sector), foreign investment recorded a US$390.0 million-plus figure in FY2004. However, the growth in the foreign investment is largely contributed by the steady growth of foreign investment flow into the EPZs, which during the FY2004 have received US$114.5 million of foreign investment (Table 1.20).

TABLE 1.20

Foreign Investment

(in million US$)

	Foreign Investment				Annual Growth of Total Foreign Investment
	Net Foreign Direct Investment[a]	Net Portfolio Investment	Total Foreign Investment	Of which FI in EPZs[b]	
FY2000	383.0	0.1	383.1	34.9	
FY2001	550.0	-0.4	549.6	48.4	43.0
FY2002	391.0	-5.6	385.4	55.7	-26.2
FY2003	376.0	1.6	377.6	103.1	8.9
FY2004	385.0	6.0	391.0	114.4	5.1

Notes: [a]Survey data, which include reinvested earnings, intra-company loans and non-cash equity flow; [b]Includes investments in joint-venture enterprises with local entrepreneurs.

Source: CPD (2004) and Finance Division (2004c).

However, the resurgence of the controversy regarding trade union rights in the EPZs, reflecting the concerns of Bangladesh's largest export market, the USA, vis-à-vis the concerns of some of Bangladesh's largest sources of investment in the EPZ, drawn from Japan and the Republic of Korea, need to be resolved without prejudice either to Bangladesh's export or investment prospects. The recent agreement between the governments of the USA and Bangladesh to phase-in trade union rights in the EPZs and its slow operationalisation indicate that this may not be an easy task.

1.5.6 Capital Market

The all share price index of Dhaka Stock Exchange (DSE) stood higher at 1,319 at the end of June 2004 compared to 830 at the end of June 2003. Total market capitalisation of all shares and debentures of the listed securities at the end of June 2004 stood at

[14] On the basis of banking data, the net amount of foreign aid stood at US$209.4 million (of which foreign direct investment was US$89.0 million), which was 6.5 per cent higher than that of FY2003.

Tk 142.0 billion, which is about 95.0 per cent higher than that of the previous year (end of June 2003). On the other hand, all share price index of Chittagong Stock Exchange (CSE) stood at 2292, which is 64.0 per cent higher than the index (1395) of FY2003. Market capitalisation during this period increased by 111.0 per cent from Tk 60.0 billion in FY2003 to Tk 127.0 billion in FY2004 (Table 1.21).

TABLE 1.21

Capital Market

	DSE			CSE		
Year (end June)	All Share Price Index (as of End June)	Listed Securities (Including Mutual Fund and Debenture)	Market Capitalisation (in Billion Tk)	All Share Price Index (as of end-June)	Listed Securities (Including Mutual Fund and Debenture)	Market Capitalisation (in Billion Tk)
FY1999	546.8	230	50.7	222.1	154	41.0
FY2000	561.0	239	54.0	1,173.9	161	44.8
FY2001	716.1	244	72.2	1,502.4	171	62.8
FY2002	792.6	257	65.5	1,315.7	184	56.2
FY2003	830.5	260	73.0	1,395.0	185	60.2
FY2004	1,319.0	267	142.4	2,292.0	195	127.2

Source: Computed from CPD (2004) and DSE (2004).

Between July 2003 and June 2004, DSE General Index and DSE 20 Index grew by about 65.0 per cent and 60.0 per cent respectively. A bullish trend in the bourse may be observed from mid-November, which gathered steam in the early part of December recording a 1015.9 general index for the first time after the 1996 bubble. Suspecting speculative trading in December 2003, the Securities and Exchange Commission (SEC) suspended trading of 16 companies with weak fundamentals (Z Category Companies), following a surge in their share prices. Subsequently, all prices of all shares in categories B and Z went down, resulting in price corrections in the Category A shares. However, an upturn has again been observed at the end of April 2004 when the DSE index crossed the thousand-mark once again.

No rational reason could be identified behind the upward surge observed in the market in November-December 2003. It may be recalled that 64 (29.0 per cent) companies out of 221 did not pay any dividend in 2000 and 49 in 2001 (21.0 per cent) out of 230 companies, whereas 76 (32.0 per cent) companies out of 241 companies are yet to declare dividends for 2002. It is suspected that the lucrative initial public offerings of banks attracted a significant amount of undeclared money into the capital market. It is also reckoned that a number of blue-chip securities had been under-valued for a long time and their prices went up as they started declaring good dividends.

Box 1.11: Trend in Over Subscription of IPOs

After the boom and bust in 1996, the capital market could not regain the faith of small and medium investors on the secondary and kerb market shares. Moreover, the suspension of sixteen Z category companies by the SEC made it inevitable for the general investors to go for the primary shares of reputed companies, which has been mirrored in the over-subscription of Initial Public Offerings (IPOs) trend in recent times.

(Contd.)

(Contd. of Box 1.11)

According to the DSE statistics, the rate of over-subscription of IPOs increased from 249.9 per cent in FY2002 to 517.7 per cent in FY2003. Latest available figure shows that Tk 25,046.0 million was subscribed against Tk 1,135.0 million security offers during the FY2004, accounting for a 2,106.0 per cent over-subscription rate during this period. Thus, an amount of Tk 2,299.7 million was over-subscribed for offerings by four Private Commercial Banks (PCBs), while the remaining of the 10 companies was over-subscribed by Tk 91.37 million. Four PCBs, namely Standard Bank Ltd., One Bank Ltd., Bank Asia and Mercantile Bank Ltd., accounted for a 2770.1 per cent over-subscription during FY2004. It can be mentioned that since November 2003, no new IPO was offered on the market.

As part of a market correction, in order to ensure the supply of quality shares, and thereby broaden the depth of the stock market, the SEC agreed to specify the responsibilities of all parties, including issue managers, underwriters, and auditors, concerned with the initial public offering process. The regulatory body pointed out that it will take punitive actions against those who fail to carry out their due responsibility while issuing an IPO.

One can relate the current trend of IPO over-subscription with the reaction of the previous experience with secondary shares and current market correction initiatives of SEC.

Notwithstanding the above facts, there had been some movement in the stock market as 10 new companies were listed in FY2004 putting up about Tk 6,458.0 million as sponsors' equity. These companies offered Tk 25,046.0 million worth of securities against which Tk 25,046.0 million was deposited, recording a staggering 1204 fold over-subscription (see Table 1.22).

TABLE 1.22

Initial Public Offerings (DSE)

(in million Tk)

Year	Number of Company	Sponsors' Equity	Securities Offered	Amount Subscribed	Rate of Over-subscription (%)
FY1997	18	2998	1384	17582	1170.4
FY1998	10	1064	410	1166	184.4
FY1999	7	946	406	669	64.8
FY2000	11	2047	298	653	119.1
FY2001	10	857	175	902	415.4
FY2002	9	113	183	640	249.7
FY2003	8	486	311	1921	517.7
FY2004	10	6458	1135	25046	2106.7

Source: Computed from CPD (2004) and DSE (2004).

However, it needs to be pointed out that although almost all the IPOs in varying degrees were over-subscribed, it is the IPOs relating to banks, insurance and investment activities, which attracted most of the investors' interest.

Nonetheless, the capital market remains both shallow and skewed in Bangladesh. Market capitalisation in DSE in April 2004 amounted to US$1874.0 million, which is less than 3.2 per cent of GDP. In June 2002, the comparable figure was 3.5 per cent of GDP. Three groups of listed companies, *viz.* (i) Banks, (ii) Pharmaceuticals and Chemicals, and (iii) Food and Allied Products together controlled about 60 per cent of the market capitalisation.

It will be interesting to observe how the SEC succeeds in weeding out the dead stocks and restoring investors' confidence in the capital market. However, the recent movements in the capital market have revealed that at least Tk 2,000.0 crore of liquidity is looking for opportunities for investment in dependable scrips.

1.6 EXTERNAL SECTOR[15]

The fiscal year 2003-04 is expected to be a defining year and an important threshold for Bangladesh's external sector. One major reason for this is that FY2004 is the last fiscal year before the final phase-out of the MFA quotas on 1 January 2005. With the MFA phase-out, the relatively secured market access in the USA under the quota regime will come to an end; just as in the European Union, the advantages emanating from a quota-free market access (while quotas are imposed on major competitors) will no longer be available. The post-Cancun scenario has put completion of the Doha Development Round negotiations in a disarray. This means that the decisions on important market access issues, which are of interest to Bangladesh and other LDCs, will get delayed. Bilateral and plurilateral trade initiatives between developed countries and some of Bangladesh's competitors will begin to be felt in a more pronounced way in FY2004, as rival supply networks gradually get on with the task of regrouping and repositioning in order to take advantage of enhanced market access opportunities. The pace of the bilateral and regional trade initiatives in South Asia, in which Bangladesh is an active participant, is set to gain momentum in the current fiscal year. A welcome development of recent times is that the issues of the workers' right to organise trade unions in the EPZs appear to have been resolved for the time being.

The current year is expected to be a busy one in terms of trade negotiations. The SAFTA Framework Agreement signed at the 12th SAARC Summit in Islamabad in January 2004, requires Bangladesh to get on with the important task of preparing tariff liberalisation schedules, articulating preferred rules of origin and preparing proposals for dispute settlement and revenue compensation mechanisms. A committee of experts has already held two meetings. The next meeting is scheduled to be held in the first week of June 2004. Negotiations have also progressed significantly towards establishment of a BIMSTEC Free Trade Area. Bangladesh is also exploring possibilities of establishing bilateral FTAs with India, Pakistan and Sri Lanka.

As a result of these initiatives, opportunities are expected to emerge, which will need to be accessed. At the same time, Bangladesh's external sector will also face many challenges, which will have to be addressed with appropriate measures. All this will have important short, medium and long term implications for the performance of Bangladesh's external sector in particular and the Bangladesh economy in general. Negotiating the various bilateral and multilateral trade talks in a manner that best serves Bangladesh's economic interests will be a major challenge for the country in the coming months.

An analysis of the performance of the external sector during the first three quarters of the current fiscal year shows that, overall, in FY2004, Bangladesh's external sector

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15 For more details on the external sector of Bangladesh, see Rahaman, M. 2004. *Crossing A Critical Watershed: Bangladesh's External Sector in FY2004.* Dhaka: Centre for Policy Dialogue and Rahman, M. 2004 [under preparation]. *External Sector Performance in FY2003: Recovery and Beyond* in CPD (ed.) Independent Review of Bangladesh's Development 2003. Dhaka: Centre for Policy Dialogue and The University Press Limited.

was able to consolidate the recovery experienced in FY2003, following the deceleration of the export sector and deteriorating BoP situation experienced in FY2002. The following sections elaborate on the growth and structure of the performance of the external sector and point out some of the emerging trends, as the fiscal year draws to its end.

1.6.1 Import

The import situation in FY2004 has reversed compared to FY2003 when the sector registered a negative growth of (-) 2.7 per cent compared to FY2002. As the latest available figures indicate, imports during FY2004 stood at US$10,903.2 million, posting an increase of 12.9 per cent compared to the corresponding period of FY2003. Although, to some extent, this growth was underwritten by a rise in imports by EPZs (by 21.9 per cent); imports without EPZs also registered an impressive growth of 12.2 per cent. When imports of foodgrains are excluded, other commodities account for an impressive 12.5 per cent growth during FY2004 over the corresponding figure of the previous fiscal year. Import of textile and related articles witnessed a high growth of 17.0 per cent, while imports of important industrial raw materials, such as raw cotton (48.5 per cent) and yarn (19.6 per cent), have also registered high growth rates during the period.

Import of capital goods during FY2004 was US$2,874.5 million, which was 5.1 per cent higher than that of the corresponding amount of the previous year, and substantially higher than the 3.6 per cent registered in FY2003. Interestingly, disaggregated import figures show that import of textile and garments machineries (HS 8445-8) exhibited a robust growth of about 50.0 per cent during FY2004 over the corresponding figure of FY2003.

If fresh openings of import L/Cs are taken into consideration, it is found that L/Cs opened for import rose to US$12.4 billion during the FY2004 compared to the FY2003 when it was US$10.2 billion – indicating a growth of 21.4 per cent (Bangladesh Bank, 2004a). The amount of L/Cs opened for consumer goods during this period remained almost unchanged (a decline of -0.7 per cent); L/Cs opened for consumer goods other than foodgrains registered a high growth rate of 40.0 per cent, perhaps in response to the relaxations of L/C margin requirements. Import L/Cs for industrial raw materials posted a growth of 22.1 per cent, although growth figures for intermediate goods at 23.7 per cent were high by comparison. Growth of L/Cs opened for import of capital machineries was 18.6 per cent. This growth also captures US$33.4 million worth of import for a Power Development Board (PDB) power plant in Tongi and US$12.9 million worth of import for a glass factory financed by the Janata Bank. Both textile and garments sub-sectors showed high import growth rates of 70.9 per cent and 53.2 per cent respectively during the first 10 months of FY2004. L/Cs opened for importing machineries for miscellaneous industries registered a growth rate of 10.1 per cent. Settlements of import L/Cs for this period also shows a good performance, rising from US$9.1 billion during FY2003 to US$10.8 billion in FY2004 scoring a growth rate of 18.7 per cent. However, L/C settlements for import of capital machineries posted a growth of 13.9 per cent, although the growth figures for L/C settlements of both textile machineries (88.0 per cent) and garments (57.1 per cent) were quite robust during the FY2004 (ibid).

Box 1.12: Inconsistencies in the Information on Import of Capital Goods Machinery

Import of capital machinery is critically important because of its implications and impact on investment. However, it appears that there is a need to streamline the relevant information for reliability and comparability. The information compiled by the BB on imports of capital machineries through opening and settlement of L/Cs is collated from various banks. There is no set proforma as regards definition and classification of the relevant data, nor are compilers of such information adequately trained for the job. Data on imports of capital machineries collected by NBR is classified under HS codes at disaggregated level, which is subsequently aggregated at two digit levels, 84 and 85.

Although most of the imports under 84 and 85 are capital goods, it is sometimes difficult to ascertain whether machineries listed here are for domestic or industrial purpose, leaving a margin for error when this data is used as proxy for investment in capital machineries. Moreover, it appears that some of the imported capital machineries do not fall under HS 84 and 85. This is also evident from the fact that data on imports of capital goods provided by BB is consistently higher compared to import data of NBR under HS 84 and 85. For example, import of capital goods during July- February 2004 was US$1,412.2 million as per BB data, while import of capital goods under HS 84 and 85 as per NBR data was US$990.7 million over the corresponding period.

There is, thus, a need to (a) design an appropriate methodology for information on imports of capital goods by BB, and (b) reconcile the NBR and BB data sets.

L/C openings during the FY2004 indicate that imports are likely to sustain over the upcoming months, and there may be a pressure on BoP in the trade account. Both export earnings and remittance flows have registered a robust performance, and if growth trends of these two sectors sustain, there should not be any significant pressure on foreign exchange reserve arising from the recent surge of imports. Higher disbursement of foreign aid is also likely to provide some cushion. The exchange rate in a floating regime may also be expected to absorb a significant part of this pressure.

1.6.2 Export

Exports recovered somewhat in FY2003 when earnings registered a growth of 9.4 per cent, following the negative growth of (–) 7.4 per cent in FY2002. The export sector demonstrated remarkable resilience and the momentum generated in FY2003 has been sustained in FY2004. Export accruals rose from US$6,548.5 million to US$7,603.0 million marking a growth of 16.1 per cent in the FY2004 over the compared figure of FY2003. Export earnings from woven garments posted a growth of 8.6 per cent during the FY2004; earnings from knit garments continued to register a robust growth and increased by 29.9 per cent. Export of chemical products (20.9 per cent), leather (10.6 per cent), tea (2.20 per cent) and frozen foods (21.3 per cent) also experienced modest to high growth rates. Unfortunately, the deceleration experienced in the case of export of both raw jute (-3.4 per cent) and jute goods (-4.3 per cent) has sustained in FY2004 also. It is to be borne in mind that most of the export growth of 16.1 per cent was accounted for by a rise in volume (12.3 per cent) and only to an insignificant extent by a rise in average prices (3.8 per cent). Bangladesh's average export price fell by 10.7 per cent over the last four years. As a matter of fact, CPD analysis shows that average export prices of Bangladeshi goods are yet to reach the 1996 level. It is also to be noted that most of the incremental exports in the FY2004 came from an increase in exports to the EU. The EU comprised about half the share (50.0 per cent) of Bangladesh's total export during

FY2004, while NAFTA covered 36.0 per cent. The rest was exported to ASEAN (4.5 per cent), SAARC (2.0 per cent) and other countries (7.5 per cent) (Table 1.23).

TABLE 1.23

Categorywise Exports

Items		FY1998	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004
Raw Jute	In Million US$	107.8	71.8	72.0	67.2	61.1	82.5	79.7
	Growth Rate (%)	-7.4	-33.4	0.3	-6.7	-9.0	34.9	-3.3
	As % of Total Exports	2.1	1.3	1.3	1.0	1.0	1.3	1.0
Tea	In Million US$	47.5	38.6	18.0	21.6	17.4	15.5	15.8
	Growth Rate (%)	24.5	-18.8	-53.3	19.9	-19.5	-11.0	2.2
	As % of Total Exports	0.9	0.7	0.3	0.3	0.3	0.2	0.2
Leather	In Million US$	190.3	168.2	195.0	253.9	207.3	191.2	211.4
	Growth Rate (%)	-2.7	-11.6	15.9	30.2	-18.4	-7.8	10.6
	As % of Total Exports	3.7	3.1	3.4	3.9	3.5	2.9	2.8
Frozen Food	In Million US$	293.8	274.3	344.0	363.2	276.1	321.8	390.3
	Growth Rate (%)	-8.4	-6.6	25.4	5.6	-24.0	16.6	21.3
	As % of Total Exports	5.7	5.1	6.0	5.6	4.6	4.9	5.1
Jute Goods	In Million US$	281.4	301.9	266.0	230.4	243.5	257.2	245.6
	Growth Rate (%)	-11.5	7.3	-11.9	-13.4	5.7	5.6	-4.5
	As % of Total Exports	5.5	5.6	4.6	3.6	4.1	3.9	3.2
Handicraft	In Million US$	6.0	7.6	8.0	7.2	6.1	6.0	4.2
	Growth Rate (%)	5.8	27.0	5.1	-9.9	-15.1	-2.8	-29.4
	As % of Total Exports	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Woven wear	In Million US$	2843.3	2984.7	3083.0	3364.2	3124.6	3258.3	3538.1
	Growth Rate (%)	27.1	5.0	3.3	9.1	-7.1	4.3	8.6
	As % of Total Exports	55.1	55.2	53.6	52.0	52.2	49.8	46.5
Knitwear	In Million US$	940.3	1035.4	1270.0	1496.4	1459.2	1653.8	2148.0
	Growth Rate (%)	23.2	10.1	22.7	17.8	-2.5	13.3	29.9
	As % of Total Exports	18.2	19.1	22.1	23.1	24.4	25.3	28.3
Chemical	In Million US$	74.2	79.2	93.5	97.2	66.6	100.5	121.5
	Growth Rate (%)	-31.6	6.8	18.0	3.9	-31.5	51.0	20.9
	As % of Total Exports	1.4	1.5	1.6	1.5	1.1	1.5	1.6
Others	In Million US$	376.6	449.2	407.1	566.1	524.1	661.8	848.5
	Growth Rate (%)	19.8	19.3	-9.4	39.1	-7.4	26.3	28.2
	As % of Total Exports	7.3	8.3	7.1	8.8	8.8	10.1	11.2
Total	In Million US$	5161.2	5411.0	5756.6	6467.3	5986.1	6548.4	7603.0
	Growth Rate (%)	16.8	4.8	6.4	12.3	-7.4	9.4	16.1
	As % of Total Exports	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Computed from CPD (2004), Bangladesh Bank (2004) and Export Promotion Bureau (2003).

One has to admit that the intensive process of export expansion, experienced by Bangladesh till now, should be a matter of concern for Bangladesh's policymakers, and may not be sustainable over the medium term. This is particularly true when one single group of commodities, namely clothing, contributes the major share (three-fourths) in the export receipts. In recent years, most of the attendant growth is coming through the export of increasingly larger volume of apparels to the global market. As is well known, the export competitiveness of Bangladesh will be put to severe test once the RMG quota is phased out in a year's time, on 1 January 2005. Under the circumstances, renewed efforts will have to be undertaken to broaden Bangladesh's export basket and also in terms of assisting the country's export-oriented apparels sector to enhance its competitive strength in the global market. Bangladesh should also start to strategise on how it can make the best use of the potential market access opportunities arising out of the various bilateral and multilateral trading arrangements being negotiated at present, particularly as part of the SAFTA. Greater access to regional markets, thus, needs to be given a high priority in Bangladesh's trade strategy.

1.6.3 Remittance

In recent years, remittance sent by expatriate Bangladeshi workers has become an increasingly important component of Bangladesh's foreign exchange earnings. At present, remittance earnings are, on an average, equivalent to about four-fifths of *net* earnings from exports of goods.

Remittance flow first crossed the threshold of US$3.0 billion in FY2003 when earnings posted a growth of 22.4 per cent over the previous year. During the FY2004, foreign exchange earnings from remittance flows amounted to US$3.4 billion, which was US$310.0 million or 10.1 per cent more than the corresponding period of FY2003. It is reckoned that the post-9/11 global situation, along with government's steps to improve the efficiency of the formal channel of transfer, played an important role in accelerating Bangladesh's remittance growth (ibid). The Middle-East continues to generate most of the remittance income (about 56.5 per cent) with Saudi Arabia being the front runner (39.8 per cent) (Table 1.24).

TABLE 1.24

Foreign Remittance and Foreign Exchange Reserve

(in million US$)

Year	Remittance	Annual Growth Rate (%)	No. of Workers Abroad (000)	Annual Growth Rate (%)	Forex Reserve (As of 30 June)	Point-to-Point Growth (%)
FY1998	1525.4	3.4	243	6.6	1739.2	1.2
FY1999	1705.7	11.8	270	11.1	1523.3	-12.4
FY2000	1949.3	14.3	248	-8.1	1602.1	5.2
FY2001	1882.1	-3.4	213	-14.1	1306.7	-18.4
FY2002	2501.1	32.9	186	-12.7	1582.9	21.1
FY2003	3061.9	22.4	241	29.6	2469.6	56.0
FY2004	3371.9	10.1	273	13.3	2705.0	9.5

Source: CPD (2004) and Bangladesh Bank (1991-2003).

It is well known that it is the ordinary (unskilled and semi-skilled) workers who send most of their earnings home, while in the case of professionals the amount of retention abroad is significantly higher. A recent CPD-ICTSD study[16] shows, in view of the ongoing negotiations on GATS-Mode 4 (Movements of Natural Persons), a window of

[16] CPD-ICTSD study on *Risk and Opportunities of Liberalisation Trade in Services: Country Study Bangladesh*. Dhaka: Centre for Policy Dialogue.

Box 1.13: Are the NRBs Investing in Bangladesh? Are the Bangladeshis Investing Abroad?

A CPD survey carried out among the big entrepreneurs reveals that about 57.9 per cent of the respondents "fully agree" or "partially agree" that Non-Resident Bangladeshis (NRBs) are investing in Bangladesh. Conversely, 40.7 per cent of the respondents either "fully agree" or "partially agree" that Bangladeshis are investing overseas. However, it needs to be pointed out that the share of respondents "fully agreeing" is greater (10.1 per cent) in the case of the proposition that more Bangladeshis are investing overseas than the NRBs are investing in Bangladesh.

It is important to point out that in both cases the share of dissenting view was around 20.0 per cent.

However, it is important to note that in response to the question whether Bangladeshis are investing abroad, a larger share (39.2 per cent) pleaded ignorance, while in the case of investment by NRBs the comparable share was 24.4 per cent. This pattern of response may, on the one hand, depict the varying state of knowledge regarding both the subjects or people still feel uneasy to talk about flight of capital from the country.

While it is well known that some NRBs are investing in Bangladesh in various degrees, the recognition of the fact that Bangladeshis are also finding it opportune to invest abroad comes as a surprise.

The three major sectors where the Bangladeshis are investing abroad are real estate and housing, RMG and textiles, restaurant, trade in stocks and shares.

Curiously, these are also the sectors where NRBs are investing in Bangladesh.

Investment Situation (NRB's and Bangladeshi)	Fully Agree (In per cent)	Partially Agree (In per cent)	Don't Agree (In per cent)	Don't Know (In per cent)
Non Resident Bangladeshis (NRBs) are investing in Bangladesh	6.1 (R-82)	48.8 (R-82)	20.7 (R-82)	24.4 (R-82)
Bangladeshis are investing abroad	10.1 (R-79)	31.6 (R-79)	19.0 (R-79)	39.2 (R-79)

Note: Figures in the parentheses indicate the number of respondents.

opportunity is likely to emerge for Bangladesh in terms of enhanced opportunity to participate in the labour market of developed countries. The aforementioned CPD study has mapped Bangladesh's supply-side capacities with respect to International Standard Classification of Occupation (ISCO), which is followed by the WTO, and it is hoped that this exercise will help Bangladesh to prepare the *Request List* in terms of GATS-Mode 4 in the context of the upcoming negotiations in the WTO. A concerted effort now needs to be undertaken to address such crucial issues as skill upgradation, and also preparing new cadres of service providers capable of taking advantage of the emerging opportunities in the global labour market, particularly in Information Technology (IT) related sectors.

1.6.4 Foreign Aid

It is to be noted that following a secular decline in the volume of foreign aid disbursement since FY1999, a growth of more than 26.0 per cent was recorded in FY2003 in comparison with the preceding year. Bangladesh has experienced a ballooning aid pipeline in recent years. Bangladesh had received US$49.1 billion from the day of independence till date, of which more than US$40.7 billion (83.0 per cent) was disbursed. The trend of aid disbursement shows that the mismatch between the commitment and disbursement is increasing on a continuous basis. In FY2003, foreign aid committed to Bangladesh amounted to about US$2,179.0 million, while actual disbursement was in the region of US$1,577.0 million. During FY2003, only 73.0 per cent of the total commitment had been disbursed. The total aid pipeline today stands at more than US$6.2 billion; of this 96.0 per cent is on account of project aid (Table 1.25).

TABLE 1.25

Foreign Aid and Debt Services

(in million US$)

Year	Foreign Aid			Debt Services		Outstanding External Debt[a]	Total Foreign Currency Earnings[b]	Outstanding External Debt as per cent of GDP	Debt Service as per cent of Foreign Currency Earnings
	Commitment	Disbursement	Pipe line	Principal	Interest				
FY1998	1791.0	1251.0	4697.0	307.0	137.0	13418.0	6687.0	30.5	6.6
FY1999	2648.0	1536.0	4896.0	373.0	166.0	14354.0	7019.0	31.4	7.7
FY2000	1475.0	1587.0	5980.0	447.0	172.0	15727.0	7702.0	33.4	8.0
FY2001	2053.0	1369.0	5752.0	438.0	159.0	14677.0	8349.0	31.2	7.2
FY2002	879.0	1442.0	5858.0	435.0	151.0	15885.0	8487.0	33.4	6.9
FY2003	2179.0	1585.0	5450.0	452.0	156.0	16953.0	9610.0	33.3	6.3
FY2004	1927.0	1033.0	6344.0	397.0	165.0	17200.0	10975.0	31.7	5.1

Notes: [a]Excluding the IMF loan. [b]Total Foreign Currency Earnings = Total Export Income + Annual Remittances.

Source: Computed from ERD (2003) and CPD (2004).

Aid disbursement during the FY2004 stood at US$954.0 million, which is 39.8 per cent below the comparable figure for FY2003. Food aid receipt stood at US$35.0 million, 13.0 million or (-) 27.0 per cent lower than the matching figure of FY2003. Commodity aid fell sharply from US$175.0 million in FY2003 to only US$12.0 million in FY2004. Disbursement of project aid also came down to US$907.0 million in FY2004 from US$1,362.0 million in FY2003, depicting a (-) 33.0 per cent negative growth.

The recent increase in foreign aid inflows to Bangladesh largely owes to the Development Support Credit (DSC) contracted with the World Bank. Under the DSC, US$300.0 million was disbursed in one go to Bangladesh as it promised to implement a time-bound Structural Policy Reform Matrix.

On the other hand, the IMF has also agreed to give Bangladesh SDR 347.0 million (about US$517.0) as a loan under the Poverty Reduction and Growth Facility (PRGF), of which two tranches of SDR US$49.5 million (US$74.0 million) each has already been disbursed. The third tranche of the PRGF is expected to be discussed during the Consultation Mission of IMF with the GoB in early May 2004. The IMF also indicated that in case there is any shortfall in the BOP due to the negative impact of MFA phase-out it would provide support, if necessary.

In recent consultations, the World Bank has agreed to make available to Bangladesh about US$1.0 billion as aid under various projects subject to compliance with a host of conditionalities or "poor actions," as they are currently called. Out of this amount, US$600.0 million will be disbursed shortly as budget support under three programmes, namely the Development Support Credit Phase II (US$200.0 million), Education Sector Adjustment Credit (US$150.0 million), and Enterprise Growth and Bank Modernisation Credit (US$250.0 million). Negotiations for the Enterprise Growth and Bank Modernisation project are scheduled to start soon. The Bank is also expected to approve another five projects in education, water, communications and power sectors involving an amount of more than US$400.0 million.

It needs to be noted with some satisfaction that in comparison with many other low-income countries, the foreign debt scenario of Bangladesh remains manageable. Debt outstanding was US$16,939.0 million in FY2003, and equivalent to 32.6 per cent of the GDP, which may represent a decline from 41.0 per cent of GDP in FY1991. In turn, the country's DSL on account of foreign loans amounted to only 6.3 per cent of its total foreign exchange earnings during FY2003.

The major problem for Bangladesh originates in its weak capacity to utilise the already committed foreign aid. Thus, the aid pipeline amounted to more than US$6201.0 million (as of 1 July 2003). At the same time, most of the foreign assistance disbursed in the recent past had been in the form of loans implying the possibility of a growth in DSL in the near future.

1.6.5 Balance of Payments

As both export and remittance sectors demonstrated good performance in the face of rising imports, the current account balance remained positive during the FY2004. Although the deficit in the balance of trade in goods increased from (-) US$2,215.0 million to (-) US$2,369.0 million in view of the rise in the import bill, net current transfers rose by US$287.0 million (from US$3,440.0 million to US$3,727.0 million), thanks mostly to the rising flow of remittance. The current account balance for the FY2004 was US$104.0 million, as against US$176.0 million for the previous year. The overall balance during the FY2004 stood at US$171.0 million, which is about 4.7 times lower than US$815.0 million for the previous fiscal year (Table 1.26).

TABLE 1.26

Balance of Payments, FY2003-FY2004

(in million US$)

Particulars	FY2004	FY2003
Trade balance	-2369.0	-2215.0
Exports f.o.b (including EPZ)[a]	7521.0	6492.0
Imports f.o.b (including EPZ)	-9890.0	-8707.0
Services	-880.0	-691.0
Receipts	924.0	887.0
Payments	-1804.0	-1578.0
Income	-374.0	-358.0
Receipts	63.0	64.0
Payments	-437.0	-422.0
Of which: Official interest payment	-175.0	-167.0
Current transfers	3727.0	3440.0
Official	45.0	82.0
Private	3682.0	3358.0

(Contd.)

(Contd. of Table1.26)

Particulars	FY2004	FY2003
Of which: Workers' remittances	3372.0	3062.0
Current account balance	104.0	176.0
Capital account	278.0	428.0
Capital transfers	278.0	428.0
Financial account	75.0	413.0
i) Foreign direct investment	385.0	376.0
ii) Portfolio investment	6.0	2.0
iii) Other investment	-316.0	35.0
MLT loans[b]	543.0	918.0
MLT amortisation payments	-397.0	-452.0
Other long-term loans (net)	-41.0	-20.0
Other short-term loans (net)	13.0	142.0
Other assets	-125.0	-125.0
Trade credit (net)	-323.0	-499.0
Commercial Bank	14.0	71.0
Assets	86.0	217.0
Liabilities	-72.0	-146.0
Errors and omissions	-286.0	-202.0
Overall balance	171.0	815.0
Reserve assets	-171.0	-815.0
Bangladesh Bank	-171.0	-815.0
Assets	-235.0	-887.0
Liabilities	64.0	72.0

Notes: [a]Excludes local sales reported by EPB. Some adjustments necessitated by BoP considerations have been made. [b]Excluding supplier's credit, reclassified as trade credit below.

Source: CPD (2004) and Bangladesh Bank (2004a).

As was mentioned, it needs to be kept in mind that L/C opening during the FY2004 was as high as 21.4 per cent, alluding to a possible pressure in terms of import payments in the coming months. Under the circumstances, a watchful eye will need to be kept on the behaviour of export earnings and remittance flows in the coming months, as this will have important implications for sustaining the growth in the reserve observed in the recent past. This surveillance will be all the more necessary and judicious in view of the impending shock from the total phase out of the MFA.

1.6.6 Foreign Exchange Reserve

Foreign exchange reserve at the end of June 2004 stood at US$2,705.0 million compared to the corresponding reference point of the previous year when it was US$2,469.6 million (Figure 1.8). This shows a rise of US$235.5 million or 9.5 per cent. It is to be noted that the current foreign exchange reserve is equivalent to three months of exports. Although the current foreign exchange reserve is yet to reach the level of US$3.6 billion attained in 1995, it reflects the continuing rebound in the reserve situation experienced in recent years.

The current level of foreign exchange reserve, somewhat beefed up by foreign loans, provides a cushion for the growing demand for imports. However, in case there is a pressure on the foreign exchange reserve situation, the government may once again have to resort to monetary policy instruments to restrain the growth in imports.

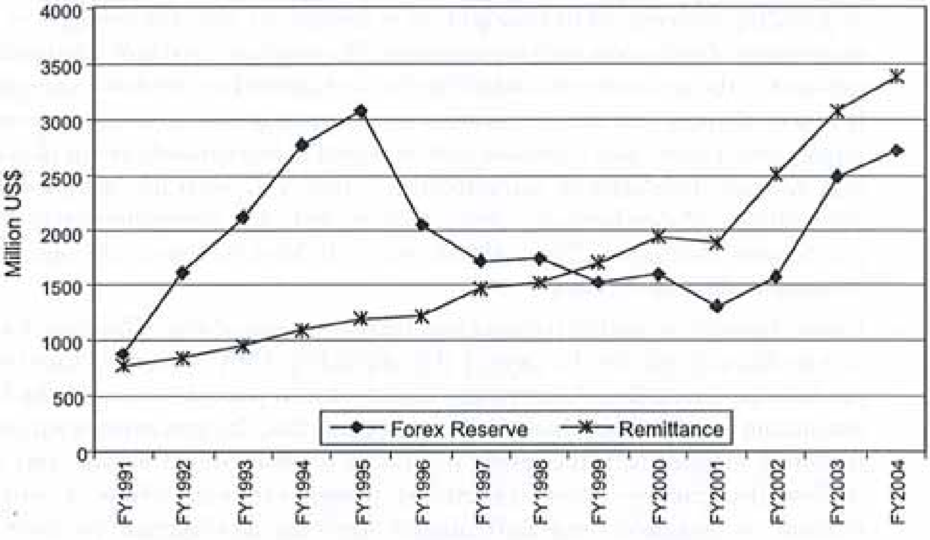

Figure 1.8: Foreign Exchange Reserve during FY1991-FY2004

1.7 CONCLUDING REMARKS

It is evident from the foregoing review that most of the key variables influencing macroeconomic performance in FY2004 did start off on a relatively strong footing. The variables were strengthened further during the second quarter of FY2004 (October-December). However, some mixed signals were visible as the economy entered into the third and forth quarter of FY2004 (January-June). The mixed signals transmitted during the beginning of the fiscal year persisted. However, the initial promises in terms of the macroeconomic performance evidenced in the first half of the current fiscal year did become somewhat less robust in the second half.

Major distinguishing features of FY2004 had been stability in export growth recovery, buoyancy in remittance flows and the steady state in agriculture production. Positive movements have also taken place in the case of import growth, industrial loans and agricultural credit disbursement. However, these reassuring trends are somewhat moderated by the marginal growth in the manufacturing sector, low level of FDI inflow, transitory bubbles in the capital market, and last but not the least, the perceptible price hike of essential commodities.

One observes that the fiscal balance remains sound mainly by default (largely due to low ADP implementation), and the BoP situation may be exposed to some pressure because of the increasing trade gap and the expected pressure of import payments in the coming months.

The four critical factors for successful implementation of the national budget for FY2004 mentioned in CPD's June 2003 budget review (Bhattacharya, 2003b) may be revisited in this connection.

(i) Delivery of ADP still remains the most vulnerable aspect of this year's economic programme from the point of view of both quantity and quality. Implementation of the ADP, underpinned by slow off-take of foreign aid, has now emerged as the major issue of macroeconomic management. No systematic attempt was made to implement the recommendations of the Public Expenditure Review Committee. It is now obvious that the acceleration in economic growth to a higher level is largely contingent upon enhanced and improved public expenditure in physical and human development infrastructure. This will warrant not just the streamlining of development administration, but also strengthening of local government institutions. These issues need to be kept in focus in the upcoming national budget for FY2004.

(ii) Export recovery is getting stronger and there are signs of diversification in new non-traditional exports. In view of the impending MFA phase-out, this trend needs to be strengthened. Given the likelihood of a possible shock on the BoP emanating from the apprehended export deceleration, the government will need to closely monitor both the inflow (including remittance and foreign aid) and outflow (particularly import growth) of foreign exchange. While it will be prudent to negotiate some BoP support from the development partners on account of the MFA phase-out, one should not exclude the need for import control, if the situation calls for such a step. The possibility of strong pressure on the national currency should also not be overruled altogether.

(iii) Private investment in the manufacturing sector has gathered steam, particularly in the backward linkage industries of the RMG (i.e. yarn and fabric production). Other import-competing and potential export-oriented industries, such as pharmaceuticals, are showing sustained growth. However, one can observe from the BoI data that the rate of registration of FDI has slowed down since January 2004. BoP data also corroborate this trend. The expansion in investment that we observe relates largely to the existing enterprises coupled with "old" entrepreneurs investing in "new" businesses. Assessment as regards the state of small enterprises remains unclear because of paucity of reliable data.

(iv) A successful supportive monetary and fiscal policy has generated an enhanced inflow of investible surplus into the market, although the real outcome of the campaign for interest rate reduction remains suspect. An upward trend in the price index, which was visible in the recent past, has been temporarily halted. With the emerging pressure on the BoP, the floating exchange rate regime will have to effectively adjust the exchange rate of taka, and some intervention in the market may become necessary.

Thus, it appears from our updated review that, other than the ADP and inflation, almost all other major target indicators of the Mid-Term Macroeconomic Framework of the I-PRSP will be achieved. Accordingly, the economy is poised for a growth of 5.5 per cent or more in FY2004. However, it is well known that a 5.5 per cent growth will result in a little above 3.5 per cent per capita income growth, which, although impressive in the global context, may not be good enough for alleviating the situation of more than 40.0 per cent of the population living below the poverty line. This is important particularly in the context of the aggravating income disparity in the country.

Box 1.14: Increasing Disparity and Marginalisation of Middle Class

Bangladesh has been experiencing a modest, but stable 5.0+ per cent GDP growth rate in the recent past. However, the deteriorating distribution of income suggests that some of the citizens are disproportionately benefiting from the incremental income generated in the economy.

The Household Income Expenditure Survey 2000 (HIES 2000) reveals that income accruing to top 5.0 per cent of the households is about 46 times larger than that of poorest 5.0 per cent of the households. The comparable multiple in 1995/96 was 27 times.

On a broader scale, concentration of income in the hands of the top 20.0 per cent of households increased from 50.1 per cent in 1995/96 to 55.0 per cent in 2002. Conversely, the share of income accruing to the bottom 20.0 per cent of households during the same period decreased from 5.7 per cent to less than 5.0 per cent.

As a consequence of the above trends, the Gini-coefficient deteriorated from 0.432 in 1995/96 to 0.472 in 2000.

Income disparity is more pronounced in rural areas compared to the urban areas.

The growing concentration of financial wealth in Bangladesh is also revealed by the fact that the top one per cent of account holders in the banking sector control about three-quarter of the banking assets. On the other hand, only 13.5 per cent of the assets in the banking sector accrue to the bottom 95.0 per cent.

Curiously, in this process of income differentiation, the middle class (defined as the middle 20.0 per cent of the households) is becoming marginalised. In 1995/96, this group controlled about 14.0 per cent of the national income; in contrast, in 2000 this share has fallen to 12.5 per cent.

Thus, the major economic challenges for FY2005 would be: (a) Pushing GDP growth beyond 6.0 per cent; (b) Ensuring a more equitable distribution of incremental GDP; (c) Lifting private investment share beyond 20.0 per cent of GDP within a couple of years; (d) Improving domestic savings rate to 20.0 per cent; (e) Keeping inflation under control; and (f) Maintaining exchange rate stability.

Regarding the macroeconomic balances, one needs to also emphasise the relatively lack-lustre performance in revenue mobilisation. It is not only that the non-tax and non-NBR tax components remain underachieved, but also there has been no significant improvement in the collection of income tax vis-à-vis VAT (local) expansion. Thus, an effective increase in income tax collection continues to be a major challenge. On sectoral prioritisation of development expenditure, while the emphasis on education and health is necessary, there is also the emerging necessity to pay attention to power generation on an urgent basis. Lack of dependable power supply is emerging as the major impediment to investment, particularly for small enterprises. Among the indirect sources of revenue, the price of energy, particularly of petroleum products, will be a major issue in the backdrop of the global rise in oil prices. Given the political costs involved in pushing up prices, the government will be well advised to reduce the taxes on petroleum products. There is also an urgent need to monitor the rising trend in global price of rice, and in anticipation of this, the domestic food stock.

Box 1.15: Petroleum: Increasing Retail Price or Duty Adjustment?

Bangladesh Petroleum Corporation (BPC) is the single largest source of government tax earnings, as petroleum is also the single largest imported item in Bangladesh. Through multiple taxation that includes import tariffs, supplementary duty, VAT, development surcharges, advanced income tax, etc. the BPC is paying around 13.0 per cent of the total budgetary tax revenues annually. This profit-making institution began to incur huge losses since the mid-1990s due to an upward trend of petroleum prices in the international market. However, it continued to enrich the revenue budget with an average Tk 2,500.0 crore tax payment each year. Even with a net loss of Tk 1,162.0 crore in FY2000 and Tk 1,311.0 crore in FY2001, it paid around Tk 2,854.0 crore and Tk 3,032.0 crore respectively to the national exchequer over these years.

Tax is charged on the imported price of petroleum on an incremental basis. According to the latest government gazette, a 30.0 per cent customs duty is charged on imported petroleum. Additionally, a 15.0 per cent (25.0 per cent for jet oil) supplementary duty is charged on the customs duty added price and another 15.0 per cent VAT is charged on the supplementary duty added price. A 4.0 per cent infrastructure development surcharge and 3.0 per cent advanced income tax is charged before the price is adjusted within the BPC handling and service charges. In FY2003, the BPC contributed Tk 2,766.0 crore tax, of which customs duty, VAT, development surcharge and income tax accounted for 59.0 per cent, 32.0 per cent, 5.0 per cent and 4.0 per cent respectively.

The international price of petroleum has been going up steadily during the last couple of months. Under such circumstances, possible actions that could be taken to eliminate the losses that BPC is currently facing are:

- increasing the retail price of petroleum products;
- liberalising the sector to allow competitive private participation; and
- reconstructing the petroleum sector taxation structure (if possible through a duty cut).

Increasing retail prices would be irrational at this moment as it would affect the overall inflation rate, which is already quite high. Besides, increasing the diesel price may have a severe effect on the agricultural production process. Liberalising the sector would again involve various policy measures and reforms, which may be part of a long-term strategy.

Thus, adjusting the import duty would be a better option for the government at this moment. From 1 May 2004, the price of kerosene has been adjusted with the diesel price, which would supplement some of the losses that the government might face if the duty structure is not fine-tuned. The latest statistics show that the price of oil in the international market has stabilised, which may encourage the government not to raise the petroleum price in the upcoming budget.

As the regime moves on to "last lap," when the budget for the next fiscal year is to be presented to the nation, the first signs of the oft-seen mid-term inertia are already visible. In all probability, nothing short of a *big-push* will enable the economy to attain the sort of growth rates that has the capacity to address the major challenges, such as poverty alleviation and reduction of income inequality growth. So, what is it that's holding back the country from a big push? Successive surveys, carried out by CPD (and other institutions such as the World Bank-BEI and the Japanese Commerce and Industry Association in Dhaka) to assess the business environment, have revealed that it is the non-economic factors relating to governance, viz. high corruption, and the weak law and order situation, which are creating serious disincentives for investment. Entrepreneurs no longer complain so much about unpredictability of policy; rather they are putting increasing emphasis on the need to raise the efficacy of the public institutions. These are the factors, which can largely explain the mismatch between the strong macroeconomic fundamentals of Bangladesh and lack of confidence on the part of the investors.

Box 1.16: Independent Commission on National Statistics

To Improve Understanding of Macroeconomy and Raise the Quality of Policy Making, set up an *Independent Commission on National Statistics* to undertake the following tasks:

- Make available Real Time Data
- Ensure better coordination among related government agencies
- Strengthen the methodology of data collection and relevant institutional capacity
- Reconcile various indicators and variables
- Enable users to have better access to information and data

Admittedly, the trigger to alleviating such a situation lies more within the domain of politics rather than economics. Will the underlying political economy of Bangladesh continue to undermine its development potentials and arrest its development prospects, which will inevitably result in perpetuation of poverty and inequality? The final outcomes of Bangladesh's economic performance in FY2004 may partly provide some answers to these questions. As the last quarter of the fiscal year tends to play an important role in ensuring economic growth in Bangladesh, it is now to be observed to what extent the emerging political scenario is going to influence that opportunity in FY2004, with consequent impact for the period and far beyond.

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Chapter 2

PERSPECTIVE ON BANGLADESH DEVELOPMENT FORUM 2004

2.1 INTRODUCTION

Bangladesh Development Forums (BDFs) have traditionally been seen as important events from the perspective of mobilising resources for the purpose of Bangladesh's economic development. The focus and objectives of the BDF, however, have changed over the years.

In recent years, the BDF has moved away from being a venue where financial pledges were made and transformed into government-donor summit where Bangladesh's development priorities and future strategic directions are tabled for discussion. The BDF meeting was held in Dhaka for the first time in 1973. Followed by a long lull it was held in Dhaka once again in 1997 and then in 2003. Formerly known as the *Paris Consortium Meeting*, the BDF has in recent times developed a tradition of meeting in Dhaka with the ostensible intention of bringing the discussion "where the action is." However, even when the BDFs have been held in Bangladesh, these are criticised as being "closed-door meetings" that do not allow civil society participation, either in the setting of the agenda, or in the discussion. The focus of the paper is to (a) contextualise BDF 2004, with a review of its background and the agenda laid down on the table; (b) review and analyse the evolving aid scenario, changing structure of aid and donor-recipient relationship in the context of Bangladesh; and (c) highlight some of the important emerging issues, which need immediate attention of both Bangladesh's policymakers and development partners.

However, the purpose of the present paper is not to assess the micro-level impact of foreign aid in Bangladesh (some of the relevant issues in this respect have been addressed in IRBD 2003). Rather, the intention is to analyse the dynamics of Bangladesh's aid situation, relate this to BDF2004, comment on some of the agendas, which would be discussed at the BDF and highlight some of the issues that are perceived to be important.

2.2 BDF 2004 AND CIVIL SOCIETY'S DILEMMA

2.2.1 Background of BDF 2004

The Government of Bangladesh and development partners from 32 countries and multilateral agencies, scheduled to meet at the BDF 2004, are to discuss seven key themes: (1) policies and programmes to deliver the PRSP; (2) promoting good governance; (3) enhancing partnership between government and NGOs; (4) improving human development outcomes; (5) improving trade and investment climates; (6) promoting infrastructure to support growth and development; and (7) aid governance and implementation of development programme. Each of these themes is to be discussed in separate working sessions. A look at the proposed themes indicates that the agendas of the BDF 2004 would concentrate on issues associated with good governance as a means of raising the efficacy of aid.

Bangladesh Development Forum 2004 is taking place at a time when the socio-economic and political scenario evinces mixed signals. The meeting is being held at a time when the country, after a long hiatus, is under the IMF programme, the PRSP process is attaining maturity and there is now an opportunity to review Interim-PRSP implementation. Though Bangladesh's macroeconomic fundamentals continue to remain relatively strong, donors' restive mood about reforms would likely, be a key factor at the forum. The government has passed its halfway mark. One gets an idea that it is trying to take stock of what has been accomplished and what remains to be done in the next two years. The "last lap syndrome" usually tends to constrain government's activism and go slow on reform initiatives; "mid-term inertia" that tends to inform second half of elected regimes. One can feel the government's temptation to go for expansionary measures keeping in mind the upcoming election. Besides, the forum is taking place at a time when the political acrimony and agitation has also intensified.

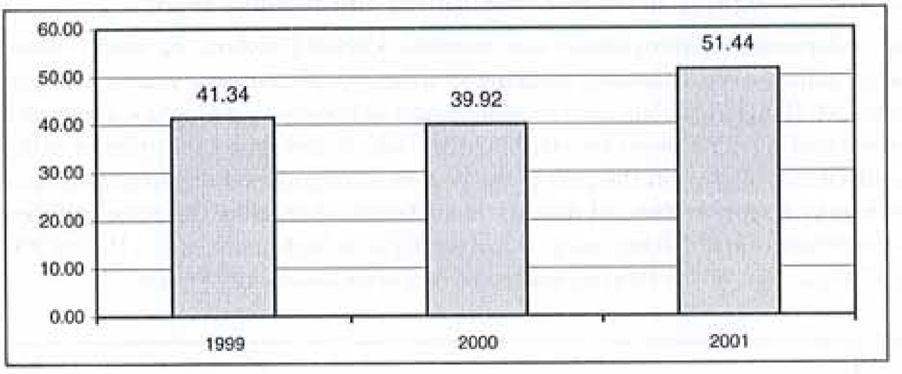
2.2.2 Dilemma of the Civil Society

The Bangladesh civil society is in a dilemma as regards its approach to foreign aid. The civil society believes in articulating a domestically-owned development agenda evolved through a participatory process. Consequently, in Bangladesh, civil society has strong reservations regarding the hands-on policy stance of the donors manifest through the various aid conditionalities. On the other hand, a number of issues raised by the donors in their interaction with the government are of high interest and concern to the country's civil society. The citizens of the country have articulated many of these concerns on several occasions. A number of the "prior actions" articulated by the donors had long been the pivotal demands of the civil society as well.

However, the citizens of the country feel disempowered to observe that the government, instead of being responsive to its citizens' concerns, is more responsive to demands when the donors articulate the same. The dilemma of the civil society is that as it takes a critical view of the BDF, there is a danger that when the issues are flagged by the BDF, these will be seen to lack support, and as a result, will get undermined.

2.3 GLOBAL AID SCENARIO AND BANGLADESH

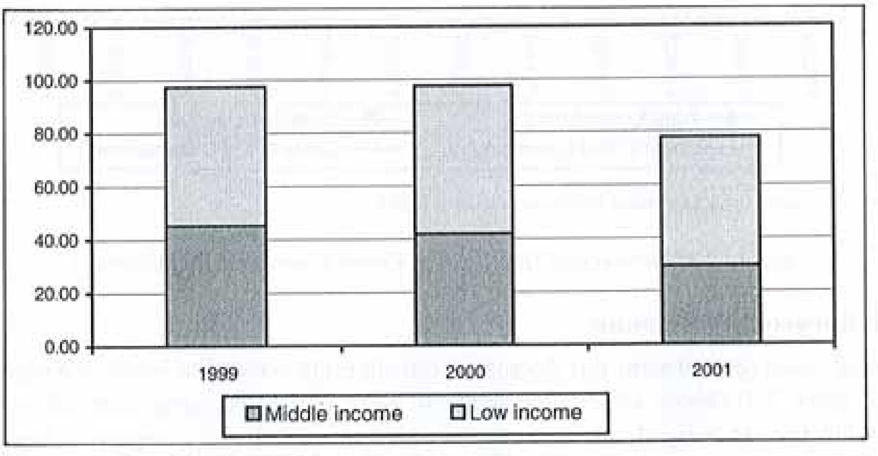
An analysis of aid to Bangladesh in the context of the global aid scenario, and the demands articulated at some of the recent global initiatives, shows the flow of aid resources has only increased marginally in the run up to the *Monterrey meeting* where the Monterrey Consensus was reached. Global Official Development Assistance (ODA), at US$41.3 billion in 1999, fell 3.4 per cent in 2000 to reach US$39.9 billion; however, it has registered a significant increase in recent years to reach US$51.4 billion in 2001 (Figure 2.1).



Source: Computed from UNDP (2003).

Figure 2.1: Trend in Flow of Global ODA

However, at the same time, the share of low-income countries in ODA has come down in recent years. In FY1999, their share in total ODA disbursement was 52.0 per cent, in FY2000 the share of low-income countries went up to 55.7 per cent but then declined again to 48.3 per cent in FY2001. Middle-income countries experienced a more dramatic decrease in their share, enjoying a share of 45.2 per cent in FY1999, which came down to 29.5 per cent in 2001 (Figure 2.2).



Source: Computed from UNDP (2003).

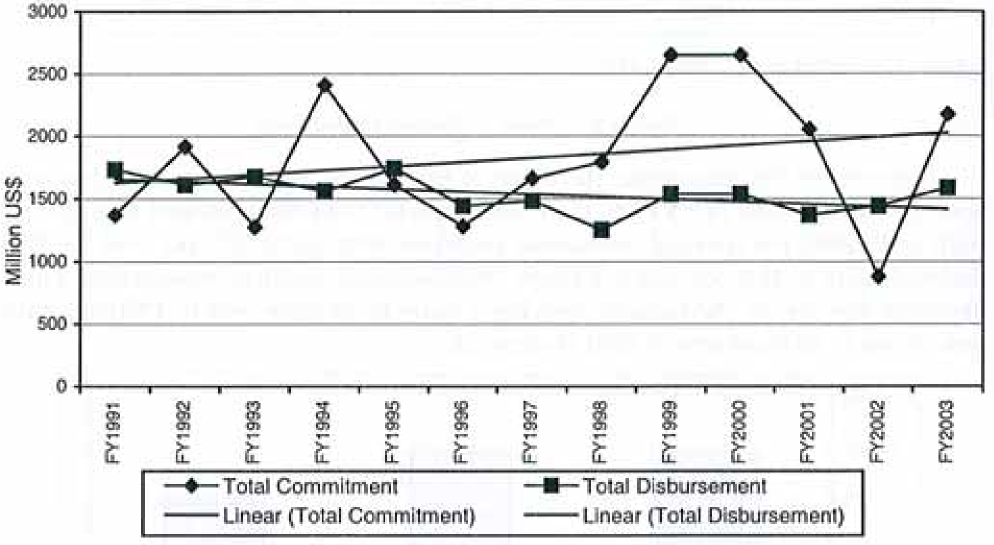
Figure 2.2: Share in Total ODA Disbursment

Although Bangladesh is considered as a highly aid dependent country, it is interesting to note that in terms of volume of aid received, Bangladesh's position is 11th among the 134 countries. Countries such as Pakistan, India and Indonesia are far ahead of Bangladesh as aid recipients. Moreover, in terms of per capita foreign aid, Bangladesh's position is 86th among the 134 aid recipient countries.

2.4 AID IN BANGLADESH: SOME STYLISED FACTS

2.4.1 Increasing Gap between Commitment and Disbursement

Since independence, Bangladesh has received US$49.1 billion, of which more than US$40.7 billion were disbursed, marking an average disbursement rate of 83.0 per cent. As a result, Bangladesh has been experiencing a ballooning aid pipeline in recent years. This inflated pipeline could be attributed to lack of domestic capacities to utilise the committed aid, apathy on the part of the donors as regards aid disbursement or lack of government response. The aid disbursement trends show that the mismatch between the commitment and disbursement is increasing on a continuous basis. During FY2003, only 73.0 per cent of the total commitment had been disbursed (Figure 2.3).



Source: Computed from Economic Relations Division (2002).

Figure 2.3: Incremental Gap between Commitment and Disbursement

2.4.2 Burgeoning Pipeline

Although total commitment has fluctuated considerably across the years, the regression line (Figure 2.3) shows aid commitments to have registered some increase over the years. On the other hand, the linear total disbursement shows a negative slope. With commitments increasing and disbursement falling, the pipeline gets bloated. The question is what are the driving factors behind this burgeoning pipeline?

It appears that project aid has played a significant role in this context. The share of project aid in total aid has been on the rise over the recent past. While the share of project aid was 42.0 per cent of total aid in FY1973, it almost doubled (82.0 per cent) over the next eight years (by FY1981). This situation was further strengthened in subsequent years: in FY1991 and FY2001 the share of project aid was 88.0 per cent and 98.0 per cent of total aid respectively. The total aid pipeline today stands at more than US$6.2 billion; of this 96 per cent was on account of project aid. It should also be noted that linear growth of project aid compared to total aid also corroborates this trend. Project aid in the pipeline was US$2.0 billion in FY1981, it has gone up to US$5.9 billion in FY2004. Total aid in the pipeline was US$2.4 billion in FY1981 and US$6.2 billion in FY2004 (Table 2.1). Since FY1981, project aid has played a cardinal role in replenishing the aid pipeline. Consequently, it should be recognised that a concerted effort must be made to fully utilise project aid commitments.

TABLE 2.1

Opening Pipeline of ODA in Bangladesh

(in billion US$)

	FY1973	FY1981	FY1991	FY2001	FY2004
Total Aid	0.3	2.4	5.9	5.7	6.2
Project Aid	0.1	2.0	5.2	5.6	5.9
Project aid as % of total aid	42.0	82.0	88.0	98.0	96.0

Source: Computed from Economic Relations Division (2002) and CPD (2004).

2.4.3 Rising Loan and Declining Grant Components

A decomposition of aid also shows a significant shift in donors' emphasis from grants to loans in the aid package. While the share of grant was 91.0 per cent in total ODA in FY1972, the share decreased significantly to 52.0 per cent in FY1981. The decreasing trend has continued over the subsequent years. In FY1991 and FY2001, the corresponding shares were 48.0 per cent and 37.0 per cent respectively. The scenario turned more serious in FY2003 when the share of grant nose-dived to only 21.0 per cent of total ODA (Table 2.2). Even when it is a *soft loan*, the donors prefer loans to grants, as a loan component is perceived to ensure an efficient use of the resource and also import responsibility to the recipients.

TABLE 2.2

Share of Grant in Total ODA

	FY1972	FY1981	FY1991	FY2001	FY2003
Grant as per cent of Total ODA	91.0	52.0	48.0	37.0	21.0

Source: Computed from Economic Relations Division (2002) and CPD (2004).

2.4.4 Increasing Project Aid, Vanishing Commodity and Food Aid

The compositional changes of project, commodity and food aid to Bangladesh have undergone substantive changes over the past years. After independence, the share of commodity aid was the highest in the total aid flow to Bangladesh. In FY1972, 52.0 per cent of the total aid came in the form of commodity aid, followed by food aid at 48.0 per cent (Table 2.3). In a single decade the entire scenario has changed dramatically. In FY1981, the share of project aid was 49.0 per cent of the total ODA while it was just 1.0 per cent of total ODA in FY1972 (although the year 1972 may not be an appropriate comparator). The share of commodity aid in total ODA declined from 24.0 per cent in FY1991 to about 11.0 per cent in FY2003, since the balance of payment support at present is not as important as it was in the 1980s. The share of food aid has also declined from 15.0 per cent in FY1991 to only 3.0 per cent in FY2003, as Bangladesh moved towards food sufficiency. In this turn, the share of project aid reached 86.0 per cent in FY2003 from 61 per cent in FY1991.

TABLE 2.3

Composition of Aid (Project, Commodity and Food)

	FY1972	FY1981	FY9191	FY2001	FY2003
Project Aid (% of ODA)	1.0	49.0	61.0	83.0	86.0
Commodity Aid (% of ODA)	51.0	34.0	24.0	13.0	11.0
Food Aid (% of ODA)	48.0	17.0	15.0	4.0	3.0

Source: Computed from Economic Relations Division (2002) and CPD (2004).

2.4.5 Sources of ODA: Shift from Multilateral to Bilateral

With respect to sources, bilateral aid flow to Bangladesh has always been relatively more dominant compared to multilateral aid, barring the exception of the 1990s. In FY1972, about 86 per cent of total aid came from bilateral sources, although it has declined to 72.0 per cent by FY1981. The scenario changed over the subsequent years and in FY1991 its share came down to a meagre 39.0 per cent of total aid. In recent times, however, bilateral aid has become more predominant compared to multilateral aid. The share of bilateral aid in total ODA has increased to 51.0 per cent in FY2003, while the share of multilateral aid declined from 61.0 per cent in FY1991 to 49.0 per cent in FY2003 (Table 2.4).

TABLE 2.4

Sources of Aid as % of Total ODA

	FY1972	FY1981	FY1991	FY2001	FY2003
Bilateral Aid	86.0	72.0	39.0	51.0	51.0
Multilateral Aid	14.0	28.0	61.0	49.0	49.0

Source: Computed from Economic Relation Division (2002) and CPD (2004).

2.4.6 Debt Situation

The foreign debt situation in Bangladesh can now deemed to be "under control." Indeed, the debt situation compares quite favourably with other countries. Total Debt Service Liability (DSL) as a percentage of total foreign earnings[1] was 4.2 per cent in FY1974, and increased to 6.3 per cent in FY1981. The scenario deteriorated over the next few years. In FY1991, DSL as per cent of total foreign earnings has increased to 11.0 per cent. However, the situation started to improve thereon and the corresponding shares were 6.5 per cent and 6.0 per cent in FY1991 and FY1993 respectively. At present, outstanding foreign debt as per cent of GDP gives reasons for comfort. In FY1974, DSL accounted for only

[1] Total foreign earnings comprise the total export, remittances and invisible earnings.

3.4 per cent, which is understandable. However, within a short period, it has increased to 22.0 per cent in FY1981, and galloped further to 41.0 per cent in FY1991. But it again came down to 32.0 per cent in FY2003. Per capita debt remained more or less stable over the period, although it was very low just after the country's independence, registering at only US$4.0. At present, it stands at US$125.0, which essentially means that currently every newborn child in Bangladesh has a Tk 7,600.0 worth of foreign debt on his/her head (Table 2.5).

TABLE 2.5

Foreign Debt Situation

	FY1974	FY1981	FY1991	FY2001	FY2003
DSL as % Total Foreign Earnings	4.2	6.3	11.0	6.5	6.0
Outstanding Foreign Debt as % of GDP	3.4	22.0	41.0	32.0	32.0
Per Capita Foreign Debt (US$)	4.0	49.0	114.0	116.0	125.0

Source: Computed from Bangladesh Bureau of Statistics (2000) and CPD (2004).

Box 2.1: Foreign Aid and Macroeconomic Performance: Some Theoretical Arguments

A significant number of literature exist that try to decipher empirically the relationship and impact of foreign aid on various macroeconomic indicators of the aid recipient countries. Research suggests that there is a significant relationship between foreign aid and domestic savings, revenue earnings, domestic consumption and national income. Examination of these aid relationships can be important instruments to understand the role of foreign aid in Bangladesh economy.

Several studies have established a negative relationship between domestic savings and foreign aid in Bangladesh. Sobhan and Islam (1988) found a negative coefficient of foreign aid and domestic savings using a multiple regression that also included GDP as a determining factor. The study followed similar findings of an earlier research done by Rahman and Rahman (1982). In the recent past, Razzaque and Ahmed (2000), using co-integration and error-correction modelling strategies to tackle the problem of non-stationary data, found that the "negative relationship between savings and aid is quite *robust*." Though in the early 1970s a study undertook by Alamgir and Rahman (1974) found a positive relationship between savings and foreign *capital* inflow using data from the pre-liberation period, subsequent studies have found a significant negative relationship between the two, both from long and short term perspectives.

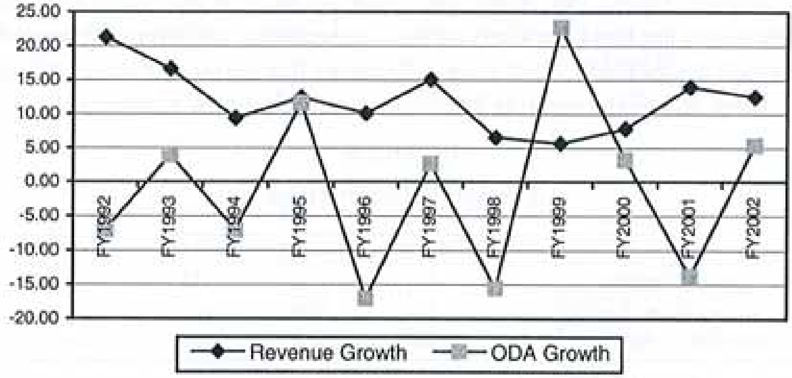
Several studies have found that foreign capital may in fact substitute for domestic savings. By making resource relatively easily available, external flows allowed for a relaxation in saving efforts by the governments and encouraged an increase in consumption. Consequently, external flows may particularly impede public savings, and also private savings (Ahmed and Ahmed, 2002). Griffin (1970) termed this relationship as the "fungibility of aid."

The Independent Review of Bangladesh's Development (IRBD) 2001 observed that the size of the government in Bangladesh is putting an increasing pressure on the annual revenue expenditure basket; government's Debt Servicing Liabilities (DSL) for foreign aid stood at around 4.0 per cent of total revenue expenditures (Bhattacharya, 2002). In this setting, an earlier volume of IRBD (1995) argued that if public expenditure is heavily concentrated on the recurrent expenditure, and as long as foreign aid is being used to finance a portion of the public expenditure budget, it is quite likely that it will not help the process of capital accumulation (Chowdhury, 1995).

It is also argued that the developing countries might voluntarily relax their effort towards domestic resource mobilisation when foreign aid is readily available (Rahman, 1970). Alternatively, as Razzaque and Ahmed (2000) suggest, relative scarcity of foreign aid results in improved domestic resource mobilisation efforts by the government. Figure 2.4 corroborates this notion showing a negative relationship between growth trends of revenue collection and foreign aid over the past 10 years (FY1992-FY2002).

(Contd.)

(Contd. of Box 2.1)



Source: Computed from Economic Relations Division (2002) and CPD (2004).

Figure 2.4: Growth Rates of Foreign Aid and Revenue Collection

A study undertaken by Gupta et al. (2003) at the IMF suggests that concessional loans are associated with higher domestic revenue mobilisation, while grants have the opposite effect. They also advocate that, on an average, the dampening effect of grants on the revenue effort is modest and indicate that foreign aid is non-linearly related to domestic revenue, and its impact is influenced by the level of corruption. In other words, results suggest that in countries plagued by high corruption, decline in revenues completely offset increase in grants (Gupta et al., 2003). However, Granger (1969) suggests that in the short run low savings might cause aid to rise. Since, in the long run, the availability of foreign aid to finance the budget deficit is unpredictable, it is suggested that in the long run domestic resource mobilisation is the more predictable option than foreign aid for development financing. Consequently, national economic policy should address the foreign aid scenario keeping in mind the multidimensional relationship of foreign aid with other macroeconomic indicators.

2.5 FOREIGN AID IN BANGLADESH: DIMINISHING ROLE BUT STRATEGICALLY RELEVANT

2.5.1 Diminishing Role of Foreign Aid

It becomes evident from the experience of the last three decades that the role of foreign aid in the development process is gradually diminishing. Interestingly, the per capita ODA availability also supports the declining role of foreign aid. In FY1973, ODA as percentage of GDP was 3.8 per cent and per capita ODA availability was just US$17.4. In about eight years, both these indicators have increased significantly, and reached 5.8 per cent and US$44.6 respectively in FY1981. The share of ODA in GDP and per capita availability of aid have fluctuated over the last decade. ODA as percentage of GDP has dropped to half, and declined from 5.6 per cent in FY1991 to 2.8 per cent in FY2003. On the other hand, the per capita ODA availability[2] declined from US$65.2 in FY1991 to US$57.2 in FY2003 (Table 2.6).

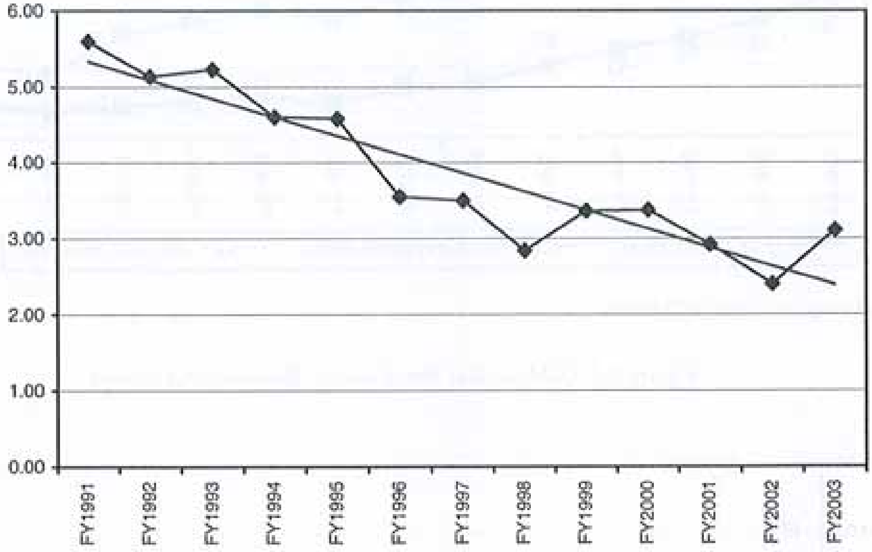
[2] Annual ODA Availability = (Opening Pipeline + Annual Commitment)+/- Transfer/Cancellation.

TABLE 2.6

Diminishing Share of ODA in GDP and Per Capita Availability

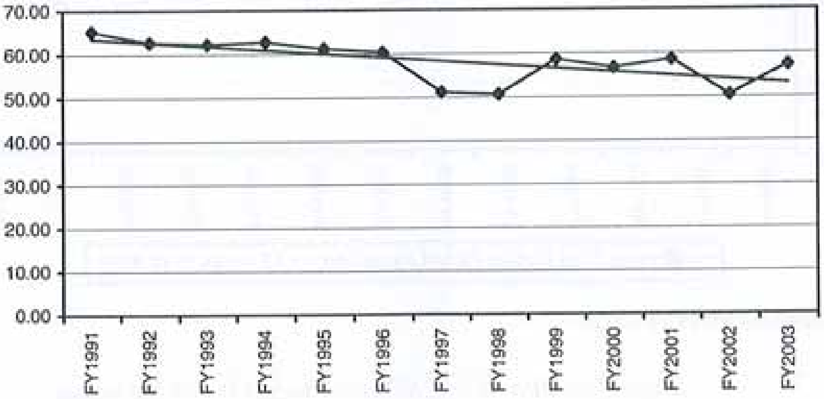
	FY1973	FY1981	FY1991	FY2001	FY2003
ODA as % of GDP	3.8	5.8	5.6	2.9	2.8
Per Capita ODA Availability (US$)	17.4	44.6	65.2	58.5	57.2

Source: Computed from Economic Relations Division (2002) and CPD (2004).



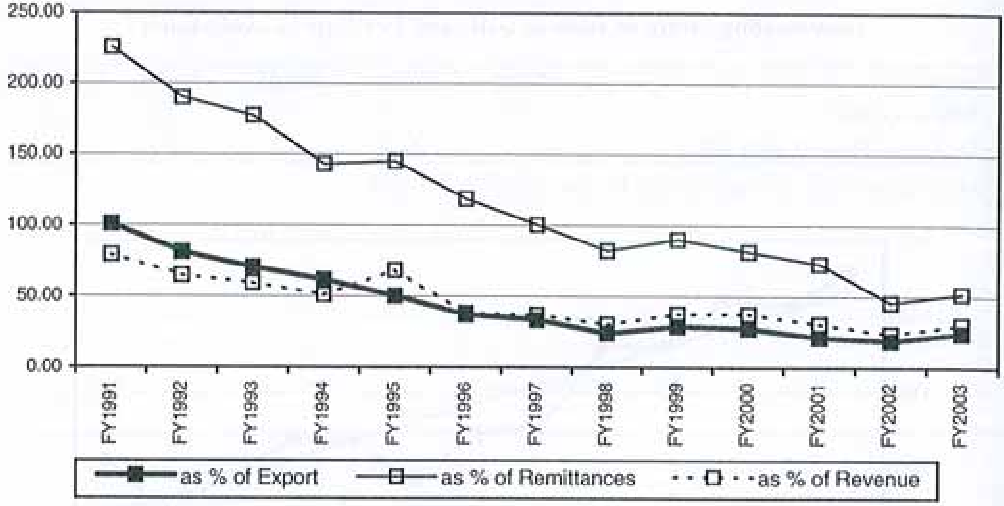
Source: Computed from CPD (2004).

Figure 2.5: ODA as % of GDP



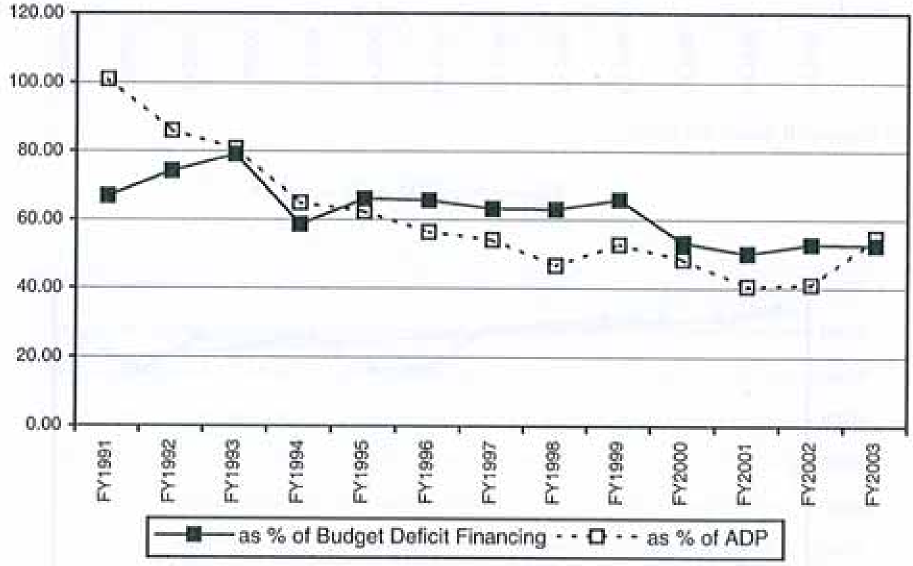
Source: Computed from CPD (2004).

Figure 2.6: Per Capita ODA Availability (US$)



Source: Computed from CPD (2004).

Figure 2.7: ODA as % of Remittances, Revenue and Export



Source: Computed from CPD (2004).

Figure 2.8: ODA as % of ADP and Budget Deficit Financing

Over the last two decades, the ODA's share has waned significantly from 5.8 per cent of GDP in FY1981 to 2.8 per cent in FY2003 (Figure 2.5). In FY2003, value of aid was about 24.2

per cent of Bangladesh's earnings from export and remittance. ODA as percentage of revenue receipt was only 26.8 per cent in FY2003. In contrast, the share was 106.2 per cent in FY1981.

It was pointed out earlier that during the 1980s, ADP was almost fully funded by foreign aid. At present, aid accounts for less than 50.0 per cent of ADP, which was only 42.0 per cent in FY2003. On the other hand, dependence on foreign aid for the financing of fiscal deficit emerging from the need for financing development activities had also come down to 52.5 per cent in FY2003 (Figure 2.8).

A cautionary note is perhaps warranted at this stage. While it is true that the role of ODA in Bangladesh economy is decreasing quite rapidly, it does not necessarily mean that there is no need for foreign aid in the economy. Indeed, there is a savings-investment gap in the economy, and part of this has to be bridged through financing from external resources, either through foreign aid, foreign direct investment, remittances or through a combination of all these.

2.5.2 Sectoral Intensity of Foreign Aid

Sectoral aid intensity shows significant change over time. With the drop in flow of aid, overall contribution of aid to various sectors has also decreased. However, aid has continued to play an important role in terms of financing of particular sectors. During the rule of the last two political regimes, transport sector remained the highest recipient of ODA, while health, population and family welfare sectors secured second position in terms of sector-wise weighted share (per cent) in aid dependence. Five sectors, namely, transport, health and population, education and religious affairs, rural development and power collectively account for three-fourths (73.3 per cent in FY2003) of the total project aid at present. A part of the related investments can be attributed to achieving the Millennium Development Goals (MDGs) in the Bangladesh context (Table 2.7). MDGs relate to such areas as eradicating extreme poverty and hunger, achieving universal primary education, improving maternal health, and combating diseases such as HIV and malaria. Consequently, the focus of foreign aid would be in health and population, education, and rural development.

TABLE 2.7

Sectoral Composition of Project Aid

Rank	Project Aid as % of Total Sectoral Allocation					
	2003		1997		1984	
1	Health, Population and Family Welfare	73.7	Water Resources	60.7	Population Control & Family Planning	78.5
2	Public Administration	73.5	Health, Population and Family Welfare	60.6	Scientific and Technological Research	72.6
3	Oil, Gas and Natural Resources	47.4	Transport	52.0	Natural Resources	70.8
4	Agriculture	46.1	Public Administration	45.6	Power	69.1
5	Mass Media	42.9	Oil, Gas and Natural Resources	45.2	Rural Development Institution, Div. Boards	62.4 62.4
For All Sector		38.8	For All Sector	43.3	For All Sector	51.1

Source: Computed from BBS (2001) and CPD (2004).

2.5.3 Strategic Importance of Foreign Aid

Foreign aid has been playing an increasingly important role in terms of financing of the non-government sector, and also the private sector. The grant support to the NGOs was US$250.0 million in FY2003. At the same time, either through equity participation, soft-term loans or through risk-underwriting, the private sector had received more than US$300.0 million during the FY1998-FY2002 period. Thus, in spite of foreign aid's declining role in the national economy, it continues to play a strategic role in Bangladesh's economy.

2.6 THE EMERGING CONCERNS

As was noted earlier, BDF 2004 was set to discuss a number of emerging themes, which relate to the interests and attention of Bangladesh civil society. Here a brief discussion is made of five areas that are perceived to be of high importance from the perspective of the Bangladesh civil society: (i) Macroeconomic; (ii) Meso/sectoral; (iii) Reforms; (iv) Governance; and (v) PRSP.

2.6.1 Macroeconomic Issues

The Bangladesh economy has started off on the right foot in the first quarter of FY2004; macroeconomic trends strengthened during the second quarter, and there are signs of investment pickup. However, it should be noted that although the macroeconomic fundamentals remain robust, a number of concerns nevertheless continue to persist. A major problem is the weak capacity for utilisation of foreign aid, which results in low level of ADP implementation. Besides, under-realisation of National Board of Revenue (NBR) targets coupled with under-achievement of non-NBR and non-tax targets may create a need to borrow more than what has been targeted to provide counterpart fund to implement the ADP to its fullest extent. Energy sector subsidies have gone up in the recent months. One important task would be to keep the revenue expenditures within the budgetary limit, streamlining "subsidies" to energy sector on account of rise in global price of petroleum products. On the other hand, if exports of goods and remittance fail to keep pace with the recent robust surge in import, there may be pressure on the Balance of Payments (BoP) situation. This fear is compounded by uncertainties emanating from impending phase-out of the Multi-Fibre Arrangement (MFA) with consequent negative impact on export of apparels, the country's major foreign exchange grosser.

2.6.2 Meso/Sectoral Issues

A major concern at the sectoral level involve the operationalisation of "Programme Approach" for aid financing of sectoral programmes, particularly in health and primary education sectors, and possibility for *Overall Budgetary Support*, in place of the "project approach." Apart from streamlining and strengthening of processing of projects and trade-related technical assistance for capacity building towards export diversification, trade negotiations will be a major concern in the subsequent months. Other sectoral concerns involve mobilisation of resources for expansion of health and education services and improving quality of the expenditures, developing investment and trade supportive physical infrastructure, including modernisation of port, power generation and natural gas supply, building roads and bridges.

2.6.3 Reforms

Banking sector reform is relatively the most advanced area of the reforms. However, the schedule for privatisation of banks appears to be unrealistic. The privatisation process, at this moment, remains somewhat paralysed with the Privatisation Commission having nothing much to do, given the recent government policy shifts. In the case of revenue mobilisation, the indirect tax, viz. VAT (local) is expanding; while income tax base is broadening, plugging of leakages has made slow progress. However, the income tax base is not increasing as fast as it should be in comparison with the expansion of VAT base; this is of particular concern since the expansion of indirect tax tends to be anti-equity. The quality of public expenditure is also a major concern and there is a need to act more dynamically on the recommendations of the Public Expenditure Review Commission (PERC). In this connection, a relevant quote from the Finance and Planning Minister of Bangladesh made in a recent meeting is worthy of mention. The minister said: "There are many projects, which seek funds double or even triple the actual cost. During the revision of a project, the cost multiplies progressively" (*The Daily Star*, 21 December 2003).

In the case of public administration reform, the incentive structure demands radical reform and manpower needs to be rationalised. In line with other reform initiatives, the recommendations of earlier Public Administration Reform Commission (PARC) also need to be implemented. In the case of local government, devolution of power to elected local bodies and strengthening of related institutions is a major concern, especially in the context of the frustrating experience with the *Gram Sarker*.

2.6.4 Governance

There should be more in-depth discussion on governance issues, such as the state of functioning of the legislative body, efficacy of the envisaged Anti-Corruption Commission, law and order and rights situation, separation of Judiciary from the Executive branch, government's relationship with the NGOs and phasing-in of Trade Union rights in the EPZs. There is a general agreement that non-economic factors are holding back economic growth, which is also often mentioned by the Finance and Planning Minister M Saifur Rahman. For example, in a recent Economic Relations Division (ERD) meeting he observed that, "macro-level stability is not the sole factor to attract investment. A good law and order situation and friendly environment are also essential for alluring investment. Because of lack of enabling environment, foreign direct investment is not coming as expected" (*The Financial Express*, 21st January 2004).

2.6.5 PRSP

PRSP is expected to receive critical attention in the upcoming BDF. However, there is still ambiguity on whether the PRSP is going to substitute the Five Year Plan or whether the country is having a plan holiday with the interface of the Mid-Term Planning Process. As the PRSP gets finalised, one waits to see how the preparation of sectoral targets and estimates of resource requirements are worked out, and how the various ministries are going to integrate the sectoral programmes in their own activities. Finally, the government should look into the resource envelope for PRSP. Whether this would be estimated through a top-down or a bottom-up method is also an important question to be answered by the donors at the BDF.

2.7 CONCLUSION

BDF in its incarnation is no more a pledging platform for the donors. However, its proceedings are likely to influence mid-term prospect of Bangladesh's aid availability. BDF 2004 may revisit the agreed policy measures to evolve a realistic timeframe for the reform measures, which is fully owned by the GoB. It will not be unrealistic to expect that the BDF 2004 should provide indications about donor's contribution to the resource envelope for the PRSP. It may consider donor support to underwrite a possible BoP problem, following the MFA phase-out on 31 December 2004. The BDF 2004 is only an event at a point in time. But the hard work on many of the issues flagged through government-development partners' dialogue, and those that concern the real interest of the country will have to be continued in all earnest by all the national actors and stakeholders concerned. If in this process of Bangladesh's march towards prosperity and development, the BDF forfeits its relevance, that will perhaps be the real test of success of donor-recipient collaboration in the context of Bangladesh. Achieving this will be the ultimate litmus test and a measure of the real efficacy of Bangladesh's partnership with its donors.

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Chapter 3

AN ANALYSIS OF THE NATIONAL BUDGET FOR FISCAL YEAR 2004-2005

3.1 INTRODUCTION

3.1.1 Pre-budget Concerns and Challenges

The National Budget for the fiscal year 2004-05 (FY2005) has been placed in the context of a mixed macroeconomic performance in the FY2004. The benchmark of FY2004, on which the Budget for FY2005 has been prepared, includes both positive developments and negative drawbacks.

Positive Developments in FY2004

One major positive development in FY2004 has been the attainment of the GDP growth target (5.5 per cent) which was earmarked by the macroeconomic framework of Interim-Poverty Reduction Strategy Paper (I-PRSP). There was already a low fiscal deficit planned for and then the actual realised fiscal deficit turned out to be lower than what was planned (though some may also argue that this was because of low spending requirements of the government). There was a pick up in both domestic and foreign private investments in FY2004. Most of the proxy indicators of investment have also reflected this positive trend in investment in FY2004. In addition, steady agricultural production and fresh movements in the capital market have supplemented this positive trend of the economy. The performance of external sectors also followed the trail of import resurgence, particularly after the collapse of the last year, which is also an indication of growing domestic demand. Continued export recovery after the 9/11 terrorist attacks in USA was also observed. The buoyant flow of remittances contributed to the improvement in foreign exchange reserve and no shock was observed in the exchange rate during the FY2004.

Disturbing Developments in FY2004

Some failures in macroeconomic performance somewhat diluted the achievements of FY2004. Under-achievement in revenue earnings, particularly in the non-NBR and non-tax components, continued failure in the utilisation of ADP and low off-take of foreign aid are among the major disturbing developments of FY2004. The stagnated savings-investment scenario has been worsened by the lowest public investment rate in the last 14 years and there has been no change in the domestic savings rate as well. The income disparity is growing in many fields, particularly tax incidence, resulting in inequitable outcomes. The privatisation process faced near-retardation during the previous fiscal year. The political acrimony and agitation has intensified during the third and fourth quarter of the FY2004.

Macroeconomic Challenges for FY2005

In this milieu, the major macroeconomic challenges for the FY2005 would be to push the 5.5 per cent GDP growth rate beyond 6.0 per cent while ensuring a more equitable distribution of incremental GDP. A mere growth in GDP does not automatically lead to poverty alleviation and does not necessarily improve the lot of the poor. Rather, we need a more equitable distribution of incremental income created by the GDP growth. Improving the savings-investment scenario by lifting the private investment share from 17.5 per cent to beyond 20.0 per cent of GDP and improving the domestic savings rate from 18.3 per cent to at least 20.0 per cent of GDP would be other key challenges for the FY2005. The government will have to keep the inflation under control (currently 6.0 per cent) and maintain a stable exchange rate. More importantly, the government will have to hold back the *last-lap syndrome*, where the conservative attitude of the government at the end of its tenure will prevent it from taking any crucial reform initiatives.

Key Concerns of FY2005

The key concerns in producing a budget for the FY2005 have been the implementation and improvement of the delivery mechanisms of development programmes. Greater off-take of foreign aid and improvement of foreign aid disbursement (particularly project aid) are major concerns for the development programmes since the financing and utilisation rate of ADP are tagged to those. So, a fuller delivery of the development programme would be a cardinal concern for the FY2005. Increase in agricultural subsidy has been a prime debate before the budget. However, CPD believes that the effective delivery of agricultural subsidy, which includes better targeting, better volume and better quality, should be the major concerns. Broadening of the effective income tax base is also a very crucial issue. The growth of the income tax should ensure that people who can afford to pay income tax should be paying more and should promote measures to identify them more effectively without harassment. The non-NBR and non-tax rates (e.g. railway, postage) also need to be raised and adjusted as the rates are outdated and the quality of services is poor. CPD also highlights the rationalisation of para-tariff regimes of the country. Along with the 15.0 per cent VAT, there is an infrastructure surcharge of 4.0 per cent, advance income tax of 3.0 per cent and also supplementary duties of varying degrees; all of these are coming as taxes on taxes. Thus, rationalisation of para-tariffs is an important agenda for the government as the global prices have been going up in the recent past and the quasi-fiscal deficit of the government is increasing because of the high government taxes; prices of petroleum products are another major headache for the government.

Other key concerns of FY2005 include providing a new pay scale to government and quasi-government employees and establishment of a Permanent Pay Commission; expansion of safety-net programme; introducing separate savings scheme for pensioners/small savers and other disadvantaged groups; ensuring greater flow of Initial Public Offerings (IPOs) to the capital market; and monitoring global price hike of rice as well as domestic food stock. Finally, the government's absorbing mechanism of the post-MFA shock with large retrenchment, while pre-empting any large devaluation, will also be tested. However, the government will have to deal with the emerging energy crisis too, as there is a severe shortfall (about a 500 megawatt) in electricity.

3.1.2 Initial Observations

- As the country enjoys a "planning holiday", the National Budget for fiscal year 2004-05 (FY2005) has been placed as an extension of the three year National Strategy for Economic Growth, Poverty Reduction and Social Development (NSGPRSD), better known as I-PRSP.
- This NSGPRSD has been presented as a "Three Year Rolling Plan." Should we produce such a plan every year for the following three years, or after every three years, are we going to have another three-year plan? Till 2015?
- The budget for FY2005 has been anchored in the Mid-Term Macroeconomic Framework (MTMF) of the I-PRSP. Clarity on the macro-parameters within which revenue generation and allocation are going to take place is helpful. However, at least on two occasions, possibility of revising the MTMF has been alluded to. The first is when scarce resource (domestic + foreign) falls short of project. The second is if resources are not properly utilised as per target and reforms are not implemented.
- The 15 principles for developing pro-poor strategies have been well articulated. But there is no mention about reduction of mal-governance (including corruption) or strengthening of local government, which are well known pro-poor policies. Apart from the promised new programme for the "hardcore poor", all other principles are traditional ones with a clear bias towards microcredit programmes.
- The thought of reforms being accomplished "at such speed we deem appropriate and according to our own design" is well taken. But, on the one hand, this proposition does not stand up to "reality check," as the country remains under IMF programme and continues to enjoy various structural adjustment credits from the World Bank. On the other hand, "incremental reforms" may basically foretell no major reforms in such areas as public administration, local government, public expenditure, privatisation and energy until the next general elections.
- The expression of sensitivity about the existing negative influence of the non-economic factors is well appreciated. The economy is appealing for a greater need to improve the law and order situation of the country. Establishment of good governance also has to be addressed adequately, moving beyond partisan rhetoric.

- The fiscal stance of the budget is an expansionary one. In the backdrop of recent shabby delivery of the development programmes and faltering revenue collection, the high-reaching targets lack credibility. It is particularly so because there is no well-thought-out delivery strategy, which takes note of the impediments to implementation of government programmes and policies.
- Overt attempts to please a diverse constituency with symbolic allocation are reminiscent of the fact that the national election is not far away.

3.1.3 Some Salient Features of the Budget Presentation in FY2005

There have been some significant changes in the presentation of the budget this year. The budget was logically cogent in terms of size – it was smaller and it had its explicit macroeconomic parameters mentioned. As the government had its Mid-Term Macroeconomic Framework (MTMF) of I-PRSP, it was easier for the government to make the budget more cogent in line with the I-PRSP outline. The budget was not crowded with number of donors' endorsements as it was observed in the previous years. It also recognised the role of non-economic factors in the economy in terms of corruption and decreasing the volatility of the law and order situation. It also avoided the usual blame game, which goes on between the government and the opposition party. This time, the artificial bifurcation of the budget between the development and non-development expenditures has been minimised and the government has published a separate book that pooled the development and non-development sectoral expenditures under a single cover. The budget summary was more transparent in terms of resources availability and their usage. Finally, the tariff changes have been skilfully made obscure in the Finance Bill. All the changes in tariffs and duties were not mentioned in the budget annex that helped the government escape any major reaction from the market.

3.2 PUBLIC FINANCE

3.2.1 Changes in Reporting System

One has to be careful about some of the changes, which have been brought about in the government documents reporting the budget figures. They have been done to make the information more consistent and transparent and this can be perceived as a constructive measure. Foreign grants have been grouped together with total revenue. As a part of the changes in the reporting of government expenditure, the capital expenditures from the revenue budget have been taken out and put under "Non-Development Capital Expenditure." There are also some separate items under non-development expenditures that include net outlay from account operation, loans and advances, structural adjustment and programmes financed from non-development budget. Also, the "Non-ADP FFW & Transfers" are to be included under development expenditures.

Attempts have been made to bring both non-development and development expenditures under one Demand for Grant. This is a welcome step towards unification of the budget.

3.2.2 Overview

In FY2005, total revenue earning is targeted to grow by about 16.7 per cent along with total public expenditure growth of about 16.0 per cent. Both are very far-reaching targets. The matching realised figures for FY2004 were 13.8 per cent and 12.4 per cent respectively. Bangladesh suffers from both low domestic revenue yield and low public investment. Thus, such "high income-high spending" budget is commensurate with the potential need of the country. But the government's record in this respect, particularly in the case of implementation of development programmes, makes these targets suspect.

Due to the lacklustre revenue mobilisation and ADP implementation in FY2004, the economy has failed to achieve the projected figures of the MTMF of the I-PRSP. For example, in FY2004, the revenue-GDP ratio was to be 10.9 per cent, the achieved rate (based on revised figure) was 10.6 per cent. In case of public expenditure-GDP ratio, the realised figure was 14.8 per cent against a target of 15.8 per cent. Incidentally, shortfall occurs in the case of both development and non-development expenditures. Full realisation of the budget figures of FY2005 will not allow us to achieve the I-PRSP targets for revenue and public expenditure. No wonder the budget speech refers to revision of the MTMF!

The fact that the overall expenditure growth has been kept below the revenue growth is well taken. The gross budget deficit in FY2005 is, by and large, to remain steady at (-) 4.3 per cent at the same level of FY2004. Understandably, the low fiscal deficit occurred by default.

3.2.3 Revenue Earnings

The government has experienced a major shortfall in its revenue earnings during the last fiscal year (FY2004). The total revenue earnings as percentage of GDP accounted for a (-)0.2 per cent shortfall when compared with the I-PRSP target. This was mainly due to the underachievement of tax components. The targeted figure for the FY2005 also shows a deficit from the I-PRSP targets (Table 3.1).

TABLE 3.1

I-PRSP and Performance of Revenue Earnings, FY2004-FY2005

Item as per cent of GDP	FY2004			FY2005		
	I-PRSP	Actual	Change %	I-PRSP	Budget	Change %
Total Revenue	10.8	10.6	-0.2	11.3	11.2	-0.1
Tax	8.7	8.5	-0.2	9.2	9.1	-0.1
Non- tax	2.1	2.1	0.0	2.1	2.1	0.0

Source: CPD-IRBD Database (2004).

Still, the total revenue is to grow in FY2005 at 16.7 per cent, of which tax revenue at 18.8 per cent and non-tax at 7.9 per cent. National Board of Revenue (NBR) has the most "challenging" target of increasing its intake by 19.0 per cent. All these projected growth rates of revenue collection remain far above the trend rates.

TABLE 3.2

Sectoral Share of Revenue Earnings, FY2004-FY2005

	Sectoral Share			Growth			
	FY2003	FY2004 (revised)	FY2005	FY2004 (original) over FY2003	FY2004 (revised) over FY2003	FY2004 (revised over original)	FY2005 over FY2004 (revised)
Total Revenue	100.0	100.0	100.0	16.2	13.7	-2.1	16.7
Tax	80.2	79.9	81.4	16.5	13.4	-2.6	18.9
NBR	76.3	76.4	77.9	16.8	13.9	-2.5	19.0
Non-NBR	3.8	3.5	3.5	10.1	4.2	-5.4	16.0
Non-tax	19.8	20.1	18.5	15.1	15.1	0.0	7.9

Source: CPD-IRBD Database, 2004.

Structure of NBR Component

NBR accounts for about 78 per cent of total revenue intake. As a consequence of trade liberalisation, the role of customs duty has been falling over time. It is expected that growth of direct taxes (viz. income tax) and VAT (local) is to fill up the void and generate incremental resources.

However, figures show that in FY2004, within total NBR collection, the share of customs duty has gone up (from 18.9 per cent to 20.6 per cent), as against the decline in shares of income tax (from 15.4 per cent to 14.9 per cent) and VAT (from 25.9 per cent to 24.2 per cent). Concurrently, the contribution of supplementary duty has increased as well (from 14.1 per cent to 15.3 per cent). These trends are in direct opposition to what is intended. More importantly, the effective expansion of VAT (local) at a rate faster than income tax collection is making the tax incidence disproportionately biased against the income of the poor.

Income Tax

The FY2005 budget proposed a revision of income tax rate by raising the ceiling of tax-exempted income to Tk 100,000.0 from Tk. 90,000.0.

Despite the revision, the low-income group of taxpayers will pay relatively more compared to the high-income group people. Moreover, absolute tax burden has increased for the lowest slab of taxable income group by 25.0 per cent. For all other income groups, absolute tax burden reduced between 9.0 per cent and 16.0 per cent from the tax amount of FY2004.

This year, the government introduced a system of compulsory submission of expenditure statements for the *individual assessees* reflecting their style of living, which is targeted for bringing consistency between the tax return and standard of living. In case of *corporate assessees*, for bringing more companies into the self-assessment system, the requirement to show increase of income by 10.0 per cent every year has reduced to 5.0 per cent.

TABLE 3.3

Implication of Revised Income Tax Rate for Individual Assessee for FY2004-FY2005

(amount in Tk)

Income	Per month salary	Tax			Difference	
		2002-03	2003-04	2004-05	Amount	Per cent
100,001	8,333.0	2,500.0	1,200.0	1,500.0	300.0	25.0
200,000	16,667.0	12,500.0	11,000.0	10,000.0	-1,000.0	-9.0
300,000	25,000.0	26,250.0	24,000.0	20,000.0	-4,000.0	-17.0
400,000	33,333.0	42,500.0	39,500.0	35,000.0	-4,500.0	-11.0
500,000	41,667.0	62,500.0	59,500.0	50,000.0	-9,500.0	-16.0
600,000	50,000.0	82,500.0	79,500.0	67,500.0	-12,000.0	-15.0
700,000	58,333.0	106,250.0	102,500.0	87,500.0	-15,000.0	-15.0
800,000	66,667.0	131,250.0	127,500.0	107,500.0	-20,000.0	-16.0
900,000	75,000.0	156,250.0	152,500.0	127,500.0	-25,000.0	-16.0
Minimum Taxable Monthly Income		6,250.0	7,500.0	8,333.0		
Minimum Tax		1,200.0	1,200.0	1,500.0		
Exemption		75,000.0	90,000.0	100,000.0		

Source: Author's calculation based on Budget statement FY2004-2005.

Till May 2004, the number of registered taxpayers was 15,50,000. In 2004-05, there is a target of identifying 300,000 new taxpayers from the prospective corporate businesses and individuals. Also, for submission of income tax return for all individuals, firms and companies or institutions, holding Tax Identification Number (TIN) has been made compulsory.

However, there is an apprehension that the empowerment of the NBR to choose any return for audit out of the self-assessment returns submitted by individual and company assesses will create more problems and frustrate the tax collection initiative.

To make the income tax system more equitable, CPD has always emphasised the need for rationalisation of income tax in line with VAT. CPD's recommendation has been to increase the income tax and to include more people, who can afford to pay taxes, under the tax base, rather than increasing the VAT, which affects the lower and upper class people almost equally. However, in the projected revenue target for the FY2005, *for each Tk 1.0 income tax, the government has targeted Tk 2.2 as VAT earnings*.

Value Added Tax (VAT)

The government is systematically broadening the VAT net aiming at a switch from customs duty to VAT. During the last budget, the government brought new items into the VAT net, including money exchange business, credit card, cigarette Band Roll & stamp, locally produced soft drinks, soap, detergent powder, mineral water, revenue from sale of all items in auction by the government (at the rate of net *1.5 per cent* of the auction value), semi-government and autonomous body, banks, insurance and other limited companies and decorators, caterers and sweetmeat shops within the metropolitan and the district town areas. This year, fresh items have been brought into the VAT net from both manufacturing and services sectors.

In the manufacturing sector, among others, these include: (a) Pressure cooker at manufacturing stage, (b) Food supplied in community centres, (c) 4 HR (Hot Rolled) coil at import stage, (d) LP gas cylinder at import stage, (e) Copra (of coconut) at import stage, and (f) Raw silk at import stage. In the services sector the items brought under VAT net include: (a) Shooting spots, amusement and theme parks, historical places, picnic spots and tourist spots, (b) House cleaning and maintenance organisations, (c) Lease or investment and credit financing institutions, (d) Express Mail Service, (e) Film distributors, (f) Lottery ticket sellers, (g) Upper grade tailoring shops at Dhaka and Chittagong, and (h) Commercial and residential apartment builders.

The VAT on pressure cooker at manufacturing stage may make local manufacturers uncompetitive. The VAT on hot rolled coil will increase the price of Corrugated Iron (CI) sheet, which ultimately hits the low-income group as the major use of CI sheet is for construction of houses. However, VAT on LP gas, copra and raw silk at import stage may act as protections for the domestic industries.

It is interesting to note here that during the last year, doctors and lawyers have been proposed for inclusion into the VAT net. However, in the face of the protest from these two professional groups, the idea was dropped. The policymakers did not take the risk to try it again this time.

The government is also planning to impose VAT on goods and services rendered against local and international tenders in foreign currencies, which might be a major source of revenue for it. The government has proposed to introduce rewards for the highest VAT-paying businesses and establishments of each district, although it is not clear which types of reward are being planned. Definitely, some fiscal rewards would be worthy of consideration in this regard.

Some restructuring has also been proposed in the budget, which concerns spinning and weaving industries and airlines. For the former, VAT has replaced excise duty. For the latter, application of fresh excise duty has been proposed.

The government is proposing to exempt VAT from two specific areas: indenting commission remitted from abroad, and locally manufactured wheat crushers. While the objective of the first one is to bring the money from indenting business into the country, the latter aims at providing further support to the agro-based industry and small and medium enterprises.

Tariff Reform

The customs duty contributes to 28.0 per cent of the total national tax revenue. However, application of para-tariff significantly distorts domestic markets. In some cases, customs duty and para-tariffs act as domestic protection measures. In others, these act simply as revenue generation measures. Moreover, these are applied as tax on tax. As a result, total collection at import stage rises up to 50.0 per cent of total tax revenue.

The budget proposed substantive reform for further liberalisation in tariff system, going beyond what was decided earlier. One may question the rationale and timeliness of the matter also.

During the last budget, it was announced that the tariff system would be reduced from a four-tier system to a three-tier system. The tariff slabs had been proposed to be 30.0 per cent, 20.0 per cent and 10.0 per cent. The budget for FY2005 has proposed to reform the system with three tiers; however, the highest slab has been proposed to be 25.0 per cent, which raised controversy from several quarters.

Firstly, many import substituting industries will be adversely affected due to increased competition with imported products, which will be imported with lower duties. Local manufacturing and backward linkage industries, particularly textile, ceramic, footwear, electronics, toiletries, agro-based and food-processing industries, will suffer from this decision. It is to be mentioned that importers of some 2,400 finished products now pay 30.0 per cent duty. Major finished products that fall under the highest duty slab include girls and women's suits, readymade dresses, boys and men's shirts (cotton or synthetic), women's petticoats, nightdress, babies' garments, sports outfit, undergarments, handkerchiefs, footwear, sports footwear, umbrella, tiles, flooring blocks and tableware. The highest duty is also applicable for kitchenware, ceramic articles, iron and steel products, metal industry, electro-mechanical domestic appliances like vacuum cleaner, food grinders and mixers, electric cables, different electric parts, bicycle, electric lamps, wooden furniture, toys, ballpoint pens, woven fabrics of cotton (dyed and unbleached), soap, shampoo, cosmetics, cigarettes, tobacco substitutes, fruit juices, tea and fish.

Secondly, the autonomous liberalisation through budgetary measures will reduce bargaining opportunity in the bilateral and multilateral negotiations of tariff reductions in which Bangladesh is involved. The average tariff in Bangladesh was 21.9 per cent in 2002, which was lower than India by 9.1 per cent.

Thirdly, the issues of coherence of policies of the International Financial Institutions (IFIs) with the negotiations dynamics are still under discussion in the WTO. Thus, pressure for reducing tariffs by the IFIs, which is the case this time, is contradictory and is creating disadvantageous situation for LDCs like Bangladesh. The government should reconsider the proposal of fixing the highest slab at 25.0 per cent and keep it to the promised level of 30.0 per cent.

Fourthly, reduction of duty slabs from four to three may also result in revenue loss. While Bangladesh is fighting for compensation of revenue loss in SAFTA and BIMSTEC, it is not clear why the government is creating such a situation through autonomous initiative.

It is also to be mentioned that the highest tariff slab in India is 30.0 per cent. A four-tier system is in practice there till now, which is under active consideration for revision.

TABLE 3.4

Further Liberalisation of Tariff System: Customs Duty in FY2005

	Earlier System (per cent)	Promised System (per cent)	Proposed System (per cent)
I	7.5	10.0	7.5
II	15.0	20.0	15.0
III	22.5	30.0	25.0
IV	30.0	–	–

Source: Compiled from various budget speeches and Economic Survey.

After revision, the list of importable articles now contains a variety of items numbering 6,799. The distribution of tariff lines is presented in Table 3.4 after the restructuring.

TABLE 3.5

Items Under Various Slabs

Tiers	Previous			Present		
	Nominal	Cumulative	Cumulative (%)	Nominal	Cumulative	Cumulative (%)
0.0 %	541	541	7.9	519	519	7.6
7.5 %	1,431	1972	29.0	1510	2029	29.8
15.0 %	1,305	3277	48.2	1,879	3908	57.5
22.5 %	1117	4394	64.6	0	3908	57.5
25.0 %	0	4394	64.6	2,891	6799	100.0
30.0 %	2405	6799	100.0	0	6799	100.0

Source: CPD-IRBD Database (2004).

The government estimated that the possible revenue loss from this restructuring would be Tk 775.0 crore. It, however, expects to collect Tk 3,328.0 crore from normal growth of import and administrative improvements.

Supplementary Duties: The government proposed three slabs of supplementary duties (15.0 per cent, 25.0 per cent, and 30.0 per cent) instead of seven slabs (15.0 per cent, 25.0 per cent, 30.0 per cent, 40.0 per cent, 50.0 per cent, 60.0 per cent and 75.0 per cent). This streamlining of supplementary duty will allow the government to use these para-tariff tools effectively for domestic protection and revenue generation purposes.

This time, the government did not propose any rise in Infrastructure Development Surcharge (IDSC), which was increased to 4.0 per cent during the last budget. The legitimate question is how the collection from IDSC is being distributed in the infrastructure development programmes of the government. The budget also observes no change in AIT, 2.5 per cent and VAT (import), 15.0 per cent.

Export Promotion

The government has also taken bold tariff measures for promoting the country's textile sector as the backward linkage industries of the garments sector. In addition to the facilities already provided, it proposed reduction in the existing rates of duty on most of the raw materials and essential machinery and spares needed by this industry. The number of HS 8-digit level items for textile sector, which will enjoy duty-free and VAT-free import, is 34.

Domestic Protection

Tiles Industry: For promoting domestic tiles industry, which is complementary to the booming construction sector, the government decided to reduce supplementary duty on locally manufactured tiles from 20.0 per cent to 5.0 per cent.

Processed Agricultural Products: The government is proposing to impose VAT on processed, primarily agricultural, products like fruit, pulp and paste, packed spices in powdered form, flavoured milk and yoghurt, etc. For this purpose, the government will fix the tariff value of these products.

IMPORT SUBSTITUTION

Dairy and Poultry: In order to give a further boost to the dairy and poultry industry of the country, the government proposed to withdraw customs duty and VAT on 87 capital machineries needed for this sector.

Coil: In place of tariff value, the government is planning to apply VAT on the normal value of domestically produced cold rolled coil. This initiative will increase the revenue generation scope for the government; but will diminish consumer welfare because the main product from these coils is Corrugated Iron (CI) tin, which is the main raw material for house building in rural areas.

SOCIAL CONCERN

Cigarettes: The government proposed slight change in supplementary duty structure for cigarettes at different slabs by 2.0 per cent, the implications of which are not clear. The duty, both customs and supplementary, could be increased substantially for revenue generation and discouraging the harmful trade, which adversely affect the productive power of the population.

SECTOR SPECIFIC TARIFF MEASURES

Energy: In the second Interim IRBD 2004 of the CPD, it was mentioned, "given the political costs involved in pushing up prices, the government will be well advised to reduce its taxes on petroleum products" (Bhattacharya, 2004). It was observed that the government restructured taxes on fuel. The government also proposed withdrawal of the existing Advance Income Tax (AIT) from all types of petroleum as well as reduction of the existing supplementary duty on Kerosene from 25.0 per cent to 15.0 per cent. As a result, tax burden on crude oil, kerosene and all other fuel oil will be reduced by 9.0 per cent, 25.0 per cent and 10.0 per cent respectively.

Health Sector: For encouraging establishment of high quality referral hospital of international standard for the treatment of life-threatening diseases, the government proposes to withdraw customs duty on medical and hospital equipment and accessories, withdraw all types of taxes and duties on certain life-support systems used in such hospitals.

Food and Beverage Industry: A proposal to reduce the supplementary duty on sugar from 30.0 per cent to 15.0 per cent has been made in order to promote domestic biscuits, chocolates, soft drinks, and condensed milk industries. It needs to be mentioned that CPD criticised last year's increase in such taxes. Consumers are expected to be benefited from the measure.

Mobile Telephony: A proposal to reduce customs duty on mobile phone sets from Tk 300.0-400.0 to Tk 150.0 has been proposed, which will boost the market growth and increase access to telephony.

Vehicle: Although the highest rate of customs duty is under consideration for reduction and the supplementary duty rates undergoing re-structuring, the government restructured supplementary duty on vehicles. The supplementary duty on motor cars and jeeps has been proposed to be revised at 30.0 per cent in place of the existing 15.0 per cent on those having cylinder capacity up to 1649. For those having cylinder capacity above 1649 but not exceeding 3000, it is proposed to be enhanced to 60.0 per cent from the existing 40.0 per cent, and for those having a cylinder capacity over 3000, it is proposed to be raised to 90.0 per cent from the existing 75.0 per cent.

It is not clear whether these rates are applicable for both re-conditioned and new cars. On one hand, these measures will facilitate revenue generation. On the other, the middle class will be deprived of access to cheap personal vehicles.

HARMONISATION

Export-Oriented Industries: The government has proposed to withdraw VAT at source on insurance, shipping bill of 100.0 per cent export-oriented industries and commission of Clearing and Forwarding (C&F) agents involved in such industries. The export-oriented industries will also receive 80.0 per cent refund of the tax paid on inputs relating to gas, electricity and insurance.

Paper: About 80.0 per cent of the paper imported in the country is now subjected to duty at a rate of 30.0 per cent, the remaining is subject to only a slightly lower rate. Both these rates are proposed in the budget to be unified and re-fixed at 25.0 per cent across the board. It, however, needs to be examined whether this duty benefits domestic printing industry and general consumers or not.

Billets: The government proposed to fix tariff value of ferro manganese, ferro silicon and silicon manganese used for the production of billets. These tariff values will be used for application of VAT on the finished products. It should be noted here that the re-rolling mills are producing billets locally and it is also imported from abroad. During the last fiscal, the price of MS rod and billets increased astronomically. It is expected that this particular measure will rationalise price on these materials.

Structure of Non-NBR Component

The share of non-NBR component has been plummeting over time (3.3 per cent of total revenue in FY2004 – down from about 5.5 per cent during the last decade). The most important item is non-judicial stamp, which recorded a negative growth in FY2004 (-3.3 per cent). Still, the target rate for non-judicial stamp in FY2005 is 14.4 per cent higher than FY2004.

Structure of Non-Tax Component

The share of non-tax revenue is also going down. The share of non-tax revenue as per cent of total revenue in FY2004 (revised) was 20.0 per cent, while in FY2005 the target rate is 18.5 per cent. Most important items are T & T (4.6 per cent), dividend and profit (2.6 per cent), administrative fees (2.6 per cent) and interest income (1.9 per cent). The predicted growth rate for FY2005 is 7.9 per cent (as against 15.1 per cent in FY2004). Tariff rates of these services need to be reviewed to make a realistic adjustment with social concerns in mind.

3.2.4 Public Expenditure

Revenue Expenditure

The target for revenue expenditure in FY2005 is Tk 30,518.0 crore, which is 13.8 per cent higher than the revised figure of FY2004. Three heads account for more than 70.0 per cent of the total. These three heads include: *pay and allowances* (24.0 per cent), *subsidies and transfers* (27.0 per cent), and *interest payments* (19.0 per cent). In FY2005, the allocation for defence services accounts for 12.7 per cent of the total revenue expenditure.

Revised figures for FY2004 show a shortfall of revised revenue expenditure in FY2004 over its original target for the same period. The revised figures of FY2004 show only a growth of 10.5 per cent over the revised realised figure of FY2003, when in the original estimate it had shown 16.8 per cent growth over FY2003 (target).

An additional amount of Tk 431.0 crore has been provided for "Repair and Maintenance," which is a positive aspect of the revenue expenditure. Another additional amount of Tk. 365 crore has been pledged for ongoing microcredit programmes with a view to reducing poverty. Moreover, Tk 200.0 crore has been allocated for Micro Entrepreneur Development Fund, a special fund for employment generation for hardcore poor and a special fund for re-training the voluntarily retired and retrenched employees.

A "Pay Commission" will be constituted at the beginning of the next financial year for re-fixation of pay scales for the officers and employees of the government and autonomous bodies taking into consideration the increased cost of living. The new pay scale will be effective from January 2005. CPD has strongly argued to set up a permanent Pay Commission for government employees. The CPD has also emphasised, along with pay enhancement, on the issues of Public Administration Reform such as workforce rationalisation, skill development, and predictability of career path, in its IRBD-Second Interim Report. CPD also believes that it is high time to think about establishment of a wage commission to ensure minimum pay for the low-paid working class.

In the budget, it has proposed to raise the medical allowances of all government employees from Tk 300.0 to Tk 400.0 per month from July 2004. The government will also grant one Festival Allowance equivalent to net monthly pension from the next fiscal year to all retired government servants. The government has also emphasised on the issue of "Public Administration Reform" by taking some important decisions like promotion of civil servants on the basis of merits and efficiency. The ministries/divisions have been already grouped into four clusters in order to promote specialisation in civil service and a provision of Tk 200.0 crore has been kept in next year's budget to fill up essential vacant posts.

The government needs to carry out these measures within the broader context of Public Administration Reform. One also wonders why a wage commission should not be set up as well.

Development Expenditure

Annual Development Programme

The ADP target for FY2004 was originally fixed at Tk 20,300.0 crore but was then axed down to Tk 19,000.0 crore. During FY2003, the total ADP implementation was only 80.0 per cent of the original target; this year the situation seems to be even more precarious. Information on ADP implementation until March of FY2004 suggests that a total amount of Tk 9,189.0 crore, i.e. about 45.0 per cent of the total allocation was spent during the first three quarter (July-March) of FY2004. Out of this amount, Tk 5,852.0 crore was spent as local resource and Tk 3,337.0 crore as project aid expenditure, which indicates that 50.0 per cent and 39.0 per cent of their respective allocations have been expanded. It is not clear though how effective it is to use the expenditure figure as a proxy of on-the-ground implementation of the projects.

The share of internal resources in ADP has crossed the 55.0 per cent mark in the proposed ADP for FY2005. In FY2004, the target for foreign resources was Tk 10,301.0 crore, accounting for a 50.7 per cent share in the total ADP financing. However, the revised figure shows that both the foreign and internal resources failed to reach the target in FY2004. The rate of foreign aid flow was lower than the internal resource mobilisation rate that turned around the external-internal share from 51:49 to almost 50:50.

The government is targeting a 55.5 per cent (Tk 12,207.0 crore) internal resource into the ADP for FY2005. The rest of the 44.5 per cent (Tk 9,793.0 crore) would come from the foreign financing, of which project aid accounts for about 33.7 per cent (Tk 7,425.0 crore) of total ADP financing.

The declining trend in both external and internal resource mobilisation in the recent past puts a question mark on the achievement of the proposed ADP. Keeping in mind the poor ADP implementation, CPD suggests that proper guidelines for expenditure and performance auditing of ministries should be undertaken as the major criterion for their future funding.

During FY2004, some of the ministries have failed to implement their allocated budget for development marginally, but some have failed utterly. Among those ministries, Planning Ministry's allocation was revised dramatically to about 7.0 per cent of its original. The original allocation was Tk 521.0 crore, which was reduced to Tk 33.0 crore (a 93.0 per cent reduction). In FY2005, the allocation for the said ministry is Tk 586.0 crore. The Ministry of Establishment's budget was also reduced by 31.5 per cent to Tk 39.0 crore from Tk 57.0 crore. For FY2005, its allocation is Tk 99.0 crore. The Ministry of Disaster Management's allocation was condensed by 74.0 per cent to Tk 50.0 crore from an original allocation of Tk 193.0 crore during FY2004. The Ministry of Liberation War Affairs also performed poorly with a revised ADP, showing a 77.0 per cent reduction in allocation. The original reduction was Tk 26.0 crore, which eventually reduced to Tk 6.0 crore. The allocation for FY2005 for the said ministry is Tk 46.0 crore. A similar situation has been noticed in the case of the Ministry of Information. The revised budget was trimmed by almost 49.0 per cent; an original allocation of Tk 82.0 crore was brought down to Tk 42.0 crore in FY2004, the allocation for FY2005 has been set at Tk 76.0 crore. The whole cluster of entertainment, culture and religious affairs ministries' allocation was revised and reduced by 20.0 per cent to Tk 257.0 crore from Tk 325.0 crore during FY2004; still their allocation was increased by almost 40.0 per cent from their revised allocation of Tk 359.0 crore.

It is observed that some of the ministries are provided with increased allocation in FY2005 even after failing to realise the original target and then revised targets were set at substantially reduced level during FY2004. In CPD's IRBD 2004 paper, mention was made on the poor condition of ADP implementation. It was suggested before the budget that the size of the ADP would be around Tk 17,000.0 crore. This suggestion, very unfortunately, might become a reality given the poor implementation of ADP by various ministries.

The CPD IRBD Second Interim Report observed that the aggregate ratio of ADP implementation compares almost equally with the same for the last year (with respect to actual ADP size). During the July-March period, the rate of ADP implementation for FY2001, FY2002 and FY2003 was 54.0 per cent, 42.0 per cent and 45.0 per cent respectively. However, it needs to be pointed out that such a business-as-usual approach will not be helpful in realising the full annual target of the ADP in the current fiscal year. It is now becoming increasingly obvious that one of the prime reasons for under-achievement of the ADP relates to low utilisation of foreign project aid available in the pipeline.

During the period July 2003-March 2004, Tk 7,128.6 crore, i.e. 60.0 per cent of the total government allocation was released for government expenditure. Among the line ministries, the Ministry of Religious Affairs utilised most of its allocation (70.0 per cent), followed by the Ministry of Home Affairs (69.0 per cent), Local Government Division (65.0 per cent) and the Ministry of Health & Family Welfare (57.0 per cent).

TABLE 3.6

Budget Allocation and Expenditure of Religious Affairs Ministry, FY2004-FY2005

	Allocation 2003-04 Budget	Revised 2003-04 Allocation	Allocation 2004-05 Budget	Growth between 2003-04 allocated and 2003-04 revised allocation (%)	Growth between 2003-04 allocation and 2004-05 allocation (%)
Non-Development	28.0	66.0	33.0	135.7	-50.0
Development	51.0	44.0	64.0	-13.7	45.4
Total	79.0	110.0	97.0	39.2	-11.8

Source: Compiled from Budget Survey FY2004-FY2005.

On the other hand, the Ministry of Liberation War Affairs, the Ministry of Information and the Planning Division were among the low ADP implementing ministries/divisions, utilising 5.0 per cent, 10.0 per cent and 13.0 per cent of their corresponding ADP allocations during the first three quarters of FY2004. The Road and Road Transport Division, Power Division and Ministry of Education have implemented around 55.0 per cent, 48.0 per cent and 45.0 per cent of their total allocations respectively during the first nine months of the FY2004.

One can identify at least four factors, which have contributed to the poor implementation of the ADP. First, introduction of the new public procurement policy squeezed the scope for indulging in corruption while implementing foreign aided projects created some disincentive to spend. Second, inability to undertake "prior actions" as agreed with the development partners under the project documents seriously constrained the country's access to foreign aid in the pipeline. Third, over-centralisation of the project-planning and programme approach made the utilisation of resources more time consuming. Finally, the state of uncertainty pervading the public administration in the backdrop of growing political confrontation encouraged many of the key persons in various government agencies to be indecisive or free sitters. *It is also getting abundantly clear that without an effective devolution of power and decentralisation of development administration through setting up of a strong upazila system, Bangladesh will not be able to effectively handle a larger ADP.*

Box 3.1: Sectoral Allocation of Development and Non-development Expenditure in FY2005

Sectors	FY2004 Revised	FY2005 Budget	Per cent growth of FY2005 over FY2004
Fuel and Energy	3977.0	4361.0	9.6
Transport and Communication	5709.0	6148.0	7.7
Rural Dev. & Cooperation	4685.0	4902.0	4.6
Education	6919.0	7859.0	13.6
Health	3345.0	3732.0	11.6
Agriculture	2859.0	4063.0	42.1
General Public Service	4995.0	8165.0	63.4
Social Security & Welfare	2015.0	2588.0	28.4
Industrial and Economic Services	616.0	595.0	-3.4
Recreation, Culture and Religious Affairs	647.0	712.0	10.0
Defence Services	3811.0	3901.0	2.4
Housing	561.0	611.0	8.9
Interest	5842.0	6533.0	11.8
Public Order and Safety	2387.0	2581.0	8.1
Memorandum Item	999.0	497.0	-50.2
Total	49367.0	57248.0	15.9

Source: CPD-IRBD Database (2004).

General Public Service (GPS)

- Large increase due to abnormally low allocation in FY2004, Development Support Credit was absent in FY2004 but has been budgeted for in FY2005. This is reflected in the allocation of the Finance Division, whose allocation increased by 73.0 per cent (from Tk 3,362.0 crore to Tk 5,807.0 crore).
- Planning Division allocation grew by 640.0 per cent between FY2004 and FY2005 (Tk 87.0 crore to Tk 644.0 crore).
- Establishment Division allocation grew by 24.0 per cent (Tk 342.0 crore to Tk 424.0 crore).
- Prime Minister's Office's allocation grew by 33.0 per cent (Tk 137.0 crore to Tk 235.0 crore).

Education

- Primary and Mass Education funding grows by 21.8 per cent (from Tk 2702.0 crore to Tk 3,292.0 crore). Majority of the increase (Tk 574.0 crore growth) is from Development allocation.

Agriculture, Fisheries & Livestock

- Agriculture allocation grew by 95.0 per cent (from Tk 910.0 crore to Tk 1,777.0 crore).
- Water resources allocation increased by 24.2 per cent (from Tk 911.0 crore to Tk 1,132.0 crore).

Social Security & Welfare

- Liberation affairs' increased by 55.6 per cent (from Tk 81.0 crore to Tk 126.0 crore).
- Social Welfare funding grew by 31.9 per cent (from Tk 389.0 crore to Tk 513.0 crore).

3.2.5 Fiscal Deficit

Overall budget deficit for the FY2004 was programmed at 4.8 per cent of GDP (Tk 15,809.0 crore), as the government targeted an 18.9 per cent increase in the total public expenditure from Tk 43,908.0 crore in FY2003 to Tk 51,980.0 crore in FY2004. The under-achievement of the public expenditure target (by -5.0 per cent) has slashed down the GDP-budget deficit ratio to (-) 4.2 per cent in the revised budget of FY2004. In this context, the government's target to achieve a 15.9 per cent higher public expenditure during the FY2005 has contributed to a marginal increase in the GDP-budget deficit ratio to (-) 4.3 per cent in FY2005 from (-) 4.2 per cent in FY2004.

In FY2004, the government targeted an amount of Tk 6,713.0 crore of foreign financing to fill up the 50.8 per cent of the total budget deficit. In practice, however, only 47.1 per cent of the total budget deficit was financed by the foreign financing and the remaining 52.8 per cent was financed by domestic resources (according to the revised budget FY2004). For the FY2005, the government has set a balanced target to finance its budget deficit with domestic (44.5 per cent) and foreign financing (55.5 per cent). Between the two major sources of domestic borrowing, borrowing from the banking sector would provide 16.3 per cent and another 28.2 per cent will come from non-bank sources. Bank source is to provide Tk 2,599.0 crore while Tk 4,500.0 crore will be provided by the non-bank sources. The nature of fiscal deficit is important as it is a synthetic indicator. It may grow when the economy is absorbing more investment, but it may go down because of inability spread.

3.3 SELECTED SECTORAL MEASURES

3.3.1 Agricultural Development

It has been proposed that there be a total allocation (revenue and development) of Tk 1,777.0 crore for FY2005 for Ministry of Agriculture (Tk 867.0 crore more than the revised allocation in FY2004). It is promised that in FY2005, agricultural extension research, training, production of improved seeds, conservation and distribution of seed and irrigation activities will be bolstered. In addition to the projects initiated under ADP, 16 development programmes financed from revenue budget will be implemented. Some major features of this year's budget are:

- Increased allocation on agricultural subsidy and agricultural incentives from Tk 300.0 crore in FY2004 to Tk 600.0 crore in FY2005. Increased budgetary allocation is a necessary precondition to bring about the desired changes. However, the sufficient condition for desired impact relies on the quality and effectiveness of implementation. Up to January 2004, only 31.4 per cent of the budgeted subsidies in FY2004 were utilised. Therefore, it is not clear how the targets of the FY2005 budget would be achieved through the existing institutions and implementation procedures.
- Cash incentive for export of agricultural products, fruits and vegetables will be raised to 30.0 per cent from 25.0 per cent. Past experience with disbursement of cash incentive indicates that due to the absence of clearly articulated and realistic procedures, allocated amount could not be spent. It is hoped that, proper mechanism would be in place and steps for awareness building among potential exporters would be taken to promote export of agro-products.
- Necessary incentives are to be provided for production of *rabi* crop.
- Bangladesh Bank will provide financing as required at a 5.0 per cent rate of interest to Bangladesh Krishi Bank (BKB), Rajshahi Krishi Unnayan Bank

(RAKUB) and other nationalised banks so that they can provide adequate agricultural loan to the farmers at an 8.0 per cent rate of interest. This is a clearly spelt out mechanism, which can be monitored to evaluate the progress and impact.

3.3.2 Fisheries and Livestock Sector

The government proposed a total allocation (development and revenue budget) of Tk 546.0 crore for the fisheries and livestock sector in FY2005 (an increase of Tk 110.0 crore from the revised budget allocation of FY2004). The budget mentioned that increased allocation would enable the ministry to increase expenditure for purchase of equipment and medicine for treatment of livestock, feed for livestock and poultry, production of vaccine, research, etc. The government has also announced import of capital items for poultry farms without customs and supplementary duties. These will surely reduce the cost of importing such items and would be beneficial to the poultry industry by reducing cost of production and enhancing competitiveness. The Ministry of Fisheries and Livestock will implement 30 projects under the development budget for extension of pisciculture (recovering fish habitat in open water bodies), extension of pisciculture technology at the Union level, extension of artificial insemination and also livestock services at the Union level. These are welcome initiatives but delivering the outcome would surely require concrete planning and monitoring. In the absence of such mechanisms, it would not be possible to achieve the targets. It may be noted that in FY2004 (up to January 2004), the ministry of Fisheries and Livestock spent 53.9 per cent of revenue budget and only 15.4 per cent of the development expenditure.

3.3.3 Water Resources

Government has proposed an allocation of Tk 1,132.0 crore in the revenue and development budget for Ministry of Water Resources in the budget for FY2005.

Up to January 2004, only 24.6 per cent of the development expenditure's budgeted amount for agriculture (allocated for Agriculture, Fisheries and Livestock, Environment, Land, Water, Ministry of Food) was utilised. In the case of revenue expenditure, utilisation was 60.9 per cent. Low implementation progress during the first half of the year may result in mis-utilisation at the end of the fiscal year. To overcome such problems in the proposed budget, one would naturally expect clear direction, which is missing in the budget document.

3.3.4 Rural Development

For local government and the rural development sector, it has been proposed that there be a total allocation (revenue and development) of Tk 4,902.0 crore in FY2005 (Tk 217.0 crore more than the revised budget of FY2004). The Local Government Engineering Department (LGED) will construct 3000 km of metal roads, 5,500 km of earthen road and 220 Union Parishad complexes. A "Char Livelihood Project" in five districts with an outlay of Tk 475.0 crore is being implemented to raise the living standards of the extreme poor, belonging to some disaster prone districts. The "Abashan Project" is being implemented by the Prime Minister's Office to provide land, houses, credit facility, education, health, family planning services and employment to 65,000 landless and extremely impoverished people. The Youth Development Directorate is also implementing projects for employment generation of unemployed rural youth, both men and women, through provision of training and microcredit.

In the case of rural development and local government, only 40.5 per cent of the revenue expenditure and 40.1 per cent of the development budget was utilised. Thus, it is to be seen how far the planned projects would be completed.

3.3.5 Industry

According to the provisional estimates provided by the BBS, the manufacturing sector grew at the rate of 7.41 per cent in FY2004, which is higher than that of FY2003 (6.6 per cent). The share of manufacturing sector in the GDP increased from 15.9 per cent to 16.2 per cent, which is well below the target of 25.0 per cent. It needs to be mentioned here that the growth rate of small industries was higher than large and medium industries.

On a point-to-point basis, industrial production has declined between February 2003 and 2004 by about (-) 2.7 per cent. Conversely, the first eight months' average QIP for FY2004 was only 1.5 per cent higher than the same in FY2003. It is interesting to note that the QIP during July-February of FY2003 grew by 5.1 per cent over the matching period of the previous year. It is contrary to the common wisdom that QIP is less in current year when overall growth in manufacturing sector is better than the previous years.

The industrial sector did not witness any new import tariff and tax; at the same time, the tariff peaks have been reduced through restructuring of tariff slabs. The measures are expected to boost industrial sector growth. The budget measures in some selected sectors are discussed below.

- *Textile:* Considering the importance of textile industry as a backward linkage industry of RMG sector, which is under tremendous pressure at the advent of the MFA phase out, the government proposed to reduce the income tax for the sector from 20.0 per cent to 15.0 per cent.
- *Jute:* The government reduced the income tax for jute industry, which might interest the private sector to invest in the sector. However, the disincentive of production of jute by the farmers was not addressed. As a result, the rebate will not bring the desired result.
- *RMG:* The government decided to withdraw collection of VAT from insurance, shipping bill and C&F agent's commission relating to 100 per cent export-oriented industries including readymade garments industries at source. Although the measures came as a rationalisation move of tax system, these will also benefit, at least to a certain degree, the exporters, particularly those belonging to the RMG sector, by inspiring them to attain more competitiveness.
- *Agricultural commodities:* Cash subsidy for export of agricultural commodities, introduced by the alliance government, has been increased to 25.0 per cent, which is considered as a welcome step. The government increased allocation for the promotion of agro-based industries to Tk 100.0 crore from Tk 50.0 crore in FY2005.

- *Equity Entrepreneurship Fund*: The government is continuing the allocation in EEF in FY2005. The volume of allocation is Tk 200.0 crore, which is Tk 100.0 crore less than that of the previous fiscal year. This fund is reserved for providing equity support to computer software, food processing and agro-based industries. It is to be mentioned that the system and framework of EEF was restructured following a CPD policy brief in FY2002, which started to give fruit and during last fiscal the application for fund exceeded the allocation. However, the disbursement was slow because of the cumbersome selection procedure.

3.3.6 Investment Promotion

Industrial Park: To create employment opportunities for about 900,000 people, the budget proposed building of an industrial park (to be set up by BSCIC) in the Adamjee Jute Mills complex and setting up of 150 industrial units by the Bangladesh Export Processing Zones Authority in the 74-acres land of the closed Chittagong Steel Mills.

Refinancing for SMEs: The Bangladesh Bank will expand refinancing facilities amounting to Tk 250.0 crore at 5.0 per cent rate of interest to financial institutions for extending credit to entrepreneurs of small and medium industries.

Restructuring Banks: The government allocated Tk 200.0 crore as capital for expanding the loan operation in rural areas through the Karma Sangsthan Bank (KSB), Bangladesh Krishi Bank (BKB) and Rajshahi Krishi Unnayan Bank (RAKUB). The allocation is expected to promote financing operations of these institutions targeting the rural non-farm economy.

3.3.7 Foreign Direct Investment

According to the BoI registration figures, the FDI increased from US$111.7 million during July-April period of FY2003 to US$242.3 million during the corresponding period of FY2004. The actual flow of FDI, including those in EPZs, was US$119.9 million for July-January FY2004, which was 54.3 per cent higher than that of the previous period. Despite this increase, the investment could not reach the peak of 1997.

Measures related to attracting FDI are few in this budget, which reflects the reality that non-economic factors dominate an investment climate where fiscal incentives matter in an insignificant way.

To encourage foreign direct and joint venture investment, the existing tax rate of 15.0 per cent on income from capital gains arising out of transfer of stocks and shares of private limited companies has been proposed for reduction to a level of 10.0 per cent.

3.4 SOCIAL SECTOR

3.4.1 Education

Education has received the highest allocation of Tk 7,680.0 crore in the combined revenue and development budget, which is 13.4 per cent of the total budget of 2004-05. Out of this allocation, Tk 3,071.0 crore will be spent from the development budget for implementing 51 projects in the education sector. Measures that will be undertaken in order to ensure human development include appointment of new teachers, construction of new classrooms, training of teachers, introduction of stipends at the primary levels and financial assistance to students. In addition to the current programme on "Primary Education Development Porgramme-2," a new project named "Reaching Out of School Children" for an amount of Tk 400.0 crore will be undertaken to create opportunities for primary education for the deprived children. The budget proposed to double the number of scholarships at different primary and secondary levels from 35,000 to 77,000 from July 2004-05. This will leave a positive impact on human development.

In terms of its share in total GDP, the allocation in the education sector was almost stable during the last few years, remaining at around 2.0 per cent of the GDP. Allocation in the education sector is 13.7 per cent higher than that of the previous budget (2003-04).

It is mentioned in the budget that in order to improve higher education, infrastructure facilities are being constructed, stipends for women have been introduced and four science and technology universities have been established. These are, however, not new proposals and the budget does not indicate whether these activities will be expanded or not. While quality of education at all levels remains a major concern, the budget also does not say anything about the job opportunities for these educated people.

3.4.2 Health

An amount of Tk 3,732.0 crore has been allocated for the health sector in the combined revenue and development budget, which is marks an increase by 11.6 per cent from the last year (Tk 3,345.0 crore). The share of health expenditure in the total budget is 6.5 per cent. Various measures for improving the health services, both in the urban and rural areas, include setting up of medical universities at the national level and medical colleges and health institutes in the private sector are being taken up for the development of the health sector.

However, how health services will be ensured among the urban poor is not mentioned. How many people will be benefited from the doorstep health services and how will it be ensured for the poor and deprived are not mentioned in the budget.

A new programme in 21 upazilas aimed at reducing the maternal mortality by 75.0 per cent in line with the MDGs being launched from July 2004 is a commendable step.

TABLE 3.7

Allocation for Social Sectors and Defence Services

Sectors	2004-05	2003-04 (Revised)	Increase (%)	Percentage share in total budget
Education	7,680.0	6,757.0	13.66.0	13.4
Health	3,732.0	3,345.0	11.56.0	6.5
Defence	3,901.0	3,811.0	2.36.0	6.8

Source: Compiled from Budget Survey FY2004-FY2005.

3.5 SAFETY NET

3.5.1 MFA Phase Out

In FY2004, the reduction of corporate tax from 30.0 per cent to 10.0 per cent up to June 2006 facilitated positive export growth by the RMG sector. This measure provides some breathing space to the sector. However, the sustainability of the growth in the sector will depend on improvement of productivity and diversification of the market and products within the sector.

The government has admitted that the MFA phase-out might have some short-term impacts on employment in this sector and its exports. To mitigate the potential negative impact, the government allocated a special fund with an allocation of Tk 20.0 crore "for retraining and creating employment opportunities for employees/labourers of garment industries." Considering even 0.1 million possible unemployment in the sector, this allocation will be Tk 2,000.0 per person which is very insignificant, given that a major portion will be spent for management of such programme. But this cosmetic measure will fail to address the concern of the workers and mitigate the creeping panic among the workers of the sector.

3.5.2 Privatisation and Golden Handshake

The government also allocated Tk 30.0 crore "for retraining and creation of employment opportunities for the voluntarily retired, retrenched employees/labourers." This fund has been provided by the World Bank. It is not clear how many workers and employees will be retrenched under the programme and how much compensation they will receive from the "voluntary retirement."

3.5.3 Social Safety Net

In the case of social safety net, it is a pleasant exception in the Bangladesh context that programmes undertaken during the earlier government are continued and improved by the successive governments. Under the FY2004 budget, the amount of *Old-age Allowance and Widowed and Deserted Women Allowance* would increase to Tk 165.0 per month (from the existing Tk 150.0) and the number of beneficiaries would be increased from 15.0 lakhs to 18.0 lakhs. The government also raised the allocation for the "Fund for Acid-burnt Women and Rehabilitation of Physically Handicapped" to Tk 65.0 crore. Allocation of Tk 150.0 crore as "Fund for Mitigating Risk due to Natural Disaster" and Tk 148.0 crore as "Fund for the Housing of the Homeless" deserves to be lauded. The government also decided to raise the number of beneficiaries of "Honorarium Programme for Insolvent Freedom Fighters" by 10,000, reaching 60,000. The budget proposed to increase distribution of foodgrain under VGD, VGF, FFW, TR, GR and other non-monetised channel from 6.5 lakh metric tons in FY2004 to 7.4 lakh metric tons in FY2005. In addition, budget for food for works programme (cash) also increased from Tk 140.0 crore in FY2004 to Tk 168.0 crore. It may be mentioned here that total amount of foodgrain distributed under these programmes was 8.4 lakh metric tons in FY2002, which is still high to reach.

The government also allocated Tk 100.0 crore to meet sudden natural disasters as block allocation in the next year's budget to the Ministry of Food and Disaster Management.

The major problem lies in implementation of social security and welfare measures. Until January 2004, only 21.5 per cent of the budgeted amount in FY2004 has been spent. Therefore, it is not clear if the targets of distribution would be achieved at all. One may even question the proper targeting of the deserving people to whom the desired benefit would be delivered. The budget failed to outline the delivery mechanism for the allocated amount of support to the deserving individual. In the case of social security measures, geo-targeting is needed. Special and targeted employment programmes for the vulnerable poor should have received priority in the upazilas with high incidence of poverty. According to a recent study, the areas with highest incidence of poverty (greater than 47.0 per cent) are the depressed basins in Sunamganj, Habiganj and Netrokona districts; the north-western districts of Kurigram, Nilphamari and Nawabganj; and Cox's Bazaar and coastal islands of Bhola, Hatia and Sandeep. The areas with low levels of poverty are the greater Dhaka and Barisal regions, and Bogra, Pabna, and Jessore regions.

3.5.4 Mitigating Economic Shocks

In addition to the poverty-targeted programmes, the budget also proposed two new programmes to enable employees/labourers to face sudden economic shocks with an allocation of Tk 50.0 crore for these programmes. Out of Tk 50.0 crore, Tk 30.0 crore is put aside for retraining and employment creation opportunities for voluntarily retired, retrenched employees/labourers. The remaining Tk 20.0 crore will be used for retraining and creating employment opportunities for employees/labourers of garment industries.

3.5.5 Microcredit for Self-employment

The budget proposed a combined allocation (development and non-development) of Tk 5,850.0 crore for various kinds of programmes related to expansion of microcredit programmes by NGOs and six ministries. Through its *Abashan Programme* the government plans to rehabilitate 65,000 landless and homeless families through self-employment.

Increased allocation to Palli Karma Sahayak Foundation (PKSF) for microcredit programme, fund for NGO Foundation, special fund for employment generation of the hardcore poor and fund to create micro enterprise in the rural areas through the PKSF are proposed in the budget of FY2004. Moreover, the budget also proposed an allocation of Tk 100.0 crore for promotion of agro-based industries.

3.6 LAW AND ORDER

Recognising the seriousness of the law and order situation, the government decided to allocate Tk 2,367.0 crore for the Ministry of Home Affairs, which is 32.2 per cent higher than that of the previous year. Of the amount, Tk 306.0 crore would be pumped into the Police Administration for its modernisation through improved logistics support and making the Rapid Action Battalion (RAB) fully operational. It is well understood that the present state of the law and order has largely resulted *inter alia* from the inadequate size of the police force, existing state of the high level corruption within the department, and lack of professional ethics among the members of the force. The budget did not address these important issues, and did not provide a clear guideline as to how these problems will be solved. If no measures are taken to increase the size of the entire force, develop professional ethics of the police personnel, and curb corruption within the department, spending money for obtaining more logistics, initiating a new battalion would have little impact on the deteriorating law and order condition.

The government also made a separate allocation of Tk 5.0 crore for forming the independent Anti-Corruption Commission.

Defence Services: The allocation for the defence sector has increased by 2.36 per cent from Tk 3,811.0 crore in 2003-04 (revised) budget to Tk 3,901.0 crore in the combined revenue and development budget, which is 1.2 per cent of total GDP. In the total budget, the share of allocation for defence has decreased from 7.7 per cent in 2003-04 (Revised) to 6.8 per cent in the proposed budget.

3.7 CONCLUDING OBSERVATIONS

Bangladesh remains a country of paradoxes, where on the one hand the economy suffers from under-investment, and on the other, investible surplus remains unutilised. Thus, in the final analysis, it boils down to the question of delivery, rather than effective and quality delivery, of public resources to the disadvantaged groups. Under the circumstances, magnitude of allocation acquires secondary importance.

Bangladesh is living between twin crises. On the one hand, it needs bigger budget for achieving higher GDP growth and meeting the MDGs. On the other, it fails to implement even a much smaller budget from that perspective, inviting criticisms from the sceptics. The country needs to be pulled out from these gravitational paradoxes.

In this context, the implementation outlook appears to be myopic due to absence of a cogent strategy. There is hardly any introspection or soul-searching about the causes, which have led to significant shortfall in ADP implementation in the successive years. There is nothing on public administration reform, local government strengthening, means to improve utilisation of foreign aid, improving the quality of services in public health and education, etc. *So the question is what is the main reason behind this under-utilisation-is it the absorption failure, demand failure, delivery failure, outreach failure or governance failure?*

Each of these may be equally responsible. Thus, in the final analysis, full delivery of the resource package as well as faithful delivery of the development outlay will be the yardstick for judging the success of this year's budget. In the absence of successful delivery of the development package envisaged by the government, it will be difficult to anticipate gearing up of the private investment. Incidentally, the early signals of pick up in private investment in FY2004 have already been blurred during the third quarter. If the government fails to ensure supply of quality electricity in adequate quantity to protect life and property of its citizens, much more than implementation of budgetary measures will be at stake.

However, review of various revealed variables of the MTMF shows that a number of key indicators are performing below the target. These include such key variables as domestic savings, both public and private investments, revenue-GDP and public expenditure-GDP ratios. Inflation rate has gone beyond the targeted rate. On the other hand, GDP growth rate along with export-import growth rate remains on target. Accordingly, in the coming months, protecting the integrity of the macro framework may emerge as an issue.

With impending external shocks such as MFA phase-out and possible escalation of internal conflict such as political confrontation, the delicate balance between development and stagnation may be broken. However, safeguards against such situations remain beyond the scope of a national budget.

Annexures

Annexure A

CHRONOLOGY OF MAJOR ECONOMIC EVENTS IN FY2004

(July 2003–December 2004)

2003

July 1	The Bangladesh Bank directs the non-banking financial institutions to increase their paid-up capital to Tk 250.0 million from a level of Tk 100.0 million within the next two years.
July 3	The BGMEA officials disclose that Australia will provide duty-free access of Bangladeshi readymade garments products into its market from 1 July 2003.
July 4	Trade officials show scepticism about the benefit of the proposed Trade and Investment Framework Agreement (TIFA) with the United States since the accord itself does not guarantee the much desired duty-free access for Bangladesh.
	The Export Promotion Bureau (EPB) undertakes 13 different projects worth Tk. 100 million to enhance the export of Information and Communication Technology (ICT) services.
July 7	The cabinet approves the draft anti-corruption commission Bill 2003, paving the way for formation of an independent body with sweeping power to deal with corruption.
	The Jatiya Sangsad passes Member of Parliament (Remuneration and Allowance) (Amendment) 2003 Bill, providing an increase of allowances for MPs.
July 8	Bangladesh is ranked 139 in the Human Development Index (HDI) of the United Nations Development Programme (UNDP) for the year 2003. The rank is slightly better than last year when it was 145.
July 11	UNB reports that an official audit of 10 foreign aided projects under six ministries involves irregularities worth about Tk 589.6 million.
July 13	Chittagong Port Authority reduces port charges in order to bring dynamism in export trade of the country.
July 14	The cabinet approves amendment of the Insurance Act of 1938, making it mandatory for insurance companies to seek approvals from the Chief Controller of Insurance before removing its managing director or chief executive officer.
	Dhaka City Corporation (DCC) unveils a Tk 7.6 billion budget for FY2004 with a revenue earning target of Tk 3.0 billion.
July 15	The governments of Bangladesh and India agree to begin talks on bilateral Free Trade Agreement, which will be held in October this year. The agreement is reached between Bangladeshi Foreign Minister Mr Morshed Khan MP and his Indian counterpart Mr Yaswant Sinha at the JEC Standing Committee Meeting.
July 24	Commerce ministry discloses that Thailand has granted tariff concession of 128 Bangladeshi export products, among which 40 items can be exported under zero-tariff facility.

July 27 Thailand proposes to form Thai-South Asian business forum in order to develop business link with South Asia, including Bangladesh.

July 28 In a bid to develop full-fledged secondary bond market, the Bangladesh Bank in a circulation decides to appoint primary dealers from banks and financial institutions for handling secondary transactions of treasury bills.

July 31 Metropolitan Chamber of Commerce and Industry (MCCI) prepares a list of 968 products for the government to use in negotiation in the proposed Free Trade Agreement (FTA) with India.

August 18 The Cabinet decides to promote cash subsidies, which will be provided directly to the farmers in order to support the agriculture sector.

August 19 Direct train communication linking the west part of the country with the eastern part is established. Prime Minister Khaleda Zia in a small ceremony in Rajshahi Railway Station opens the link formally.

Commerce Minister Amir Khosru Chowdhury launches the Bangladesh-Thai Chamber of Commerce and Industry in order to increase Thai-Bangladesh trade and investment.

Bangladesh Bank discloses that the remittances from abroad record a benchmark of US$3.06 billion posing a growth of 22.4 per cent, thanks to the series of measurements, which were taken recently in order to encourage the expatriates to send money through the formal banking channels instead of the unauthorised "hundi."

August 22 The three-day "4th TexTech 2003 International Exhibition" organised by Conference and Exhibition Management Services (CEMS) begins in the city.

September 6 The Cabinet Committee on Economic Affairs approves Re-procurement Guideline 2003, aiming to make country's public procurement process transparent, corruption-free and attuned to the international laws. The guidelines will set the standard for procuring goods, services and building infrastructure in the country, which is now worth Tk 70.0 billion annually.

September 8 The Securities & Exchange Commission (SEC) decides on compulsory credit rating of all public limited companies (PLCs) ahead of collecting funds from the capital market through Initial Public Offerings (IPOs). The commission also decides to restrict companies, which have undisputed tax arrears from going public.

September 10 The Fifth WTO Ministerial Conference begins in Cancun, Mexico. Commerce Minister Amir Khosru Mahmud Chowdhury leads the 16-member team. For Bangladesh, the duty- and quota-free access of agricultural and non-agricultural exports from developing and poor countries into the markets of the developed countries and the free movement of labours to developed countries are the two prioritised agendas.

September 16 The government introduces an in-depth financial monitoring system in six ministries (communications, education, health, agriculture, social welfare and women & children affairs) to ensure transparency and accountability in public expenditure.

September 30 The World Bank (WB) agrees for the first time in last one decade to finance Bangladesh's fund-starved energy sector, which needs billions of dollars in investment.

October 1 At the two-day ministerial level meeting of Bangladesh-India Joint River Commission (JRC) held in India, the two countries sign the seven-point agreed minutes that includes the discussions on Indian river interlinking issue as well as seven common river's water sharing issues.

The government undertakes a Tk 3.0 billion master plan to make the Foy's Lake at Chittagong a tourist spot of international standard.

October 4 Bangladesh Bank starts today same day clearance of cheques amounting to Tk 500,000.0 and above to help the country's business community speed up its activities.

October 5 Bangladesh Bank takes step to clean up the loan portfolio of the Non-Banking Financial Institutions (NBFIs) by initiating a move against the defaulting directors. In a circular issued to the executives of the NBFIs, the Bangladesh Bank gives two months' time to regularise the loans to avoid removal of errant directors.

October 7 The Transparency International Bangladesh (TIB) launches Corruption Perception Index (CPI) for 2003. Bangladesh tops the list as the most corrupt nation in the world for the third successive year with a score of just 1.3 out of 10.

October 15 Bangladesh Bank halves the L/C margin on Import of 56 items to 50.0 per cent in line with the IMF conditions on getting loans under Poverty Reduction Growth Facility (PRGF).

October 19 In order to maintain consistency with other public policies, the government decides that the duration of the country's new export and import policies should be three years (2003-2006) instead of five years.

October 20 Talks on a Free Trade Agreement (FTA) between Bangladesh and India begin in the city with focus on removal of para-tariff and non-tariff barriers to pave the way for broader free trade.

The 14th Bangladesh Apparel and Textile Exposition (BATEXPO-2003) begins in the city.

Bangladesh Bank launches the online trading of Treasury Bills (TBs) to foster the development of a secondary market of the government-approved securities. The new system replaces the manual system of auction of TBs, enabling the banks and financial institutions to participate in trading without sending their representatives to the Bangladesh Bank.

October 22 The three-day-long Bangladesh-India trade talks at the mid-official level conclude by agreeing to remove the Non-Tariff Barriers (NTBs) and Para-Tariff Barriers (PTBs).

October 27 The government revives the move to corporatise the Bangladesh Biman after its attempt to find a strategic partner and some desperate measures to make it profitable fails.

October 29 Bangladesh Bank approves a total of 33 projects of the Equity and Entrepreneurship Fund (EEF). Of the 33 projects, 27 are agro-based and the remaining six are ICT-based projects. The total estimated cost of these projects is about Tk 5.0 billion and the EEF's contribution is Tk 1.7 billion.

October 30 The government launches a microcredit programme for child labour under a project titled Eradication of Hazardous Child Labour in Bangladesh with a view to withdrawing the child labours from hazardous occupations.

November 2 Dhaka and Colombo agree in principle to sign a comprehensive Free Trade Agreement (FTA) within a year as the first round of talks lay down the framework for "smooth negotiations" ahead.

In order to support the growth of the country's pharmaceuticals industry, the government exempts all kinds of duties on the import of 132 chemical products, which are used in making raw materials for medicine.

November 3	The Asian Development Bank (ADB) approves a $100.0 million long-term soft loan for the $1.8 billion Second Primary Education Development Programme (PEDP-II), which is being undertaken by the government to improve the primary education.
November 4	The Sectoral Committee Meeting of the Bangladesh, India, Myanmar, Sri Lanka, and Thailand Economic Cooperation (BIMST-EC) kicks off in Dhaka. The meeting aims to devise the ways to increase investment opportunities in the region.
November 5	The government hands over the Teknaf Land-port to the United Enterprises and Company Limited, becoming the country's first private operator to run a port.
	The government okays a project worth Tk. 182.1 million to introduce pre-paid telephone cards by the BTTB for making overseas and interdistrict phone calls both from fixed lines and mobile phone sets.
November 6	Bangladesh Bank lowers bank rate by 1.0 per cent to 5.0 per cent, aiming to help schedule banks reduce lending rates for encouraging investments in the country. Besides, the central bank also re-fixed the ratio of Statutory Liquidity Reserve (SLR) to 16.0 per cent from the existing 20.0 per cent.
November 8	Bangladesh Bank selects eight banks and one Non-Banking Financial Institution (NBFI) as primary dealers to handle secondary transaction of Treasury Bills and other government bonds.
November 10	The ADB assures to provide a record $530.0 million worth of loans to Bangladesh for implementing projects in key sectors.
November 12	The government increases the cash incentive for exporting agro products including vegetables and fruits to promote export of these items. The incentive is now set to 25.0 per cent instead of previously set 15.0 per cent.
November 13	The Bankers Club, an association of the top bankers of nationalised and private commercial banks, takes the decision to cut both deposit and lending rates by 1.0 per cent from December next.
November 16	The two-day mid officer level talks between Bangladesh and Pakistan begin at the Ministry of Commerce aiming to create a framework agreement for negotiating the free trade deal between the two countries. During the meting, Islamabad agrees to recognise the LDC status of Bangladesh, thereby accepting its claim for S&D treatment in trade access.
November 18	The government decides to give a 5.0 per cent cash incentive to the exporters of jute goods during the current fiscal to promote export.
November 29	The BoI discloses that the country wooed more than US$275.0 million worth of FDI in the January-June period of 2003, which is more than 60.0 per cent higher than that of preceding year when the country attracted a total of US$168.0 million.
December 1	Bangladesh and China sign two separate agreements that aim to strengthen economic and cultural ties between the two countries. Under the deals, China will provide Tk 530.0 million grant to Bangladesh for strengthening economic cooperation and exchanging cultural programmes.
	The three-day 6th Asia-Pacific High-Level Employers' Conference begins in the city.
December 2	Bangladesh Bank (BB) withdraws the mandatory Letter of Credit (L/C) margin restrictions on all imports in line with the policy of further liberalising the market. In a circular, the BB also directs all the commercial banks to set L/C margins on imports on the basis of bank-client relationship.

December 3 The first-ever three-day National Agri-business Event (2003) begins at Dhaka, which is jointly organised by the Board of Investment (BoI), Ministry of Agriculture of the GoB, and South Asia Enterprise Development Facility (SEDF). The event will help to promote and facilitate agri-industries to ensure maximum value addition and to create opportunity for business networking.

December 4 Bangladesh embassy in Nepal and the Confederation of Nepalese Industries (CNI) form a joint taskforce to find out ways and means for strengthening bilateral trade and commerce between the two countries.

December 8 The Securities and Exchange Commission (SEC) withdraws the *Weighted Average Index* from Dhaka and Chittagong stock exchanges with effect from 9th December as the regulator feels that the index does not reflect the real market situation.

December 13 The National Economic Council (NEC), in a meeting, decides to double the number of beneficiaries of the old-age allowance and the per head amount of allowance. The NEC also decides that the *Gram Sarker* will determine the eligible persons for receiving the benefit and if the *Gram Sarker* fails to coordinate the scheme, the local government institutions at the upazila level will shoulder the responsibility to disburse the allowance.

December 14 The government finally allows import of used taxicabs between 1250cc and 2000cc not older than three years, in line with the Forest and Environment Ministry's directive. Besides, it also restricts import of more than four-year old automobiles for private and official use, ignoring the demand of the reconditioned vehicle importers.

December 21 The Prime Minister Khaleda Zia opens the Dharala Bridge, which will provide scope for trans-border trade with Indian States of Assam, Meghalaya, Nagaland, Monipur, Mizoram, Tripura and Arunachal.

December 23 The Asian Development Bank (ADB) approves a US$20.0 million loan for a livestock enterprises project aimed at income generating activities in rural areas of 20 north-western districts of Bangladesh. The loan at 1.0 per cent interest during the first eight years and 1.5 per cent interest thereafter will be distributed by Palli Karma Sahayak Foundation (PKSF). The rest of the total project cost of US$55.8 million will be borne by the government.

December 24 The Asian Development Bank (ADB) agrees to provide US$1.2 billion under the Country Strategy and Programme (CSP) for 2004-2006; the strategic priorities will include promotion of the private sector, good governance, gender and regional cooperation.

December 27 The fifth five-day-long SAARC Trade Fair begins at Dhaka, aiming to expand intra-regional trade and strengthen economic ties among the seven SAARC countries. The fair is jointly organised by the Ministry of Commerce and Export Promotion Bureau (EPB).

December 28 Bangladesh Bank sells the newly introduced government treasury bonds worth of Tk 290.0 million to four commercial banks (Sonali, Agrani, Janata and Prime) through auction to formally activate the secondary market of those banks.

December 29 A two-day Buyer-Seller Meet (BSM) 2003 between Bangladesh and India begins in Dhaka. The event is jointly organised by the Federation of Indian Export Organisations (FIEO), a leading trade body in India, and the Indian High Commission in Dhaka. The BSM provides an opportunity for one-to-one interaction with a premier group of Indian businessmen.

December 30 The state-owned Bangladesh Telegraph and Telephone Board (BTTB) reduces its overseas call charge to Tk 7.5 for each minute. The call charge is reduced for the

USA and Canada, and later on this service will be expanded to eight other countries, such as UK, Australia, France, Italy, Germany, Malaysia, Singapore and Hong Kong within the next three months.

December 31 The government slashes interest rates on saving certificates with effect from 1 January 2004 to facilitate reduction of lending rates by the bank. The government also removes a provision in the Sanchayapatra Rules 1977 that allows securing loans granted against saving certificate pledged to the banks. The authority, however, withdraws a 5.0 per cent tax charged at sources from the profits of all saving instruments.

The government issues a gazette notification postponing a 2001 notification that provided for allowing Trade Union (TU) activities in the country's six Export Processing Zones (EPZs) from 1 January 2004.

2004

January 1 The 10th Dhaka International Trade Fair (DITF) begins in the city.

January 5 The Association of Bankers Bangladesh (ABB) decides that the country's commercial banks will cut both deposit and lending rates this month in response to Bangladesh Bank directive. Moreover, decision is also taken to boost the economic activities in the country through financing Small and Medium Enterprises (SMEs) at the rate of 10.0 per cent. Earlier, the rate was 16.0 per cent.

January 7 The chief executives of the country's commercial banks at a meeting with Bangladesh Bank Governor Fakhruddin Ahmed agree to set interest rate on all kinds of export credit at 7.0 per cent to accelerate economic activities. The interest rates are currently ranging between 7.0 per cent and 10.0 per cent, depending on the type of export items.

January 12 In a major policy shift, the Cabinet Committee on Economic Affairs decides to take loans under supplier's credit arrangement for the country's investment-hungry power sector that requires US$7.6 billion till 2012 to improve electricity generation and distribution capacities.

January 13 The government reduces the customs duties on import of scrap vessel and MS rod following the increase in the price of rod in the local market. It also revises the tariff values of both the products, as their actual prices are different from the tariff values.

January 15 The government makes a series of commitments to the IMF to expedite the fiscal and monetary reforms in the country to get the remaining five chunks of the PRGF credit from the multilateral agency. The government commits that the Rupali Bank would be ready for sale by December, trade taxes and supplementary duties would be reduced in the next budget, limits would be imposed on access by individuals to National Saving Certificates, and action plans to operationalise the strategies on NCBs would be drawn up by end-November.

January 17 A high profile international business conference titled *Global Economic Governance and Challenges of Multilateralism* begins in Dhaka with a plea to start a serious dialogue between the east and the west to pave the way for shifting to a 'new economic model'. The conference is organised by the International Chamber of Commerce-Bangladesh (ICC-B). Prime Minister of Thailand Thaksin Shinawatra presents the keynote paper in the opening session.

January 18 The government decides to offload its shares lying with four state-run fuel marketing companies under the Bangladesh Petroleum Corporation (BPC) in the capital market within the next six months.

January 23 The Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) and the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) sign an agreement to form a *Joint Business Council* to boost bilateral trade between the two countries.

January 24 Bangladesh and Indonesia sign four agreements and Memorandum of Understandings (MoUs) to provide new impetus to trade, economic and cultural ties between the two countries.

The government extends the contracts with the three Pre-Shipment INSPECTION (PSI) firms by five months to allow the customs department enough time to take over the responsibilities from the next fiscal.

January 25 The Privatisation Commission enlists the Rupali Bank Limited for privatisation after the Finance Ministry sent a proposal in this connection late last month.

January 26 The government sanctions Tk 120.0 million as conditional loan to the Mongla Port Authority (MPA) to accord golden handshake to 1,122 of its workers. The Shipping Ministry also asks the Food Ministry to ensure 40.0 per cent of the country's foodgrains import via the Mongla Port in a bid to inject dynamism into the ailing seaport.

January 29 The Asian Development Bank (ADB) approves a $550,000.0 Technical Assistance (TA) grant for Bangladesh to help prepare a Financial Markets Governance Programme (FMGP).

January 31 The inter-bank call money rate soars to an all-time high to reach 60.0 per cent from 15.0 per cent only a day earlier.

February 5 Bangladesh files a complaint with WTO over duties imposed by India on import of batteries, which is the first LDC trade dispute before the WTO. The complaint asks for consultations with India about Anti-Dumping Duty (ADD) imposed in 2002 on lead acid batteries. Bangladesh cites 17 reasons why it claims the measures taken by India are illegal under the WTO rules.

February 7 The BIMST-EC meeting begins in Phuket, Thailand where trade ministers from South and Southeast Asian countries agree on a draft free trade deal, which will abolish import tariffs.

February 8 Six Asian nations agree to sign a Free Trade Agreement (FTA) committing to open their markets by the year 2017. All five founding nations of BIMST-EC are expected to ink the draft trade deal but Bangladesh pulls-out after demanding compensation for any revenue loss as a result of dropping tariffs.

The government announces 10.0 per cent dearness allowances for the project officials. According to a circular of the Finance Ministry, the officials of all development projects will be entitled to the allowance, with effect from 1 July 2003.

February 11 The National Board of Revenue (NBR) takes some special measures including setting up of a VAT intelligence unit to attain the Tk 277.5 billion target of revenue collection in the current fiscal.

February 18 Denmark approves a grant of Tk 4.9 million to provide technical assistance to support export-oriented handcraft, apparel and home textiles enterprises.

February 19 The 4th Summit of the Developing Eight (D-8) concludes in Tehran with a renewed pledge to expand economic cooperation within the group. The D-8 leaders also decide to bolster coordination on international economic matters including multilateral trade issues.

February 22	Bangladesh Bank sends about 700 files to the Bureau of Anti-Corruption (BAC) requesting the agency to investigate into unrealised export bills worth Tk 5.8 billion (Tk 579.0 crore).
February 25	*Euro-Bangla Apparels 2005*, a programme under the Asia Invest II, is launched in Dhaka to enhance trade relations between Bangladesh and some selected European countries. The main objectives of the 18-month programme are to build marketing capacity of small garment units of Bangladesh and increase their sales power to EU member countries against the backdrop of the upcoming challenge in quota-free regime.
February 27	The government decides to reopen three closed mills under the Bangladesh Chemical Industries Corporation (BCIC). It also decides to turn the recently closed Chittagong Chemical Complex Limited (CCCL) into a full-fledged industrial park.
March 7	Bangladesh Bank (BB) directs the banks to reduce the spread between lending and deposit rates immediately, voicing deep concern over the poor response to its advice on reducing lending rates. The instruction comes at a meeting with the chief executives of the banks held at the conference room of the central bank while BB Governor Fakhruddin Ahmed presides over the meeting.
March 12	The government decides to constitute a central intelligence cell to check tax erosion at individual and institutional levels. The proposed cell would monitor and compare living expenses of individuals against their sources of income and payment of taxes.
March 13	The National Board of Revenue (NBR) identifies a total of 220,000 new taxpayers after conducting a 14 month-long intensive survey across the country. The NBR has already processed 100,000 new files to bring the persons under the government income tax net by the next month.
	An interministerial meeting cleared a key hurdle to the country's signing of the Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation (BIMSTEC) Free Trade Agreement (FTA) by middle of this year. The meeting decides that Bangladesh could sign the agreement provided that its key industrial and agricultural areas remained out of the purview of the free trade negotiations.
March 14	The World Bank (WB) decides to provide credit for generation of electricity in the public sector after 15 years. The Bank would provide credit to build three new power plants – two in the public sector and one in the public-private joint venture, to generate 670 megawatt (mw) electricity in the country.
March 20	The Board of Investment (BoI), at its first meeting outside the capital, approves 28 projects with an estimated outlay of Tk 14,932.2 million from foreign and domestic investment sources. The projects include establishing an industrial park and an agro-processing complex in Chittagong, which is worth Tk 1.4 billion.
March 21	The Government of Japan (GOJ) formally makes announcement for debt relief in the form of cancellation of debt, amounting to US$1.46 billion (Tk 83.9 billion) for Bangladesh.
March 22	Bangladesh and Vietnam ink two agreements and one protocol to enhance bilateral cooperation in trade, agriculture and cultural fields. Prime Minister Khaleda Zia and Vietnamese President Tran Duc Luong led their respective countries in the talks at International Conference Centre at the Prime Minister's Office.
March 23	South Korea decides to allow duty-free access of Bangladeshi products under the Bangkok Agreement of 1976.

March 24	The Artha Rin Adalat (Amendment) Bill 2004 is passed in the Jatiya Sangsad. The Bill has a provision to relieve thousands of poor and marginal farmers for defaulting loan less than Tk 0.5 million (Tk 5.0 lakh).
March 25	The government adopts fresh policy strategies, including establishment of a trade facilitation centre in Dhaka to facilitate growth of the country's export. Formulation of homegrown rules of origin and major reforms in the existing trade arbitration laws are also under active consideration.
	Commerce Minister Amir Khosru Mahmud Chowdhury resigns from the cabinet following the criticism from within the ruling party for his alleged failure in containing the recent price hike of essentials. Home Minister Altaf Hossain Chowdhury is given the charge of the Commerce Ministry.
	The Ministry of Law submits the draft Trade Union Law for the enterprises in the country's Export Processing Zones (EPZs) to a high-profile committee comprising all the stakeholders. But the multilateral body, formed with representation from the government, the World Bank, US labour lobby and investors, in its meeting could not reach a consensus on a transitional period to make the law effective. The EPZ investors sought three years for the transition allowing trade unions in their enterprises after enactment of the law, but the meeting decides to shorten the timeframe.
March 27	India rejects Bangladesh's demand to remove all non-tariff barriers on its goods during the second Joint Secretary-level meet held in New Delhi. The senior trade officials of both the countries fail to agree on a common ground to withdraw the non-tariff and para-tariff barriers.
March 29	The government decides to use railways as the primary option for transportation of petroleum from the country's principal port Chittagong to other domestic destinations.
March 31	The government slashes the lending rate on agro-credit further from 10.0 per cent to 8.0 per cent to galvanise the country's rural economic activities. The new rate on agro-credit will come into effect from April 14 to encourage the farmers to cultivate their lands through purchasing seeds and other agro inputs.
April 1	A secretary-level committee finalises the Industrial Policy 2004, envisaging creation of special economic zones in the country and continuing tax holiday for new industries for another five years. The five-member committee finalises the new policy, which also sets new definition of heavy, medium and small industries.
April 3	The government assigns a high-profile National Coordination Council (NCC) to prepare a report within a short time as to how it would tackle the quota-free onslaught on its garment export. The NCC will suggest the ways on how the RMG sector can contain the damages on its export market and also steer the biggest export grosser of the country to a prosperous future.
April 5	The foundation stone of Bangladesh-Myanmar Friendship Highway is laid at Ramu – 15 kilometres off the tourist town of Cox's Bazar.
April 9	The Ministry of Finance initiates some tough measures to streamline and discipline the release and use of funds against projects under the Annual Development Programme (ADP). The government in a recent circular set May 15 as the deadline to submit self-explanatory proposals to the Finance Division to release the fourth instalment of the fund sanctioned against development projects under the ADP for the current fiscal. The finance division would release funds by May 31 next after completing all the formalities.

April 12 The government decides to provide subsidy up to 50.0 per cent to different agricultural sub-sectors in the next budget to help farmers produce more at less cost.

April 22 Multilateral donor agencies assure Bangladesh of extended budget financing for the fiscal 2004-05 and support to withstand possible losses following the phasing out of Multi-Fibre Arrangement (MFA) after 2004. They would also help Bangladesh qualify for United States Millennium Challenge Account (MCA) to have augmented assistance for poverty-reduction programmes, power-sector development, financial sector reform and education.

April 25 The government drastically reduces interest rates of local and foreign loans it lends to its sector corporations, autonomous and semi-autonomous bodies through a fresh set of lending and re-lending terms. The Finance Division in a circular announces the new terms, which brought the interest rate on local currency loan to 5.0 per cent from the existing 8.0-9.0 per cent and interest on foreign currency to 6.0 per cent from the existing 9.0 per cent.

The Federation of Bangladesh Chamber of Commerce and Industry (FBCCI) introduces the Bangladesh Council of Arbitration (BCA) to ensure speedy settlement of commercial disputes. The BCA, first of its kind in the country, is introduced to resolve commercial disputes through a simple, harmonious, cost-effective and speedy arbitration process.

April 29 Country's two seaports decide to increase berthing facilities, introduce night-time banking and office facilities, build more shades, raise efficiency in stuffing and un-stuffing facilities to help the garment exporters face the post-MFA regime.

The Bangladesh Bank (BB) introduces a re-financing scheme worth Tk 1.0 billion (100.0 crore) for the development of SMEs across the country. The central bank issues a circular in this connection and instructs the banks and the financial institutions to sanction loans under the scheme, which will come into effect from May 2 next. Under the scheme, small entrepreneurs can avail themselves of credit facilities ranging between Tk 0.2 million and Tk 5.0 million from the commercial banks and Financial Institutions (FIs).

May 2 Germany agrees to provide a grant of 40.6 million euro equivalent to Tk 278.0 crore for the development of energy and infrastructure under two agreements. The funds are envisaged to be used for a power transmission line from Baghabari to Bogra and a project to support renewable energies.

May 4 Bangladesh is re-elected as the member of three subsidiary bodies of the Economic and Social Council (ECOSOC) for a four-year term (2005-2008) in elections held during the ECOSOC Organisational Session in New York. The subsidiary bodies are the Commission for Population and Development, the Commission for Social Development and the UN Human Settlements Programme (UN-HABITAT).

May 6 Three-day European Sea Food Exposition ends in Brussels, Belgium where Bangladeshi frozen food exporters participated and received spot orders worth US$17.0 million from different overseas buyers.

May 7 A three-day meeting between Finance Ministry and the IMF ends in Dhaka with a consensus to increase revenue collection of the government. The meeting emphasises the importance of sustaining development activities and accelerating poverty reduction efforts. It also focuses on the progress in restructuring the Nationalised Commercial Banks (NCBs).

May 8 The taskforce on Value Added Tax (VAT) starts its drive at Chittagong to bring unregistered shops and service-houses under the VAT net and check their proliferation.

Prime Minister Khaleda Zia inaugurates a three-day Bangladesh Development Forum (BDF) meeting at the Sonargaon Hotel in Dhaka to review the pledges the government made at the past two BDF meets. Governmental officials, the delegates from 32 countries and donor agencies take part at the meeting. The BDF meeting is dominated by discussion on non-economic issues like formation of the much-talked-about anti-corruption commission, law and order, and good governance. Development partners at the BDF meeting say that dysfunctional politics, politically linked violence, growing crimes and corruptions are holding back the nation's growth.

May 10 The Cabinet approves the draft of Tobacco Control Law 2004 seeking to ban smoking in open places and in public transports. The Tobacco Control Law proposes restriction on the sale, distribution and consumption and ban on advertisement of tobacco products in public places and in print and electronic media.

The Cabinet approves the draft of National Women Development Policy, aimed at establishing women's rights and ensuring their security in all spheres of life.

The three-day BDF meeting ends at the Sonargaon Hotel in Dhaka. The meeting discusses several issues like policy and programmes to deliver the Poverty Reduction Strategy Paper and Millennium Development Goals (MDGs), good governance, government-NGO partnership, health and education, trade and investment climate, infrastructure for growth and development and aid governance. Donors say that they are committed to pump in $2.0 billion a year to implement the country's ambitious Poverty Reduction Strategy Paper (PRSP), provided the government improves law and order, curbs corruption and takes measures to end confrontational politics. Donors reiterate that there will not be any rollout of normal aid-flow in case the overall situation does not improve.

May 11 The Asian Development Bank (ADB) assures that it will provide funds to set up two power generation plants, each having the capacity of producing 450 megawatt electricity at Sirajganj and Meghnaghat in Siddhirganj. The ADB also shows interest to provide financial assistance to the private entrepreneurs for installing power transmission line of Power Grid Company, Bangladesh (PGCB) from Ashuganj to Sylhet.

The Ministry of Finance decides that the power and seed sub-sectors under agriculture will now get 20.0 per cent and 25.0 per cent subsidy respectively. Subsidies in both the sub-sectors will be 5.0 per cent higher than the existing rates.

May 13 The Petrobangla approves the Unocal's Bibiyana gas field development plan. Under the Bibiyana development plan, the Unocal will refurbish two existing wells and drill 13 new wells. In Phase-1 of the plan, the US company will also set up two glycol plants, each having a capacity of 150-MMCFD, and two more in phase-2, and also construct 30 inch-dia-40-kilometre gas-selling pipeline and 6-inch-dia 40 km condensate selling pipeline.

May 15 The Cabinet Committee on Law and Order agrees in principle to raise the Dhaka Metropolitan Police (DMP) stations from 22 to 50 to cope with the escalating crime incidents. The Committee also agrees to recruit an additional 19,277 personnel for 565 police stations across the country in order to raise police-people ratio to 1:1070 from existing ratio 1:1300, the lowest in the world.

May 16 Trading of four more listed companies comes under the Central Depository System (CDS) in the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). The companies are the Progoti Insurance Limited, the Pioneer Insurance Limited, the Southeast Bank Ltd. and the Dhaka Bank Ltd.

May 18 Prime Minister Khaleda Zia opens the Lalan Shah Bridge (1.8 km), the country's second largest bridge over the Padma River at the Pakshey-Bheramara point, ushering in a new horizon in road communications between the country's south-western and north-western regions. The bridge is built at a cost of Tk 10.6 billion and will ease the communications and goods transportation directly from Chittagong to Mongla port via Dhaka. It will also help make trade easier with India and Nepal through Mongla port. The bridge is built parallel to the Hardinge Bridge with a credit of Tk. 8.2 billion from the Japan Bank for International Cooperation (JBIC). Tk 2.4 billion is provided by the Government of Bangladesh.

Under the Danida Private Sector Programme (PSD), Denmark provides Tk 16.7 million as grant for training and technical assistance and loan for purchase of equipment to support setting up of an engineering facility to manufacture spare parts for the pharmaceutical industry in the country.

May 20 An investor's conference is held in Singapore to project the investment opportunities in Bangladesh. Finance Minister M Saifur Rahman inaugurates the conference where the Executive Chairman of the Board of Investment (BoI) Mahmudur Rahman and Executive Director of Centre of Policy Dialogue Debapriya Bhattacharya are the main speakers. The conference focuses on labour-intensive and medium-sized industries such as IT, electronics, plastic and agro-processing industries in Bangladesh and highlights that such industries have excellent growth potentials at home as well as for export to other countries following opening of markets.

An agreement is signed between the state-owned Bangladesh Railway (BR) and the LG Industrial Systems Ltd of the Republic of Korea to computerise the signalling and interlocking system of 22 railway stations on the Dhaka-Sylhet route. Under the agreement, the Korean company will implement the project within 24 months from the date of receipt of the letter of credit by the contractor. The cost of the project is Tk 800.0 million, which will be entirely financed by the Bangladesh government.

A two-day 15th annual general meeting of the Association of Shippers' Councils of Bangladesh, India, Pakistan and Sri Lanka (Ascobips) begins at Dhaka. The meeting is organised by the Shippers' Council of Bangladesh (SCB). A number of representatives from shippers' councils of four SAARC countries attend the meeting.

May 22 Bangladesh Bank decides to float government bonds for the public through the capital market to develop the secondary bond market and improve liquidity in the market. Bonds of five-year and ten-year terms, treasury bonds and different development bonds for specific projects are in the list for floatation in the capital market.

Production from the Bangladesh Petroleum Exploration and Production Company Limited (BAPEX)'s second gas field at Fenchuganj begins its experimental operation.

May 23 The Cabinet approves the 'EPZ Labour Organisation and Industrial Relations Act 2004' that allows Trade Union (TU) in the country's export processing zones.

May 26 An interministerial meeting approves the Post–MFA Action Programme (PMAP), which will be undertaken by various ministries. The meeting discusses various aspects of the PMAP to protect the RMG sector from possible adverse impact of the MFA phase out. Under the programme, the government will implement eight projects worth US$40.0 million to face challenges of the quota-free regime. The projects are: The Skill and Quality Development Programme (SQDP), Displaced Workers' Rehabilitation Programme (DWRP), Small Enterprise Capacity Enhancement Programme (SECEP), Technical Capacity Development of SMEs (TCD), Support of Primary Textile Sector (SPTS), Support to Handloom Sector (SHS), Support to Forward Linkage Industries (SFLI) and Support to New Market Opportunities (SNMO).

May 29 The Executive Committee of National Economic Council (ECNEC) finalises the proposed Tk 228.0 billion Annual Development Programme (ADP) for the fiscal year 2004-05 with special focus on poverty reduction. The NEC additionally allocates Tk 800.0 crore from the revenue budget for the ongoing small-scale development projects. Fifty-three per cent of the new ADP will be supported by local resources and 47.0 per cent by foreign aid.

May 30 In a major development in the country's capital market, Chittagong Stock Exchange (CSE) formally launches Internet Trading System (ITS), enabling people to make online share transactions from anywhere in the world.

June 4 The World Bank (WB) approves $15.5 million (1.5 crore) for increasing coverage and improving the quality of power supply in the country. Of the total, $8.4 million will be provided as a grant and the remaining amount as an interest-free loan. The WB financing will support the Power Sector Development Technical Assistance Project designed to address some of the fundamental weaknesses in the country's power system.

June 6 Bangladesh Bank (BB) enforces a middle rate (mid-rate) system in the fixation of lending rates by the banks replacing the existing band system. The central bank in its circular says that the measure is undertaken to facilitate the borrowers through ensuring accountability in fixing the lending rates.

The government decides to import onion and dates through the state-run Trading Corporation of Bangladesh (TCB) to keep their prices stable during the upcoming Ramadan. The decision is taken during the first meeting of a national taskforce, constituted to keep the prices of essentials stable and within tolerable limits.

June 7 The Cabinet decides to sell gasoline other than petroleum, jet fuel, and kerosene at the international marker price.

June 8 The three-day Japan Trade Show 2004 begins in Dhaka.

June 9 The World Bank (WB) approves today a US$250.0 million interest-free credit to support Bangladesh's enterprises and the banking reform project. The 'Enterprise Growth and Bank Modernisation Project' will support the reform of the country's nationalised commercial banks – Rupali Bank, Agrani Bank, Janata Bank and Sonali Bank. It will also encourage the development of small enterprises while strengthening institutions like the Board of Investment, the Privatisation Commission and the Bangladesh Export Processing Zones Authority.

The ADB agrees to provide US$350,000.0 as grant to help Bangladesh monitor and evaluate its poverty reduction programmes. Financed by the UK government, the grant will be available from the ADB's Poverty Reduction Cooperation Fund. The purpose of the grant is to strengthen Bangladesh's National Poverty Focal Point (NPFP), which was established last year at the Planning Commission.

The Waste Water Treatment Plant starts its operation. The plant has been set up by the BASF Bangladesh Ltd., a subsidiary of the BASF Aktiengesellschaft of Germany.

June 10	Finance Minister M Saifur Rahman presents the Budget for FY2004-05 at the Parliament. He proposes Tk 572.5 billion national budget, aiming to attain an ambitious 19.0 per cent growth in tax revenue to manage finances for a larger development budget, with major thrusts on agriculture, social sectors and infrastructure. The budget outlay includes Tk 305.2 billion as revenue expenditure, Tk 220.0 billion as the Annual Development Programme (ADP) and Tk 26.9 billion as non-development capital expenditure. The remaining amount will be spent in areas, such as food account operations, structural adjustment, employment generation schemes and non-ADP development programmes.
June 12	The government decides to enhance the gas tariff from 1 July 2004 to fulfil the conditions of the World Bank. The gas tariff will be increased by 5.8 per cent on an average and it will be implemented in two phases. In the first phase, it will increase by 2.8 per cent.
June 17	The three-day Bangladesh Trade Show ends in Toronto, Canada. During the event, Bangladeshi exporters fetched spot orders worth $5.5 million and potential orders amounting to US$9.5 million. Almost all the participating companies received orders during the event.
June 22	The World Bank approves financial support to the tune of US$20.0 million for Bangladesh to carry out a project on economic reforms to improve its investment climate, enhance government effectiveness, and improve service delivery to the poor. The Government of Bangladesh will contribute $5.0 million dollars to the US$25.0 million project.
June 23	The World Bank agrees to provide Bangladesh US$265.5 million as credit and grant from for two separate projects. Of the total amount, US$25.00 million (Tk 15.0 billion) will be available for the "Enterprise Growth and Bank Modernisation Project (EGBMP)," while another $15.5 million (Tk 930.0 million) will be provided for implementing the "Power Sector Development Technical Assistance Project (PSDTAP)." Both the credits are repayable in 40 years, including a 10-year grace period, with a 0.7 per cent service charge per annum.
June 30	The Swedish International Development Cooperation Agency (SIDA) sign an agreement with the Government of Bangladesh to provide Tk 1.7 billion (175.0 crore) as grant under the Second Primary Education Development Programme (PEDP-II) project.
	The Budget for FY2004-05 is passed in the Parliament.
2004	
July 1	The Government increases rebate on power tariff for agro-based industries to 20.0 per cent from the previous 15.0 per cent.
	The Government introduces 'five-year pensioners' savings certificates for retired employees of government, semi-government and autonomous bodies (Under the plan they can receive Tk 2,750.0 each every three months by investing Tk 1.0 lakh in a new savings scheme).
July 4	Japan approves Tk. 900.0 crore to support Bangladesh's budget for the fiscal year 2004-05.
July 7	The Executive Committee of the National Economic Council (ECNEC) approves Tk 390.0 crore reaching for the Out-of-School Children Project, covering some 20 lakh children, mostly from the disadvantaged and ultra poor section of the society.
July 10	The Government takes shipping action plan to raise efficiency in international trade.

July 11 — The Government constitutes National Pay Commission to frame new pay scales for Government officials and employees of all classes.

July 13 — The National Parliament passes a bill entitling workers in the export processing zones (EPZs) enterprises with the right to association but without any affiliation with political parties or their labour fronts from 1 November 2006 until 31 October 2008.

July 15 — Dhaka City Corporation (DCC) introduces a self-assessment system on the holding tax to perk up tax collection.

July 16 — The Finance and Planning Minister inaugurates the Sylhet Railway Station.

July 19 — The Asian Development Bank (ADB) approves US$480,000.0 in technical-assistance grant for natural gas sector development project.

July 22 — At the National Disaster Management Council meeting the Government decided to rehabilitate about 2.5 lakh flood-affected farmers by providing them with the agricultural inputs required for a bigha (33 decimals) of land after the flood water recedes.

July 24 — The Ministry of Food and Disaster Management allocates cash and foodstuffs worth Tk 852.0 million for the flood affected people of 27 districts.

July 25 — The Ministry of Shipping set up a 'control cell' to help the shippers for taking necessary precautionary and safety measures during journeys.

July 26 — Bangladesh and Myanmar sign the Shipping Protocol under the Coastal Shipping Agreement in Yangon to increase trading between the two countries.

July 27 — The World Food Programme (WFP) gives commitment to carry out a massive food assistance programme for the flood affected people in Bangladesh with 1.2 lakh metric tons of wheat, providing 32 kg of wheat to 50 lakh ultra-poor family during September-December period under Vulnerable Group Feeding programme.

Australian company Asia Energy Plc. begins feasibility study for exploration and development of Fulbari field having 350 million tons of coal reserves equivalent to 9.0 TCF of gas.

The World Bank (WB) approves US$200.0 million loan for reform programmes (including implementing the Medium Term Macroeconomic Framework (MTMF) under the IMF-supported Poverty Reduction and Growth Facility (PRGF), providing support for privatising some nationalised commercial banks (NCBs), downsizing the state-owned enterprises (SoEs) etc.) on condition that the government will increase gas and power tariffs and immediately launch a fully-staffed anti-corruption commission.

July 28 — The International Monetary Fund (IMF) approves two loans worth about US$87.0 million to Bangladesh; a loan of US$72.0 million under the poverty reduction growth facility (PRGF) programme, and another US$45.0 million under the Trade Integration Mechanism (TIM) plan.

European Commission in Brussels announces to provide 2.9 million Euro (approximately Tk 215.2 million) emergency funds for flood relief to help flood victims in rural Bangladesh.

July 29 — The United States Agency for International Development (USAID) approves US$0.9 million to relieve human sufferings in 17 severely affected districts, which is an addition to a previous USAID relief allocation of US$50,000.0 to provide operational and administrative support for the distribution of relief goods to the flood-affected people and US$10,000.0 in support of the distribution of high energy biscuits in the northern districts (the funds will be utilised through a collaborative flood relief programme with CARE Bangladesh).

August 1 The Government approves Tk 271.0 crore as agricultural subsidy to make three types of imported fertiliser (DAP, MoP, TAP) available to the farmers at 25.0 per cent reduced price.

August 3 International Development Association (IDA) signed an agreement with Bangladesh Government to provide US$200.0 million (equivalent to Tk 1,204.0 crore) to Bangladesh as development support credit.

August 5 The Government decides to speed up spending of Tk 15.0 billion from budgetary allocation for the rehabilitation and immediate repair of flood-damaged infrastructures.

August 8 China announces US$0.1 million in cash and relief commodities worth Tk 5.1 crore for flood rehabilitation programme.

August 14 The Ministry of Environment and Forest at an emergency meeting decides to disburse Tk 27.0 crore among people engaged in participatory afforestation.

August 18 The Prime Minister launches a special poverty reduction programme called "Char Jibikayan" at a cost of Tk 500.0 crore for people living in char areas in five northern districts.

August 19 The Government brings another 1.1 lakh people under the old-age allowance scheme pushing the number of beneficiaries to 13.1 lakh.

August 20 A meeting of the ECNEC approves eleven development projects at a cost of Tk 8.9 billion including project assistance of Tk 650.0 million.

August 22 A three-day international exhibition on textiles and garments machinery 'TEXTECH Expo 2004', organised by event management company Conference & Exhibition Management Services Ltd (CEMS), begins at Sheraton hotel.

August 30 Denmark decides to provide Bangladesh Tk 4.6 crore in grants for training, technical assistance and hi-tech export promotion, and support for establishment of a back-office for advertising services as part of DANIDA Private Sector Development (PSD) programme.

The National Board of Revenue (NBR) issues a statutory regulatory order (SRO) making it mandatory for the commercial importers to pay 1.5 per cent VAT at import level from 1 September 2004.

August 31 Bangladesh signed an agreement with Netherlands Government for implementation of the project titled "Integrated Planning for Sustainable Water Management (IPSWAM)" under the Ministry of Water Resources at an estimated cost of Tk 87.6 crore, of which Netherlands Government will provide Tk 61.8 crore as grant and Bangladesh Government providing the rest Tk 25.2 crore.

At a meeting on post-flood road maintenance and rehabilitation programmes the DFID Infrastructure and Livelihood Adviser Michael Scott informs that DFID will provide Tk 360.0 crore in financial assistance under the Periodic Maintenance Programme of Roads and Highways Department for repair, restructure and maintenance of post-flood road communication infrastructures.

September 1 The World Bank (WB) approves US$100.0 million credit to Bangladesh for implementation of a reform programme to enhance access and quality of secondary education.

September 4 Petrobangla signs an 'agreement initial' with Unocal to pave the way for signing a formal gas purchase and sale agreement (GPSA) on the Bibiyana gas field.

September 5	The Siddhirganj 210 mega watt (mw) Power Plant, built at a cost of around Tk 13.0 billion, starts supplying 100 mw electricity to the national grid.
September 8	Japan exempts Bangladesh from repayment of debt amounting to Tk 8.9 billion.
September 12	Bangladesh receives a consignment of 22,500 metric tons of wheat from Australia under a bilateral agreement. The food grains are to be utilised for the WFP country programme covering more than 40.0 lakh poor people to help them attain food security and more sustainable livelihood.
September 16	The visiting five-member Transport Mission team of the British Department for International Development (DFID) announces that DFID will provide Tk 490.0 million to Bangladesh as essential support under the Emergency Road Communication Restoration Programme.
	A meeting on the Medical Surgical Requisite (MSR) of the Ministry of Health and Family Welfare approves Tk 1.06 billion to provide quality medical services for various hospitals of the country.
September 17	A three-day Dhaka international Food Fair-2004 of the Export Promotion Bureau (EPB) begins in the ball room of the Dhaka Sheraton Hotel to help boost export of agro-processed food items.
September 21	Japan grants Tk 27.2 crore aid for strengthening water examination system in Bangladesh.
	The IDA signed a credit agreement with Bangladesh Government to provide Tk 6.0 billion in the current year as assistance for identification and implementation of reforms at secondary level education.
September 22	Three day long Bangladesh Knitwear Exposition-2004, organised by Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA), begins in Dhaka.
September 26	Bangladesh and the United States sign an agreement to avoid double taxation between the two countries, which will encourage greater amount of FDI by US investors especially in education, and roads and communication sector.
October 6	The SAARC nations wrap up the fifth expert committee negotiation in Dhaka with a hope to settle four major issues related to the South Asian Free Trade Area (SAFTA) (negative listing of products, Rules of Origin (ROO), revenue compensation mechanism and technical assistance for the LDCs in South Asia) by June next year before it comes into force in 2006.
	A three-day Bangladesh Apparel and Textile Exposition (BATEXPO), organised by Bangladesh Garment Manufacturers and Exporters Association (BGMEA), begins in Dhaka.
	Switzerland-Bangladesh Business Forum (SBBF), a newly formed joint body of businesspeople in the two countries, is launched with the overall goal for promoting bilateral trade and investment.
October 8	A three-day 'Bangladesh Industry and Tourism Fair', organised by the Export Promotion Bureau (EPB), begins in Kathmundu of Nepal aiming at expanding bilateral trade and economic relations between the two countries.
October 10	United Nations Children's Fund (UNICEF) launches a new project worth Tk 20.0 million to educate slum children. The two-year programme – Urban Slum Children's Education Project will cover 6000 children between six and nine years.
October 13	Bangladesh Cotton and Textile Convention 2004 begin in Dhaka.
	India's Tata Group signs an Expression of Interest (EoI) with the Board of Investment (BoI), getting a formal go-ahead to its proposed US$2.0 billion investment package.
October 17	A new food security programme has been launched for Barisal division through an agreement signed between the Ministry of Food and Disaster Management and Save the Children, USA.

October 20	The parliamentary standing committee on Chittagong Hill Tracts (CHT) affairs at the National Parliament discloses that a United Nation Development Programme (UNDP)-funded project worth US$50.0 million will be launched to improve the socio-economic status of the indigenous people in the CHT.
November 2	The European Commission (EC) and Bangladesh sign a financing agreement for the EU-Bangladesh Economic Cooperation Small Projects Facility (SPF).
November 4	Prime Minister Begum Khaleda Zia opens the Mohakhali flyover for traffic. The 1.12 km long and 17.9 meter wide flyover was designed to ease increasing traffic congestion in city's Mohakhali area.
November 20	Danish Ambassador in Dhaka Niels Severin Munk approves a grant of Tk 4.6 crore for training, technical assistance and export promotion to support the establishment of an Offshore Digital Mapping House as a part of the DANIDA Private Sector Development (PSD) programme.
November 21	The government constitutes the Anti-Corruption Commission with Justice Sultan Hussain Khan as its chairman. The three-member commission also includes former Vice Chancellor of Dhaka University and Ambassador M Moniruzzaman Miah and former Member of the Securities and Exchange Commission (SEC) Moniruddin Ahmed.
November 22	Japan and the WB jointly organize a seminar titled "Toward a More Prosperous Bangladesh- Next Steps for Development Partners" at the World Bank's (WB) Dhaka office. It is informed in the seminar that Japan has identified 12 sectors of Bangladesh namely private-sector development, transport, power, ICT, tourism, agriculture and rural development, education, health, arsenic mitigation, urban environment, disaster management and governance for future aid under a new country-assistance plan.
November 24	Metropolitan Chamber of Commerce and Industry (MCCI) welcomes the government decision to exempt all export-oriented industries from value added tax (VAT).
November 25	A ten-day Bangladesh Tourism Fair, organised by Bangladesh Embassy in Beijing, begins at Presidential Plaza Hotel in Beijing, also featuring a ten-day Bangadeshi food festival.
	A five-day mega Softexpohy 2004 begins in the city's Bangladesh-China Friendship Conference Centre, Dhaka, aimed at facilitating the growth of information communication technology (ICT) in the country.
December 1	The Cabinet Committee on Economic Affairs decides to set up an export processing zone (EPZ) on the lands of Adamjee Jute Mills in Narayanganj.
December 9	With view to reaping economic benefits through SAARC, Dr VP Vaidik, Chairman of Council for Indian Foreign Policy, calls for more regional trade among South Asian countries at a seminar organised by the Bangladesh Institute of International and Strategic Studies (BIISS).
December 11	The ECNEC meeting approves a two-year massive flood rehabilitation programme worth Tk 1,429.0 crore.
December 12	The government launches a Tk 30.0 crore rehabilitation programme for the voluntarily retired and sacked employees of different state-owned enterprises (SOEs), providing 15,000 jobless workers training in different trades and loans so that they can earn a living.

December 19	The First Bangladesh-Malaysia Business Forum, 2004 organised by Bangladesh-Malaysia Chamber of Commerce and Industry (BMCCI) held in Dhaka with representatives of the Private and Public Sectors of Bangladesh and Malaysia with support of the respective governments, adopts a declaration for consideration of the Governments of Bangladesh and Malaysia, to enhance trade and investment between the two countries.
December 21	The Asian Development Bank (ADB) approves a loan of US$30.6 million to finance the Chittagong Port Trade Facilitation Project for enhancing efficiency in Chittagong Port and enabling it to meet international port security and environmental standards.
December 28	Prime Minister Khaleda Zia launches "Reaching Out of School Children (ROSC)" project of Tk 400.0 crore for the schooling of nearly half a million deprived and dropped-out children, providing each poor student attending regular classes an education allowance amounting to Tk 800.0 to Tk 1,250.0 annually. The project is scheduled to run for six years with assistance from the World Bank and the Swiss Agency for Development Cooperation.
December 30	Dhaka postpones the 13th SAARC Summit indefinitely in the wake of 26th December earthquake-triggered tsunamis that devastated three South Asian countries.

Annexure B

Dialogue on

BANGLADESH DEVELOPMENT FORUM 2004: CIVIL SOCIETY'S PERSPECTIVES

B.1 THE DIALOGUE

The Centre for Policy Dialogue (CPD) organised a national dialogue titled "Bangladesh Development Forum 2004: Civil Society's Perspectives" which was held on 05 May 2004 at the CIRDAP auditorium, Dhaka. The purpose of the dialogue was to create an opportunity for constructive engagement to discuss the context, agenda and possible outcomes of the Bangladesh Development Forum 2004 (BDF 2004), scheduled to be held between May 9 and 11, 2004. Furthermore, the dialogue aimed to create a platform for candid and open discussion on issues tabled for discussion by major stakeholders including the civil society groups, the government and the development partners.

Dr Debapriya Bhattacharya, Executive Director, CPD, presented the keynote paper at the dialogue. Professor Rehman Sobhan, Chairman, CPD, presided over the dialogue. The Honourable Minister for Finance and Planning Mr M Saifur Rahman, MP was present at the dialogue as the chief guest. Mr Mushfiqur Rahman, MP, Chairman, Parliamentary Standing Committee on Ministry of Finance and Mr Saber Hossain Chowdhury, Political Secretary to the Honourable Leader of the Opposition in the Parliament attended as special guests on the occasion.

Participants of the dialogue included leaders of the mainstream political parties, high level policymakers, representatives of international and bilateral development agencies, leading development activists, leaders of the trade bodies, academics, and media personalities. The list of participants is attached in Appendix A.

B.2 THE KEYNOTE PRESENTATION

Dr Debapriya Bhattacharya, Executive Director, CPD, presented the keynote paper titled "Bangladesh Development Forum 2004: Civil Society's Perspectives." The presentation focused on the evolving aid relationship of Bangladesh in the context of BDF 2004. Bhattacharya stated at the outset that the purpose of his presentation was not to assess the micro-level impact of foreign aid in Bangladesh[1]; rather the focus of his presentation was to analyse the dynamics of Bangladesh's aid situation, relate this to the holding of BDF, and comment on some of the agenda that will be discussed at the BDF.

Bhattacharya drew the attention of the dialogue participants to the dilemma of the civil society with regard to foreign aid. The civil society believes in articulating a domestically-owned development agenda evolved through a participatory process. Consequently, the Bangladesh civil society has strong reservations regarding the hands-on policy stance of the donors

[1] The *Independent Review of Bangladesh Economy* for 2003 (IRBD 2003), the annual state of economy report prepared by the Centre for Policy Dialogue (CPD) takes a close look at the micro-level impact and other issues related to foreign aid.

projected through the various aid conditions. On the other hand, he pointed out that a number of issues raised by the donors with the government are of high interest and concern to the country's civil society and these have been articulated by the citizens of the country on several occasions. A number of the "prior actions" stipulated by the donors had long been the pivotal demands of the civil society, such as setting up an independent Anti-Corruption Commission.

Bhattacharya felt that the citizens of the country feel disempowered to observe that the government is more responsive to demands of the donors, instead of being responsive to its citizens' concerns. The dilemma of the civil society is that when it criticises the "intrusive approach" of the development partners, there is a danger that the issues of common concerns flagged by the BDF will get undermined as well.

He reviewed Bangladesh's aid situation in the context of the global aid scenario and the demands relating to the transfer of resources articulated at some of the recent global initiatives. The flow of Official Development Assistance (ODA) had only marginally increased in the run up to the Monterrey Meeting (2002) amounting to US$51.0 billion annually. However, the share of low-income countries in this flow had indeed decreased and stood at less than 50.0 per cent in FY2001.

Bhattacharya presented an analysis of the dynamics of aid flow to Bangladesh and noted that the country has been facing an image problem, as it is considered an extremely aid dependent one. However, empirical evidence shows otherwise. In terms of the volume of aid received, Bangladesh's position is 11th among the 134 countries; countries such as Pakistan, India and Indonesia are far ahead of Bangladesh in terms of flow of ODA. Moreover, in terms of per capita foreign aid, Bangladesh's position is 86th among 134 aid recipient countries. He pointed out that Bangladesh has been experiencing a burgeoning aid pipeline in recent years. The country has received US$49.1 billion in foreign aid since independence (1972), of which more than US$40.7 billion has been disbursed showing an aggregate disbursement rate of 83.0 per cent. The trend in aid disbursement shows that the disparity between the commitment and disbursement is increasing over time. During July 2002-June 2004 (FY2003), only 73.0 per cent of the total committed aid had been disbursed. Consequently, the total aid pipeline stood at more than US$6.2 billion as of 30 June 2003. Of this amount, 96.0 per cent was on account of project aid.

Presenting a disaggregated analysis of aid flow, Bhattacharya noted that the change of ODA's composition showed a significant shift in donors' emphasis from grants to loans. The share of grants in total ODA declined from 48.0 per cent in FY1991 to 21.0 per cent in FY2003. The donors preferred loans even if it is a "soft loan" in comparison to a grant, as it is maintained that loans obligate the recipient country to use the resource more responsibly. Concurrently, the relative shares of project, commodity and food aid have undergone discernible changes. The share of commodity aid in total ODA has declined from 24.0 per cent in FY1991 to about 11.0 per cent in FY2003, as the need for Balance of Payment (BoP) support is not as important as it was in the 1980s. The share of food aid has also went down from 15.0 per cent in FY1991 to only 3.0 per cent in FY2003, as Bangladesh moved towards food self-sufficiency. This implies that foreign aid currently comes to Bangladesh overwhelmingly in the form of project aid (86.0 per cent in FY2003). On the other hand, as regards aid sources, bilateral aid is becoming more predominant compared to multilateral aid. The share of bilateral aid in total ODA has increased from 39.0 per cent in FY1991 to 49.0 per cent in FY2003, while the share of multilateral aid declined from 61.0 per cent in FY1991 to 51.0 per cent in FY2003.

He observed that the foreign debt situation of Bangladesh was under control and tallied very favourably with other countries. Total Debt Service Liability (DSL) as a percentage of total foreign earnings[2] has declined from 11.0 per cent in FY1991 to 6.0 per cent in FY2003, while outstanding foreign debt as a share of GDP has dropped from 41.0 per cent in FY1991 to 32.0 per cent in FY2003. Per capita debt remained more or less stable over the period and presently

[2] Total foreign earnings comprise the total export, remittances and invisible earnings.

stands at US$122.0, which essentially means that currently every child in Bangladesh is born with a foreign debt burden amounting to Tk 7,200.0.

Share of ODA in GDP and per capita availability of foreign aid have been waning over the last decade. ODA as percentage of GDP has dropped by half as it declined from 5.6 per cent in FY1991 to 2.8 per cent in FY2003. On the other hand, the per capita ODA availability[3] declined from US$65.2 in FY1991 to US$57.2 in FY2003.

Bhattacharya was of the opinion that the diminishing relative role of foreign aid in the Bangladesh economy needs to be assessed in terms of other macroeconomic variables. In FY2003, foreign aid accounted for less than a quarter (24.2 per cent) of Bangladesh's export earnings. On the other hand, foreign remittance from migrant workers was almost double the amount of foreign aid inflow. These trends indicate the waning importance of foreign aid as a source of foreign exchange. Furthermore, ODA as a percentage of revenue receipt was only 26.8 per cent in FY2003; compared to 106.2 per cent in FY1981. He pointed out that during the 1980s, ADP was almost fully funded by foreign aid; but at present it is less than 50.0 per cent and was only 42.0 per cent during the last fiscal year (FY2003). On the other hand, the dependence on foreign aid for financing the fiscal deficit, emerging from the need for financing development activities, has also come down to 52.5 per cent in FY2003.

Dr Bhattacharya, however, cautioned the audience that while it is true the role of ODA in the Bangladesh economy is markedly decreasing, it does not necessarily mean that there is no need for foreign aid in the economy. Indeed, there was a savings-investment gap in the economy and part of this had to be bridged through financing from external resources, either through foreign aid, foreign direct investment, remittances or by a combination of all these. Sectoral aid intensity shows a significant trend. Interestingly, during the last two political regimes, transport remained the highest recipient of ODA, while health, population and family welfare secured second position in terms of sectoral weighted shares (per cent) and dependence. Five sectors, namely transport, health and population, education and religious affairs, rural development, and power essentially account for three quarters (73.3 per cent in FY2003) of the total project aid at present. Foreign aid has been playing an increasingly important role in terms of financing the non-government sector, and also the private sector. The grant support to the NGOs was US$250.0 million in FY2003. At the same time, whether through equity participation or through soft-term loans or through risk-underwriting, the private sector had received more than US$300.0 million during the FY1998-2002 period. Thus, though foreign aid's role has been on the gradual wane in the national economy, it continues to play a significant strategic role.

He pointed out the salient features against the backdrop of which the BDF 2004 was taking place. In this connection, he outlined the context of the upcoming Bangladesh Development Forum meeting in the following manner:

- Continuation of the welcome tradition of holding the meeting in Dhaka (first time in 1973, after a long pause in 1997 and then in 2003).
- Bangladesh, after a long hiatus, is under an IMF programme.
- Intensification of political acrimony and agitation.
- PRSP process is attaining maturity and there is now an opportunity to review the Interim-PRSP implementation.
- Relatively strong macroeconomic fundamentals, yet donors' restive mood about reforms.
- Opportunity to take stock of and avert "mid-term inertia" that tends to impede the second half of government' terms.

[3] Annual ODA Availability = (Opening Pipeline + annual commitment)+/- transfer/cancellation.

In the context of BDF 2004, Dr Bhattacharya raised a number of emerging concerns of the civil society in relation to the themes of the five working sessions of BDF 2004, these pertained to: (i) Macroeconomy; (ii) Meso/sectoral issues; (iii) Reforms; (iv) Governance concerns; and (v) PRSP.

On the macroeconomic issue, he noted that although the macroeconomic fundamentals remain robust, there are a number of concerns:

- The weak capacity for utilisation of foreign aid, leading to the low level of ADP implementation was a major concern;
- Slow realisation of NBR targets coupled with the under-achievement of non-NBR and non-tax targets may create a need to borrow more than the target to provide counterpart fund for full implementation of the ADP;
- Keeping revenue expenditures within the budgetary limit, streamlining "subsidies" to energy sector on account of the rise in global price of petroleum products;
- Failure to export and slowdown in the flow of remittance together with the recent robust import surge may put pressure on the BoP. This fear was compounded by uncertainties triggered by the impending MFA phase out.

On the meso/sectoral issue, the paper highlighted the following concerns to be addressed in the upcoming BDF:

- Operationalisation of "Programme Approach" for aid financing for sectoral programmes (e.g. Health & Primary Education) and scope for Overall Budgetary Support;
- Streamlining and strengthening of project processing;
- Trade related technical assistance for capacity building for export diversification and trade negotiations;
- Resources for the expansion of health and education services, and improving the quality of expenditures;
- Developing of investment and trade infrastructure including modernising ports, power generation and national gas supply, constructing roads and bridges.

As regards the ongoing reform agenda, which was likely to be a major focus of BDF 2004, Bhattacharya noted the following:

- Banking Sector Reform: Relatively, the most advanced area of the reforms. The schedule for privatisation of banks appears unrealistic.
- Privatisation: The process remains paralysed with the Privatisation Commission having nothing much to do.
- Revenue Mobilisation: Indirect tax, viz. VAT (local) is expanding; while income tax base is broadening and plugging of leakages are progressing slowly. Indirect tax tends to be inequitable.
- Quality of Public Expenditure: Need to act more energetically on the recommendations of the Public Expenditure Review Commission (PERC).
- Public Administration Reform: The incentive structure demands radical reform, and manpower needs to be rationalised. Implementation of recommendations of earlier Public Administration Reform Commission (PARC).
- Local Government: Devolution of power to the elected local bodies, and strengthening related institutions. Recent experience with *Gram Sarker* is rather frustrating.

On the governance issue, Bhattacharya pointed out that the following issues needed more indepth discussion which include the present state of functioning of the legislative body, efficacy of the envisaged Anti-Corruption Commission, law and order, and human rights situation, separation of Judiciary from the Executive branch, government's relationship with the NGOs and phasing-in of trade union rights in EPZs.

He considered PRSP as one of the major issues to be discussed during the BDF 2004. He emphasised the importance of the following issues in this context:

- Interface with the mid-term planning process (Plan Holiday?);
- Consultation in the process of finalising PRSP;
- Preparing sectoral targets and estimates of resource requirements;
- Ownership by the ministries and integration of sectoral programmes in PRSP,
- Resource envelope for PRSP (to be estimated through top-down or down-up method?).

Dr. Bhattacharya wrapped up his presentation by stressing on the required follow-ups of the BDF. He pointed out that the BDF was no more a pledging platform for the donors; however, its proceedings were likely to influence the mid-term prospect of Bangladesh's aid availability. BDF 2004 may revisit the agreed policy measures to evolve a realistic timeline for the reform measures that are fully owned by the GoB. He further stressed that the BDF 2004 should provide indications about donor's contribution to the resource envelope for the PRSP. It may consider donor support to underwrite a possible BoP problem following the total elimination of the MFA in January 2005. In concluding his presentations, he pointed out that BDF 2004 was only an event at a point in time, and that the hard work on many of the issues flagged through government-development partners' dialogue that concern the real interest of the country will have to be continued in earnest by all the national actors. He concluded by saying that if in this process, the BDF forfeits its relevance that will be the litmus test and a measure of the real efficacy of Bangladesh's aid partnership.

B.3 THE CIVIL SOCIETY PERSPECTIVES

An animated discussion followed the keynote presentation, which dealt with such issues as the agenda to be discussed in BDF 2004, conditionality of foreign aid, accountability of NGOs, law and order situation and the state of political governance and the current political situation. The chairman, in his opening remarks, noted that the first BDF took place in Dhaka in 1973 and hoped that henceforth all development forums will be held in Dhaka. Addressing the distinguished participants, he opened the floor for discussion by saying that CPD felt it appropriate that it should take an initiative to amass civil society members at a platform where it would be able to share its views with the Finance Minister who will lead Bangladesh delegation at the BDF. Such a forum will also allow the development partners to share their thoughts and perspectives on the BDF agenda.

The following is a summary of the major points raised throughout the dialogue.

B.3.1 Policy Ownership

There was a wide consensus among the participants about the need for owning policies to be formulated by the GoB. It was felt that if all parties agreed to a policy that they thought should be pursued by government, then those policies should be owned by the government and the nation as a whole, and not be left to the discretion of the development partners alone. Taking part in the discussion, Professor Rehman Sobhan observed that any process that sets the trajectory of Bangladesh's development and its agenda for reform should originate from within the country. It should be something that is developed by the elected representatives and the policymakers and it should derive from a process of consultation with and within the civil society. Such a process should emerge as a process of change within the economy and society, which then can be communicated to our development partners, he added. Professor Sobhan observed that the development partners have now elevated the concept of 'policy ownership' to a permanent feature of the contemporary agenda on international aid movements, and that the Bangladesh civil society respects such a policy shift. Many participants agreed with Professor Sobhan, and felt that policy ownership should be internalised into our policy-making processes. They also agreed with the assertion of the keynote presenter that the lack of ownership undermines both design and implementation of policies.

B.3.2 Environment for Development: Confrontational Politics, Law and Order and Corruption

A stimulating discussion took place on the issue of creating a suitable environment for development to take place in Bangladesh. A number of participants were critical about the current political situation, criticising the state of law and order and felt that widespread and pervasive corruption was retarding the economic potential of the country.

Mr Kutubuddin Ahmed, President, MCCI, emphasised the importance of ensuring a peaceful environment for conducting business in Bangladesh. Referring to the recent political confrontations, he observed that during the Opposition campaigns and government's mass arrest programmes, businessmen suffered the most. Workers and businessmen were sentenced to jail, and many business enterprises had to be shut down. He felt that politicians from both the major parties should come forward with a *common agenda* guiding the way for the national economy to run. He felt that some crucial areas of developmental significance should be spared from confrontational political movements. Complaining about the existing law and order situation, Mr Ahmed questioned whether one could expect foreigners to invest in Bangladesh at a time when local investors do not feel confident enough to do so. Some of the participants recalled that the Transparency International Report had identified Bangladesh as the most corrupt country for last three consecutive years. This was entirely unacceptable, and he thought that the government lacked a *vision* in terms of controlling such widespread corruption.

Ms Sultana Kamal, Executive Director of Ain-O-Shalish Kendra (ASK), stressed on the issue of human rights and governance. Quoting from ASK findings, she informed the audience that there had been more than 250 cases of violence against women (including rape, acid burn, dowry related violence and *fatwa* or religious injunctions), 136 cases of journalist harassment, 250 cases of political clash, and 46 deaths in police custody only from January to March 2004. In some places, it was the law enforcing agencies that were directly responsible for many of the assaults, she added. Referring to that day's (05.05.2004) newspaper, she said that people like *Bangla Bhai* are taking the law into their own hands. This was very disturbing, she maintained. Failures to reduce political tension and to strengthen the democratic process have further undermined the ability of state institutions to uphold the rule of law, including safeguards against human rights violations. Describing the current situation as totally unacceptable, Ms. Kamal blamed the police and administration for a dysfunctional parliament, confrontational politics, ineffective judiciary, and endemic corruption, dismal law and order situation and ever-increasing crime rate. She felt that these were major roadblocks to Bangladesh's development.

Mr Ataus Samad, an eminent journalist, noted that the security of the individual citizens is the most important issue from the perspective of development, and the journalists have been talking and writing about this issue for long. He lamented the fact that the general citizens do not feel secure any more, and this sense of insecurity has spread all over the country. He pointed out that the journalists have warned the government through their writing that if they fail to provide personal security, people will think of alternative methods in order to protect themselves, and will act accordingly. He mentioned that such official failure had given rise to a group of vigilantes, who are acting in the presence of the police. He felt that this was because the policemen have failed in their duty and handed this over to the vigilantes, set up by the police. These vigilantes and the police are working in tandem at the instruction of political leaders. If this is the situation, he continued, then the party at the receiving end has an equal right to strike back in the name of 'self defence'. He questioned whether we are handing the country over to the vigilantes and warlords who are at loggerheads with each other at times. He cautioned that such a situation would strike at the root of democracy and push the state towards lawlessness and anarchy. He warned that such a state of affairs cannot exist! Another issue that Mr Samad drew the attention of the audience towards was that of justice for the poor. He observed that the insecurity of the impoverished and the failure of the judicial system to protect them was demonstrated during the episodes of mass arrests, when the magistrates sentenced accused people for something which they alleged that the arrested people had done without giving the accused an opportunity to defend themselves. He felt that the human rights institutions and the NGOs have to some extent failed in their duties. He also observed that in Bangladesh "corruption has increased with foreign aid."

Mr A K Azad, President, Bangladesh Chamber of Industries, demanded to know what the political representatives have done for the business community and for the people in general over the last few years. Pointing to the failure of both the government and the opposition political parties, he questioned the ethics of taking recourse to public money without attending parliament! Pointing at some earlier incidences, including the recent killing of CEPZ head, he put the question before the civil society and the political leaders that if a person such as the CEPZ head cannot live, how can justice be ensured for the common people!

Former Deputy Speaker of parliament, Professor Ali Ashraf, opined that the law and order and governance issues should be at the top of agenda in any country. He urged the government and all concerned to try not to top the list of the Transparency International report on corruption again. He requested CPD to organise a dialogue on corruption, where all major stakeholders should be invited to have a frank and open discussion.

B.3.3 Conditionality and Management of Aid

The dialogue saw an open discussion on the issues of aid conditionality and the management of aid. The discussion centred on the targeting and effectiveness of aid administration.

Recalling an early debate regarding whether foreign aid was for the government or for the people, former Finance Minister and the Member of CPD Board of Trustees Mr M Syeduzzaman noted that it was now universally accepted that foreign aid was primarily meant for the well being of common people, and not the government. However, there is no system of accountability and transparency in place to monitor the management of aid, and expressed his doubt whether aid was actually reaching the poor. He also questioned the justification of the ever-increasing number of conditionalities linked with aid. He felt that there should be a mechanism to discover whether particular conditionalities were acceptable to the people. Though the aid flow has decreased significantly to about 2.8 per cent of GDP, compared to 9.0-10.0 per cent in the 1980s, he felt that the number of conditionalities has multiplied over the past years. He further noted that if one looks at any matrix of conditionality attached to a project or non-project aid, one will see that this statement is very true. He observed that the increase in the number of conditionalities originates from the weakness in project implementation and the poor design quality of reform initiatives undertaken by successive governments. He suggested that the conditionality attached to any aid package should be discussed in the parliament to keep the electorates informed. He questioned the practice of using aid for political purpose, and noted that successive governments have attempted to influence people's opinion by asserting that developmental funds will not be channelled to the constituency if they did not vote for the government candidates.

Questioning rationale behind the closure of Adamjee Jute Mills, Dr Wajedul Islam Khan, General Secretary of the Trade Union Centre maintained that when the donors prescribe any action to be taken by the government, there is no suitable entity to verify the appropriateness and authenticity of such demands. He commented that although the country receives huge amounts of foreign aid, not even a quarter of these resources are reaching the poor people in the name of whom the aid was received in the first place.

Professor Abu Ahmed, Department of Economics of the University of Dhaka, also urged for making the conditions by set forth by the donors public, and to let people know how much money is received under the respective conditions. He commented that the government should not depend entirely on the donor's conditions and suggestions. Addressing the issue of demand for aid in all sectors, Mr Rezaul Karim suggested that the demand has to be met on the basis of equitable and appropriate distribution of limited resources among contending sectors.

Ms` Khushi Kabir, Coordinator of Nijera Kori, demanded that the BDF deliberation be made public. A press release and a press briefing at the end of discussion is not enough. She also enquired about repayment mechanisms for soft loans to private sector projects. Questioning the relevance of aid in the national economy, Former Ambassador Major Gen A.M.S.A. Amin commented that if foreign aid flow stopped, the people at the grassroots level would stand to lose nothing; rather the development process would attain a new momentum.

B.3.4 Microcredit and the Accountability Issue of NGOs

A very stimulating discussion took place on the issue of microcredit and the accountability of NGOs. Some participants were of the view that NGOs should be more accountable and transparent in their activities and financial reporting. Others demanded that there should not be any discrimination in the attitude of the government towards NGOs.

Taking part in the discussions, Professor Abu Ahmed commented that there was widespread suspicion among the general public about the accountability of NGOs. This should be removed, and it is the duty of the government, as well as the NGOs themselves, to work towards this goal. He suggested that the Bureau of NGO Affairs should be replaced by a full-fledged *NGO Regulatory Commission* and the NGOs should put up their elaborate and comprehensive balance sheet, somewhat in line with the private banks. This will enhance the transparency of NGO activities. However, Mr S M Al-Husainy, Chairman of Swanirvar Bangladesh, could not support the idea of a NGO regulatory commission, as he believed that more regulations were likely to breed more corruption. In place of this, he proposed that if the NGOs are going to work as partners and development agents for the government, then there has to be an *umbrella plan* for each sector in which the share of the work to be carried out by the government and NGOs should be laid out clearly.

Admitting that NGOs are public entities and need to be accountable too, Ms Khushi Kabir added that to ensure accountability, one should not create a system that will lead to more corruption and bribery, which in turn will trigger even greater corruption and diversion of funds. Dwelling on the issue, Dr Salahuddin Ahmed of BRAC informed the audience that BRAC has always maintained transparency in its work and any one could familiarise themselves with BRAC's financial situation if they visited the BRAC website.

Mr Rezaul Karim Chowdhury, Secretary, SUPRO, criticised the involvement of NGOs in politics and asked the government to undertake an exercise to evolve mechanisms through which NGOs activities can be channelled to perform their designated duties in a lawful manner.

B.3.5 Infrastructural Development

A number of discussants stressed the key role of infrastructure in the development of the economy. They particularly laid emphasis on the role of rural infrastructures as they felt that the rural economy was the mainstay of the overall development of a country such as Bangladesh.

Mr Kutubuddin Ahmed, President, MCCI, picked up the issue for discussion by saying that a simple initiative of the government in the area of developing infrastructure may encourage and facilitate the private sector to contribute immensely in creating employment and income generating opportunities in the country. Recalling the government scheme for developing Ashulia road, Mr Ahmed observed that this single step on the government's part has persuaded the private sector to invest millions of dollars and has created employment opportunities for thousands of people in the neighbouring areas. Quoting from the Japan External Trade Organisation's (JETRO) report, he added that the development of public utility services, such as telephone, electricity, gas etc. is important for stimulating both foreign and local investment.

Underscoring the role of rural resources in the national economy, former Finance Minister Mr M Syeduzzaman argued that aid money should be channelled more towards the development of infrastructure in the rural areas. Mr Ataus Samad called upon both the government and private entrepreneurs to invest in rural infrastructure in view of its exceptionally high multiplier impacts on the economy.

B.3.6 Reform Initiatives for Development

Discussants at the dialogue highlighted the importance of administrative and legal reforms to create a conducive environment for development. There was wide consensus among the participants regarding this issue, as everyone agreed that without an effectual reform initiative, the development process will not proceed accordingly. Mr. M. Syeduzzaman commented that the local government reforms were essential for better management of foreign aid. To ensure that the flow of aid reaches the targeted population, administrative and legal reforms pertaining to the local government were extremely important, he added. Mr Hasanul Huq Inu, President, Jatiya Samajtantrik Dal, criticised the government for its failure in implementing the reform agenda and blamed it for pursuing a donor driven agenda. He claimed that there was no breakthrough in facilitating access of the poor to resources; rather the inherent structural injustices are creating more impoverished people. He stressed the need for formulating a development programme, which will go beyond the contemporary microcredit centred programmes. He also emphasised on reforming the Election Commission so that the next election is acceptable to all parties. He also stressed the need to make the national parliament more functional.

Agreeing with the need for an efficient reform initiative on the part of the government, Ms Sultana Kamal of Ain-O-Shalish Kendra criticised the government for its failure in separating the judiciary from the administration, for not establishing the office of the ombudsman, and for failing to set up an Anti Corruption Commission.

B.4 RESPONSES FROM THE POLITICIANS

In response to the growing concerns on confrontational politics, Former Commerce Minister Mr Amir Khosru Mahmud Chowdhury, MP admitted that often politicians are blamed for violence, and political practice was truly bad in many ways. However, he argued that still there were some good politicians who did not patronise the *mastans* or hoodlums. There are politicians who can be proud of being a public representative, who spoke for their people, he added. He requested the participants to appreciate the work of the good politicians, and emphasised the need to keep 'faith' in politics and politicians.

Mr Chowdhury laid importance on private sector led growth, and noted that this was not the case at present. He informed the audience that most of the developed countries are now developed because of the contribution of their respective private sectors. He added that the private sector has been playing a cardinal role in the development of roads, energy and telecommunications in those countries. He felt that the government should involve the private sector in the development of the country's infrastructure backbone.

Acknowledging that the NGOs were really doing good work for the development of the country, Mr Chowdhury, however, said that some NGOs were directly involved in politics and advised those to join in politics as a political party. If certain NGOs get involved in politics, it could tarnish the image of other NGOs, which were doing exceptionally good jobs for the nation. It did not augur well for the country's development that NGOs were getting involved in politics, he said, adding that he had seen lot of donors patronising a section of the NGOs, which were involved in funding political campaigns.

About donor funds, Mr Chowdhury commented that in many instances, too many consultancy jobs were carried out and million of dollars were spent on reports, but very few of the recommendations had been implemented. Dwelling on the role of parliament, he said that for ensuring sustainable development process, well functioning parliamentary committees were a must.

Supporting Mr Khosru's comments as regards politics, Mr Saber Hossain Chowdhury, Political Secretary to the Honourable Leader of the Opposition, agreed that people should keep their 'faith' in the political system, especially on the political parties since they were the direct representatives of the people. Emphasising on the role of parliament in a democracy, he agreed that indeed the parliamentary committees are functioning well. He also agreed that the NGOs should not be involved in politics. However, he added that the government should not judge any NGO on the basis of the particular ideology they hold or subscribe to. Quoting some statistics from the keynote presentation on the donor contribution, he said that the role of foreign aid in the development process of Bangladesh is decreasing. However, at the same time, there was a wide consensus and belief that donor's influence is increasing day by day. He suggested that zero-dependence on foreign aid should be the nation's target.

Describing the importance attached to donors' "certificate" as a bad signal, he said that the Prime Minister should not refer to the donors while addressing public meetings, and claim receipt of foreign aid as a testimony of donors' support towards the government.

Mr Saber Hossain Chowdhury also laid importance on the reform of the Election Commission and observed that a free and fair election would not be possible with a bureaucracy that had unfortunately been extremely politicised. He suggested that Bangladesh should have a long-term policy agenda targeted for 10 to 20 years, and should work towards political and economic stability to ensure the sustainability and continuity of the policies, high quality of civil service and effective and functioning decentralisation.

Mr Mushfiqur Rahman, MP, Chairman, Parliamentary Standing Committee on Ministry of Finance, in his speech, as the special guest, congratulated the CPD for arranging such an important event. Mr Rahman sounded optimistic and commented that despite the pervasiveness of bad governance, poverty and unstable political system, one should look at the brighter side of the coin too. He noted that per capita income of the people has increased from US$70.0 during the post-independence period to U$410 at present. We should not be too pessimistic, he maintained. Rather, one should think how to inspire constructive attitude and behaviour of individual citizens and political parties, and how to encourage good practices. Emphasising on non-economic factor as a very important underlying factor of development, he observed that the goal of development should be social justice, employment generation and poverty reduction. In response to the criticism against the confrontational politics in the country, he argued that political parties, whether it is in position or in the opposition, should play a constructive role in the country's development process.

Qualifying recent performance in domestic resource mobilisation as very efficient, Mr Rahman stressed the need for further initiative in this regard and informed the audience that the Tax-GDP ratio in Bangladesh is still one of the lowest in South Asia. It is the responsibility of the political parties to help the process of domestic resource mobilisation, he added. Criticising the role of political parties in the development process, he said that the influence of donor community was on the rise precisely because highly politicised institutions were more likely to favour donors for their petty political gains, rather than caring for the nation's development. Referring to institutional dysfunctions, Mr Rahman maintained that politicians could not shrug off their responsibility since they are the leaders of nation's development process. In reply to the comment that economic development depends on political stability, he made the observation that the state of economy also was a creation of politics. A poor economy makes more poor people and creates unemployment, which generates more *mastans* and leads to instability in politics, he argued. Appreciating the initiatives of some NGOs such as BRAC and Grameen Bank, he said that some NGOs were diversifying their activities and this was an appropriate time for the country to form a *Regulatory Commission* for the NGOs. However, he suggested that the NGOs should be "home-grown" and should not be dependent only on foreign aid and should not get involved in party politics.

B.5 RESPONSES FROM THE DEVELOPMENT PARTNERS

Ms Christine Wallich, Country Director of World Bank in Bangladesh, initiated her comments by thanking the participants for their thought provoking discussion. She agreed with Finance Minister's comment about the high quality of the keynote presentation, which she found both informative and educative.

About Bangladesh's current political situation, she felt that Bangladesh needed greater political unity between the major parties. It is a challenge especially for the two major political parties, she observed. She suggested that the political parties should identify areas (such as policy reform, power, health and education) where they could reach a consensus. Political parties could fight on issues; it was their prerogative but should not fight on issues where they have reached a consensus. She thought that the electoral system in Bangladesh is one of most expensive in the world. On an average, about 20.0 million taka was required to win a seat in the parliament. A country with a per capita income of just under US$400.0 a year could ill afford such an exorbitant expenditure.

She shared told the audience that in the World Bank Internal Rating System, Bangladesh had moved from a low performer to a middle performer country. She thought that Bangladesh had a good record as far as macroeconomic fundamentals and performance were concerned; in some areas particularly banking reform and privatisation, she said that the country had performed reasonably well. She felt that Bangladesh's development is very close to the Indian benchmark since the country has just outperformed five Indian states taken individually. She also informed the audience that Bangladesh has moved from a *low case* to a *base case* as far as World Bank was concerned and the Bank has labelled Bangladesh as a *base case* for the second year.

However, Ms Wallich observed that Bangladesh should put greater emphasis on improving the quality of governance. Apart from governance, Bangladesh was doing well in terms of many other indicators and that is why World Bank's lending programme has expanded in Bangladesh, she added.

About donor conditionalities, she said that World Bank is working with the government to help them to define and design reforms at a technical level and provide the support after the reforms are initiated. In fact, donor community as a whole is trying to move away from the conditionality approach, she added. Ms Wallich wondered that a lot of people here in Bangladesh talks about the influence of World Bank on the government's activities, which she has not seen in any other country where she had worked in the past!

About the PRSP, she invited suggestions from the participants on how to organise public debates on the relevant issues. One of the difficulties as regards the PRSP consultation process in Bangladesh was that not many people read newspapers here and had no idea about the radio. But she admitted that serious discussion is needed around the PRSP process. She mentioned that the development partners are urging NGOs to become more self-reliant, and be less dependent on donors. She also maintained that donors encourage NGOs to create an endowment fund for themselves so that dependence on donors could be gradually lessened. About transparency in NGOs activities, she felt that NGOs should operate in an environment of transparency and accountability. NGOs should not work as the private businesses do; rather the profit of business carried by NGOs should be channelised for development purpose only.

Participating in the discussion, Mr Gene V George, USAID Chief of Mission said that though Bangladesh was doing very well, investment in the social sectors, especially in health and education, was still very low and in fact, to some extent it was below what is the norm even by developing countries' standards. About NGO activities, he said that the donors have a very good understanding about what the NGOs are doing and what they are intending to do with the money that the donors provide. He informed that a number of NGOs have not been given loans second time as their performance during the first time was not good enough. He felt that the notion about NGOs lacking accountability is a misperception. However, he requested all the parties involved not to blame each other; rather to work with each other. He was also of the opinion that both the NGOs and the private sector entrepreneurs should conduct their financial transactions in a transparent manner.

Danish Ambassador H E Mr Niels Severin Munk said that views differ from donor to donor; principles which guide their work in the process of development cooperation are also different. He cautioned that Denmark will withdraw its assistance if it cannot ensure a well-functioning partnership with the government. He also pointed out that about 1.0 per cent of Denmark's GDP goes to its development aid programmes and most of it was in grants. Over the last three years, Denmark was to fully utilise its commitment too. He informed that out of 15 partners, Denmark was placed fifth in terms of its involvement in Bangladesh. Getting aid is not a big problem for Bangladesh; rather the major problem for Bangladesh was proper utilisation of its received aid, he noted.

About the conditionality of aid, Mr Munk maintained that unlike the World Bank, Denmark didn't have any problem making her views public as regards conditionalities. He said that since 2001, Denmark informed the government of Bangladesh on three occasions about pulling out her assistance on the ground of corruption, but the government did not listen to that. He said that Denmark is involved in Bangladesh to support the country's poverty alleviation initiatives. It is here because 65 million people still do not have access to basic needs and the nutrition level is still very low, he added. Supporting the comments of Danish Ambassador, the German Ambassador H E Mr Dietrich Andreas observed that different donors have different criterion for aid. He commented that the donors are spending the money of their respective taxpayers, and thus are accountable to their taxpayers and to their national parliaments. He agreed that the NGOs should follow some rules and regulations and should not be a party to political polarisation. However, he pointed out that NGOs have made commendable contribution to poverty reduction at grassroots level, which is a very important factor for bilateral support.

On the aid conditionality issue, the Australian High Commissioner H E Ms Lorraine M Barker noted that the issue of conditionality was not so much an important factor for Australia in her relationship with recipient countries. However, she urged the audience to look at the positive aspects of conditionality, as in many cases, this ensures that the recipient countries utilise the funds judiciously in the first place. Maintaining that Australia was a very good development partner of Bangladesh, Her Excellency reminded the house that Australia was the first western country to recognise Bangladesh after its independence in 1971.

B.6 RESPONSES FROM THE GOVERNMENT

Finance and Planning Minister Mr M Saifur Rahman commenced his speech by appreciating CPD for its initiatives to organise a pre-BDF dialogue. He profusely thanked the Centre for Policy Dialogue (CPD) for organising this high level dialogue with wide representations from the country's civil society. He appreciated CPD's endeavour for presenting the civil society perspectives on the eve of the forthcoming BDF, where all major stakeholder groups from various parts and sectors of the country could voice their concerns, as *a galaxy of talents*. He termed the keynote presentation of Dr Bhattacharya as excellent an exposition of the current aid situation and BDF context and thought that the paper called for an indepth discussion.

The minister agreed with the central thesis of the paper and questioned widespread misconception that Bangladesh was a highly aid dependent country. He noted that 42.0 per cent of its ADP financing is coming from the ODA. This share was on the wane, and it was mostly project aid; only 2.8 per cent equivalent of GDP coming from foreign assistance at this moment, which is not very high, compared to other countries. ODA share in fiscal deficit as percentage of GDP is less than 3.0 per cent, he added. So the conception that Bangladesh will not survive if foreign aid does not come is not a correct proposition. Instead, he stressed on internal resources mobilisation in order to be self-reliant. The minister expressed his disappointment with the current internal resource mobilisation scenario. In this connection, he mentioned that tax and non-tax revenue together at present account for only 9.0 to 10.0 per cent of GDP.

The Finance Minister drew attention of the audience to various reform measures initiated by the Ministry of Finance and Planning. Some of those initiatives, as he mentioned, were the civil service reform, various regulatory and institutional reforms, banking sector reform and setting up of the Anti-Corruption Commission. He reminded the audience that all these initiatives have been under taken and pursued by the Ministry of Finance, and the Ministry of Law provided the legal support to those.

He blamed the ongoing political strife inside the country as the prime cause for slowing down of the reform measures, indicating that a position of a blind opposition on every issue undermines the efficacy of the reform process. A good reform process demands consensus on the part of both the major political parties and also an active support from the civil society, he continued. When the politics becomes confrontational or divisive, it is very difficult to create an ideal environment for carrying out complicated reforms, he noted. Referring to comments made by some of the participants as regards reforms measures in Pakistan, he argued that in a well-functioning democracy, reform process has to be more responsible than what is usually the case in autocracy and that is why it is more difficult to implement reforms in Bangladesh.

Supporting Bhattacharya's comment on the purpose of the BDF, the Finance Minister pointed out that the development forum is no more a forum for receiving aid pledges as was the case during the early aid consortium meetings. Instead, it is now more of a deliberation on the policy and programme of the country, he added. The forum is meant to convince firstly our society, and then in the process, the outsiders participating in our development process in their respective areas, that we have appropriate infrastructure, institution, governance, legal systems and regulatory framework in which a competitive private sector economy can work, he maintained.

Laying emphasis on the role of the private sector in the national economy, the Finance Minister added that with the existing regulatory institutional set up, absolute reliance on the private sector may not be very healthy at this stage, and may even prove to be counter productive. The private sector has to be developed quite substantially and at the same time major regulatory and institutional reforms are required to evolve a private sector dominated economy, he strongly reiterated. He commented that the psychology of business community and also the ethos of business ethics have to be changed if we are to go for a private sector-dominated development process. Stressing on the need for privatisation, the Finance Minister mentioned that the private sector was not ready to dominate the national economy at the moment. He added that there are important roles still to be played by the public institutions. In this regard, he mentioned the role to be played by the banking sector. Despite the debates about the reform and privatisation of the banking sector, the minister strongly felt that he is not fully comfortable with leaving every bank in the private sector. Dialogue is still on with the development partners as regards this issue. He assured that people's interest will guide them in this respect.

With our own talent and our own resources, Bangladesh was capable of achieving a self-sustained development if good governance, good regulatory institutions and a healthy and non-confrontational political process, he said in a note of optimism. Expressing his faith in the new generation of entrepreneurs in Bangladesh, the Finance Minister said that they were capable of competing at the newly emerging global business arena because they were forward looking, risk-takers and resilient. The minister thought that if they had the benefit of adequate resources, good business environment, properly functioning institutions and good governance to back them, these entrepreneurs could do many good things.

Highlighting the importance of infrastructure development in the national economy, the minister informed the audience that sectors such as railway and power are still under-invested. These sectors demand a lot of resources. In this context, he contested the comments made by the FBCCI about the size of the ADP being bloated and pointed out that one should have an ambition to do better. Since Bangladesh was under-investing in the infrastructure, this called for allocating more resources in the ADP for sectors such as this one, he argued In conclusion, the Finance Minister once again thanked Bhattacharya for an excellent presentation and expressed his readiness to discuss more indepth the issues that the keynote paper and the discussants had raised. He also felt that the dialogue with the civil society must go on.

B.7 CONCLUDING REMARK

In his concluding remarks, Professor Rehman Sobhan thanked the participants for their insights and comments and contributions to the civil society's consultation process. He concluded by hoping that the comments made by politicians, development partners and the civil stakeholders present at the dialogue will provide important inputs for the Bangladesh Development Forum Meeting 2004. He also hoped that both the GOB and the development partners will pay serious attention to the points raised in the keynote paper and the civil society representatives presented at the dialogue.

Appendix A

List of Participants

(in alphabetical order)

Mr A K Azad
President, Bangladesh Chamber of Industries

Mr A K M Shamsuddin
Former President, (Foreign Investors Chamber of Commerce & Industry) FICCI and Chairman, Aventis

Mr A K M Shamsuddoha
Managing Director, Dohatech New Media

Major Gen (Retd) A M S A Amin
Former Ambassador & Member, Advisory Committee, Bangladesh Awami League

Professor Abu Ahmed
Department of Economics, University of Dhaka & Chairman, Shilpa Rin Sangstha

Dr Abul Hashem
Section Chief (Retd), Development Research & Policy Analysis Division
UN-ESCAP, Bangkok

Mr Afsar Karim Chowdhury
Director, Dhaka Chamber of Commerce & Industry (DCCI)

Professor Ali Ashraf
Former Deputy Speaker
Bangladesh Jatiya Sangsad

Mr Amir Khosru Mahmud Chowdhury
MP
Former Commerce Minister
Government of Bangladesh

Professor Amirul Islam Chowdhury
Former Vice Chancellor
Jahangirnagar University

Ms Anne Bruzelius
Counsellor, Embassy of Sweden

Mr Ataus Samad
Editor, Weekly Ekhon

H E Ms Aud Lise Norheim
Ambassador, Royal Norwegian Embassy

Dr Badiul Alam Mazumdar
Country Director
The Hunger Project, Bangladesh

Ms Christina M Rozario
Deputy Director
Impact Foundation, Bangladesh

Ms Christine Wallich
Country Director, The World Bank

Mr Cleveland L Charles
Chief Economic and Commercial Officer, Embassy of United States of America

H E Dietrich Andreas
Ambassador, Embassy of the Federal Republic of Germany

Mr Dundas McCullough
Counsellor, Political and Economic Affairs, Embassy of USA

Mr Fazle Rabbi
Senior Information Officer, Ministry of Finance, Government of Bangladesh

Mr Fazlur Rahman
Secretary, Planning Division
Government of Bangladesh

Mr Gene V George
Chief of Mission, USAID

Dr Hameeda Hossain
Founder Member
Ain-O-Shalish Kendra (ASK)

Mr Hasanul Huq Inu
President, Jatiya Samajtantrik Dal (JSD)

Mr Herman Parfenov
Head of Trade & Economics Department
Embassy of Russian Federation

Mr Ildar Gibadiukov
Third Secretary
Embassy of Russian Federation

Mr Imtiyaz Hussain
Chairman, Imtiyaz Hussain & Co

Mr Jahangir Bin-Alam
Secretary, Foreign Investors Chamber of Commerce & Industry (FICCI)

Mr Johan Norqvist
First Secretary, Embassy of Sweden

Mr K Z Islam
Managing Director
Nirman International Limited

Mr Kamran T Rahman
Vice-President
Bangladesh Employers' Federation

Dr Kaniz Siddique
Associate Professor, Department of Economics, North South University

Dr Kazi Saleh Ahmed
Former Vice Chancellor
Jahangirnagar University

Ms Khushi Kabir
Member, CPD Board of Trustees and Coordinator, Nijera Kori

Mr Kutubuddin Ahmed
President, Metropolitan Chamber of Commerce and Industries (MCCI)

H E Ms Lorraine M Barker
High Commissioner
Australian High Commission

Mr M A Sattar Bhuyan
Economic Advisor, Ministry of Finance
Government of Bangladesh

Mr M Aminuzzaman
Managing Director
National Credit & Commerce Bank Ltd

Mr M Anis Ud Dowla
President
Bangladesh Employers' Federation

Mr M Hafizuddin Khan
Former Advisor to the Caretaker Government

Dr M Mostafa Zaman
National Professor

Mr M Saifur Rahman, MP
Hon'ble Minister for Finance and Planning
Government of Bangladesh

Mr M Syeduzzaman
Member, CPD Board of Trustees
Former Finance Minister and Chairman
Bank Asia

Ambassador M M Rezaul Karim
Member, Advisory Committee
Bangladesh Nationalist Party (BNP)

Mr Mahbubur Rahman
President, International Chamber of Commerce Bangladesh (ICC,B)

Mr Masahiko Kiya
Counsellor, Head of Economic and Development Cooperation, Embassy of Japan

Mr Matiul Islam
Former Finance Secretary
Government of Bangladesh

Mr Md Aziz Khan
Chairman, Summit Group of Companies

Mr Md Quddus Khan
Joint Secretary (Banking), Ministry of Finance, Government of Bangladesh

Dr Mirza Azizul Islam
Chairman, Securities and Exchange Commission

Professor Mohammad Masum
Department of Economics
Jahangirnagar University

Mr Mushfiqur Rahman, MP
Chairman, Parliamentary Standing Committee on Ministry of Finance

Mr Mustafa Mohiuddin
Director General, Export Promotion Bureau

H E Mr Niels Severin Munk
Ambassador, Royal Danish Embassy

Dr Quazi Mesbahuddin Ahmed
Member (GED), Planning Commission
Government of Bangladesh

Dr Rajani Alexander
First Secretary (Development)
Canadian High Commission

Mr Reazul Islam
Programme Officer
Embassy of Sweden

Mr Rezaul Karim Chowdhury
Secretary, SUPRO (Shusasan-er Jonno Prochar Ovijan)

Ms Rezwana Rasheed
Department of Sociology, University of Dhaka

Mr Robert Beadle
Head of Development Cooperation, Canadian High Commission

Ms Rokia A Rahman
Former Advisor, Caretaker Government and Chairman, Airlinks

Mr S A Chowdhury
Managing Director, Jamuna Bank Ltd

Mr S M Al-Husainy
Former Chairman, PSC and Chairman, Swanirvar Bangladesh

Mr Saber Hossain Chowdhury
Former Deputy Minister and Political Secretary to the Hon'ble Leader of the Opposition

Dr Salehuddin Ahmed
Deputy Executive Director, BRAC

Mr Samson H Chowdhury
Chairman, Square Groups

Ms Shaheena Sultana
Development Programme Specialist, USAID

Ms Shamim Hamid
Principal Officer, UNDP

Advocate Sultana Kamal
Executive Director, Ain-O-Shalish Kendra

Mr Syed Manzur Elahi
Member, CPD Board of Trustees, Former Advisor, Caretaker government & Chairman, APEX Group of Industries

Mr Toru Shibuichi
Country Director, Asian Development Bank (ADB)

Dr Wajedul Islam Khan
General Secretary, Trade Union Kendro

List of Journalists
(in alphabetical order)

Mr A Hussain
The Daily Rupali

Ms Badrun Nahar
The Executive Times

Mr Faruque Ahmed
Bangladesh Sangbad Sangstha (BSS)

Mr Jamal Uddin
The Daily Ittefaq

Mr K Khandokar
The Daily Manabzamin

Ms Mahfuza Moslehi
News Network

Mr Masudul Karim Biswas
The Bangladesh Observer

Mr Md Azizur Rahman
The Dakpeon

Mr Mhawaza Moinuddin
The New Age

Mir Mostafizur Rahman
The Independent

Mr Monjur Mahmud
The Daily Star

Mr Motahar Hossain
The Ajadi

Mr Nurul Hasan Khan
The Dinkal

Ms Parveen Ahmed
Correspondent, AP

Mr Rashidul Islam
Dhaka Correspondent, Radio Tehran

Mr S M Mezanur Rahman
Staff Reporter, The Bangladesh Today

Mr S R Ratan
Staff Reporter, NNB

Mr S Rehman
The Daily Muktokantho

Mr Salahuddin Bablu
The Daily Inquilab

Mr Sayadul Islam
The Daily Ittefaq

Mr Shahnewaz
The Daily Jugantor

Mr Shakhawat Hossain
The News Today

Ms Sharmeen Rinvy
Channel–I

Mr Shawkat Hossain Masum
Prothom Alo

Mr Shohel Siddiquee
Bhorer Kagoj

Mr Tareq Al Naser
Sr Staff Reporter, Financial Express

Mr Zia Rahman
Sangbad

Mr Ziaul Huq Mizan
Shaptahik Robber

Annexure C

Dialogue on

STATE OF THE BANGLADESH ECONOMY AND BUDGET RESPONSES 2004

C.1 THE DIALOGUE

The Centre for Policy Dialogue (CPD) organised a dialogue on "State of the Bangladesh Economy and Budget Responses 2004" on 15 June 2004 at the CIRDAP Auditorium, Dhaka. The initiative was taken with a view to sharing comments, observations and analysis on budget FY2005 presented by the Finance Minister on 10 June 2004. CPD Chairman Professor Rehman Sobhan moderated the dialogue, while Dr Debapriya Bhattacharya, Executive Director, CPD presented the keynote paper. The dialogue was attended by former ministers, MPs, politicians, senior government officials, economists, academicians and representatives of the development agencies.

C.2 INTRODUCTORY REMARKS BY THE CHAIRMAN

Welcoming the guests, Professor Rehman Sobhan, Chairman of the Centre for Policy Dialogue (CPD), pointed out that the dialogue was a sequel to earlier discussions organised by CPD at the time of *Bangladesh Development Forum Meeting* held in Dhaka and to review the state of Bangladesh economy. Professor Sobhan thanked the distinguished group of high level policy makers, government officials, business leaders, representatives from grassroots organisations, academics and experts for their presence in the dialogue. He hoped that the dialogue would lead to useful insights as regards the State of Bangladesh Economy and the required interventions to address the attendant challenges. He informed the audience that the Finance Minister would not be able to join the dialogue, as he would be presenting the supplementary budget in the parliament. The main opposition party Awami League was also attending the budget session. So, a number of MPs from the opposition parties were not being able to attend the dialogue. He hoped that the dialogue participants would conduct an in-depth discussion on the key issues on the table and that the discussions would generate useful inputs for the Finance Minister and members of the parliament.

C.3 KEYNOTE PRESENTATION BY DR DEBAPRIYA BHATTACHARYA, EXECUTIVE DIRECTOR, CPD

In his initial remark, Dr Bhattacharya stated that the ongoing dialogue was the fourth of a series organised by the CPD as part of monitoring the state of the economy during the last one and half months. He noted that the process had started with the CPD dialogue on Bangladesh Development Forum meeting, followed by a press briefing on state of the economy before the budget was placed in the national parliament. Besides, another press conference was organised on budget responses immediately after the announcement of 2004-05 fiscal budget. "Now, with this public dialogue, CPD is finally rounding up its monitoring of the state of the economy under its Independent Review of Bangladesh Development (IRBD) programme," he added. He also informed the audience that for the first time CPD has organised live web-cast of its budget reaction, which was presented at a press briefing on June 11 and of the current dialogue also.

C.3.1 Backdrop

Dr. Bhattacharya initiated his deliberations by highlighting the positive developments of the economy in the Fiscal Year (FY) 2003-04. He noted that GDP growth has achieved the target of 5.5 per cent, which was also projected in the Interim-Poverty Reduction Strategy Paper (I-PRSP) framework. Fiscal deficit was also lower than what was anticipated, although it can be argued that this achievement was due to lower level of development spending. Moreover, the Executive Director of CPD also pointed out that there were accelerations in both foreign and domestic investments, and some fresh movements in the capital market were evident beginning from last October. Bhattacharya observed surge in imports, particularly after the previous year's slump, which he thought was a reflection of growing domestic demand. There was also a steady recovery in export earnings, increase in the flow of remittance and improvements in the foreign exchange reserve. He pointed out that the exchange rate had not experienced any shock.

Dr Bhattacharya considered all these as positive signs for the new budget. On negative sides, he stated the shortfall of revenue collection, particularly in the non-tax and non-NBR sector, under-utilisation of the ADP allocation and the very low off-take of foreign aid. Moreover, there was stagnation in savings-investment scenario, particularly domestic savings rate was stagnating and public investment was the lowest in the last 14 years, about 6.12 per cent of GDP. Bhattacharya added that income disparity was increasing and the tax incidence contributed to the deterioration of income distribution. He observed that privatisation process remained almost retarded, while political acrimony and agitation intensified during third and fourth quarters of the FY2003-04.

Analysing these positive and negative factors, the economist pointed out some macroeconomic challenges for the FY2004-05, which the Finance Minister and his team would have to overcome. Bhattacharya insisted that GDP growth needs to be pushed up beyond 6.0 per cent from the current level of 5.5 per cent. Moreover, he felt that mere growth in GDP would not automatically translate into poverty alleviation. Consequently, more effort should be put for an equitable distribution of the incremental income created by GDP growth. He also emphasised on lifting private investment share beyond 20.0 per cent of GDP from the current 17.5 per cent, also raising domestic savings rate to at least 20.0 per cent of GDP from 18.3 per cent, keeping inflation under control, which is about 6.0 per cent and maintaining exchange rate stability particularly in the upcoming MFA phase-out period. He also stressed the importance for overcoming the "last lap syndrome," which is a situation when towards the end of a political regime, in the run up to the elections, there is a fatigue and the enthusiasm for reforms tends to suffer erosion.

Dr Bhattacharya identified greater off-take of foreign aid and improving foreign aid disbursement as a major concern. He particularly mentioned project aid since an amount of US$7.0 billion had already been lying in the pipeline. Without addressing these issues, there would be a vacuum in ADP financing, and ADP utilisation would remain stagnant. Therefore, the issue of full delivery of development programmes was very important, he added. Moreover, despite the increase in the subsidy, effective delivery of the agricultural subsidy with better targets and better quality remained a concern. He also pointed out that expanding the income tax base effectively, instead of widening local VAT collection, was another crucial issue that needed to be addressed. People who are capable of paying taxes should be identified and brought under the tax net without unnecessary harassment. He also mentioned that non-NBR and non-tax rates needed to be adjusted, since charges were often under-rated while the quality of services remained poor in such areas as postal delivery and rail services. Stressing on rationalisation of para-tariff, he noted that there was 15.0 per cent VAT, 4.0 per cent surcharge, 3.0 per cent advance income tax and different rates of supplementary duties, and all these are eventually giving rise to taxes on tax (cascading tax). Bhattacharya pointed out that addressing the price of petroleum products was another major issue as global petroleum price has increased and quasi-fiscal deficit of the government was also increasing due to high taxes/duties imposed on imports. He felt that the government should not increase the petroleum price; rather it should reduce tax incidences. He observed that the government had already done that in the budget.

Other issues, which remain a concern include providing a new pay scale to government employees and establishing a permanent pay commission, expansion of social safety-net programmes, evolving separate savings scheme for pensioners, small savers and other disadvantageous groups, and ensuring greater flow of Initial Public Offerings (IPOs) in the capital market.

Bhattacharya also stressed on monitoring the impact of global inflation on the price of rice as well as domestic food stock. Ensuring food security was important particularly in view of large-scale Chinese procurement in the global market. The emerging energy crisis should also be looked into as shortfall now averages 600 MW per day in the country. He also expressed his concern about the possible post-MFA shocks, which would result in, not only large retrenchment, but also pre-empting large devaluation, i.e. large shock in exchange rate due to a possible export setback.

The CPD Executive Director noted these as the backgrounds in which the budget was prepared and placed.

C.3.2 Salient Features of the Budget

Presenting the salient features of the FY2005 budget, Dr Bhattacharya noted that the budget was logically cogent, and had explicit macro parameters. It was also of relatively manageable size. The budget was not crowded with donor endorsements, which was noticed in other budgets where Finance Ministers had developed some kind of penchant for referring to endorsement of international financial institutions in order to establish their credibility.

Budget FY2005 recognises the role of non-economic factors such as corruption, law and order situation etc., which he identified as an important acknowledgment. The budget also avoided usual blame-game with respect to the opposition political parties. Dr Bhattacharya pointed out that there was some movement towards integration of development and non-development components since a separate document provides development and non-development expenditures under a common grant. He added that the budget summary was more transparent in terms of resource availability and their uses, but the tariff changes were most skilfully made obscure in the Finance Bill. The Finance Minister did not mention all the changes in taxes in the annex of the budget speech, which was regarded as common practice in previous years.

The CPD Executive Director then elaborated on the macroeconomic scenario comparing it with the I-PRSP framework. He noted that in domestic savings the shortfall was almost 1.0 per cent, in national savings there was a 0.19 per cent increase over the target, while in gross investment the shortfall was 1.8 per cent. By disaggregating private and public investments, he showed that the shortfall was of 1.2 per cent and 0.6 per cent respectively. He also added that despite the achievement in GDP growth rate of FY2004, all the macro parameters except national savings have missed their respective targets. Against this backdrop, Bhattacharya questioned whether a new tension was being created in the macroeconomic framework because growth was taking place but investment was not, and also domestic saving was almost stagnant. He also questioned how much of it would be covered up in FY2005 and how far the I-PRSP mid-term macroeconomic framework would be protected? He was of the view that the way it started in FY2004, macroeconomic framework has taken a beating and people have to wait and see what happens in FY2005.

The economist also pointed out that the inflation rate was higher than what was planned, the total revenue earning was lower by 0.2 per cent, particularly in case of tax, total expenditure was lower than 0.7 per cent of GDP, and it was equally less in case of ADP and current expenditure at 0.4 per cent in each case. The overall budget deficit was 0.5 per cent less than the target mainly due to lack of implementation of policies, which resulted in low expenditure. Net domestic borrowing was also lower than planned. The projections, which have been made in the current budget, more or less follow the I-PRSP target. However, the revenue target in the budget is smaller than what was envisaged in the I-PRSP, and the same holds in the case of total expenditure and budget deficit. Pointing to this, Bhattacharya mentioned that although people might think the budget was big with large expenditures, comparison with I-PRSP framework implied that it was not so large because I-PRSP projected a bigger public expenditure package.

C.3.3 ADP

In his keynote presentation, Dr Bhattacharya mentioned that the Annual Development Programme (ADP) for FY2004 was originally estimated to be Tk 20,300.0 crore, which was later downsized to Tk 19,000.0 crore. Sharing CPD's estimate, he projected that ADP utilisation would not exceed Tk 17,000.0 crore. Unveiling the top performers of the ADP up to March 2004, he noted that religious affairs ministry ranked first with utilisation of 70.0 per cent of allocation, followed by home ministry (69.0 per cent), local government ministry (65.0 per cent), health and family welfare ministry (57.0 per cent) and road and transport ministry (55.0 per cent).

Moreover, those lagging behind in terms of ADP utilisation were liberation war ministry, which utilised only 5.0 per cent of the allocation, followed by information ministry (10.0 per cent), planning division (13.0 per cent), post and telecom (14.0 per cent) and finance ministry (20.0 per cent).

The ADP priority, as noted by Bhattacharya, has not changed substantively in FY05 when compared with FY2004. Local government and power division ranked first and second in both the fiscal years. However, road and transport came down in fourth position while education moved to third and health continued to occupy the fifth position.

Furthermore, in terms of ADP allocation in FY2005, general public services were the biggest gainer growing at a rate of 15.3 per cent over the revised allocation in FY2004. These services stand for all the administrative expenditures including that for the offices of the President and the Prime Minister. He also noted that substantive allocation for recreation, culture and religious affairs have seen a growth of 40.0 per cent, followed by education (34.0 per cent), social security and welfare (33.0 per cent), agriculture (22.0 per cent), health (12.5 per cent) and transport and communication (10.5 per cent).

He felt that it hardly matters how much a sector's allocation is; what matters is the implementation of the allocated resources. In this context, he noted that the implementation performance varies significantly across the sectors. In terms of revenue expenditure, Dr Bhattacharya mentioned that the biggest increase was in bloc allocation. Although there is a debate as regards allocation of fund in this category, this particular provisioning was made in view of Dearness Allowances (DA) for government officials and employees. He also said that CPD's prediction on higher revenue expenditure for interest payments has proven to be true, which was disappointing. He also pointed out that though the government has reduced borrowing from banks, interest for domestic borrowing has increased by 11.0 per cent, while it is 16.0 per cent for foreign debt servicing due to large disbursement for foreign funds, which remained largely unutilised.

The CPD Executive Director projected that the overall revenue expenditure would increase by 14.0 per cent. He, however, appreciated the announcement of a new pay scale. At the same time, he stressed on thinking seriously about setting up a wage commission because the workers also have the right to receive better payment. Mentioning that there is a large increase in the number of microcredit based self-employment programmes within the revenue expenditure, he argued that it is a matter of debate whether the government should carry out such large programme and whether the ministries are efficient enough or not to run such large programmes.

He noted that the new allocation was Tk 1,379.0 crore of which Tk 660.0 crore would be distributed by government agencies and departments, although there are microcredit programmes implemented by PKSF and NGO Foundation. He was surprised to see that Tk 660.0 crore has been allocated for various ministries despite the fact that they have already been allocated Tk 5,200.0 crores?

Dr. Bhattacharya also spoke about the allocation of about Tk 750.0 crore for supporting entrepreneurship development, of which Tk 100.0 crore has been earmarked for agro-based industries, Tk 200.0 crore for equity entrepreneurship fund, Tk 250.0 crore for SME refinancing and Tk 200.0 crore for lending through SCBs for generating employment.

C.3.4 Revenue

Regarding the revenue resource components, Dr Debapriya Bhattacharya mentioned that the share of the non-NBR component has been falling and it would be very difficult to achieve the aggregate revenue target without an increase in non-NBR earnings. He pointed out that income from non-judicial stamp, the most important non-NBR source, recorded a negative growth in FY2004, and therefore, questioned whether people have stopped transferring property.

He also drew attention to the fact that the share of non-tax revenue was declining and has fallen below 20.0 per cent of total revenue in FY2004. He added that T&T, dividend and profit, administrative fees and income from interest were the most important items, and combined incomes from these sources are projected to grow by 7.9 per cent in FY2005, against the 15.0 per cent target set in FY2004. Dr Bhattacharya felt that tariff rates of these services needed to be reviewed and adjusted keeping social concerns in mind, and if this was not addressed in the budget, then it might happen subsequently after the budget, and that would be less transparent.

Dr Bhattacharya stated that one of the most interesting part of this year's budget was tariff reform; tariff rates on specific products were not an issue, but there were fundamental changes in import tariff and supplementary duty. There was a four-tier system — 30.0 per cent, 22.5 per cent, 15.0 per cent and 7.5 per cent and two years ago the Finance Minister promised to bring it down to a three-tier system at 10.0 per cent, 20.0 per cent and 30.0 per cent respectively. However, he changed this to 7.5 per cent, 15.0 per cent and 25.0 per cent and reason behind such last moment change remained unknown. The CPD Executive Director also felt that such changes were not done in an appropriate time; moreover, they also lack adequate analysis and consultation. Such unilateral liberalisation may undermine Bangladesh's strength in bilateral and multilateral negotiations. He cited that Bangladesh did not sign BIMST-EC, as it was not allowed any compensation measure. He was of the view that such tariff reduction was not required under WTO provisions and if any IFI asked to do so it was a violation of policy coherence among the IFIs.

He, however, termed the para-tariff rationalisation as an excellent move as it was set at the three-tier system (30.0 per cent, 25.0 per cent and 15.0 per cent) and the impact of this would be a subject of empirical verification. At the same time, Dr Bhattacharya stressed on rationalisation of the Advance Income Tax (AIT) and Infrastructure Development Surcharge (IDSC), and added that the legitimate question was how the collection from IDSC would be distributed among the various infrastructure development programmes of the government. He doubted that a significant amount does not go to the development areas and stressed that the distribution should be transparent.

The changes in income tax and the increase in the exemption limit for the purpose of taxation was supported by Dr Bhattacharya as he felt that it took into account the increased cost of living. Explaining the implication of revised income tax rate for individuals, he said that people earning Tk 1.0 lakh now have to pay 25.0 per cent more as income tax. This is because, the minimum amount fixed currently is Tk 1,500.0 and previously it was Tk 1,200.0. However, those who earn Tk 9.0 lakh or more would enjoy 16.0 per cent rebate as they now have to pay Tk 107,000.0, while they earlier had to pay Tk 127,000.0. Bhattacharya felt that under this system those who earn less would benefit less, while those who earn more would enjoy more benefits relatively, and this he thought was not rational. He suggested that either the tax-free limit should be raised or the ceiling of Tk 900,000.0 be revised downwards. He pointed out that the minimum taxable monthly income would be Tk 8,333.0, which is in right order; however, extra thought should be given so that people with low income could benefit from the measures.

On the VAT net expansion, the CPD Executive Director said that the inclusion of manufacturing sub-sectors was a welcome move as those were mostly intended to protect local industries. However, he doubted whether the pressure cooker manufacturers would be able to sustain the competition after imposition of VAT. He added that VAT on raw silk at the import stage appeared as a protection to local industry, but before that, the government should decide whether it would encourage local sericulture industry or not. Dr Bhattacharya appreciated the expansion of VAT net for bringing different services into it, but questioned what would be done to bring professionals such as doctors, lawyers and chartered accountants into the network. He noted that the government had in the past tried to bring these professionals under VAT net but retracted later. This time, the government did not even dare to repeat the step and probably would not be able to do it till the next election. He insisted that it would be fair to bring all these professions under VAT coverage evenly.

Explaining the tax measures, Dr Bhattacharya pointed out that tax on transaction of real estate increased from 5.0 per cent to 10.0 per cent. However, only two years back, the Finance Minister reduced the rate to develop a secondary market in the sector. Now, the rate has been increased on the plea that government has not been able to mobilise enough fees in spite of the tax break. The economist felt that the government should be more patient since such frequent changes were not greeted well. He also mentioned that tax on profits from bond/securities, which was reduced to 20.0 per cent, would hopefully stimulate secondary bond market.

The keynote presenter also noted that the tax authority had a basic problem with the administrative measures in terms of transparency. One key issue was administration and enforcement of tax measures, he added. In this regard, he pointed out that although there was a demand for universal self-assessment system, the current self-assessment empowered the tax authorities to audit any tax return based on their choice, which may lead to corruption, harassment and embarrassment of the taxpayers. He said that the tax returns should be randomly chosen through automated system, and desirably, under the office of the tax ombudsman. Similarly, tax ombudsman should moderate arrest power of VAT assistant commissioners.

According to Dr Bhattacharya, withdrawal of AIT, from all types of petroleum, as well as reduction of the existing supplementary duty on kerosene would reduce the tax burden on crude oil, kerosene and all other fuel. This would not increase as the prices of these items are politically sensitive. He, however, thought that the gas price was going to rise.

Bhattacharya termed the increase in supplementary duty on vehicles a "pleasant surprise" as it was necessary to bring some equity within the budget structure.

On budgetary measures for export promotion, he stated that the exemptions accorded to textile machinery, leather and other export-oriented industries from customs duties and VAT are positive. However, he felt that the possible impact of re-fixation of import duty on paper at 25.0 per cent was ambiguous.

In the case of domestic protection, Dr Bhattacharya suggested that the potential areas are grey cement, poultry, furniture, tiles and agro-based industries. However, the elimination of VAT on import of poultry egg, chicken meat and potato, and reduction of supplementary duty on food industry, soft drinks, Portland cement, ceramic products, bicycle, LP gas and toy were negative moves, he opined. He also stated that that elimination of VAT/IDSC at the import stage and VAT at the manufacturing stage on wheat, rice, flour, all rice, lentil, live animal, all types of meat, fish, oil seed, crude oil, refined palm oil, soybean oil, vegetables and salt are positive initiatives in terms of consumer welfare. Moreover, Dr Bhattacharya reminded the participants of the dialogue that two years ago the Finance Minister argued in favour of consumption of locally grown fruits and increased duty on imported fruits. However, this year he reduced the supplementary duty to 25.0 per cent from 40.0 per cent. Elimination of VAT at import stage from life saving drugs, transport, and newspapers was deemed as a positive step by the keynote presenter, but not from powdered milk (retail and bulk), chocolate, coil, tobacco and aircraft or helicopter.

In the case of import of sugar, Dr Bhattacharya stated that last year supplementary duty was increased substantively. However, it has been brought down from 40.0 per cent to 15.0 per cent this year, while VAT has been eliminated at the import stage. He noted that the budget did not distinguish between raw sugar and processed sugar. Moreover, raw sugar is now being processed and exported to the EU, and therefore, should enjoy a more liberal regime. From the perspective of consumer welfare, he said supplementary duty or VAT exemption or relaxation on health equipment, mobile telephone, fishery, crop, vegetable, fertiliser, pesticide and agricultural equipment was positive. However, steps taken regarding wheat are negative. On domestic protection, the keynote presenter added that actions taken for uplift of light engineering, handloom and textile, printing industry, cosmetics and toiletries, dairy and poultry are all positive, but the imposition of supplementary duty at the manufacturing stage of plastic industry would cast a negative impact.

Bhattacharya also expressed his surprise regarding the increase of supplementary duty on expensive cigarettes and decrease of the same on low-cost cigarettes, and asked whether it meant that the government was less concerned about poor people's health.

C.3.5 Sectorwise Allocation

The total allocation for agriculture, as pointed out by keynote presenter, has almost doubled. He considered this to be a significant change. Moreover, the reduction of interest rate to 5.0 per cent is also a substantial support. He added that raising cash incentives for export of agricultural products, fruits and vegetable from 25.0 per cent to 30.0 per cent and farm subsidy from Tk 300.0 crore to Tk 600.0 crore was a step in the right direction. However, he expressed concern about the utilisation and targeting of increased resources, and added that in the last fiscal, up to January 2004, only 31.4 per cent of subsidy allocated was utilised. Moreover, for the current fiscal, no mechanism was announced as to how Tk 600.0 crore worth of subsidies would be utilised.

The Executive Director of CPD pointed out that on fisheries, total allocation has been increased by 25.0 per cent, while allocation for rural development also experienced a 5.0 per cent increase.

C.3.6 Industry

Referring to the decline in the highest slab of import tariffs, the keynote presenter agreed that the government did not impose new tariff and fresh taxes but extended coverage of VAT and income tax. He said that the reduction of income tax for jute and textile industries was the right decision and also withdrawal of collection of VAT from insurance, shipping bill and C&F agent's commission for RMG sector were positive steps. The economist was of the view that industrial park, refinancing for SMEs, restructuring banks and slashing capital gain tax from 15.0 per cent to 10.0 per cent for Foreign Direct Investment (FDI) are all positive moves.

C.3.7 Social Sector

Dr Debapriya Bhattacharya underscored that education had received the highest allocation of Tk 7,680.0 crore, which saw a 13.7 per cent increase. However, he expressed his concern regarding the utilisation of the resources allocated and the quality of education offered in educational institutions. On health sector, allocation increased by 11.5 per cent, which was less than education while direct defence expenditure increased by 2.4 per cent. Bhattacharya added that the previous government introduced many safety net programmes, and this government was not only continuing these, but had also introduced some new programmes. He mentioned that allocation for old-age allowance, allowance for widowed, deserted and destitute women and honorarium for insolvent freedom fighters increased by 31.0 per cent, while the total number of beneficiaries increased by 20.0 per cent. The keynote speaker also pointed out that funds for mitigating risk due to natural disaster, rehabilitation of the acid burnt women and physically handicapped and housing for the homeless increased by 70.0 per cent. On VGD, VGF, test relief, GR, FFW, the increase was 14.5 per cent over the FY2004, however, compared to FY2002, it was lower by 18.7 per cent. Dr Bhattacharya observed that the major problem of the safety-net programme was that it still missed out on geographical coverage, which was a key instrument of targeting.

On MFA phase-out, he mentioned that allocated fund was Tk 20.0 crore in the budget for retraining and creating employment opportunities for employees-labourers of garments industries. But this amount was not enough for the possible retrenchment. Moreover, there was no allocation for small entrepreneurs in the garment sector. He opined that not only workers but also small garment owners would be affected.

C.3.8 Final Observation

Drawing his presentation to a close, Dr Bhattacharya stated that the budget would be tested in terms of its implementation, and allocation would have very little importance if implementation is inefficient. He termed a low-income country like Bangladesh, as a nation of paradox. On the one hand, Bangladesh is an under-invested country, where investment is not picking up and it cannot fulfil the target it sets for itself. On the other hand, large sum of money remains under-utilised. "We have almost Tk 10,000.0 crore in the bank as excess liquidity, we have US$7.0 billion foreign aid in the pipeline, we cannot spend Tk 5,000.0-6,000.0 crore of ADP, we cannot even utilise public savings where 200.0 per cent over subscription takes place in the capital market when sometimes IPO is floated," Dr Bhattacharya bemoaned. He was of the view that resources were not the problem in the country. He questioned whether it is an absorption failure, or there is no demand for the money. He further asked that whether it was a failure in the delivery mechanism, or was it an outreach failure in terms of not being able to take the money to the people, or was it a governance failure, as a result of which resources were not managed in the right way in the right time. Dr Bhattacharya expressed his hope that the implementation of the budget for fiscal year 2004-05 would provide some answers to these burning questions.

C.4 OPEN DISCUSSION

C.4.1 Challenges of Implementation

Former Finance Minister M Syeduzzaman pointed out that some praise worthy and eye-catching measures, which the present Finance Minister M Saifur Rahman have undertaken in the current budget were similar to measures that he himself had advocated in his first budget of FY1981 as a Finance Minister. Such measures included increased support to agriculture, rural development and infrastructure sectors as well as increased backing to the social sector, social safety net and other measures for reducing poverty. M Syeduzzaman stated that the Finance Minister's action proved that the basic challenges that the economy of Bangladesh faces remains similar to what they were 20-24 years ago. He felt that the challenges which the current Finance Minister faces include such tasks as maintaining a sustainable macroeconomic balance, improvement in quality of public sector management and service delivery, expediting the pace of improvement in implementing projects and utilising foreign aid, increasing investment in the social sector and improvement in physical and non-physical infrastructures for supporting the private sector-led growth. He said that these problems remained unchanged over the last two decades. Syeduzzaman mentioned that he himself, in his initial reaction to the media, termed it a "bold budget". However, after reviewing the budget documents rigorously, he realised that the appropriate word for this budget should be "daring". The ex-finance minister substantiated his comment by saying that the high target of the budget was not justified if we learn from our experience as regards past performance.

Referring to CPD's projection on actual implementation of the Annual Development Programme (ADP) this year at a range between Tk 16,000.0 crore and 17,000.0 crore, Syeduzzaman stated that the ADP growth stood at about 40.0 per cent in the next fiscal year. He pointed out that no new measures had been announced for improving ADP implementation, except for a new procurement policy, a new format for project document and a new procedure for project approval. "These have not yet been finalised, (though) currently under consideration," he added.

In the entire non-development budget, the Former Finance Minister could not identify a single item where expenditure cut had been proposed.

He claimed that it was often told that we could do without foreign aid. However, he pointed out that the budget showed that 44.5 per cent of the ADP was financed by foreign aid, and particularly for all development expenditures, almost 47.0 per cent of the fund, would come from foreign aid. Therefore, it is clear that the development budget is heavily dependent on foreign aid, especially for social sectors, education and health.

The ex-finance minister expressed his conviction that unless the quality of implementation and the administrative efficiency were improved, targets for the FY2005, PRSP, mid-term targets for reduction of poverty, increasing revenue, using foreign aid and implementation of ADP, improvement in quality of social sector services would remain elusive. He identified these as the major challenges of the budget.

M Syeduzzaman stressed on the importance of monitoring a large number of measures, as proposed in the budget, for agricultural and rural development sectors, social sector, poverty alleviation and employment generation.

President of International Chamber of Commerce, Bangladesh (ICC,B) Mahbubur Rahman stated that he found the budget to be a very positive one. However, he believed that a single budget could not address the entire spectrum of the needs of the country. Describing the budget's targets as challenging and ambitious, he stressed that the country had to achieve those and the challenge was the implementation of the ADP and the utilisation of the allocated resources.

Awami League leader Professor Ali Ashraf expressed his doubt about the implementation of the budget proposals, referring to the present government's performance in the last two and a half years. He doubted the government's capacity to implement the budget and said that only 42.0 per cent of the outgoing ADP had so far been implemented. "How can it be possible? Is there any magic to implement the rest of the ADP in only 15 days," he questioned. Professor Ali Ashraf said that with the present set-up of the National Board of Revenue (NBR), the revenue target would not be achieved. The opposition leader felt that nothing would happen, 'until and unless' there was good governance, which the budget left unmentioned. He noted that the law and order situation was not up to the mark, corruption was rampant and the country would be prepared once more for being the champion in corruption. In this context, he stated that the budget would end up without any fruitful result and it would not be able to bring in any positive result for the citizens.

Former Ambassador M M Rezaul Karim said that the most important and critical observation made about the budget was that "it is over-ambitious and also that it cannot be implemented as the government has no capacity to do that." Admitting the reality, he simultaneously questioned how one could achieve progress without setting any target. He said that the nation should look at the future, not at the past every time. The Former Ambassador also expressed optimism that at least parts of the target, if not entirely, could be implemented, provided that there were sincerity, determination, skills and efforts for translating this budget into reality. Ambassador Karim said that in order to do this, it was essential to get necessary cooperation from all sectors, not from businessmen alone, but also from politicians, economists and the civil society as a whole.

Awami League leader Dr Abdur Razzaque, MP, stated that the budget was ambitious, unrealistic, and not implementable. He added that the current regime had already implemented three budgets but failed to implement any of those completely. He referred to the last fiscal's budget saying that almost 80.0 per cent of the revised ADP of Tk 19,300.0 crore was not achieved. In the outgoing fiscal, only 45.0 per cent was implemented till April, he noted. In its revenue collection, the Awami League leader pointed out that the government achieved a meagre 13.0 per cent growth last year against a target of 19.0 per cent.

Abdur Razzaque stated that the budget was highly dependent on donor funds although some US$700.0 million idle money was there with the national exchequer. "And still we cannot utilise the funds," he lamented. He further expressed doubt on the utilisation of money, given the present state of law and order situation and the inefficient bureaucratic system.

The World Bank's Country Director Christine I Wallich pointed out that being a low-income country, Bangladesh required substantial investments for providing public goods, development of infrastructure and public investment to support growth and poverty alleviation. At the same time, she observed, there was an apparent inability to carryout the expenditure programme whether it was on the revenue budget or development budget. There were undisbursed donor funds and the budget witnessed under-spending every year, as it would be in this year too, she added. Wallich said that the budget could not be implemented due to the inability to spend effectively. She further added that on the one hand there was a huge requirement for public investment for public expenditure, and on the other hand, there was a system that believed in non-spending. The World Bank official noted that spending decisions were not correct all the time as spending on road construction turned into spending on contracts and spending on women's education turned into spending on teacher's salaries.

Christine Wallich stated that the issue of decentralisation and public administration needed to be addressed because a budget could not be implemented properly under the current state of high centralisation and the present quality and capacity of the administrative machinery. The ability to implement was the most important issue and it would require some degree of decentralisation with better accountability and emphasis on administrative machinery, civil service reform and pay reform as well, she added. She was of the view that the budget was only good if it could be implemented, and that challenge of a budget lies in its implementation.

Country Director of the Asian Development Bank (ADB) Toru Shibuichi noted that Bangladesh had a limited implementation capacity due to multifaceted factors. He mentioned that some people blamed the imposition of some difficult conditions by the World Bank and the ADB as one of the factors. However, he added, there were institutional, systemic and human resource handicaps in implementing the development plan. In this connection, he mentioned that some agencies took more than two years to decide on purchasing US$10.0 million equipment and donors could not accept such delays. He also added that out of ADB's US$2.5 billion aid commitment, the country was only able to use US$800.0 million only. He requested the government for effectively using concessional lending, which was also not utilised.

Toru Shibuichi appreciated the fact that M Saifur Rahman was the minister of both Planning and Finance ministries and felt that this would make him responsible for approval, monitoring and implementation of development projects. He added that the minister had already asked development partners for the simplification of approval procedures for streamlining development project documents.

C.4.2 Capital Market Development

Former Commerce Minister Amir Khosru Mahmud Chowdhury, MP, stated that reforms which were required in the capital market had already more or less taken place. He also added that it was high time that some institutional changes were made as regards the Securities and Exchange Commission (SEC). Khosru also stressed the need for certain structural changes in the country's stock exchanges. They should go for de-mutualisation so that brokerage control can be waived. He emphasised on creating depth in the market as it currently does not have enough diversity for attracting investment. The former minister pointed out that every time when there was an IPO, it was over subscribed since there was no dearth of fund. However, the number of shares available did not match the high demand and this leads to too much money chasing after too few shares. The BNP leader insisted that government shares, as pledged earlier, should be offloaded in the securities market to create more depth. He said that the country's capital market had almost all the necessary structure as stock exchanges were automated with real-time online trading, a central depository company for scrip-less share trading, and one of the stock exchanges was already available for internet trading. Khosru mentioned that he personally took many efforts to bring about positive changes in stock exchange trading.

SEC Chairman Dr Mirza Azizul Islam mentioned that whatever benefits had been given in the last budget remained unchanged in the new one, indicating the continuity of the positive impacts of those measures. He was of the opinion that the impact of changes to the interest rate structure on the capital market would probably be felt over a long period, and therefore Bangladesh Bank and the SEC should work in tandem for activating the secondary market of the bonds.

Dr Islam further said that any capital market in the world was typically characterised by some type of irrational behaviour in a short-term context, but those were addressed over medium and long period of time. He stated that just after the announcement of the budget, capital market index had fallen during first two days, but then again rebounded significantly. He explained that there was an expectation for additional benefits in the budget and their absence triggered immediate adverse impact during the first two days. "Later, the market fundamentals started dictating the market trend," he said, adding that the budget did not have any adverse impact on the capital market.

Agreeing with Khosru's contention on dearth of good scrips, the SEC Chairman mentioned that the SEC was trying its level best, and government departments and ministries needed to be more active in this regard. He, however, differed on structural changes to the SEC right at the moment, claiming that the SEC had been running with inadequate manpower. He claimed that for 248 listed companies, the SEC's corporate finance department has only three officers who have to examine and monitor whether these companies are holding Annual General Meetings (AGMs), distributing dividends, maintaining accounts properly and so on.

Mirza Aziz stated that there have already been some changes to the basic infrastructure along with change in technical structure. However, there were still many areas that depended on judicial system for any change. In this connection, he referred to the fact that not a single case of the 1996 share market scam had been settled till now, and this involved factors that were outside domain of SEC's authority.

He also questioned whether de-mutualisation had always resolved conflicts of interests in the stock exchanges and recommended further examination before going for de-mutualisation.

C.4.3 Tariff Reduction and Impact of Local Industry

Differing with Dr Debapriya Bhattacharya's point on maintaining slower pace of tariff reduction, Amir Khosru noted that it was the government's commitment to reduce tariff and there was no justification for delaying this process. On keeping room for trade negotiation, the ex-minister said that it was better to pace up negotiation process rather than keeping high tariff as a bargaining point for future trade talks.

In a similar vein, SEC Chairman Mirza Azizul Islam termed the idea of keeping tariff rate high on the plea of bargaining more effectively with other negotiating partners as a "poor logic." He felt that tariff rate should be determined on the basis of consideration for investment incentives, consumer welfare and income distribution. The SEC chief said that there were "very rare" instances in bilateral or regional or multilateral trade negotiations where anyone really saw a provision for compensation for tariff loss. He added that even in the European Union there was a European Development Fund for block allocation for relatively weaker economies, but no compensation package for tariff loss.

Khosru admitted that some of the growing industries in Bangladesh would be affected by the tariff reduction. In this connection, he named steel industry, which had already started to export its products. The former commerce minister noted that it had started from corrugation, then introduced galvanising and now produces CR coil as well. "It is moving up to HR coil, thus making an integrated industry," Khosru said adding that this industry should be allowed to continue with the old tariff structure so that they could accumulate some wealth and go for the integration since the country needed basic steel industry.

A Rouf Chowdhury, Director of the Federation of Bangladesh Chamber of Commerce and Industry (FBCCI), stated that narrowing down the gap between the highest and the lowest tax slabs was a wrong signal for investors in the industrial and manufacturing sectors. He pointed out that the reduced gap would make raw materials costlier compared to finished products despite the fact that raw materials were still imported under lowest tax slab and finished products under the highest one. He mentioned that the gap came down to 18.5 per cent from 22.5 per cent due to the proposed changes in the budget.

Professor Abu Ahmed suggested that the lowest slab should be brought down to 5.5 per cent, widening the gap between imported finished goods and imported raw materials, in order to balance any adverse impacts of tariff reduction on local industries. He further said that the country has to reduce customs duty following the current global trend, and there was no reason why Bangladesh could not have a faster pace of liberalisation.

ICC,B President Mahbubur Rahman pointed out that in the early 1990s "we had become holier than the pope, even before the emergence of the World Trade Organisation (WTO) we had reduced all duties and taxes."

The Bangladesh Bank Governor Dr Fakhruddin Ahmed, pointing to the movement in terms of duty reduction, stated that it was the right direction towards liberalisation (in line with the global trend). Dwelling on specific individual industries, he said that there should be research on the implications of tariff measures. "Otherwise, the general argument like '30.0 per cent (highest slab) is better than 25.0 per cent' seems to be going around."

Referring to the Indian tariff rates, Awami League lawmaker Dr Abdur Razzaque stated that they were much higher than those in Bangladesh. The opposition lawmaker accused the present Finance Minister for hurrying up on tariff reduction, which he had done in his last tenure as the Finance Minister during the 1991-96 period.

He was critical of the fact that the country imports juice from Malaysia and Indonesia and furniture from Malaysia although Bangladeshi carpenters were "very good and doing splendid in craftsmanship."

The opposition leader said that if timbers were imported and used in making furniture then it could have generated employment opportunities. "When developed countries could use many strategies to protect their industries and market, why are we not doing that the same," he questioned.

C.4.4 Taxation, Revenue Collection, PSI and Tax Holiday

Former Finance Minister M Syeduzzaman claimed that the high targets of the budget were not well backed up by the past performance. He noted that total tax revenue was to increase by 19.0 per cent and in that head, income tax by 20.0 per cent, VAT by 26.0 per cent, import duty by 22.0 per cent and non-tax revenue by 17.0 per cent. On expenditure, he pointed out that non-development revenue expenditure would rise by 16.0 per cent and capital expenditure by 50.0 per cent. However, the ex-Finance Minister said that in all these cases, revised estimates were lower than the original budget targets and despite this fact, the Finance Minister had made a quantum leap in next year's budget. According to him, it would be the highest jump in revenue target since 1991-92 when the government introduced Value Added Tax (VAT).

Explaining the annual economic survey findings, the former minister added that the proposed growth in import duties was 22.0 per cent whereas import growth, which was 15.0 per cent this year, would go down to 8.0 per cent next year. He claimed that there was an assumption that exchange rate would depreciate substantially.

FBCCI Director A Rouf Chowdhury stated that the Finance Minister M Saifur Rahman, spoke about expansion of allocation for subsidy and investment, and at the same time, expanded the VAT net, which would affect medium and small enterprises much more deeply than any other sectors. The worst thing, according to the business leader, was that without conducting efficient reforms in the VAT administration, VAT inspectors would be empowered to arrest businessmen. He expressed apprehension that such a step would shed a cloud on the investment climate.

Referring to the reduction of supplementary duty on refined sugar, Mr Chowdhury stated that the Finance Minister's steps would destroy local sugar industry, which employ more than half a million people directly or indirectly. He suggested introduction of same duty on raw and refined sugar and the pattern should follow the duty on refined vegetable oil and crude vegetable oil.

The business leader noted that the Finance Minister was very silent about whether to stop or go ahead with Pre-Shipment Inspection (PSI), a dilemma that has been causing serious difficulties to the business community, particularly importers of raw materials and capital machinery. He mentioned that the withdrawal of tax holiday was a wrong signal to the industrial sector and new industries desperately need this tax holiday facility, he said.

Former Secretary of the Economic Relations Division (ERD) Dr Masihur Rahman was of the opinion that ensuring tax growth would be a challenge particularly because of lowering of duty by about Tk 750.0 crore to Tk 800.0 crore. Therefore, the growth projection for the next fiscal would be higher than 20.0 per cent. He pointed out that as growth would not exceed 6.0 per cent, the Finance Minister was anticipating a disturbing level of inflation and adjustment of exchange rate. *Rahman* also claimed that there was a trick in the budget. For instance, he said that the Planning Commission has been given a development budget worth Tk 582.0 crore while the agriculture sector got Tk 582.0 crore as development expenditure. "This sector (agriculture) spends money while the commission only holds it," he added. The former bureaucrat said that allocation of Tk 650.0 crore for microcredit would be spent over a number of years. In fact, according to him, the Finance Minister has maintained "caution in the budget with built-in mechanism." The former secretary noted that the Finance Minister admitted "if things don't happen, if taxes and aid do not come, then it has to be adjusted." All finance ministers have to resort to tricks and play to the galleries, he mentioned.

Regarding the expansion of the VAT net, the Former Secretary supported the idea. However, he stated that it was going to take a considerable toll on small entrepreneurs, since given the quality of tax administration, they (entrepreneurs) might be subject to harassment. He suggested a review of both tax administration and tax rate. He also said that this required adjustments, which would take capacity to pay into account. He expressed the apprehension that Advanced Income Tax (AIT) might be "vulgarised administratively" although its target was to get more people under the tax-net, rather than getting more revenue.

Awami League leader Ali Ashraf also questioned whether the government was capable of achieving the revenue target with the present set-up of the NBR.

President of Metropolitan Chamber of Commerce and Industry (MCCI) Kutubuddin Ahmed stated that though the budget announced appointment of a tax ombudsman, there was no allocation in the budget in respect to this, and it was not clear whether it would start functioning from this year or the next year. He supported Dr Bhattacharya's contention that people needed less interaction with the taxmen. The chamber leader suggested introduction of electronic system such as internet for submitting tax papers and all other documents, including self-assessment scheme.

The MCCI president pointed out that they did not want any surprise announcement in the budget as businessmen or investors want to invest under transparent and predictable policies. "So, if the announcement changes (policies) all of a sudden, that would upset the entire programme of investment," he added. Mr Kutubuddin further stated that the budget did not mention anything about the PSI, which, he felt, was a very good scheme that was introduced by the last government. He favoured continuation of the system for its transparent nature and relevance in the customs system. On the budget announcement of refunding 80.0 per cent VAT to the exporters against utility services, he asked, "Why doesn't the government reduce the bill by 80.0 per cent?"

On the regressive nature of the tax system, Jatiya Party MP G M Quader mentioned that the Finance Minister was talking about a pro-poor budget; however he resorted to collecting revenue from them (the poor) through indirect taxes. He stated that out of the additional projection of Tk 5,000.0 crore as revenue, around Tk 4,000.0 crore would come from import duty, supplementary duty and VAT, and that would ultimately be paid by the low-income group. Quader added that for government salaries, the projected expenditure increased by Tk 2,011.0

crore. He was of the view that revenue would be collected from the poor people and would be spent for government servants. He criticised the "gigantic size" of the cabinet and insisted on its downsizing to 20 from 60 ministers, state ministers and deputy ministers. The JP lawmaker said that even for the Prime Minister's Office, the budget increased by 27.0 per cent and "such extra expense has been a sheer wastage (of money)."

Delwar Hossain, former Director, FBCCI suggested that empowering of the VAT inspectors with authority to arrest businessmen was not a fair decision. He rejected the idea of continuation of the PSI system and said that it could be a choice of the importers. "We have to pay additional 1.0 per cent charge and face a lot of hazards and it is encouraging smuggling," he added.

C.4.5 Is the Budget Pro-Poor?

Economist Dr Atiur Rahman pointed to the fact that the budget was supposed to be one of the early budgets designed during the implementation of the PRSP and seemed to give real indication on how the reduction in poverty would take place. He, however, regretted that the budget itself did not talk about poverty alleviation, and also how the implementation of different objectives would take place. He claimed that the Finance Minister laid a lot of emphasis on the revenue budget, which increased by about 71.0 per cent over the last three years, while the development budget increased approximately by 20.0 per cent. The economist further added, "on the one hand, you are not implementing development budget, on the other hand you are increasing revenue budget – the non-productive part of it."

He also hinted towards an element of tokenism in the budget for the marginalised groups i.e. farmers, street children, hardcore poor women and the disabled. Dr Rahman noted that these groups had managed to get only 5.0 per cent of the revenue budgets, an allocation which marks only 1.0 per cent increase over the last fiscals' allocated amount. He also pointed out that despite certain improvement in old-age pension these days, an elderly woman gets a meagre Tk 5.5 per day and suggested that this should be increased to a minimum of Tk 500.0 a month to help her fight against the vicious circle of poverty. Atiur questioned that if the budget was really rural-centric, how it is that the development budget for the local government was reduced by 1.0 per cent? "Not a single Union Parishad will get an additional one taka although it is the only functional body in the rural area," he added.

Former Ambassador M M Rezaul Karim stated that the government took lessons from the Indian election, where the Congress Party said that their economic policy would be people-oriented. "Our Finance Minister too spoke of a caring budget for the general masses," he added. He said that increase in GDP is not enough unless benefits trickle down to the poor and rural masses. He viewed that farm subsidy had to be designed for improving the living conditions of the poor.

Echoing the sentiment of Dr Atiur Rahman, G M Quader too saw an element of tokenism in the budget and accused the government for allocating Tk 400.0 crore for this purpose. He thought that this fund would be distributed for the election purpose and among the ruling party activists, especially the MPs would distribute the fund as per their will. He said that not only the ruling party lawmakers, but also potential candidates among selected party workers would distribute the fund. He further alleged that they have started election campaign three years before the general elections.

The JP lawmaker also described Tk 600.0 crore as a meagre amount of subsidy compared to the need of the people, saying that people wanted diesel, selling points, and storage facilities so that the vegetables they produce could be stored and sold at competitive prices. He insisted that the government should take adequate measures to stop the practice of tolls extracted by the police and the ruling party-men. The opposition MP also mentioned that the government has taken the challenge of beating up people in order to achieve the target of 16.0 per cent growth in revenue earning. "It's not a budget for the poor, it cannot be so," he added.

C.4.6 Focus on Rural Economy, Agriculture Subsidy and Agro-Based Industry

M Syeduzzaman appreciated the budgetary move to double the credit flow to the rural sector. He, however, said that it had to be sustainable, and could not be a one-shot operation for the FY2004-2005.

Jatiya Samajtantritk Dal (JSD) leader Hasanul Huq Inu claimed that the budget contained no support for the marketing of agricultural products for the marginal farmers, nor was there any programme for fertiliser distribution and pricing system.

Moreover, regarding the farm subsidy Awami League MP Abdur Razzaque pointed out that subsidising fertiliser or irrigation in the name of farm subsidy would not be effective in helping the farmers. Furthermore, he added that when 54.0 per cent of farmers were landless, a subsidy such as this would have limited usefulness.

Referring to the utilisation of a mere 30.0 per cent of the total subsidy allocated in the outgoing fiscal, he pointed out that there was no specific guideline for utilisation of Tk 600.0 crore subsidy to be provided during next fiscal year. According to him, agriculture does not cover only the crop sector, and hence livestock and fisheries should also be covered by the subsidy. He stated that if a landless farmer could run a poultry or dairy farm by availing of the subsidy, it would bring positive results. Razzaque noted that as the country has 10 million farmers, the count of per capita subsidy stands at Tk 600.0, "which is not much," he claimed.

However, he appreciated the move to increase cash incentives for agro-based products to 30.0 per cent from 25.0 per cent. The Awami League leader noted that in the first year, the government had kept Tk 100.0 crore to support export of agro-based products, which was not utilised and in the second year, Tk 300.0 crore was kept as Equity and Entrepreneurship Fund (EEF) for promoting agro-processing and information technology sectors and this also remained unutilised. He mentioned that this year also Tk 50.0 crore has been reserved, but he wondered how much of the fund would be utilised.

C.4.7 Unaddressed Issues

Former Minister M Syeduzzaman pointed out that issues that frequently hit the newspaper headlines were law and order, investment climate, price-hike of essential commodities, frequent changes in import taxes, interest rate regime, level of foreign investment, privatisation, controversy surrounding the NGO sector, post-MFA regime and quality of social sector service delivery. However, he noted that very few of these issues really received any attention in the budget, apart from the support to the garments sector in the post-MFA period. He claimed that the Finance Minister mentioned that price increase this year was mainly due to an increase in international market price, a claim that was not true for all the cases, and reasons other than the international price-hike were also cited in the media.

On the government-NGO relationship, he claimed that there was controversy between the NGOs and the government machinery and between government leaders and NGO leaders. He underlined the need for clear directives in this regard so that the NGOs could continue to play their "very important" role in implementing important development projects in education and health sectors.

Referring to M Syeduzzaman's comment, JSD leader Hasanul Huq Inu stated that without analysing past years' mistakes, the government has set higher targets, which were not achievable. The politician also noted that there were no major steps for reforms, no major steps for decentralisation of the administration by empowering the local government, no land reform and ownership of wetlands for the poor, to remove injustices inherent in the structure were taken. He also drew attention to absence of any recovery plan for jute and sugar sectors. He added that after the closure of Adamjee Jute Mills, Indian jute mills were thriving. The politician also felt that the government had no plans for reopening seven closed textile mills. He claimed that there should be some provisions for youth entrepreneurs. Inu blamed the government for making no proposal for reducing the *mastan* tax, bureaucratic tax and ministers' tax. Moreover, he added that without better financial management and better governance, this budget was unlikely to make a breakthrough in the current state of poverty.

Kutubuddin Ahmed noted that an allocation of Tk 5.0 crore towards setting up of an anti-corruption commission was "too little" considering the tasks they were expected to perform.

C.4.8 Financial Sector

Referring to the financial sector of the economy, Former Finance Minister M Syeduzzaman stated that the budget had no reference to the private sector except for the declining lending rate in the financial sector. The probable presumption was, he added, that private investment would continue to depend mainly on commercial banks — both nationalised and private. Moreover, he claimed that a low interest rate regime, as past experience showed, gave rise to some dangers as well.

Former ERD secretary Dr Masihur Rahman mentioned that in the financial sector, the thrust had been towards more repressive financing. He pointed out that there was a certain pressure on the banking sector to reduce the interest rates. The former secretary added that reducing the deposit rate and correspondingly the lending rate, result in the profit remaining the same, which in effect implies protection of the banks' profits and squeezing the same of the depositors. He apprehended that it would affect long-term investment and savings. Dr Rahman claimed that for the last few years, both investment and savings remained almost stagnant, however, savings were more than investment, which he termed as a "bad trend."

Moreover, he stated that huge sums of fund were involved since the IPOs were oversubscribed. However, this money was not getting into the system due to a gradual weakening of intermediation, which was again due to repressive measures. Dr. Masihur Rahman requested the Governor to pay serious attention to the management of financial sector and investment, particularly intermediation.

Bangladesh Bank Governor Dr Fakhruddin Ahmed conceded that in some neighbouring countries like India, Pakistan and Thailand, interest rate was lower compared to Bangladesh. The Governor claimed that the all time lowest interest rate in India had really contributed to a surge in the growth of the country. Moreover, he added that Pakistan's budget had also emphasised on keeping a low cost of capital, which contributed to a large growth of the manufacturing sector.

Dr Ahmed also ruled out the observation that Bangladesh Bank was directing the banks to reduce the interest rate. He said that since the last few months central bank has reduced the SLR requirement, and maintained rate of repo and reverse-repo low and kept the overnight rate very low. Dr Ahmed claimed that these were all signals to the banks for reducing interest rate. He also stated that, on numerous occasions, he had discussions with bankers regarding these issues. Referring to central bank and SEC's joint proposal to the Finance Ministry for lowering the income tax rate on bond investment to 20.0 per cent, which was reflected in the budget, he said that they were trying to develop a secondary bond market. "Basically, we want to make the industry more efficient. So, interest rate has already come down," he added.

On increasing the savings rate, the Bangladesh Bank Governor stated that it was not a valid logic that retaining high bank rates would lead to higher deposits. He claimed that if things were so, savings should have been higher since banks have had high deposit rates in real terms for the last several years. It was thus not clear whether deposit rates actually determine the savings.

On excess liquidity, the Governor pointed out that the actual surplus was not so high. He stated that according to the market discipline, interest rates should go down with increasing liquidity. Therefore, keeping the liquidity high would ultimately reduce the interest rates.

Regarding the financial sector, Professor Abu Ahmed stated that there should always be some idle fund in the market economy. Professor Ahmed also stressed the need for estimating the optimum level of idle money that should be present in the economy. The economist also stressed on identifying the reasons, and asked CPD to estimate what amount of money should remain idle in the economy at some point of time.

C.4.9 Post-MFA Issue

Regarding the post-MFA challenge, ICC,B President Mahabubur Rahman stated that since the budget has allocated some Tk 20.0 crore for job losses and Dr Bhattacharya was advocating compensation to the losing SMEs, it seems "we are already considering the garments sector to be a losing concern." The ICC,B president questioned why the sector could not be competitive even after enjoying the quota and other privileges for years together? He underscored the importance of free movement in global economy and suggested to provide fiscal and non-fiscal supportive measures to this sector. Moreover, he also added that the textile sector should be competitive so that it could generate enough input for the entire garments sector. He added that for the last two years, people were listening to debate between BGMEA and BTMA. However, both textiles and apparels are domestic industries and we have to save both.

Referring to the textile sector, the MCCI President Kutubuddin Ahmed noted that textile spare parts had been exempted from duties, however, garments spare parts did not receive such privilege. He stated that the textile sector grew because of the ready-made garments sector. Furthermore, the MCCI President pointed out that although the budget kept Tk 20.0 crore for retraining and other programmes for the jobless garments labourers, no provisions were made for small investors.

C.4.10 Mid-Term Planning Issue

Regarding the medium-term macroeconomic framework, M Syeduzzaman questioned whether targets, proposed in the budget, such as revenue-GDP ratio to increase by 12.0 per cent in three years, public expenditure by 16.2 per cent of GDP and budget deficit by 4.2 per cent of GDP, would be achieved or not. Moreover, he added, "there is no indication about generating public savings, monetary expansion targets, weakness of growing foreign aid pipeline, accumulation of liquidity with the banking sector and generating current account surplus." He was of the view that all these were indications of the inability of the government to employ all available resources. Furthermore, he insisted that the government should implement CPD suggestion for a *fiscal responsibility act*, which CPD proposed some two to three years back.

Mr M Syeduzzaman also stated that a new pay commission and a new pay scale should be carefully thought out since it was a major issue of fiscal management and not of populism, especially when privatisation had virtually come to a standstill. He further noted that a pay increase without other accompanying measures would bring enormous pressure on the fiscal balance and upset all macroeconomic projections unless it was accompanied by measures to improve quality, efficiency and productivity of the public servants and rationalisation of their numbers.

On the macroeconomic framework, Professor Md Masum of Jahangirnagar University pointed out that the country did not have any medium term plan, which usually spells out what should be the policy over the next few years. Moreover, he claimed that the annual budget was not framed against the background of a medium term plan. Referring to the allocation for education in the proposed budget, Professor Masum stated that although allocation for education was highest, in terms of GDP, it was only 2.0 per cent, which was not helpful for ensuring the quality of education in a country where income disparity is increasing. He further added that the rich section becomes richer while the low-income group is further marginalised and unless emphasis is laid on human resource development in the truest sense, we would not be able to perform. Professor Masum noted that like primary education, it was very important to have a stipend programme for boys in the secondary schools; otherwise, the poor would never have meaningful access to education.

Speaking on inflation, Dr Masihur Rahman claimed that the target of 4.2 per cent inflation might not be achieved. He suggested that the government should improve the mechanism, which it uses to measure inflation and identify some core areas so that it can be used as a bargaining point while dealing with the World Bank and IMF.

Dr Rahman also stated that the macroeconomic balance would not be a major problem. However, major challenges lie with micro-economy and the government should look more carefully at it. Furthermore, he claimed that as long as we have remittance and aid, macroeconomic balance would not be a problem.

Referring to the macroeconomy, Bangladesh Bank Governor stated that since there were no major macroeconomic problems and incentive impediments, the question was whether target of the budget was ambitious but implementable.

The Governor also noted that there were both short-term and long-term issues. He added that there were institutional changes, which would require time. He questioned whether people could wait that long or if there were any other ways to improve the implementation capacity with some short-term measures.

C.4.11 Employment

On the issue of employment generation, M Syeduzzaman made a proposal for monitoring the implementation of Finance Minister's budget statement as regards creation of some 900,000 jobs when textile parks would be set up on the premises of the closed Adamjee Jute Mills and the Chittagong Steel Mills.

FBCCI Director Rouf Chowdhury identified employment generation as a major instrument for alleviating poverty. He further added, "If the manufacturing sector, including agro-processing, is to create more jobs, it must get right signals from the government."

On the issue of creating employment, Dr Atiur Rahman stated that the present budget fails to address the issue of job creation. He then mentioned that, "we have to wait another one year to see whether nine lakh jobs will really be there on Adamjee compound and on the other abandoned industrial estates."

C.4.12 Supporting Industries

Former Commerce Minister Amir Khosru Mahmud Chowdhury pointed out that although the private sector was described as the engine of growth, it was not reflected in reality. The BNP lawmaker stated that in the budget, there should be plan for the development of the private sector and it must be known that whether the private sector could participate in the infrastructure, industry or the social sector in short-, medium- and long-term. The politician claimed that he did not see a clear roadmap for the industrial sector. Khosru further added, "If you want the private sector to play a crucial role in the infrastructure development, entrepreneurs must know what the policies are, and it must be reflected in the budgets. And that went missing."

The politician expressed his regret and pointed out that in order to generate a private sector-led growth, private sector's effective integration into the economic development mechanism was needed. However, in reality this was missing.

Speaking on jute and textile sector, Dr Masihur Rahman stated that jute and textile sectors receive rebates on income tax although most of these industries were losing concerns. The former bureaucrat noted that due to technological stagnation, improvements in these sectors were limited, lack of investment also contributed to this. He suggested that the government should provide investment support rather than tax relief since people hardly understood where exactly they were receiving a tax discount. Furthermore, regarding direct subsidy, Masihur stated that it was possible to establish links between performance and cash support.

Taking part in the discussion former Foreign Minister Barrister Anisul Islam Mahmud pointed out that the main reason behind low investment was the poor condition of the infrastructure. He claimed that it required 25 bighas of land to set up a spinning or textile mill. However, this is not available in Tongi and Mymensingh, where gas facility is also available.

Moreover, the Former Minister further stated that it was not possible to run the computerised machinery of the mills with PDB or REB electricity. He said that it was not the shortage of power, rather the quality of it that was more important and so investors had to set up gas-based captive power generation plants. Mr Mahmud suggested setting up more specialised economic zones with all utility services for investment and ecological balance. He insisted that the EPZs did not actually provide any extra facilities rather they merely provided regular utility services and land without any litigation. "So, foreigners are coming here go to the EPZs to avail those facilities," he added.

Moreover, Mr Mahmud claimed that there would be a change in the nature of business in the textiles sector. Bangladesh needs strong backward linkage backbone in the textiles sector.

Delwar Hossain pointed out that the government has increased price of furnace oil from Tk 8.0 to Tk 10.0 per litre despite the fact that 80.0 per cent of the industry depends only on furnace oil and only 20.0 per cent have the privilege of gas connection. He stated that for the Small and Medium Enterprises (SMEs), one could get only 49-kilowatt-capacity electricity connection from the PDB, and for anything beyond that, one had to set up his/her own sub-station. Mr Hossain noted that an entrepreneur investing Tk 50.0 lakh to Tk 1.0 crore in a business could not afford to invest additional Tk 5.0 to Tk 15.0 lakh for setting up a sub-station. He stressed on supplying at least 200kw of electricity by PDB or REB to the SMEs.

C.4.13 Role of MPs in Budget Monitoring

CPD Chairman Professor Rehman Sobhan urged the opposition lawmakers to prepare a report on the state of the development projects in their respective constituencies. Professor Sobhan offered them professional and technical support from CPD to carry out assessment of particular development projects. Prof. Sobhan said that the Members of Parliament should take responsibility and present the report in the Parliament and to the Finance Minister on the basis of their inspection of the projects.

However, in response, Awami League MP Abdul Razzaque explained that they had little opportunity for carrying out such inspections due to the current state of over centralisation. The opposition lawmaker further added, "Even for any allocation in a primary school, it requires the Prime Minister's approval, and district education and local education officers have no authority to sanction even the blackboards."

Expressing a similar sentiment, G M Quader stated that the development budget was made in a centralised manner, by taking suggestions from various government departments as there was no geographical distribution in the allocation. He added that the opposition MPs, in general, were not given development funds and they had deliberately been deprived of funds for infrastructure development and other areas. He further claimed that until and unless the opposition lawmakers express agreement with government policies, they cannot expect to receive fair share in budgetary allocations. The JP leader pointed out that the revenue budget was being distributed regularly. However, funds from development budget were only allocated to those constituencies where the ruling party had their own lawmakers. This is due to the presumption by the ruling party that if they allocate fund to the constituency of an opposition MP, this will help the opposition lawmaker to gain popularity. He, however, expressed his agreement with the CPD Chairman's proposal, saying that they would try to monitor the implementation process and raise the issues in the Parliament.

Economist Professor Nurul Islam said that it was unfortunate that the opposition MPs were seeking the CPD Chairman's help to influence government policy. He was of the view that CPD should ensure the presence of the members from both the parties at the dialogue since it was 'only the poor opposition members' who were venting their anguish against the ruling party and this was not a healthy sign.

The eminent economist observed that everyone, either from the ruling party or from the opposition camp, complained about the Prime Minister's Office (PMO), which made it apparent that the government of Bangladesh was absolutely "of the Prime Minister, by the Prime Minister, for the Prime Minister." He questioned if any ruling party member would dare to say that everything was PMO-centric. Professor Islam suggested that CPD should organise a dialogue on public expenditure in the future.

C.5 CONCLUDING REMARKS BY THE CHAIR

Professor Rehman Sobhan concluded the session by expressing his gratitude to everyone present at the dialogue, and hoped that the key issues articulated at the dialogue would be debated in the parliament at the time of discussion over the budget for FY2005.

Appendix C

List of Participants

(in alphabetical order)

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Anwar-Ul-Alam Chowdhury
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Dr Zafrullah Chowdhury
President
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Professor Amirul Islam Chowdhury
Former Vice Chancellor
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M Ghulam Faruq
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Chairman, Imtiyaz Hussain & Co

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Dewan Hanif Mahmud
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Part-B

REGIONAL COOPERATION IN SOUTH ASIA

Chapter 4

SETTING THE ENHANCED AGENDA FOR REGIONAL COOPERATION FOR THE NEXT DECADE

4.1 THE ISLAMABAD SUMMIT

This paper addresses the prospects for South Asian cooperation in the aftermath of the 12th SAARC Summit in Islamabad held on 4-6 January, 2004. It discusses what may immediately emerge out of the Summit and will move on to explore whether the ground covered in Islamabad provides a road map which takes us towards a South Asian Economic Union.

That we should at all discuss the prospect of an Economic Union for our fractured and troubled region owes to the landmark nature of the Islamabad Summit and the far reaching decisions which originated from its deliberations. The substance of my paper derives from Para (3) of the Islamabad declaration, which states that:

> We reiterate our commitment made at the 11th SAARC Summit at Kathmandu in January 2002 for the creation of a South Asia Economic Union. In this context, we underline that creation of a suitable political and economic environment would be conducive to the realisation of this objective.

In this statement the leaders of South Asia articulated a bold and far reaching vision while recognising the political and economic environment which needs to be established to attain this goal. This vision was in considerable measure influenced by the Report of the SAARC Group of Eminent Persons established by the 9th SAARC Summit in 1997 at Malé. This report titled *SAARC: Vision and Beyond the Year 2000* was submitted to the 10th SAARC Summit in Colombo in 1998. The report was never fully discussed or endorsed by the SAARC Summit but its recommendations and suggested road map to an Economic Union have found expression in the agendas of subsequent summits and are captured in some of the important decision of the Islamabad Summit. The agenda proposed in the Eminent Persons report was given some political ballast, when the Prime Minister of India, both prior to and at the Islamabad Summit, stated that the region needs to set its sights on an economic union and to even contemplate the idea of a single currency.

The main reason why the Islamabad declaration inspired such optimism originated in the fact that both India and Pakistan had been lukewarm towards SAARC in the preceding years. Tensions in India-Pakistan relations had already contributed to the postponement by a year of the Islamabad Summit. India, in particular, appeared to have marginalised SAARC in its global agenda and was seen to be more engaged with negotiating bilateral arrangements with its neighbours. Pakistan had, at the best of times, argued that the settlement of bilateral disputes needed to precede any real progress in SAARC. Pakistan's denial of MFN privileges to India had tended to compromise moves to liberalise trade within SAARC. In these circumstances the fact that it was in Islamabad that a framework agreement was signed for a South Asia Free Trade Area and where the Indian Prime Minister chose to proclaim his vision for an Economic Union, was seen as particularly propitious.

It is however not always advisable to depend on the goodwill which informs summits, particularly for SAARC. It is more useful to see what emerged out of the Summit in the way of a credible agenda for SAARC and the relevance of the declaration in setting out a road map towards an Economic Union. In my paper I propose to focus on some of the key issues identified in the Islamabad declaration which may provide guideposts on the path to an economic union and I will try to spell out the problems which have to be resolved if progress is to be made in each of these areas. The main elements of the decisions and declaration coming out of the Islamabad Summit are spelt out below:

The Summit signed three agreements:

- The SAARC Social Charter
- The Framework Agreement for a South Asia Free Trade area
- The Additional Protocol to the SAARC Regional Convention on Combating Terrorism.

The Summit endorsed the report of the Independent Commission for Poverty Alleviation in South Asia (ISACPA) and committed itself to implement its recommendations.

The Summit furthermore committed itself to intensify cooperation in a number of areas which include:

- Reiteration of the commitment made at the 11th SAARC Summit at Kathmandu in January 2002 for the creation of a South Asian Economic Union
- Energy cooperation
- Strengthening transportation, transit and communication links across the region
- Harmonisation of standards and simplification of customs procedures
- Public and private sector cooperation through joint ventures
- Setting up a South Asia Development Bank
- Cooperation among Central Banks
- Development of tourism within South Asia

- Discussing, coordinating and exchanging information with a view to adopting common positions, where appropriate, in multilateral fora,

The Summit gave special recognition to the challenge of poverty alleviation by approving the Plan of Action on Poverty Alleviation prepared by the Finance and Planning Ministers at their meeting in Islamabad in 2004.

4.2 THE ROAD MAP TO AN ECONOMIC UNION

If we examine the above list we observe that the key Summit decisions define a road map towards an economic union in South Asia. The SAFTA agreement is the first step towards such a union. However if South Asia's trade is to be integrated then this will require integration of the infrastructure of the region. This would point to cooperation in the areas of energy as well as the strengthening of transportation, transit and communication links across the region. This would further require harmonisation of standards and simplification of customs procedures. Trade cooperation would point to monetary cooperation, thereby suggesting the need for greater coordination among Central Banks. To sustain trading links would require investment cooperation involving public and private sector cooperation through joint ventures. Investment cooperation would need to be underwritten by financing through a prospective South Asia Development Bank. It would follow from such levels of cooperation that the governments would discuss, coordinate and exchange information with a view to adopting common positions, where appropriate, in multilateral fora.

In each of the above areas, as interaction develops, there would be scope for deepening cooperation. The Free Trade Area could evolve into a Customs Union with a common tariff barrier with the rest of the world. The Customs Union could lead on to a common exchange rate policy and eventually a common currency underwritten by coordination of macroeconomic policy across the region. Energy cooperation could evolve into a common energy grid across the region with integrated electricity and gas systems as is the case in Europe today. Transport cooperation would lead on to an integrated transport infrastructure which permits for uninterrupted travel from Peshawar to Chittagong and from Kathmandu to Colombo as is the case in the European Union. Investment cooperation would culminate in regional corporations with production facilities located across the region within vertically and horizontally integrated production systems. Shares of both national and regional companies would be quoted in the stock exchanges across the region as capital flows without hindrance across national boundaries to underwrite investment in any part of the South Asia region.

Within such a framework of cooperation the goal of poverty reduction enunciated by ISACPA would evolve from a regional goal implemented at the national level into a regional agenda to eradicate poverty across South Asia. The noble goal of a South Asian Social Charter would move beyond a set of pious declarations made in Islamabad into binding commitments for charting out the social obligations of each of the member states which would be enforceable across the South Asia region.

If we were to indeed move towards an Economic Union, we would have to take the ultimate step which today binds Europe, by integrating our labour markets. Today in Europe any European can move across national boundaries to seek work anywhere in the region. Those of us who watch European football on Cable TV would note that in the leading clubs of Europe such as Arsenal, Manchester United, Real Madrid and A.C. Milan there are more Europeans than nationals playing in each team.

Publishing a road map to a distant destination does not provide any indication of when such a journey may commence, how long it would take or whether we would at all reach journey's end. In the reminder of this paper I aim to briefly discuss the prospects and pitfalls of moving towards an Economic Union by evaluating the trajectory of cooperation in each of the areas identified at the Islamabad Summit along with the attendant political implication of deepening integration in South Asia.

4.3 TOWARDS A FREE TRADE AREA

The first stage in moving towards an Economic Union would be to enhance trade. For a region which aspires to an Economic Union we have one of the lowest levels of intra-regional trade anywhere in the world. While this, in considerable measure, originates from prevailing trade barriers in each country, the more substantive constraint lies in the structural asymmetries in the national economies which limit the scope for trade. Moving towards SAFTA helps the region across the first hurdle of the journey to a Union. It is argued here that this first obstacle remains less severe than may be apparent at first glance but we should not underestimate the weight of the challenge.

Intra-regional trade has increased significantly in the last decade mostly through imports by all countries in the region, except Pakistan, from India. While South Asia is a fast growing destination for Indian exports it remains marginal as a source of India's imports. The principal export destination of all South Asian countries remains North America and the European Union (EU). Trade liberalisation with South Asia has, thus, largely served to stimulate Indian exports within the region but with low levels of reciprocal export growth to India. This owes in some measure to India's relatively more restrictive import regime compared to its neighbours but it also reflects the structural rigidities in the smaller economies who have relatively little to export to India. Thus, a primary goal of trade cooperation in South Asia has been to encourage India to open up its import regime to imports from its neighbours through significant trade concessions and to help the smaller countries to enhance as well as diversify their production and export capacity to exploit emerging market opportunities in India.

While SAFTA was seen as the route to opening up trade it always needed to address the problem of trade asymmetry in the region. To the extent that the SAARC process moved slowly to address these issues bilateralism became a preferred option to stimulate intra-regional trade. As of today India has entered into bilateral free trade agreements with Nepal, Bhutan and Sri Lanka. In the case of Bangladesh a bilateral free trade agreement is under negotiation with India which is being strongly supported by the Metropolitan Chamber of Commerce and Industry, which brings together the leading business houses in Bangladesh. It is expected from the negotiations that India would offer accelerated market access to Bangladeshi exports as has been permitted under the Indo-Lanka Free Trade Agreement (ILFTA). In return, the smaller economies would be given more time to eliminate their trade barriers to Indian exports. There is some apprehension among economists in the region that the bilateral FTAs may compromise the move towards SAFTA. It could, however, be argued that these FTA's may actually facilitate the move to SAFTA since they have already opened up the doors for enhanced trade in the region. Negotiations have already begun through the SAARC Secretariat on working out the details of SAFTA. These negotiations will have to factor in the implications of the already prevailing bilateral FTAs in place within the region or under negotiation.

The key to rapid progression towards SAFTA which could obviate any potential contradiction associated with the bilateral FTAs lies with India. Every member of SAARC, including Pakistan, is apprehensive that the overwhelming size and diversity of the Indian economy will impose competitive pressures on their smaller and weaker economies. For those countries who have already seen their markets flooded with Indian imports the immediate goal within the SAFTA process would be to seek reciprocity through accelerated entry into the Indian market. This search for special concessions mostly from India, by the weaker economies of South Asia, could slow down the SAFTA negotiations. In such circumstances, the logical step to accelerate progression towards SAFTA would be for India to make a unilateral gesture, within the spirit of what is now popularly known as the Gujral doctrine, by declaring that it would immediately open up its market to all exports from across South Asia as a prelude to the SAFTA negotiations. This may be done through concluding an FTA with Bangladesh which offers Bangladesh immediate duty- and quota-free access to the Indian market and also opening up discussions with Pakistan to enhance bilateral trade by offering them special concessions for their exports.

There may be scope to argue over the details of the SAFTA. The point at issue, at the outset, is to reach an agreement in principle, at the political level, on the guiding principles for the official negotiations. This should reach agreement that:

(1) India must make the deepest concessions.

(2) The most generous concessions must be offered to the SAARC LDCs.

(3) The negative list must be reduced to a minimum.

(4) Provision must be made to provide financial support to the weaker members to enhance their development and trade capacity.

(5) Provisions must be made for financial compensations to those LDCs such as Maldives who are likely to face import revenue losses due to trade concessions under SAFTA.

(6) Negotiation must be concluded and a final agreement reached as early as possible, preferably by the time of the next Summit.

4.4 INVESTMENT COOPERATION

The move towards SAFTA will be meaningless unless the issue of stimulating investment in the region, particularly in the less developed areas, including Sri Lanka, is accelerated. The substantive point of a free trade area is for small economies with narrow markets, such as Bangladesh, Nepal and Sri Lanka, to be able to use the incentive of the larger South Asian and particularly Indian market to stimulate enhanced investment from within and without the country. In Bangladesh as in Sri Lanka it is widely believed that the expectation of servicing a market of 1 billion people in India will open up new investment horizons in their country. Domestic entrepreneurs seeking to access global financing and foreign enterprises particularly from East and South East Asia seeking entry into the large and growing Indian market will be encouraged by SAFTA to rethink their investment plans.

Given the opportunities for unrestricted access to an integrated South Asian market, deep structural changes in their production capacities which can expand and diversify, the basket of goods available for export are essential to transforming the fortunes of the smaller economies of South Asia. Structural changes have the potential of transforming the dynamic comparative advantage of an economy and can therefore never be adequately captured in the static gravity models used to forecast gains from regional cooperation. Business houses in India and indeed outside investors could also be expected to adjust their production base by locating plants to serve South India in Sri Lanka or North East India in Eastern Bangladesh rather than to service them from Mumbai or Haryana. New patterns of vertical and horizontal integration, with plants located across the region, could serve to restructure the manufacturing landscape of South Asia.

To realise such a transformation in the investment climate in each of these countries, preconditions will have to be created where perceptions of political hostility and the attendant security threats to investors, particularly from India, will have to be put to rest. While some of these apprehensions may be addressed within a possible SAARC investment guarantee scheme and/or the use of the globally facility known as MIGA, the real apprehensions remain invisible and originate in the mind sets within both India and the host country. Here it is the primary responsibility of the host governments, the principal political parties, the business community and the media of these countries to create the preconditions whereby investors and particularly Indian investors will feel secure. Obviously, if ongoing ethnic conflict in Sri Lanka, the Maoist insurgency in Nepal and the endemic confrontational politics in Bangladesh are not systemically resolved, neither Indian nor South East Asian investors are likely to rush into these countries even for the privilege of serving a market of a billion people.

Allowing for improvements in the social environment for investment, the major task will be put in place financing facilities to service the emerging investment needs. Within India there is no shortage of private or public institutions which can underwrite investments across regional boundaries. But such facilities will need to be further encouraged by changes in the laws governing capital market convertibility. While each South Asian country will take time to open up its capital account, India can take the initiative of moving to restricted convertibility by lifting all policy restrictions to capital flows within the region.

The proposal for a dedicated South Asian development fund may also be encouraged. The Fund was endorsed by SAARC at least a decade ago but has been virtually still born. The Funds mission needs to be clarified and new life needs to be breathed into the organisation. There is some confusion as to the scope of this fund and whether it will cover both financing of infrastructure projects and private investment. Here it is suggested that two funds may be developed. One fund should be dedicated to financing infrastructure development projects mostly located in the less developed countries. As in the case of the European Union, a special fund is needed to enhance the development capacity of weaker countries to enable them to enhance their competitiveness in an integrated market. Billions of Euros were invested through the EU in such funds, initially in Spain, Portugal, Greece and Ireland when they entered the EU, to enable them to upgrade their infrastructure and enhance their competitive capacity. A similar fund, underwritten from within SAARC but supplemented by aid resources from outside the region, should be established to enable Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka to invest in infrastructure projects. Investment which would modernise and enhance capacity in the areas of transport and communications as well as energy, perhaps with a special focus on regional connectivity but not exclusive to it, would enhance the attractiveness of these economies to prospective investors.

A second fund should be established as an Investment Fund, serviced by both public and private capital, to finance private sector investment projects within the weaker economies, which involve cross border investment as well as projects for serving regional markets. This should attract prospective investors from India and Pakistan and could be used to leverage further private investment from outside the region which may even cover private investment in infrastructure projects.

4.5 INTEGRATING THE INFRASTRUCTURE

The Islamabad Summit quite appropriately identified energy, transport and communications as important areas for cooperation. Of these, the need for transport integration remains perhaps the most urgent since it is integral to the operationalisation of a free trade area. South Asia inherited an integrated transport infrastructure from the British who were themselves bequeathed a road network by the Mughal Empire. This infrastructure was fractured not by the partition of India but by its political aftermath and now needs to be rebuilt within context of greater political harmony in South Asia.

Across the mainland of South Asia the original transport infrastructure is already in place but in many areas has fallen into disuse or needs upgrading. The main obstacles to improve connectivity remain political. There is nothing to prevent a traveller from boarding a train in Delhi which could take them to Peshawar or a bus which travels from Dhaka across India to Karachi since there is a rail and road infrastructure in place which makes such journeys possible. While there is nothing to prevent anyone who can afford a plane ticket to fly anywhere within South Asia there are politically determined decisions which prohibit surface transport providers from responding to the travel needs of ordinary people in these countries. Nor can a traveller take a bus ride from Kolkata to Agartala in North-East India, transiting across Bangladesh because there are political inhibitions in Bangladesh to granting such transit rights to India. Moving from Nepal or Bhutan to Bangladesh across a narrow strip of India territory is limited to fixed hours of the day because India chooses to deny unfettered transit rights to its three neighbours. For Europeans who have been travelling across Europe from London to Istanbul on the Orient Express even before the EU came into existence these barriers to normal communication in South Asia remain incomprehensible. Apart from the inconvenience to travellers these barriers have raised the cost of trade. Bangladesh imports cotton from Pakistan for its textile industry. But a consignment of cotton now takes 40 days to move from West Punjab to Chittagong via Karachi with a transhipment in Colombo or Singapore. If a container of cotton could be put on a freight train leaving Lahore and moving across India, this could reach Dhaka within 4 days.

These barriers make neither commercial nor logistical sense and originate in the pathologies of interstate and domestic politics. The political leaders of South Asia will therefore need to first dismantle the political barriers to transport integration. Once this is done then procedures for facilitating cross border movement of people and goods will need to be harmonised (visas, customs facilities) and system connectivity will have to be established (metre gauge rail systems with broad gauge systems). Infrastructure where fractured will have to be rebuilt or upgraded to sustain a heavier traffic load and capacity will need to be expanded to accommodate the enhanced traffic emanating from intra-regional movements. In some cases new investment would be needed as for example building a bridge across the Palk Straits which would link Sri Lanka to the mainland of South Asia.

Integrating the transport infrastructure of South Asia would be crucial to the fortunes of Nepal, Bhutan and North East India because this would serve to end their land locked status which has been a major source of their underdevelopment. Nepal and Bhutan, within such an integrated regional transport network, should be able to treat the Bangladeshi ports of Mongla and Chittagong as national ports in the same way as people in Austria, Hungary or Switzerland treat Rotterdam, Hamburg, Marsailles and Genoa as European and not national ports. The North Eastern states of India should be able to treat Chittagong as their point of connectivity with the world. Within such an integrated transport system Bangladesh could aspire to become the Singapore of the land routes, linking South West China and South East Asia with South Asia and beyond to West and Central Asia.

So far SAARC has done very little to address the issue of transport integration. Some meetings have been convened by the SAARC Secretariat to look at the issue of standardising the transport infrastructure but there is no strategic vision to guide the integration process largely because of the underlay of political tensions which constrain issues of transport connectivity. Whatever dialogue on improving linkages has taken place owes either to the enterprise of multilateral bodies such as the World Bank, Asian Development Bank or UNESCAP or civil society initiatives emanating from bodies such as South Asia Centre for Policy Studies (SACEPS) and the Centre for Policy Dialogue (CPD), Dhaka. The mandate from the Islamabad Summit has inspired the SAARC Secretariat to place the issue of improving transport linkages on their work programme. However, much work is needed to both design an underlying vision and then translate this into programmes and projects which free up movement of traffic across South Asia.

4.6 ENERGY COOPERATION

South Asia is, in aggregate, an energy deficit area largely because India is emerging as one of the world's largest energy markets. In contrast, Nepal and Bhutan retain the potential to emerge as major sources of power export though harnessing the vast hydro power potential locked up in their rivers. Indeed, power is already Bhutan's largest source of export earnings directed to India which has helped to make it the only country in the region with a trade surplus with India. However, Nepal's export-oriented hydropower projects have been tied up in protracted negotiations with India, its principal market for power. These negotiations have acquired political overtones which have strained bilateral relations and has also become a major issue in domestic politics in Nepal. Bangladesh has a potential for exporting natural gas to India but is reluctant to do so because of domestic political opposition to such exports on the grounds that its gas reserves are insufficient to justify such exports. Pakistan remains a potential transit point for connecting the vast energy reserves of West and Central Asia to South Asia but has not been able to benefit from its strategic location because of its political tensions with India.

This politicisation of what would in most other regions have been viewed as economic or commercial decisions derives from the political perspective guiding the development of the energy sector in every country. The idea that the supply and demand for energy must be balanced within a country is not very meaningful in a region where some countries are major importers of energy and others see it as their principal export. In such circumstances, it would make sense for South Asia to move away from conceiving of its energy security as a national project and will have to redefine its market in regional terms. If South Asia's energy scenario were to be redefined within a regional context, its energy needs would expect to be served through a common distribution system integrated within a single energy grid of power and gas lines extending across the region. Such an integrated system would need to resolve some quite complex problems of cross border pricing, harmonisation of standards and equipments and the role of external players as sources of supply (Iran, Central Asia) or as corporate investors. It should be kept in mind that the United States, operating through its energy multinationals, has already declared a major interest in energy cooperation in South Asia and is investing heavily in the South Asia Regional Initiatives for Energy Cooperation and Development (SARI) which is systematically exploring the scope for enhanced energy cooperation across the region. The SARI programme has already studied the scope for an energy grid linking Sri Lanka with Southern India and a grid linking power exports from Nepal and Bhutan to the grid systems in Eastern India and Northern Bangladesh.

The SAARC governments have already recognised the need for cooperation in the energy sector. The Summit in Islamabad reaffirmed this interest. A meeting of SAARC Ministers was held in Dhaka in 2003 to explore the scope for cooperation. But so far very little has been done to work out the economics or explore the political implications of such cooperation. At the level of civil society SACEPS set up a Task Force to explore the scope for cooperation. Their report identified the attendant benefits as well as the complex issues of politics, ownership, pricing and management associated with building energy linkages in the region. This report was presented to the SAARC Summit in Islamabad. Another study by the Coalition for South Asian Cooperation (CASAC) and the CPD, Dhaka has taken the work of the SACEPS Task Force forward and completed a more comprehensive study on energy cooperation. There is an obvious need for both SAARC and civil society institutions in the region to come together to draw up a substantive and implementable programme for energy cooperation which can be discussed more comprehensively by the SAARC governments before concrete proposals for cooperation are placed before the Summit.

4.7 HARMONISING MACROECONOMIC POLICIES

Any move towards an Economic Union cannot limit itself to a free trade area. SAARC will sooner or later have to explore the scope for a Customs Union. This issue will not be as complex an issue as it might have appeared some years ago. Under the pressure of the WTO convergence in tariff levels across the world is the order of the day. Since all SAARC countries have been lowering their tariff rates, mostly under pressure from the World Bank/IMF structural adjustment reforms, the deep disparities in tariff levels which once characterised the region are less apparent toady. It therefore makes sense to open up discussion on adopting a common tariff policy vis-à-vis the rest of the world. However, this task is also problematic. As of today it is the smaller economies who have reduced their tariffs rather faster than India or Pakistan. Thus, the main resistance to a common external tariff may well originate from India who may entertain deep reservations about the fact that these small countries impose zero or very low tariffs on import of capital and intermediate goods since they have little or no production capacity in these areas. In contrast, India has a sizeable capital and intermediate goods industry which it would wish to protect within the limits permissible under WTO rules. In these circumstances, in the near future, an approach to tariff harmonisation would be constrained by the structural asymmetries between the bigger and smaller economies of South Asia. However, this is not a problem which can persist over a long period of time due to the WTO rules of the game. It would therefore make sense to initiate work on the implications of a Customs Union within South Asia in order to see when, under what circumstance and at what pace such a Union can be put in place.

Deepening integration will involve moving beyond trade to address the broader issue of harmonising macroeconomic policies. This would cover such areas as fiscal, monetary and exchange rate policies. Such a level of cooperation would demand coordination among SAARC Finance Ministers to ensure that their budget deficits, inflation, exchange and interest rates maintain some element of alignment. Such issues have never been discussed at any level within SAARC. By a happy coincidence such macro-economic indicators, with episodic variations, have in recent years not significantly diverged across the SAARC countries. However, this cannot always be the case so that some consultation if not coordination among Finance Ministers would be in order.

The more advanced move towards a common currency lies even further ahead. The available professional work on monetary cooperation carried out by IPS, Colombo and at RIS, New Delhi on behalf of SACEPS, has examined the implications of moving towards exchange rate harmonisation and eventually a common currency. Both studies have recognised that any move in the direction may be premature. However, what has emerged out of these civil society consultations is the suggestion that a parallel currency rather than a common currency may be put in place largely to underwrite trade and investment transactions in the region. So far little or no discussion at the official level has taken place among SAARC Finance Ministers on the issue of macroeconomic policy. Even though the Finance Ministers are expected to meet every year such meetings have been episodic and have limited themselves to safe subjects such as poverty.

It must here be noted that while there is very little discussion at the official level on such issues as exchange rate harmonisation, let alone a common currency, there is a thriving underground market which mediates capital transfers across the region with considerable efficiency. This system sets it own parallel exchange rate, converting dollars into Rupees and Rupees into Takas and has in some measure managed to keep the formal exchange rate in most SAARC countries close to its equilibrium level. Given the importance of India in the region and indeed as a competitor in common global markets such as for tea or readymade garments, no country in the region can permit its exchange rate to become too overvalued in relation to the India rupee. Maldives is the only exception since they have firmly annexed the value of the Rufiyah to the US dollar and kept it at a fixed level, notwithstanding significant depreciation of every currency in the region vis-à-vis the dollar, over the last 10 years.

While SAARC Central Bank governors meet once a year at the annual meeting of the World Bank-IMF, they have kept away from serious discussion on macroeconomics issues and can draw upon no background professional work to underwrite their exchanges. Looking ahead it would therefore make sense for the Central Bank governors to use these consultations to regularly and systematically discuss their exchange rate and related policies. Prospective research work at IPS and RIS may be undertaken to service such a meeting of the Governors. Such research would need to discuss the scope, circumstances and timing of any move towards exchange rate harmonisation and eventually a common currency.

As in the case of the European Union, moves towards macroeconomic policy harmonisation, let alone a common currency, would generate considerable political fall out because these issues are associated with national sovereignty. It is, however, to be noted that most SAARC countries have no problem in discussing their macroeconomic policies with the IMF and World Bank who have traditionally exercised considerable influence over their policies. In practice, it is highly unlikely that India would subordinate its macroeconomic policies to accommodate a broader regional consensus. Thus, policy harmonisation would mean that the smaller countries would have to take the lead from India in setting their macroeconomic targets. This to some extent takes place in both Bhutan and Nepal and may well emerge as a factor in Sri Lanka's macroeconomic management. Bangladesh, because of its common borders and fast increasing trade at the formal and informal level, cannot expect to let its macroeconomic variables become seriously misaligned with India though no Finance Minister would publicly acknowledge this. It is only in Pakistan that a strongly autonomous policy posture may emerge. However, as Pakistan's trade relations with India expands, it cannot afford to set a completely autonomous macroeconomic policy direction. In such circumstances, whilst South Asia's Finance Ministers will need to come to terms with the new market realities India should not assume a posture of indifference to the problems of its neighbours who have to reconcile market forces with domestic politics. India should thus pay attention to the concerns of its neighbours by opening up a regular dialogue, within the SAARC process, on these issues which would be supported by some serious professional work. Such a process may initially involve little more than consultations but may evolve into an informal process of macroeconomic harmonisation. Formal policy coordination may emerge as part of the long term process of creating an Economic Union.

4.8 INTEGRATING LABOUR MARKETS

It makes little economic sense to talk of globalisation though integration of factor markets, in the form of commodities and capital, while omitting all discussion of labour which is a recognised factor of production. Freeing of the movement of labour across national boundaries is not discussed either at the WTO or in SAARC fora. In the WTO the SAARC countries come together to support the inclusion of the *movement of natural persons* in any discussion on the issue of trade in services. We all agree that it is preposterous for the US and the Europeans to include such issues as the liberalisation of banking, insurance and consultancy services as part of the negotiations on the services sector at the WTO without any reference to labour services which are a major export from Bangladesh, India, Nepal, Pakistan and Sri Lanka. In contrast to South Asia's strong position on the subject in international fora, it is *verboten* to discuss the issue of movement of natural or any other variety of persons in any SAARC fora. The truth is that the issue of labour flows across borders, whether at the WTO or in South Asia, is discussed as an issue of immigration, usually illegal, by Ministries in-charge of internal security rather the trade and economic affairs.

Within South Asia labour from Nepal and Bhutan can move freely into India so that for all practical purposes an element of labour market integration prevails within these countries though not between Nepal and Bhutan where the issue of Nepali immigrants is a highly sensitive issue. In contrast, Bangladeshi labour movements into India and Pakistan remain exclusively at the informal level. This has in India becomes an explosive political issue where one major party has made the issue of repatriating illegal, Bangladeshi immigrants into an important plank of its electoral policy. In contrast, successive governments in Bangladesh have taken the position that there are no Bangladeshi immigrants in India at all. This polarised approach to a major human and economic problem is not permitted to be included on the SAARC agenda for discussion. This official de-recognition of the problem has not restricted the ongoing flow of immigrants from Bangladesh into either Pakistan or India. Under the circumstances it also makes sense for SAARC to face this issue up front before it becomes an issue of bilateral political confrontation and of domestic politics in the concerned countries.

To the extent that SAARC governments may remain inhibited about discussing the problem of labour flows it is suggested that at the level of civil society serious discussion of the issue should take place. These dialogues would need to be backed by major research on the underlying economics, the social implications in the receiving and sending countries and the political fall out from this process. Such an exercise should recognise that important issues of human rights as well as national security are involved along with the criminal dimension associated with human trafficking of women and children. It is hoped that out of such research and consultation a realistic and humanitarian policy will emerge which can serve to formalise the process of labour flows and integrate this into the process of economic cooperation in South Asia. Such an exercise will need to recognise that if a South Asian Economic Union is to emerge labour market integration will have to be a central component of the process.

4.9 TRADE IN SERVICES

South Asia has a fast and growing trade in services. Large numbers of South Asians cross each others borders as tourists, pilgrims, professionals, students and health care seekers as well as providers. Nepal, Maldives, Sri Lanka and India are major tourist destinations both globally and within the region. India is a major attraction for students and health care seekers while Indian nurses and doctors are much in evidence in a number of hospitals in Bangladesh, Nepal, Maldives and Bhutan. Managers and professionals from India are in service in Nepal and Bhutan just as Indian and Pakistani managers are running textile mills in Bangladesh while Bangladeshi cooks and waiters are ubiquitous in Maldivian tourist resorts. With the enhancement in the quality of service delivery across the region this trade in services will grow and may do so exponentially, since this is an area where South Asia has some comparative advantage.

There is however no reason why the market in services should be monopolised by India. Pakistan, Sri Lanka and Bangladesh can invest in their education and health care sector, both directly and through collaboration with India, to attract service seekers from within the region as well as globally. Pakistan already has some excellent hospitals and institutions of educational excellence such as the Lahore University of Management Sciences which attract clients from overseas. It would not take much effort to upgrade such service sectors in these countries to serve a regional and even global market.

India is now emerging as one of the major exporters of IT services at the global level. There is an expectation that this could grow to US$50 billion in service exports. Here again Sri Lanka, because of its level of educational attainment, Pakistan, Bangladesh and even Maldives have the potential to share in the fast growing IT market. Here India, in particular, can play and indeed is beginning to play a crucial role in enhancing capacity as well as investing in these sectors in all the countries of the region to enable them to connect with the global and regional IT market.

SAARC initiatives in the service sector have not moved beyond some consultations related to the tourism sector. Much more work, again possibly at the level of civil society, needs to be done to estimate the extent and nature of this market as well as its underlying dynamics. Such studies can then be used to open up dialogue at the official level to see how the issue of services should be integrated into the SAFTA process. Since much of this trade in services is informal and hence unrecorded, this trade will continue to expand through the play of market forces. It may be counterproductive for SAARC to interfere with the market but the SAARC process should certainly be used to explore ways to enhance the export capacity in services of the weaker SAARC member countries.

4.10 SOCIAL INTEGRATION

South Asia is united by its poverty. It contributes the largest share of the world's poor, illiterate, hungry and medically deprived, though Sri Lanka and Maldives contribute little to these numbers. Any move to integrate South Asia cannot therefore bypass this defining social reality. It was therefore appropriate that the Colombo Summit of 1991 set up the Independent South Asian Commission on Poverty Alleviation (ISACPA). A quite creative document on how to alleviate South Asia's poverty was prepared by ISACPA and placed before the SAARC Summit in Dhaka in 1993. The Summit indeed set 2001 as the date by which poverty would not just be alleviated but eliminated from South Asia. However, between 1993 and 2001, not much was done at the national level to honour this commitment nor was any attempt made at successive SAARC Summits to take account of progress in this area.

The emerging global compact in the wake of the Millennium Summit of 2000 has focused attention on poverty reductions and has led to the formulation of the Millennium

Development Goals (MDGs) which are expected to be realised in each country by 2015. This global emphasis on poverty as much as the awareness that poverty was still endemic in South Asia even after 2001 seems to have excited the Kathmandu Summit of 2002 to revisit poverty. The Summit accordingly commissioned an ISACPA-II to address the issue of poverty yet again. However, the only common link between ISACPA-I and II was that Mr Bhattrai, the Ex-Prime Minister of Nepal, was the Chairman of both Commissions, though he made little contribution to the work of ISACPA-II on grounds of health. The leadership in ISACPA-II was assumed by Dr Kamaluddin Siddiqui its co-chair, who is the Principal Secretary to the Prime Minister of Bangladesh and a well respected social scientist in his own right. The ISACPA-II report was submitted to and endorsed at the Islamabad Summit. It set itself the more modest goal of alleviating rather than eliminating poverty which was rewarded by the Summit who perpetuated the life of the ISACPA to oversee the implementation of its goals.

The main goals of ISACPA-II, however, appear to be mostly committed to monitoring the poverty trends and progress towards the Millennium Development Goals (MDG) in the South Asian countries and in sharing experiences and best practices across the region. These are modest goals which could well be realised even within SAARC. The actual task of eradicating or even alleviating poverty remains a national task which is supposed to be addressed by each SAARC country, except India, within the framework of a Poverty Reduction Strategy Paper (PRSP) which is the new global development fashion initiated by the World Bank and IMF. India has not taken the PRSP route claiming that its current Five Year Plan incorporates its own PRSP. Obviously, there is very little SAARC can do to alleviate poverty since this task remains the paramount obligation of the member countries. However, poverty reduction is not just an exercise in development budgeting but is integral to the political economy of the concerned society. Given the salience of political and social variables, it is less clear how far ISACPA can discharge its role as a watchdog of the progress in poverty alleviation in South Asia without major back up from South Asian civil society. South Asia presides over a strong civil society which has been at the vanguard of research on poverty and hosts NGOs who have become global role models in developing implementing and advocating programmes which help to alleviate poverty.

However, neither good research nor effective NGOs have helped to eradicate poverty in South Asia. Issues of poverty, equity and injustice are political issues which demand an engaged civil society with a capacity for political advocacy. If civil society is to be effective its initiatives will need to be synergized within and across countries if they are to make any significant impact on the political economy of a country. What is therefore important is for South Asia's civil society to graduate out of the seminar room and build a strong coalition of institutions which can be used to both hold government's accountable and influence political opinion. Such a civil society initiative can set up their own independent monitoring body to track the role of not just SAARC governments but also civil society institutions to see how far and fast they are moving to not just alleviate but eradicate poverty. Such reports can be shared with the annual SAARC summit as a measure of their progress in meeting their commitments under ISACPA-II as well as with national parliaments and the media to report on progress under the PRSP process in each country.

4.11 SAARC SOCIAL CHARTER

This prospective coalition of civil society institutions will need to extend its mandate not just to evaluate the progress towards poverty eradication but to see how far South Asian governments are meeting their obligations towards implementing the provisions of the SAARC Social Charter which was signed at the Islamabad Summit. This role of a civil society monitor for the Social Charter is even more important because there was no such entity such as ISACPA which prepared the SAARC Charter and can now oversee its implementation. The Social Charter was prepared almost as an afterthought, by bureaucrats convened by the SAARC Secretariat, and with little or no consultation either with SAARC governments or civil society. Very little is known about the SAARC Social Charter within most governments who have exercised little ownership over the final document. The signing of the Charter by the SAARC Summit was thus largely a proforma exercise since neither the Foreign Ministers nor the Presidents/Prime Ministers who endorsed the Charter are aware of its contents let alone its implications. Notwithstanding its anonymous origins the SAARC Charter is an ambitious document influenced by similar documents in other parts of the world. However, unlike its role model, the European Social Charter, the SAARC Charter is long on exhortation but makes few binding commitments to which governments can be held accountable.

Keeping the lack of official interest in the Social Charter in mind, the South Asia Centre for Policy Studies (SACEPS) set up yet another Task Force under the leadership of Godfrey Gunatilleke, as far back as 2001 to draft a Citizen's Social Charter for South Asia. This process was expected to influence the SAARC Charter by drawing upon consultations with a broad constituency of citizen's groups assembled in all the SAARC countries (except Bhutan) to prepare National Citizen's Charters. These national charters were synthesised in a South Asia Citizen's Social Charter which was intensively debated at a regional conference convened by SACEPS in Colombo in February last year. How far the Citizen's Charter influenced the SAARC Charter is not clear but the Citizen's Charter is a powerful document in its own right with a strong component of enforceable rights. The immediate task before the citizen's of South Asia remains to keep this coalition of citizens intact and to broaden its base to both monitor the work of ISACPA and to hold the SAARC governments accountable for the commitments they have in incurred by signing the SAARC Social Charter.

At the end of the day addressing such provisions of the Social Charter as the right to food, work and health care will demand strong civil action. SAARC governments have signed many such international covenants to which they pay little more than lip service. As long as South Asia remains a region mired in poverty and injustice, exposed to growing income inequality and social disparity, the Social Charter must serve as an instrument of advocacy on behalf of the deprived and excluded. It is the responsibility of civil society across South Asia to hold their governments accountable for correcting these injustices. This will demand an alert, informed and committed civil society which will need to bond together within each country and across the region to build a collective identity that can empower them to play the role of both advocate and custodian for the rights of the deprived majority of South Asia.

4.12 CONCLUSION: THE ROLE OF CIVIL SOCIETY

This paper has indicated that there is a strong and growing demand within civil society for greater cooperation within South Asia. However, the constraints to cooperation in virtually every area originate in the tendency of member governments to politicise issues for reasons of domestic expediency. Citizens in the region do want to trade with each other, travel across borders as freely as do the citizens of the European Union or ASEAN and to live without the threat of war or the fear of terrorism. The leaders of the SAARC countries need to respond to the felt needs of their citizens and demonstrate the statesmanship needed to resolve their short and long term conflicts. These conflicts can be more readily addressed within a framework of open regionalism where borders and nationality do not become constraints to the intercourse of people and commerce. Such a perspective on South Asian cooperation appeared to have emerged out of the Islamabad summit but needs to be sustained by the commitment of the SAARC leaders. Unless the leadership takes the long view towards a South Asia Economic Union and moves by mutual agreement to eliminate the roadblocks to their destination, South Asia's bureaucracies retain the capacity to transform each hurdle into an insurmountable obstacle.

While South Asia needs visionary leaders who can perpetuate the spirit of Islamabad, it needs a strong civil society who can project the felt needs of the people of the region before these leaders. These felt needs are already reflected in the commitment of the leaders to reduce poverty and uphold the rights of the excluded through the SAARC Social Charter. But for these rights to be realised South Asia has to be transformed into zone of peace where its scare resources are not exhausted in building security establishments which themselves become obstacles to cooperation in the region. The process of South Asian cooperation thus needs to become a shared project between the political leadership and the citizens of the region. This social compact must draw upon the involvement of an engaged civil society, bound by a shared commitment to live as a community. It is these citizens who will not only need to hold their government's accountable for working together to build an economic union but will have to assume a vanguard role in recreating a South Asian community.

Chapter 5

MACROECONOMIC PERFORMANCE OF SOUTH ASIAN ECONOMIES: A COMPARATIVE PERSPECTIVE ON BANGLADESH[1]

5.1 INTRODUCTION AND STUDY DESIGN

5.1.1 The Problematic

South Asian countries have pursued, in varying degrees, reform measures since the 1980s under the auspices of the Structural Adjustment Programme (SAP) promoted by the Bretton Woods Institutions. In the backdrop of economic crises, the reform measures were introduced in these countries with the objectives of achieving macroeconomic stability and accelerated economic growth. In order to achieve growth, the issue of policy stability and the ability to withstand macroeconomic shocks were also emphasised along with macroeconomic stability. Growth has been underscored as the centrepiece of development and poverty alleviation in the policy packages of the lending institutions such as the World Bank and the IMF though the outcome did not coincide with the expectation level (Bhattacharya and Titumir, 2001).

Having started with a modest liberalisation process, these countries subsequently initiated comprehensive reform packages including reforms in the areas of trade and industrial policy, fiscal and monetary policy and exchange rate management as well as safety net development and institutional restructuring. These reforms were carried out with a view to allow for a greater role of market forces to develop economic competitiveness and to integrate these countries with the global economy.[2]

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[1] The paper received insights from Professor Rehman Sobhan, Chairman, CPD and Professor Mustafizur Rahman, Research Director, CPD. The authors are grateful to Mr M Golam Mortaza, Senior Research Associate, CPD and Mr Narayan Chandra Das, Research Associate, CPD for very competent research assistance and data analysis support. Contribution of Mr Shubhasish Barua, former Research Associate, CPD is also acknowledged. The paper also received valuable comments from Professor Wahiduddin Mahmud, Professor, Dhaka University, Dr. Fakhruddin Ahmed, Managing Director, Palli Karma Shahayak Foundation, Dr S R Osmani, Professor, Ulster University, UK and Dr. Salehuddin Ahmed, Governor, Bangladesh Bank.

[2] For discussion on SAP in South Asian countries see Ahammad and Fane (1999), Ahluwala (1999), Ahmad (1999), Bandara (1999), Chelliah (1999), Mc Gillivray and White (1999), Sharma (1999), and Bhattacharya and Titumir (2001).

During the 1990s South Asian economies have demonstrated improved performance in terms of macroeconomic stability compared to the 1980s. For example, all countries in the region had performed well in terms of reducing current account deficit and keeping inflation rate low. These variables declined gradually in all the countries during 1991-2000 compared to 1986-90 (except for Pakistan) and then declined further during 2001-2004 compared to 1991-2000.

However, improved macroeconomic stability was accompanied by uneven growth dynamics among the regional economics. Indeed, Bangladesh, India and Sri Lanka have experienced enhanced growth in GDP and per capita GDP during the 1990s compared to the 1980s and, subsequently, during 2001-04 compared to the 1990s. But in the case of Bhutan, Pakistan, Nepal and Maldives the decline was observed in the case of both output and income growth (Table 5.1).

TABLE 5.1

Trends in GDP Growth and Per Capita GDP Growth in South Asia

Countries	Trend Rate of GDP Growth (%)			Trend Rate of Per Capita GDP Growth (%)		
	1981-1990	1991-2000	2001-2004	1981-1990	1991-2000	2001-2004
Bangladesh	3.6	4.8	4.9	1.1	3.0	3.2
Bhutan	7.3	6.5	5.9	5.2	3.6	3.3
India	5.6	6.1	6.5	3.5	4.3	4.4
Maldives	–	8.3*	7.8	–	5.9*	5.6
Nepal	4.4	4.7	2.1	2.2	2.3	-0.1
Pakistan	6.0	3.5	4.8	3.4	1.1	2.4
Sri Lanka	3.8	5.1	5.2	2.7	3.8	4.0

Note: *Calculated for the period 1995-2000.

Source: Calculated from the *World Development Indicators (2005).*

It appears that though macroeconomic stability was considered to be one of the kingpins of accelerated growth and poverty alleviation subsequently, stability was not adequately rewarded in all South Asian countries with accelerated growth of output and income.[3] It has been argued elsewhere that the revealed growth performance of South Asian countries had been much more modest than that of East Asian countries during comparable period (Devarajan and Nabi, 2006). Thus, question remains as to what extent the achieved macroeconomic stability contributed to enhanced growth in the region? In other words, was the issue of macroeconomic stability over-emphasised in the reform packages recommended by the International Financial Institutions (IFIs)?

In view of such apparently obvious but illusive conclusion, it is important to take an indepth look into the relationship between macroeconomic stability and growth in South Asia. The need for such a study finds further ground given the fact that almost all the South Asian countries have initiated implementation of their respective Poverty Reduction Strategy (PRS) where macroeconomic stability has been identified as the centrepiece of macroeconomic management. These countries also experienced how the

[3] Indeed, whatever growth was achieved in the South Asian countries, the incremental benefits in all of them were distributed much more unevenly during the 1990s including in Sri Lanka which till recent past boasted of distributive growth. Between 1990 and 1999, Gini co-efficient in Sri Lanka increased from 0.301 to 0.332. In the case of Bangladesh, the comparable figures were 0.283 (1992) and 0.318 (2000).

much hyped macroeconomic stability as prescribed by the IFIs may not necessarily hold true in the policy context of various countries. For example, after the flood of 1998 in Bangladesh when the economy was going through depressed demand there were debates as to whether the Government of Bangladesh (GoB) should go for expansionary measures without being bothered about fiscal deficit. The IFIs suggested against that policy on the ground that higher public expenditure might increase inflation. However, the reality was that during those periods of floods the country had a bigger Annual Development Programme (ADP) and had increased agricultural credit which resulted in more investment and higher income, Therefore, the contextual reality of countries is more important than the "one size fits all" type of suggestions.

It may be pointed out that a recent paper by Montiel and Serven (2004) has taken a retrospective look at the contents and implementation of the macroeconomic reform agenda in the 1990s in developing countries and has concluded, *inter alia*, that "the search for macro stability – narrowly defined – may in some cases have actually been *inimical* to growth." This, however, is not to say that macroeconomic stability *does not matter* at all for growth; rather it is *not all that matters*.

5.1.2 Growth-Stability Relationship

Admittedly, the relationship between macroeconomic stability and economic growth is not a simple and direct one. The role of macroeconomic stability in influencing the pace of growth has been examined in the literature in view of varying experience in countries with growth outcome and volatility. While there are views that higher macroeconomic volatility leads to lower growth[4] (Ramey and Ramey, 1994; Hnatkovska and Loayza, 2004), it is also held that macroeconomic stability facilitates economic growth but it does not necessarily lead to the promotion of growth (Easterly, 2001; Montiel and Serven 2004). In other words, slow growth may not necessarily be the cause of economic crises and macroeconomic instability, and in spite of policy reform countries may still be stagnant.

It is maintained that macroeconomic instability has been more of a problem in developing countries than developed countries (Ferrnati et al., 2000; Easterly, Islam and Stiglitz, 2001). The relationship between volatility and the level of development of countries has been negative (Hnatkovska and Loayza 2004). That is, most volatile countries tend to be from the developing world. It has been argued that countries that are more open to trade appear to be able to tolerate higher volatility without hurting their long-term growth (Kose, Prasad and Terrones, 2003).

Volatility of key macroeconomic aggregates declined in the 1990s across the developing world. Montiel and Serven (2004) found that the standard deviation of per capita GDP growth of the developing countries fell from 4.0 per cent in the 1970s and 1980s to about 3.0 per cent in the 1990s. Notwithstanding such decline in output volatility in the emerging and developing countries, it remains higher than that of in the industrial countries (Hakura, 2005).

A dissection of growth determinants based on the empirical growth regression literature reveals that slow growth is the result of shortcomings of the reform agenda and insufficient policy measures in most developing countries (Montiel and Serven, 2004). In

[4] Ramey and Ramey (1994) examined volatility in the OECD countries; Hnatkovska and Loayza (2004) have analysed cross-country data. Both have found that macroeconomic volatility and long-run economic growth are negatively related.

this regard, the role of various policies and institutions for growth has been emphasised in the recent literature.[5] Institutional quality has been found to have an overpowering impact on growth compared to policy variables[6] since the implementation and sustenance of good policies are dependent on good institutions (Pritchett, 2004b). The negative link between macroeconomic volatility and long-run economic growth is exacerbated in poor and institutionally underdeveloped countries which are undergoing primary stages of financial development[7] or unable to conduct counter cyclical fiscal policies (Hnatkovska and Loayza, 2004).

While there exists a number of cross-country studies as well as specific country case studies on the relationship between growth and macroeconomic stability, no such study is available on South Asia.[8] Although relationship between economic growth and discrete elements of macro stability has been explored in the context of certain South Asian countries, comprehensive analysis of contribution of macroeconomic performance to growth in the post-reform period remains largely wanting.

It is in this context that the present study seeks to explore the macroeconomic stability and growth relationship in individual South Asian economies as well as in the region as a whole. Macroeconomic stability has been defined as the better performance of macroeconomic indicators (such as low inflation, balanced budget and current account surplus) and lower volatility of those indicators over time.

5.1.3 Objectives of the Study

The broad objective of the paper is to examine the macroeconomic stability and growth in the South Asian countries and establish, in this context, the comparative position of Bangladesh within the region. Specifically, the paper seeks to do the following:

- Review the macroeconomic trends of the South Asian economies and assess their performance in the post-reform period.
- Examine whether there is association between constituents of macroeconomic stability and output and income growth in the regional economies.
- Analyse how has Bangladesh performed, in comparison to other South Asian countries, in achieving macroeconomic stability as well as output and income growth.
- Draw policy lessons from the record of the South Asian macroeconomic stability, output and income growth performance, focusing on their interrelationship.

5.1.4 Methodology and Information Base

The study is based on analysis of cross-country time series data. The seven countries addressed in this connection are Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka. The period covered in the analysis is from 1985 to 2004, i.e. 20 years.

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5 For example, Pritchett (2004a) summarised five syndromes that lead to low growth. Theses are: governance and institutions, macroeconomy, external policies, financial sector, and bad luck.

6 This has been empirically established in a number of studies including Easterly and Levine (2003); Rodrik, Subramanium and Trebbi (2002); and Acemoglu, Johnson and Robinson (2001).

7 The development of the domestic financial sector has also been emphasised since a high degree of financial sector development is associated with lower macroeconomic stability (Kose, Prasad and Terrones, 2003).

8 For a regional study (Latin America) on a similar theme, see Rodrick (1999b).

Timeframe

For analysis of the post-reform performance in the South Asian countries, establishing the benchmark period is somewhat difficult, since each country has started its reform programmes at various points in time. As may be observed from Table 5.2, some were initiated as early as in the mid-1970s, while others initiated their programmes in the early 1990s. For example, Sri Lanka had its first phase of economic reforms during 1977-79 and Pakistan started during the early 1980s. India, on the other hand, introduced comprehensive liberalisation programme only in 1991. The other countries saw such reforms mostly towards the later part of the 1980s or beginning of the 1990s.

TABLE 5.2

Elements of the Structural Adjustment Policies in South Asian Countries, 1980-1993

Policy areas	Year of Commencement of Reforms			
	Bangladesh	India	Pakistan	Sri Lanka
Trade policy reforms	1980	1986	1980	1977
Market reforms	1980	1991	1980	1977
Fiscal reforms	1985	1991	1988	1977-87
Monetary policy reforms	1985	1991	1988	1977-87
Exchange rate policy reforms	1986	1991	1993	1977
'Safety nets' and institutional reforms	–	–	–	–

Source: Hossain, Iyanatul and Kibria (1999).

For the sake of conformity, the present study broadly takes 1985 as beginning of the reform process in the region. Since the objective of the paper is not to compare the macroeconomic performance of pre- and post-reform periods of the respective countries, fixing 1985 as the tentative benchmark period will not have any bearing on the envisaged analysis. Thus, the empirical exercise has been done for each country mostly for the 1985-2004 period, except in some cases where adequate data were not available.[9]

Variables

Macroeconomic performance and its volatility have been examined by studying a total of ten variables in the following three broad areas.

(i) *Macroeconomic stability.* The macroeconomic variables examined in this connection are the following:
- rate of growth of real output
- rate of growth of per capita GDP
- rate of inflation
- current account balance

(ii) *Policy stability.* Policy variables considered in the study are as follows:
- fiscal balance
- foreign financing of the budget
- broad money supply
- exchange rate

[9] For example, data for current account balance were available since 1986, for fiscal balance since 1987 and financial account balance since 1989.

(iii) *External environment*: The external environment has been captured by two exogenous variables. These are:
- terms of trade
- financial account balance

Analytical Techniques

Cross-country assessments of macroeconomic trends have been done by comparing the value of average and standard deviation of the macroeconomic variables. In order to measure the volatility, standard deviations of the indicators have been used as it reflects the mean value. Instability of macroeconomic outcomes has been expressed by the volatility of macroeconomic outcomes.

In order to observe how the volatility of variables has changed over time, averages and standard deviations have been measured period wise for each country by taking five year averages since 1985. This allows us to compare the country results during four periods: 1985-89, 1990-94, 1995-99 and 2000-04. In some cases the span of periods is only four years due to unavailability of data.

Moreover, two sets of Ordinary Least Square (OLS) regressions have been performed in the study. Country-specific Ordinary Least Squares (OLS) analyses have been employed for all countries to see the individual impact of the volatility of macroeconomic stability variables, policy stability variables and the external environment variables on the volatility of GDP growth rate and per capita GDP growth rate. The time series properties of the variables have been examined by testing variables for unit roots to determine whether they are stationary or not. Annex Tables 5.2-5.8 provide the results on Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests on levels of variables with and without trend term.

Furthermore, a panel regression analyses have been done to examine what factors are associated with both the real GDP growth rate and real per capita GDP growth rate volatility in the South Asian economies. This systematic empirical analysis considers all macroeconomic stability, policy stability and external environment variables as well as country-specific dummies as explanatory variables.

Information Base

The study has articulated its hypothesis by drawing on review of literature and published empirical information. Data for analysis have been collected from various volumes of the World Development Indicators (WDI) of the World Bank, *Key Indicators of Developing Asian and Pacific Countries* of the Asian Development Bank (ADB), *World Economic Outlook* of the International Monetary Fund (IMF) and *Human Development Report* of the United Nations Development Programme (UNDP). Unavailability of data from international sources has been supplemented by drawing on national statistical yearbooks (e.g. *Bangladesh Economic Review 2005*).

5.1.5 Layout of the Paper

Following the introductory section, the performance analysis of South Asian economies in terms of macroeconomic outcomes, policy stability and exogenous shocks has been done in Section 5.2. The macroeconomic behaviour of South Asian economies has been analysed in this section by examining the ten key variables relating to macroeconomic stability for each of the regional countries. The relationship between macroeconomic stability and growth has been examined empirically in Section 5.3. The performance of Bangladesh economy in a comparative South Asian framework is provided in Section 5.4. The paper concludes in Section 5.5, by reflecting on the role of macroeconomic stability in the context of national reform agendas of the South Asian countries.

5.2 PERFORMANCE ANALYSIS OF SOUTH ASIAN ECONOMIES: MACROECONOMIC OUTCOMES, POLICY PERFORMANCE AND EXOGENOUS SHOCKS

The macroeconomic outcomes of the seven South Asian economies have been captured by the behaviour of output growth (real GDP and per capita GDP), inflation and current account balance for the 1985-2004 period. The observations for the Maldives are only for 1995-2004 period.

5.2.1 Macroeconomic Outcomes

Output Growth and Volatility

Real GDP Growth. One of the indicators of output growth is real GDP growth rate. The average real GDP growth rate in South Asia during the last two decades had been a reasonable 5.5 per cent with Bhutan and India on the higher side (i.e. 6.7 per cent and 5.8 per cent respectively) and Sri Lanka, Nepal, Bangladesh and Pakistan on the lower side (i.e. 4.4, 4.5, 4.5 and 4.4 per cent respectively).[10]

Notwithstanding the average trend, it may be observed from Table 5.3 that GDP growth performance has varied across countries and time periods. It is only in Bangladesh that has improved the average GDP growth secularly over the four five year periods (1985-89, 1990-94, 1995-99 and 2000-2004). Average GDP growth has increased also in Sri Lanka during 2000-04 compared to 1985-89. However, over the entire study period (1985-2004), Bhutan has performed best in terms of average output growth (6.7), followed by India (5.8). Bangladesh, Nepal, Pakistan and Sri Lanka remained at the bottom of the league.

TABLE 5.3

Real GDP Growth

Country	Average GDP Growth (AV_1)				Standard Deviation of Real GDP Growth (SD_1)				AV_1	SD_1
	1985-89	1990-94	1995-99	2000-04	1985-89	1990-94	1995-99	2000-04	1985-2004	
Bangladesh	3.2	4.6	5.0	5.3	0.8	1.0	0.3	0.6	4.5	1.1
Bhutan	7.4	5.9	6.8	6.5	7.0	1.9	0.8	0.9	6.7	3.4
India	6.2	4.9	6.5	5.7	2.2	2.4	1.3	2.0	5.8	2.0
Maldives	n.a.	n.a.	9.4	6.2	n.a.	n.a.	1.6	2.4	7.6	2.6
Nepal	4.8	5.5	4.3	3.6	2.2	2.1	1.1	2.6	4.5	2.0
Pakistan	6.4	4.5	3.4	4.1	1.2	2.2	1.7	1.7	4.6	1.9
Sri Lanka	3.2	5.6	4.9	4.1	1.4	1.1	1.0	3.3	4.4	2.0

Note: n.a. = not available.

Source: Authors' calculation.

10 Maldives has been excluded from the analysis as data for the comparable period are not available.

The volatility of output growth in South Asia during 1985-2004 has been captured through the volatility of aggregate real GDP growth. The scenario in this regard varies across countries.

The volatility of output growth was also lowest in Bangladesh (1.1) during 1985-2004, followed by Pakistan (1.9), India (2.0), Nepal (2.0) and Sri Lanka (2.0). Though Bhutan recorded the highest output growth volatility (3.4) during the period under review, it managed to reduce its volatility of output growth substantially (SD_1) from 7.0 during 1985-89 to 0.9 during 2000-04. Fluctuations in periodic (during every five years) volatility were not significant, except for Bhutan. However, GDP growth in Bhutan was highly volatile only in the 1980s, after which it was quite stable (Table 5.3). Periodic GDP growth volatility has also declined in Bangladesh and India during 2000-04 compared to 1985-89 though not steadily throughout the whole period.

Per Capita GDP

Per capita GDP growth is the other indicator for output growth. The periodic performance of per capita GDP growth rate shows that Bangladesh, India and Sri Lanka managed to improve their per capita GDP growth during 2000-04 compared to 1985-89, while Bhutan, Nepal and Pakistan could not do the same (Table 5.4). On the other hand, volatility of per capita output growth did not follow the same trend. Bangladesh, Bhutan and India had lower volatility, whereas Nepal, Pakistan and Sri Lanka had higher volatility during 2000-04 compared to 1985-89.

TABLE 5.4

Per Capita GDP Growth Rate

Country	Average Per Capita GDP Growth (AV_2)				Standard Deviation of Per Capita GDP Growth (SD_2)				AV_2	SD_2
	1985-89	1990-94	1995-99	2000-04	1985-89	1990-94	1995-99	2000-04	1985-2004	
Bangladesh	0.6	2.6	3.2	3.5	0.8	0.7	0.3	0.5	2.5	1.3
Bhutan	5.1	3.1	3.7	3.8	6.9	2.1	0.8	0.7	3.9	3.4
India	4.0	2.9	4.7	4.2	2.2	2.4	1.3	1.9	3.9	1.9
Maldives	n.a.	n.a.	6.7	3.8	n.a.	n.a.	1.6	2.4	5.1	2.5
Nepal	2.5	3.0	1.8	1.1	2.1	2.0	1.1	2.4	2.1	1.9
Pakistan	3.7	1.9	0.9	1.7	1.1	2.1	1.6	1.5	2.1	1.8
Sri Lanka	2.2	4.3	3.6	2.7	1.4	1.0	1.1	3.3	3.2	2.0

Source: Authors' calculation.

Over the period 1985-2004, though Bangladesh experienced the lowest volatility both in the case of real GDP and per capita GDP growth rates, it did not perform the best in either case. However, the output growth trend of both indicators in Bangladesh had been steadily upward, and given the macroeconomic stability, the growth performance may have more potential.[11]

Conversely, the reported results also suggest that the relationship between volatility and growth can also be positive. Bhutan is a case in point which had higher volatility

[11] Mahmud (2004) and Osmani et al. (2003) observe that the stabilisation of the economy is yet to generate pace towards growth in Bangladesh.

both in the case of GDP growth rate and per capita GDP growth rate during 1985-2004. At the same time, it also had the highest average real GDP growth rate and per capita GDP growth rate.

Inflation Rate

Notwithstanding fluctuations, average inflation rates across period came down in South Asia over the 1985-2004 period.

Volatility of inflation across the region also declined between the periods 1985-89 and 2000-04 (see Table 5.5). Both average inflation rate and volatility of inflation declined in Bangladesh, Bhutan and India during 2000-2004 compared to 1985-89.

TABLE 5.5

Inflation Rate

Country	Inflation Rate (AV_3)				Standard Deviation of Inflation Rate (SD_3)				AV_3	SD_3
	1985-89	1990-94	1995-99	2000-04	1985-89	1990-94	1995-99	2000-04	1985-2004	
Bangladesh	8.3	4.2	3.8	3.4	1.7	2.9	1.4	1.3	5.0	2.7
Bhutan	7.1	9.5	9.1	4.3	1.2	3.8	3.3	0.9	7.7	3.2
India	8.6	10.2	5.9	4.0	1.4	2.1	1.9	1.0	7.3	2.8
Maldives	n.a	n.a	0.8	0.1	n.a	n.a	2.3	1.4	0.4	2.0
Nepal	12.1	10.5	6.5	3.9	1.3	5.1	2.0	0.7	8.5	4.2
Pakistan	6.5	11.7	7.6	5.3	2.7	2.2	3.9	2.4	7.9	3.6
Sri Lanka	10.9	9.8	7.8	9.0	6.6	1.1	2.2	3.6	9.4	3.8

Source: Authors' calculation.

The highest volatility of inflation rate was experienced by Nepal (4.2), followed by Sri Lanka during the period under review. Bangladesh experienced lowest inflation in the region (with an average inflation of 5.0 per cent during 1985-2004), followed by India, Pakistan and Sri Lanka (7.3, 7.9, and 9.4 per cent respectively). It is an open question to what extent these low rates of inflation were the result of contractionary effect of the structural adjustment policies pursued by these countries.

Periodic performance shows that all the six countries (Maldives not included) managed to have low volatility of inflation rate and low average inflation rate. Thus, evidence from these countries suggests an association between high volatility of inflation and high rate of inflation, indicating that macroeconomic instability may result in higher inflation.

Current Account Balance

Overall trend reveals that the current account balance as a share of GDP improved in all the countries of South Asia during the review period. Concurrently, in spite of some fluctuations volatility of current account deficit decreased in the regional economies (see Table 5.6).

TABLE 5.6

Current Account Balance

Country	Current Account Balance as % of GDP (AV_4)				Standard Deviation of Current Account Balance (SD_4)				AV_4	SD_4
	1986-1990	1991-95	1996-2000	2001-04	1986-1990	1991-95	1996-2000	2001-04	1986-2004	
Bangladesh	-0.7	-0.5	-1.7	-0.4	0.7	0.9	1.0	1.4	-0.8	1.0
Bhutan	-18.7	-15.0	-0.3	-0.5	8.3	9.6	9.3	2.8	-6.9	12.1
India	-2.3	-1.1	-1.1	0.7	0.5	0.5	0.4	0.8	-1.0	1.1
Maldives	n.a.	n.a.	-6.8	-8.0	n.a.	n.a.	4.5	3.5	-7.1	3.7
Nepal	-6.5	-6.6	-4.5	-2.6	2.0	1.7	3.4	3.9	-5.2	3.0
Pakistan	-2.7	-3.8	-3.9	2.7	1.1	1.9	2.8	1.9	-2.2	3.2
Sri Lanka	-5.5	-6.2	-3.8	-1.6	1.1	1.0	2.0	1.2	-4.4	2.2

Source: Authors' calculation.

During 1986-2004, the average current account deficit as per cent of GDP was lowest in Bangladesh (-0.8), followed by India (-1.0). Though Bangladesh and India managed to keep low current account deficit, other countries of the region suffered from high current account deficits. Bhutan had the largest deficit in the region which was 6.9 per cent of GDP. The current account deficit shows a decreasing trend in all the countries, except in Pakistan. The average current account balance of Pakistan has, however, improved significantly during 2001-04.

As reported in Table 5.6, volatility of current account balance increased in all the South Asian countries, except Bhutan, during 2001-04 compared to 1986-90. The volatility of the current account balance increased in Bangladesh, notwithstanding the fact that the volatility is relatively low (second to Sri Lanka) compared to most of its South Asian counterparts.

On the other hand, Bhutan has decreased the volatility of its current account balance substantially during 2001-04 compared to all the previous periods (1986-90, 1991-95, 1996-2000). The volatility of Bhutan for the entire period considered in the study (1986-2000) was the highest among the regional economies.

5.2.2 Policy Performance Measures

In examining the performance of macroeconomic stability, a number of policy variables have been assessed in the present study. The macroeconomic policy variables included in this analysis are the following: fiscal balance, foreign financing of the budget deficit, broad money supply (M2)[12] and exchange rate.

A higher volatility of fiscal policies, which has been observed in the study by the volatility of fiscal account balance and foreign financing, is considered to increase output volatility (Fatas and Mihov, 2003). Recognising the diversity of monetary arrangements practised in the developing countries, it has been argued elsewhere that broad money (M_2) supply as percentage of GDP, as an expression of monetary policy, results in high inflation which ultimately contributes to output volatility (Acemoglu et al., 2003.) There

12 *Broad money* equals to the liability of the monetary system in currency and demand deposits to the domestic private sector (i.e. Narrow money) *plus* time and saving deposits and foreign currency deposits held in deposit money banks (i.e. Quasi money).

is also widespread evidence that large devaluations could affect output adversely through both the domestic and international factors.

Similar to Montiel and Serven (2004), the assessment under the present study seeks to understand whether a fiscal balance position (fiscal account balance and foreign financing of the budget deficit) of South Asian countries was consistently evolving with the policy designs of those economies, a monetary policy stance (broad money supply) was consistent with a low and stable inflation rate and, finally, a persistent exchange rate policy was that avoided currency devaluation (overvaluation) and excessive volatility of the real exchange rate.

Fiscal Balance

The overall fiscal deficit as percentage of GDP declined in all the South Asian countries during 2001-2004 compared to 1987-90 (Table 5.7). During 1987-2004 Bhutan had the highest fiscal deficit (18.9), while Bangladesh had the lowest (4.2). Similarly, Bhutan also experienced highest volatility (4.1) of fiscal deficit, whereas Bangladesh had the lowest (0.8).

TABLE 5.7

Overall Fiscal Balance

Country	Average Fiscal Balance (as % of GDP) (AV_5)				Standard Deviation of Fiscal Balance (as % of GDP) (SD_5)				AV_5	SD_5
	1987-1990	1991-1995	1996-2000	2001-2004	1987-1990	1991-1995	1996-2000	2001-2004	1987-2004	
Bangladesh	-5.0	-3.7	-4.1	-4.0	0.7	0.4	0.8	0.8	-4.2	0.8
Bhutan	-22.0	-16.5	-18.2	-20.7	3.7	2.8	4.3	4.6	-18.9	4.1
India	-8.6	-6.8	-6.2	-7.2	0.2	0.7	0.5	0.4	-7.1	1.0
Maldives	n.a.	n.a	-6.2	-6.6	n.a.	n.a.	1.0	1.4	-6.8	1.8
Nepal	-9.7	-8.4	-7.0	-5.7	1.3	1.6	0.6	1.8	-7.7	1.9
Pakistan	-7.7	-7.2	-6.4	-3.9	0.9	1.3	0.8	0.9	-6.4	1.7
Sri Lanka	-10.0	-8.1	-7.8	-8.4	2.1	0.9	0.9	0.9	-8.5	1.5

Note: n.a. = not available.
Source: Authors' calculation.

On the other hand, volatility of fiscal deficit increased in all the countries, except Sri Lanka during 2001-2004 compared to 1987-90. The reported results do not show a conclusive association between volatility of fiscal balance and fiscal deficit, even though the experience of Bangladesh and Bhutan could prompt to conclude that low volatility of fiscal balance may be related to lower fiscal deficit.

Foreign Financing of Budget Deficit

The government's dependence on foreign sources to finance fiscal deficit is measured to express fiscal solvency of an economy. Except Bhutan and Pakistan, all the South Asian countries have reduced dependence on foreign borrowing in 2001-2004 in comparison to 1991-95 as reflected in periodic average of this variable (see Table 5.8). Bhutan became alarmingly dependent on foreign borrowing to finance its budget; Pakistan increased its dependency marginally. There is no significant change for Bangladesh over the sample period. India has reduced its dependence on foreign financing totally.

TABLE 5.8

Foreign Financing of Budget Deficit as % of GDP

Country	Average Foreign Financing of Budget Deficit (as % of GDP) (AV_6)				Standard Deviation of Foreign Financing of Budget Deficit as % of GDP (SD_6)				AV_6	SD_6
	1986-1990	1991-1995	1996-2000	2001-2004	1986-1990	1991-1995	1996-2000	2001-2004	1986-2004	
Bangladesh	2.5	1.8	2.2	2.2	0.2	0.1	0.4	0.4	2.2	0.4
Bhutan	0.2	1.8	5.0	2.2	0.2	1.4	0.6	2.1	2.2	2.1
India	0.5	0.1	-0.1	0.2	0.3	0.1	0.4	0.4	0.2	0.4
Maldives	6.3	1.8	3.8	3.0	–	1.3	1.3	1.9	3.1	1.9
Nepal	4.3	3.4	2.0	3.3	0.7	0.3	0.8	1.1	3.4	1.1
Pakistan	1.7	1.8	1.9	1.8	0.3	0.9	1.0	0.7	1.8	0.7
Sri Lanka	2.8	0.7	1.3	1.6	1.4	0.6	1.0	1.4	1.7	1.4

Source: Authors' calculation.

The volatility of average foreign borrowing as percentage of GDP has been lowest in India (0.40) and Bangladesh (0.40) during 1986-2004. However, volatility of foreign financing has increased in almost all South Asian countries during 2001-04 compared to the three previous periods.

Broad Money Supply

Due to diversity of monetary arrangements in the South Asian countries, it is difficult to capture monetary stability. In this context, broad money supply (M2) as percentage of GDP has been measured to show monetary stability.

Money supply as percentage of GDP has increased in all the countries in South Asia during 2001-04 compared to that of 1987-90 (see Table 5.9). Average money supply was lowest in Bangladesh (27.8) and highest in India (55.6) during 1987-2004.

TABLE 5.9

Broad Money Supply (M2)

Country	Average Money Supply (as % of GDP) (AV_7)				Standard Deviation of Money Supply (SD_7)				AV_7	SD_7
	1987-1990	1991-1995	1996-2000	2001-2004	1987-1990	1991-1995	1996-2000	2001-2004	1987-2004	
Bangladesh	20.8	25.2	28.7	36.8	1.4	2.1	1.6	2.0	27.8	6.0
Bhutan	19.4	28.4	43.5	50.4	3.2	3.7	7.0	3.3	35.5	12.9
India	46.6	50.0	56.4	70.4	0.7	1.5	4.5	3.3	55.6	9.3
Maldives	n.a.	n.a.	40.4	51.4	n.a.	n.a.	3.6	8.1	43.9	8.7
Nepal	28.9	33.6	42.0	53.8	1.5	2.6	5.1	1.6	39.4	9.8
Pakistan	41.4	44.4	45.0	44.0	2.8	2.6	3.6	3.2	43.8	3.1
Sri Lanka	30.3	32.1	35.9	40.4	1.1	1.8	3.0	1.5	34.6	4.2

Note: n.a. = not available.

Source: Authors' calculation.

Money supply was highly volatile in Bhutan, Nepal and India during 1987-2000 and became somewhat steady during 2001-2004. This scenario is quite opposite for Bangladesh where volatility of money supply increased during 2001-04. Volatility of M2 has been lowest in Pakistan and highest in Bhutan during 1987-2004.

Average money supply and its volatility do not show any discernible trend. Bhutan with highest volatility of money supply did not have the highest M2/GDP and India having moderate case of volatility of money supply had the highest money supply.

Exchange Rate

The evidence, presented in Table 5.10, shows that real exchange rates with US$ depreciated in all South Asian countries during the 1980s and 1990s as devaluations occurred every year, sometimes several times a year. Most of the countries were increasingly subject to managed float of exchange rate. The volatility of the Real Exchange Rate (RER) was highest in Nepal during 1987-2004. However, volatility of RER for Bangladesh and Sri Lankan currencies was much less than that of Pakistan, India and Nepal.

TABLE 5.10

Volatility of Real Exchange Rate

Country	1987-1991	1992-96	1997-2000	2001-04	SD_8 1987-2004
Bangladesh	0.8	1.7	1.9	0.8	4.3
Bhutan	4.7	1.5	1.4	1.6	6.3
India	4.7	2.0	1.4	2.0	6.8
Maldives	0.9	0.3	0.3	0.5	1.2
Nepal	7.1	2.2	2.1	2.8	8.7
Pakistan	2.5	1.2	4.1	3.0	8.1
Sri Lanka	2.2	2.3	4.7	1.5	4.3

Source: Authors' calculation. Nominal Exchange Rate is from ADB Database. Consumer Price Index (2000=100) is from the World Economic Outlook (WEO) Database 2005.

5.2.3 Exogenous Shocks

The pattern of external real and financial shocks is an important component of macroeconomic stability. For analysis of external real shocks, the study considers the volatility of the terms of trade; for external financial shocks, behaviour of the financial account balance (as percentage of GDP) has been examined.

Terms of Trade

One of the significant determinants of output as well as income volatility relates to the volatility of terms of trade. Shevets (2004) concludes that a relatively modest magnitude of terms of trade shocks affected the developing economies in the 1990s. During the 1990s the volatility of the terms of trade declined in all developing countries compared to those of the 1960s with the exception of few Middle East and North African countries (Montiel and Serven, 2004). Hakura (2005) also mentioned that improvements in terms of trade volatility have made an important contribution to the decline in volatility of output growth in many emerging countries as well as developing countries (see Table 5.11).

TABLE 5.11

Volatility of Terms of Trade

Country	1987-1991	2000-2004	Changes
Bangladesh	13.0	6.7	Lower
India	6.0	7.7*	Higher
Pakistan	7.5	7.7	Higher
Sri Lanka	11.0	4.2	Lower

Note: *Calculated for the period of 2000-2002.

Source: Authors' calculation.

In the absence of data on terms of trade for all countries for the full period, only four countries, viz. Bangladesh, India, Pakistan and Sri Lanka have been considered in the present analysis. Volatility in terms of trade seems to have smoothened during the 1990s. Volatility of terms of trade decreased in Bangladesh during 2000-04 compared to that of 1987-1991, while volatility marginally increased in India and Pakistan during the matching periods. Volatility of terms of trade was lowest in Sri Lanka (4.2) and highest in Pakistan (7.7) during the 2000-2004 period.

Financial Account Balance

Though the trends in interest rates in the world's major financial markets capture some of its volatility, the terms on which capital is made available to developing countries incorporate risk premia that tend to be much more volatile than the country interest rates for the developed countries. It has been pointed out elsewhere (Montiel, 2004) that volatility measures based on such premia or on the behaviour of capital flows are not necessarily good indicators of the volatility of the international financial environment, since they are partly endogenous to events in the borrowing countries themselves.

Keeping these caveats in mind, one needs to interpret the data presented in Table 5.12 which portray the periodic averages of international net capital flows (in percentage of GDP) and their volatility as measured by the standard deviation. The capital flows in Bangladesh and India are somewhat more stable than other South Asian countries. However, the volatility in capital flows shows a declining trend in India, whereas in Bangladesh the trend is ambiguous.

TABLE 5.12

Financial Account Balance

Country	Net Capital Flow (AV_{10})				Standard Deviation of Financial Account Balance (SD_{10})			
	1989-1995	1996-1999	2000-2003	1989-2003	1989-1995	1996-1999	2000-2003	1989-2003
Bangladesh	1.9	-0.3	0.0	0.8	1.1	0.5	0.6	1.3
India	1.9	2.4	2.1	2.1	0.8	0.5	0.5	0.6
Nepal	9.3	4.4	–4.2	4.4	2.5	3.4	4.1	6.5
Pakistan	4.6	0.7	–2.4	1.7	1.4	5.0	2.0	4.0
Sri Lanka	7.3	2.8	–0.1	4.1	1.7	0.5	1.9	3.6

Source: Authors' calculation.

5.3 RELATIONSHIP BETWEEN MACROECONOMIC STABILITY AND GROWTH IN SOUTH ASIAN ECONOMIES

5.3.1 Does Low Volatility Mean Better Performance?

The summary results presented in Table 5.13 indicate that the stability of macroeconomic variables does not necessarily result in better performance of those variables in South Asian context. Bhutan had the highest GDP growth rate on average; at the same time, the volatility of GDP growth was also highest in this country. Though Bangladesh had the lowest volatility of GDP growth, it did not perform best in terms of output growth. Further, average inflation rate as well as volatility of inflation was lowest in Bangladesh. Moreover, average fiscal deficit and volatility of fiscal deficit were also lowest in Bangladesh.

TABLE 5.13

Summary of Results on Macroeconomic Stability and Growth in South Asia

Category	Variable	Period	Average		Standard Deviation	
			Lowest	Highest	Lowest	Highest
Macroeconomic Stability	Real GDP Growth Rate	1985-2004	Sri Lanka (4.4%)	Bhutan (6.6%)	Bangladesh (0.7)	Bhutan (2.1)
	Per Capita GDP Growth Rate	1985-2004	Pakistan (2.0%)	India (3.9%)	Bangladesh (0.7)	Bhutan (2.1)
	Inflation Rates (GDP Deflator)	1986-2004	Bangladesh (5.0%)	Sri Lanka (9.4%)	India (1.1)	Pakistan (2.4)
	Current Account Balance as % of GDP	1986-2004	Bangladesh (-0.8%)	Bhutan (-6.9%)	Bangladesh (0.6)	Bhutan (5.5)
Policy Stability	Fiscal Balance as % of GDP	1987-2004	Bangladesh (-4.2%)	Bhutan (-18.9%)	Bangladesh (0.5)	Bhutan (2.9)
	Foreign Borrowing as % of GDP	1991-2004	India (0.2%)	Nepal (3.3%)	India (0.2)	Sri Lanka (0.7)
	Broad Money Supply as % of GDP	1987-2004	Bangladesh (27.8%)	India (55.6%)	Bangladesh (2.0)	Bhutan (13.8)
	Real Exchange Rate	1987-2004	–	–	Maldives (0.3)	Nepal (2.3)
	Terms of Trade	1987-91/ 2000-04	–	–	India (6.0%)/ Sri Lanka (4.2%)	Bangladesh (13.00)/ India (7.7)
The External Environment	Financial Account Balance as % of GDP	1989-2003	Bangladesh (0.8%)	Nepal (4.4%)	India (0.5)	Nepal (5.1)

Source: Based on Tables 5.1-5.10.

On the other hand, better values of policy stability indicators in South Asia during the 1990s and in the recent past are characterised by low level of volatility. Bangladesh enjoyed lowest volatility and best performance in cases of fiscal balance and broad money supply – both expressed as percentage of GDP. Similarly, India experienced lowest level of foreign borrowing (as percentage of GDP) coupled with least volatility.

In the case of the external environment, the association with the relevant variables (i.e. terms of trade and financial account balance) is not very obvious.

Whatsoever, it is not evident from Table 5.13 that the economies characterised by low level of volatility of macroeconomic variables demonstrate best performance in terms of output and income growth. While Bangladesh disproves the examined association, India partly lends credence to it. Conversely, the case of Bhutan suggests that an economy can record high growth, notwithstanding high volatility of its macroeconomic variables. Given these ambiguities, a more rigorous test is undertaken to assess the relationship between macroeconomic stability and growth.

5.3.2 Results of OLS Regressions for Individual Countries

In the present study a set of Ordinary Least Square (OLS) regressions have been performed to understand the correlation between macroeconomic stability and growth in South Asian economies. The results of this exercise have been reported in Table 5.14. Output growth has been considered to be the change in real GDP and per capita GDP. Dependent variables are the standard deviation of the growth rate of real GDP for each country and per capita GDP over the period considered under the study. The explanatory variables are the standard deviation of other variables. In the case of M2/GDP, the ratio has been taken as an independent variable. The ratio of M2/GDP is often considered as a measure of financial deepening.

TABLE 5.14

OLS Regression for South Asian Countries
(Volatility of growth rates as dependent variables)

Country	Dependent Variable (Volatility of Growth rate of:)	Volatility of Current Account Balances	Volatility of Fiscal Account Balances	Volatility of M2/GDP	M2/GDP	Volatility of Inflation Rate	Volatility of Terms of Trade	Volatility of Exchange Rate	Volatility of Financial Account Balance	Volatility of Foreign Financing
Bangladesh	Output	(–)ve**	(+)ve***	(–)ve**	(–)ve**	–	–	(+)ve***	–	(+)ve***
	Income	(–)ve*	(+)ve***	(–)ve**	(–)ve*	–	–	(+)ve**	–	(+)ve**
Bhutan	Output	–	–	–	–	–	–	–	–	–
	Income	–	(–)ve***	–	–	–	–	–	–	–
India	Output	–	(+)ve**	–	–	–	(–)ve***	–	–	–
	Income	–	(+)ve**	–	–	(+)ve*	(–)ve**	–	–	–
Maldives	Output	–	–	(-)ve**	–	–	–	–	–	–
	Income	–	–	–	–	–	–	–	–	–
Nepal	Output	–	–	–	–	–	–	–	–	(+)ve***
	Income	–	–	–	–	–	–	–	–	(+)ve**
Pakistan	Output	–	–	(+)ve**	–	–	–	–	–	–
	Income	–	–	(+)ve*	–	–	–	–	–	(–)ve*
Sri Lanka	Output	(+)ve***	(–)ve**	–	(–)ve***	(+)ve***	(+)ve***	(–)ve***	–	(–)ve***
	Income	(+)ve***	(–)ve**	–	(–)ve***	(+)ve***	(+)ve***	(–)ve***	–	(–)ve***

Note: The dependent variables are the standard deviation of the growth rate of the real GDP and per capita GDP. The explanatory variables are volatility measures constructed as the standard deviation of the growth rate of relevant variables or the standard deviation of changes in the relevant ratios. The symbols *, **, and *** indicate statistical significance at the 10 per cent, 5 per cent and 1 per cent levels respectively.

TABLE 5.15

OLS Regression for South Asian Countries
(Growth rates of GDP as dependent variables)

Country	Dependent Variable (Growth rate of:)	Volatility of Current Account Balances	Volatility of Fiscal Account Balances	Volatility of M2/GDP	M2/GDP	Volatility of Inflation Rate	Volatility of Terms of Trade	Volatility of Exchange Rate	Volatility of Financial Account Balance	Volatility of Foreign Financing	Constant
Bangladesh	Output	(-)ve***	(+)ve***	(-)ve**	–	–	(-)ve***	(+)ve***	(-)ve**	–	(+)ve***
	Income	(-)ve***	(+)ve***	(-)ve**	–	–	(-)ve***	(+)ve***	(-)ve**	–	(+)ve***
Bhutan	Output	(+)ve**	(-)ve*	–	–	–	–	(-)ve*	–	(+)ve**	(+)ve***
	Income	–	–	–	–	–	–	(-)ve*	–	(+)ve*	(+)ve***
India	Output	–	(-)ve**	(+)ve***	–	–	–	–	(-)ve**	–	(+)ve***
	Income	–	(+)ve**	(+)ve***	–	–	–	–	(-)ve**	–	(+)ve***
Maldives	Output	–	(+)ve*	–	–	(+)ve**	–	–	–	–	–
	Income	–	–	–	–	(+)ve**	–	–	–	–	–
Nepal	Output	–	–	(-)ve*	(+)ve*	(-)ve**	–	–	–	–	–
	Income	–	–	(-)ve*	(+)ve*	(-)ve**	–	–	–	–	–
Pakistan	Output	–	–	–	–	–	–	(-)ve*	–	–	(+)ve***
	Income	–	–	–	–	–	–	(-)ve**	–	–	(+)ve**
Sri Lanka	Output	–	–	–	–	–	–	–	–	(-)ve**	(+)ve***
	Income	–	–	–	–	–	–	–	–	(-)ve**	(+)ve***

Note: The dependent variables are the growth rate of the real GDP and per capita GDP. The explanatory variables are volatility measures constructed as the standard deviation of the growth rate of relevant variables or the standard deviation of changes in the relevant ratios. The symbols *, **, and *** indicate statistical significance at the 10 per cent, 5 per cent and 1 per cent levels respectively.

Bangladesh

Regression results show that the volatility of fiscal account balances, exchange rates and foreign financing are positively correlated with both output and income volatility in the case of Bangladesh. *The results also suggest that shocks in revenue income and public expenditure, variability in exchange rate and inconsistency of foreign financing are detrimental to output and per capita income of the country.* The coefficients of volatility of current account balances, M2/GDP and the volatility of M2/GDP are negatively related to volatility of output and per capita GDP. These results suggest that financial sector developments in Bangladesh, as proxy measured by the M2/GDP and the volatility of M2/GDP, is associated with lower output volatility.

Interestingly, the volatility of terms of trade, financial account balance and inflation rates do not have any significant impact on output in Bangladesh. The results appear to be counter-intuitive given the fact that trade has been playing an important role for growth in Bangladesh in the 1990s.[13]

The relationship between inflation and growth is arguable.[14] Contrary to the common findings that growth and inflation are negatively related, empirical studies have also found that there is either insignificant association between these two variables

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[13] For developing countries, terms of trade volatility has been found to be associated with output volatility (Hakura, 2005).

[14] Malik and Chowdhury (2001) found a positive relationship between inflation and growth in Bangladesh during 1974-97.

(Clark, 1993; Levin and Zervos, 1993) [15] or there is no causal relationship found between inflation and economic growth.[16] Mahajan (2005) found terms of trade and inflation to be less volatile and thus contributed to growth.

India

In case of India, coefficients of volatility of fiscal account balances and terms of trade were found to be significant for both regressions. Volatility of fiscal account balance positively affects output and per capita income volatility, while volatility of terms of trade affects negatively. However, an increase in volatility of inflation rate is associated with an increase in volatility of per capita income.

Pakistan

On the other hand, in Pakistan, volatility of M2/GDP is found to have significant positive impact on the volatility of output and per capita income. However, volatility of foreign financing has significant negative impact on per capita income.

Sri Lanka

Results show that in Sri Lanka volatility of current account balances, inflation rate and terms of trade is risky for the stability of output and per capita output, suggesting that balance of payments has to be fixed, unpredictability in inflation rate be removed and terms of trade need to be corrected for macroeconomic stability in Sri Lanka. The results also show that volatility of fiscal account balances, exchange rate and foreign financing and the ratio of M2/GDP negatively affects output and per capita income volatility in Sri Lanka, which is favourable for output and per capita income.

Bhutan, Maldives and Nepal

Regressions for Bhutan, Nepal and Maldives do not exhibit any discernible empirical results relates to their respective macroeconomic stability. This may be due to small period of observation and/or inconsistency of data. However, in general, it can be argued from the estimated results that volatility of per capita income in Bhutan is affected positively by volatility of fiscal account balances, whereas in Maldives volatility of M2/GDP is favourable to reduce volatility of output. Volatility of foreign financing is unfavourable for the stability of output and per capita income in Nepal.

Overall

Results of the country-specific OLS regressions suggest a highly inconsistent and country-specific robust explanation for macroeconomic stability in South Asian countries. For example, while in the two very stable economies, Bangladesh and India, volatility of

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15 On the basis of a sample of 85 countries Clark (1993) arrives at the conclusion that theory provides little or no guidance for specifying empirical relationship between growth and inflation. Levin and Zervos (1993) reveal that marginal change in moderate inflation rate may not be negatively related to growth.

16 Paul, Kearney and Chowdhury (1997) studied 70 countries for the period 1960-1989 and found this true for 40 per cent of the countries.

fiscal account balances adversely affects the output and income volatility, in Sri Lanka, another stable economy, volatility of fiscal account balance is favourable for both the output and income volatility.

To give another example, volatility of inflation rates adversely affects both output and income volatility in Sri Lanka, which experienced highest average inflation rates, during 1986-2004, among all South Asian countries. Whereas in India, which observed the lowest volatility in inflation rates during the said period, the effect of inflation rate volatility on output volatility is the same as that of Sri Lanka.

Volatility of foreign financing is a risk factor affecting both output and income volatilities in countries with highly foreign financing (as per cent GDP), such as in Bangladesh and Nepal. On the other hand, in Sri Lanka, one of the lowest receivers of foreign finance in South Asia, volatility of foreign financing is a safe factor for the volatility of output and income.

However, several results are consistent with expectations. For example, in Bangladesh, which observed the lowest average and volatility of broad money supply (M2/GDP) during 1987-2004, both the volatility of M2/GDP and the ratio of M2 to GDP are contributing to the volatility of output and income. Again, in Bangladesh, which experienced the highest average and the lowest volatility, the current account balance as percentage of GDP during the 1986-2004 is favourable for the volatility of output and income.

5.3.3 Analysis of Regional Panel Regression Results

This section of the study, using panel regression analysis, examines the main determinants of GDP growth rate and per capita GDP growth rate volatility for the seven South Asian countries. A country-specific fixed effects model has been estimated to capture the effects of unobserved country-specific factors as shown in Tables 5.16 and 5.17. The dependent variables are the standard deviation of the country specific components of real GDP growth rate and real per capita GDP growth rate for the 1996-2004 period. Two sets of regression have been estimated: one is for all countries (regression 1 and 2) and another one is for four main economies of South Asia, viz. Bangladesh, India, Pakistan and Sri Lanka (regression 3 and 4). Because of unavailability of data, the first set of regressions did not consider volatility of terms of trade and volatility of financial accounts balance. In the second set of regressions, Bhutan, Maldives and Nepal have been omitted for paucity of data.

The first set of regressions, which considers all countries, show that the volatility of current account balance is significantly correlated with GDP growth rate volatility. The coefficient estimate suggests that a one point increase in the standard deviation of current account balances (as a per cent of GDP) is associated with a decrease in the standard deviation of GDP growth rates of 0.1 percentage point. *This result suggests that shocks in revenue income and public expenditures are important for output volatility in South Asian economies.* Other continuous variables are not significant in this regression.

However, country specific dummy variables for India, Maldives, Nepal and Sri Lanka are highly significant, suggesting that country-specific factors are important in analysing volatility of output and per capita output in South Asian economies.

TABLE 5.16

Fixed Effect Panel Regression Results for South Asian Countries

(Volatility of growth rates as dependent variables)

Variables	All Countries		Selected Countries	
Dependent variable (volatility of growth rate of:)	Output (1)	Income (2)	Income (3)	Output (4)
Volatility of current account balances	-0.096*	-0.049	-0.235	-0.280
Volatility of fiscal account balances	-0.006	-0.041	0.508	0.431
Volatility of M2/GDP	-0.056	-0.032	0.336*	0.320
Volatility of inflation rate	0.145	0.107	0.242	0.212
Volatility of terms of trade	–	–	-0.138**	-0.112*
Volatility of exchange rate	-0.059	-0.153	-0.139	-0.072
Volatility of financial account balance			0.552*	0.517*
Volatility of foreign financing	0.194	-0.138	-0.002	-0.251
India dummy	1.069**	0.779**	1.579***	1.175**
Bhutan dummy	0.453	0.560	–	–
Maldives dummy	1.218***	1.368***	–	–
Nepal dummy	1.194**	1.124***	–	–
Pakistan dummy	0.462	0.495	-0.015	0.031
Sri Lanka dummy	1.244***	1.452***	1.385***	1.589***
Constant	0.422	0.394**	-0.095	-0.065
Sample size	63	63	36	36
R-squared	0.26	0.26	0.42	0.41

Note: Dependent variables are the standard deviation of the growth rate of the real GDP and per capita GDP. The explanatory variables are volatility measures constructed as the standard deviation of the growth rate of relevant variables or the standard deviat ion of changes in the relevant ratios. Country-specific dummy variables have also considered in the regression analysis. The symbols *, **, and *** indicate statistical significance at the 10 per cent, 5 per cent and 1 per cent levels respectively.

In the second set of regressions, which include only Bangladesh, India, Pakistan and Sri Lanka, the coefficient of the *volatility of terms of trade* is an important factor of output as well as income volatility, which is negative and highly significant. The volatility of the ratio of M2 to GDP, as a measure of *volatility of financial deepening*, is significant in explaining output volatility in South Asian countries.[17] The *volatility of financial account balance* is found to be positively and significantly associated with both output volatility and income volatility in the regression analysis.

However, once again, country-specific dummy variables are highly significant in the case of India and Sri Lanka, pointing out the importance of country-specific factors for volatility of output and income growth in South Asian countries.

On the other hand, the coefficients of dummy variables for Pakistan in all four regressions are insignificant, suggesting that unobserved country-specific variables affect Pakistan in the same way as in Bangladesh. Similarly, the coefficients of the dummy variables for Bhutan in the first set of two regressions are insignificant which again suggests the same kind of effects for the unobserved country specific factors in Bhutan, similar to that for Bangladesh.

Another country-specific fixed effects model has been estimated by considering the growth rate of the real GDP and per capita GDP as dependent variables as shown in

17 This result is consistent with the findings of the Denzier, Iyigum and Owen (2002) and Kose, Prasad and Terrones (2003).

TABLE 5.17

Fixed Effect Panel Regression Results for South Asian Countries

(Growth rates of GDP as dependent variables)

Variables Dependent variable (growth rate of:)	All Countries Output (1)	 Income (2)	Selected Countries Output (3)	 Income (4)
Volatility of current account balances	0.028	–0.420	–0.019	–0.075
Volatility of fiscal account balances	0.246*	0.300**	–0.265	–0.249
Volatility of M2/GDP	0.205	0.174	–0.856***	–0.872***
Volatility of inflation rate	0.064	0.072	–0.455**	–0.469**
Volatility of terms of trade	–	–	0.190**	0.182**
Volatility of exchange rate	0.063	–0.0341	0.302	0.264
Volatility of financial account balance	–	–	–1.375***	–1.277***
Volatility of foreign financing	–0.786	–0.785	–0.610	–0.565
India dummy	0.626	0.920	0.134	0.383
Bhutan dummy	0.575	–0.290	–	–
Maldives dummy	2.462*	1.877*	–	–
Nepal dummy	–1.235	–1.658**	–	–
Pakistan dummy	–1.452	–2.025**	1.301	0.656
Sri Lanka dummy	–0.591	–0.055	–0.032	0.479
Constant	4.803	3.138	6.632	4.880
Sample size	63	63	36	36
R-squared	0.43	0.43	0.61	0.67

Note: Dependent variables are the growth rate of the real GDP and per capita GDP. The explanatory variables are volatility measures constructed as the standard deviation of the growth rate of relevant variables or the standard deviation of changes in the relevant ratios. Country-specific dummy variables have also considered in the regression analysis. The symbols *, **, and *** indicate statistical significance at the 10 per cent, 5 per cent and 1 per cent levels respectively.

Table 5.17. Two sets of regressions have been estimated in this case too: one for all South Asian countries and another one for four major economies. In the first set of regressions, the result suggests that fiscal account balance is positively and significantly correlated with both the growth rate of real GDP and growth rate of per capita GDP. All other continuous explanatory variables are not significant in the regression result. Among country specific dummy variables, coefficient of Maldives is significant in the regression for the growth rate of real GDP, whereas coefficients of Maldives, Nepal and Pakistan are significant in the regression for per capita GDP.

In the set of regressions for selected countries, the coefficients of the volatility of M2 to GDP, the volatility of financial account balance and the volatility of inflation rate are negative and significant in explaining the growth rate of real output and per capita GDP in the context of four major South Asian countries. The coefficient of volatility of terms of trade is significantly positive for both the regressions of the growth rate of real GDP and growth rate of per capita GDP. All country-specific dummy variables are insignificant in both the regressions.

5.4 MACROECONOMIC STABILITY AND GROWTH: BANGLADESH COMPARED WITH SOUTH ASIAN COUNTRIES

Comparative position of Bangladesh in terms of average values and volatility of all ten examined macroeconomic variables has been presented in Table 5.18.

TABLE 5.18

Bangladesh Compared with Other South Asian Countries

Indicator	Estimates	Period	Bangladesh	Bangladesh Compared with Other Countries
Real GDP growth	AV SD	1985-2004 1985-2004	4.5 1.0	Lower real GDP growth than Bhutan, India, Maldives, Nepal and Pakistan Volatility is lowest
Growth Rate of GDP Per Capita	AV SD	1985-2004 1985-2004	2.5 1.3	• Higher per capita GDP growth than Pakistan and Nepal, but lower than Bhutan, India and Sri Lanka • Lowest Volatility among all the South Asian countries
Inflation Rates (GDP Deflator)	AV SD	1986-2004 1986-2004	5.0 2.7	Both average and volatility of inflation rates are lowest Note that inflation went down as M2/GDP increased
Current Account Balance as % GDP	AV SD	1986-2004 1986-2004	-0.8 1.0	Lowest average and volatility of current account balance
Fiscal Balance as % GDP	AV SD	1987-2004 1987-2004	-4.1 0.8	Lowest average and volatility of fiscal deficit
Foreign Financing of Budget Deficit as % of GDP	AV SD	1991-2004 1991-2004	2.2 0.4	• Dependence on foreign borrowing in financing budget deficit is higher than India, Pakistan and Sri Lanka • However, volatility is second lowest
Money Supply (as % of GDP)	AV SD	1987-2004 1987-2004	27.8 5.9	• Significantly lower money supply • But more volatile than Sri Lanka and Pakistan
Volatility of Real Exchange Rate	SD	1987-2004	4.3	Highly volatile; but lower than India and Pakistan
Volatility of Terms of Trade	SD	2000-2004	6.7	Lower than Bhutan, India, Nepal and Pakistan
Financial Account Balance (as % of GDP)	AV	1989-2003	0.8	• Significantly lower financial flow in the BOP • But volatility is lower than all countries, except India

Source: Based on Tables 5.1-5.11.

5.4.1 Average Values

It was mentioned earlier that Bangladesh has performed better than its other South Asian counterparts when compared in terms of average values of most of the macroeconomic variables. During 1985-2004 Bangladesh did register a favourable performance in terms of inflation rate, current account balance and fiscal balance.

At the same time, Bangladesh had a higher dependence on foreign financing of budget compared to India, Pakistan and Sri Lanka. Further, financial deepening (expressed through broad money supply to GDP ratio) remains low. Moreover, the financial account balance (expressed through international capital flow to GDP ratio) was also worse than other countries in South Asia.

Consequently, lower real GDP growth rate is observed in Bangladesh compared to all other South Asian Countries. Although Bangladesh has improved its GDP growth performance in the recent periods, in the same vein, Bangladesh experienced lower per capita GDP growth compared to that of Bhutan, India and Sri Lanka.

5.4.2 Volatility

Bangladesh may have an ambiguous record in terms of average values of different macroeconomic variables including output and income growth, however, it did much better in terms of achieving low volatility of most of the macroeconomic variables in the South Asian context. Volatility of real GDP growth, per capita GDP growth rate, current account balance as percentage of GDP and fiscal balance as percentage of GDP was lowest in Bangladesh vis-à-vis other countries in the region. Bangladesh's performance record was bad only in the case of broad money supply (high volatility relative to Pakistan and Sri Lanka) and terms of trade (high volatility relative to Sri Lanka).

Thus, it is found that, in the region and till 2004, Bangladesh economy was characterised by the best parameters of macroeconomic stability. However, macroeconomic stability achieved by Bangladesh was not matched by comparable growth in aggregate output and per capita income.

5.4 CONCLUSIONS

The reform measures initiated in the 1980s and the 1990s contributed towards achieving stability in macroeconomic performance in the South Asian economies. However, macroeconomic stability turned out to be not adequate to unleash the growth potential in these countries. The obtained empirical results lead us to reconsider the often emphasised positive relationship between macroeconomic stability and growth. In this regard, the study offers the following findings.

- First, South Asia, at various points in time over the last two decades, has embarked on market oriented policy reforms (adjustment policies) aimed at achieving macroeconomic stability leading to accelerated growth. These were initiated often in the backdrop of macroeconomic crises. In these almost identical reform packages, macroeconomic stability had been accorded the centre stage and had been underscored as the major prerequisite (determinant) of accelerated growth. All South Asian economies during the 1990s and early 2000s (post-reform period) did in fact improve their macroeconomic performance. For example, inflation rate, current account deficit, fiscal deficit and dependence on foreign borrowing decreased in almost in all countries. During this period, volatility of most of these variables also declined.
- Second, notwithstanding general improvements in terms of achieving higher average values and stability of macroeconomic variables, not all regional countries could improve their output and per capita GDP during the period under review. For example, Bangladesh and India managed to increase their real GDP growth and per capita GDP, whereas Nepal and Pakistan could not.
- Third, even, among the South Asian countries, experiencing improvements in output growth and income, it is very difficult to establish any association between the achieved macroeconomic stability and demonstrated growth. For example, Bhutan with highest volatility in case of a number of variables recorded the highest GDP growth among the regional countries. Whereas Bangladesh having enjoyed least volatility of most variables has experienced a

moderate growth during the period under review. Country-wise variable specific analysis, at best, remains ambiguous in establishing the examined relationship.

- Fourth, pooled regional data do not reveal any systematic relationship between macro-stability variables and growth performance. This implies that while macro-stability may be important for growth, there could be other and more important country specific variables for driving the growth dynamics. Consequently, it is imperative to device, being informed by contextual reality going beyond the macro-stability dogma, a reform agenda specific to promoting growth and poverty alleviation. This becomes particularly pertinent as most of the South Asian countries are currently initiating or already implementing their national Poverty Reduction Strategies (PRS) which often contain a disproportionate emphasis on macroeconomic stability.
- Fifth, among the South Asian countries, behaviour of the Bangladesh economy appears to be the most compatible with the general levels of the macroeconomic stability approach. Comparative analysis of the macroeconomic performance of the country reveals that Bangladesh is currently the most stable country in the South Asian region in terms of macroeconomic performance. However, even with such a sterling performance on the macroeconomic front, Bangladesh could not emerge as the fastest growing country in the region. Consequently, one will have to take a more indepth look into the country's economic performance to identify the appropriate and relevant underlying elements of a national pro-poor growth agenda. It may be mentioned that our empirical analysis suggests that the unobserved country-specific variables affecting growth of output and income of Bangladesh are similar to those of Pakistan and Bhutan.

Finally, if macro-stability or lack of volatility cannot adequately explain the accelerated growth dynamics in South Asian countries, then what are those factors which could explain better the determinants of the envisaged higher levels of output and income? Admittedly, a large part of these factors are possibly captured by the currently reigning analytical concepts of *good governance*, *institutional reforms* and *capacity building*. Whatsoever, fact remains, one would possibly need to constantly articulate and rearticulate the need for a national strategy to pursue accelerated growth and poverty alleviation.

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Annexure Tables

ANNEX TABLE 5.1

Key Indicators of South Asian Countries

Indicators	Countries													
	Bangladesh		Bhutan		India		Maldives		Nepal		Pakistan		Sri Lanka	
	1990	2003	1990	2003	1990	2003	1990	2003	1990	2003	1990	2003	1990	2003
Population Density (persons/per sq km.)	737.0	912.0	–	19.0	255.0	326.0	713.0	950.0	123.0	164.0	138.0	185.0	259.0	307.0
GDP Growth Rate	5.9	5.3	6.6	6.6	5.6	8.1	16.9	8.4	4.5	3.7	4.5	5.1	2.0	5.6
Per Capita Income (US$)[18]	267.0	384.0	185.0	–	387.0	551.0	–	2441.0	194.0	246.0	364.0	571.0	488.0	947.0
Distribution of GDP														
Agriculture	29.4	21.0	43.2	33.2	31.3	22.4	–	–	50.6	39.2	26.0	23.3	22.9	19.0
Industry	20.9	25.3	25.3	39.5	27.6	26.5	–	–	15.9	20.9	25.2	23.2	27.3	26.3
Service	49.7	53.7	32.7	28.8	41.1	51.1	–	–	33.5	39.9	48.8	53.4	49.8	54.7
Inflation % (Based on CPI)	3.9	5.1	10.0	1.6	9.0	4.0	3.6	–2.9	11.5	4.8	6.0	3.1	21.5	6.3
Balance of Payments (Million US$)	138.0	815.0	-3.1	53.7	–0.6	–	1.6	55.5	20.2	56.1	377.0	4589.0	118.7	502.0
Export as % of GDP	5.1	12.6	23.4	16.5	5.6	10.0*	–	21.4	6.2	10.8	12.5	13.0	34.2	88.4
Import as % of GDP	11.6	16.8	33.4	27.6	7.2	12.4*	–	58.4	18.9	26.9	18.8	13.6	46.3	114.9
Current A/C Balance as % of GDP	–1.5	0.6	– 9.8	9.0	-2.2	1.0*	–	–6.9	–8.2	–5.6	–3.4	4.9	–6.5	–2.6
Forex Reserve (Million US $)	649.4	2624.2	84.8	313.9	1205.0	97617.0	24.4	156.7	287.0	1213.1	295.0	10693.0	422.0	1563.0*
External Debt as % of GNI	40.4	34.3	31.4	70.4*	26.7	21.7	40.2	44.8*	45.1	53.3*	52.9	56.5*	74.6	58.9

Note: *Refers to date for 2002.
Source: ADB (2005).

ANNEX TABLE 5.2

Examining the Time Series Properties of Variables (Bangladesh)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	-3.0	-3.6	-3.0	-3.6
Volatility of PCGDPGR	-3.4	-4.2	-3.5	-4.2
GDPGR	-2.4	-3.9	-3.9	-5.4
PCGDPGR	-4.1	-3.2	-2.8	-4.4
VM2	-5.5	-5.3	-7.6	-7.7
M2	-2.9	-2.8	-2.9	-2.8
VINF	-1.5	-1.7	-3.6	-3.9
CAB	-4.3	-3.9	-6.2	-5.5
FAB	-2.7	-2.5	-4.8	-4.6
VTOT	-3.5	-3.9	-2.7	-3.8

(Contd.)

18 Calculated by dividing per capita GDP with the exchange rate.

(Contd. of Annex Table 5.2)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
VER	–3.7	–3.6	–3.4	–3.3
VFAB	–2.1	–1.3	–3.5	–2.2
VFF	–3.2	–3.9	–4.4	–4.2

Levels of critical values	Without trend	With trend
1% level	–3.769597	–4.440739
5% level	–3.004861	–3.632896
10% level	–2.642242	–3.254671

Note: The ADF and PP tests suggest that all variables except share of M2 to GDP and volatility of financial account balances appeared to be stationary in level terms or I(0). The share of M2 to GDP and volatility of financial account balances are not stationary if trend term is considered in both cases. The share of M2 in GDP and volatility of financial account balances are stationary when trend term is not considered in the analysis. In fact, it is hard to see to any trend in both the volatility of financial account balance and the share of M2 in GDP. Thus it can be concluded that all the variables are stationary in levels or I(0).

ANNEX TABLE 5.3

Examining the Time Series Properties of Variables (Bhutan)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	–2.7	–3.1	–2.8	–3.2
Volatility of PCGDPGR	–2.7	–3.3	–2.8	–3.3
GDPGR	–5.1	–5.0	–7.7	–9.0
PCGDPGR	–4.8	–4.8	–5.3	–7.3
VM2	–3.0	–2.8	–2.9	–2.5
M2	–6.2	–6.5	–5.9	–6.2
VINF	–2.3	–2.2	–2.3	–2.2
CAB	–4.4	–4.8	–3.6	–5.9
FAB	–3.8	–3.6	–4.0	–3.9
VER	–6.7	–7.8	–6.2	–7.7
VFF	–2.5	–2.1	–2.6	–2.1

Levels of critical values	Without trend	With trend
1% level	–4.004425	–4.800080
5% level	–3.098896	–3.791172
10% level	–2.690439	–3.342253

Note: The volatility of the share of M2 in GDP, volatility of GDP growth rate and volatility of per capita GDP growth rate are stationary without trend term in both ADF and PP tests. Since all level variables are measured by the standard deviation, it is hard to see any systematic trend in these variables. So it can be said that they are stationary. However, volatility of inflation rate and volatility of foreign financing are not stationary in any sense. A low sample size could explain this result. Since all other exogenous variables in the analysis are stationary in the case of Bhutan, it can be assumed that these two variables are also stationary.

ANNEX TABLE 5.4

Examining the Time Series Properties of Variables (India)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	–4.8	–4.4	–4.9	–4.9
Volatility of PCGDPGR	–4.9	–4.6	–4.9	–5.2
GDPGR	–4.7	–4.6	–4.7	–4.6
PCGDPGR	–4.3	–4.5	–4.3	–4.5
VM2	–3.4	–3.5	–3.3	–3.4
M2	–4.5	–5.4	–4.5	–10.1
VINF	–3.4	–3.3	–3.4	–3.3
CAB	–4.9	–5.5	–4.9	–9.1
FAB	–4.4	–4.5	–4.4	–4.6
VTOT	–4.9	–4.8	–4.8	–4.7
VER	–4.3	–5.7	–4.3	–5.4
VFAB	–1.6	–5.2	–1.5	3.3
VFF	–2.7	–4.2	–4.8	–5.7

Levels of critical values	Without trend	With trend
1% level	–3.920350	–4.440739
5% level	–3.065585	–3.632896
10% level	–2.673459	–3.254671

Note: All variables are stationary or I(0) in both the ADF and PP tests.

ANNEX TABLE 5.5

Examining the Time Series Properties of Variables (Pakistan)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	–4.5	–4.4	–4.7	–4.5
Volatility of PCGDPGR	–4.3	–4.2	–4.3	–4.2
GDPGR	–3.2	–3.8	–3.1	–3.8
PCGDPGR	–3.4	–4.0	–3.3	–3.9
VM2	–3.5	–3.5	–3.5	–3.5
M2	–3.2	–3.1	–3.2	–3.1
VINF	–5.0	–3.9	–8.8	–9.3
CAB	–4.3	–4.4	–4.4	–4.4
FAB	–4.8	–5.1	–4.8	–8.0
VTOT	–4.4	–4.2	–4.4	–4.2
VER	–2.9	–3.1	–2.9	–3.1
VFAB	–1.5	–2.2	0.1	–3.3
VFF	–1.6	–2.4	–1.6	–2.6

Levels of critical values	Without trend	With trend
1% level	–3.769597	–4.440739
5% level	–3.004861	–3.632896
10% level	–2.642242	–3.254671

Note: Both the share of M2 in GDP and volatility of exchange rate are stationary when trend term is not considered in the analysis. However, volatility of financial account balance and volatility of foreign financing are not stationary in any case. Since all other variables are stationary in levels and both the variables in the form of standard deviation, it can be assumed that they are also stationary or I(0).

ANNEX TABLE 5.6

Examining the Time Series Properties of Variables (Maldives)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	-6.3	-6.2	-4.2	-6.5
Volatility of PCGDPGR	-6.0	-5.4	-8.8	-7.4
GDPGR	-3.4	-1.8	-1.2	-0.9
PCGDPGR	-3.5	-2.2	-1.4	-1.0
VM2	-3.5	-3.4	-3.5	-3.4
M2	-2.9	-2.8	-2.9	-2.8
VINF	-5.6	-5.6	-1.4	-2.2
CAB	-3.3	-3.1	-3.3	-4.7
FAB	-5.6	-3.7	-4.4	-1.6
VER	-6.2	-6.0	-5.9	-5.8
VFF	-2.4	-1.9	-5.3	-5.6

Levels of critical values	Without trend	With trend
1% level	-4.582648	-5.835186
5% level	-3.320969	-4.246503
10% level	-2.801384	-3.590496

Note: All variables are stationary or I(0) specially when trend term is not considered in the analysis.

ANNEX TABLE 5.7

Examining the Time Series Properties of Variables (Nepal)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	-3.2	-4.0	-3.0	-3.6
Volatility of PCGDPGR	-3.1	-3.9	-2.9	-3.5
GDPGR	-5.7	-6.9	-6.1	-6.5
PCGDPGR	-5.8	-7.3	-6.0	-7.6
VM2	-4.4	-4.7	-4.7	-6.4
M2	-2.1	-3.3	-2.1	-3.1
VINF	-3.4	-3.4	-2.2	-2.2
CAB	-4.2	-4.3	-4.0	-5.9
FAB	-6.5	-6.6	-6.0	-6.2
VER	-6.4	-6.5	-6.2	-6.4
VFAB	-6.8	-4.1	-2.4	-1.3
VFF	-3.1	-2.9	-3.1	-2.9

Levels of critical values	Without trend	With trend
1% level	-3.920350	-4.667883
5% level	-3.065585	-3.733200
10% level	-2.673459	-3.310349

Note: The volatility of inflation rate and volatility of foreign financing are stationary if trend term is not considered in the analysis. The share of M2 in GDP is not stationary in any sense. However, for analytical purpose it is assumed that the share of M2 in GDP is also stationary like all other variables.

ANNEX TABLE 5.8

Examining the Time Series Properties of Variables (Sri Lanka)

Variables	ADF		PP	
	Without trend	With trend	Without trend	With trend
Volatility of GDPGR	–3.8	–5.0	–2.9	–3.8
Volatility of PCGDPGR	–3.8	–5.2	–2.9	–4.0
GDPGR	–4.2	–4.1	–4.2	–4.1
PCGDPGR	–4.3	–4.1	–4.3	–4.1
VM2	–2.9	–2.8	–2.9	–2.8
M2	–4.0	–3.9	–4.1	–4.7
VINF	–3.5	–3.5	–3.5	–3.5
CAB	–3.9	–4.8	–3.9	–9.3
FAB	–2.5	–3.1	–2.5	–3.1
VTOT	–5.4	–5.3	–5.4	–5.2
VER	–3.4	–3.4	–3.4	–3.4
VFAB	–1.5	–3.3	–0.9	–2.0
VFF	–3.4	–3.4	–3.5	–3.5

Levels of critical values	Without trend	With trend
1% level	–4.004425	–4.886426
5% level	–3.098896	–3.828975
10% level	–2.690439	–3.362984

Note: The volatility of financial account balance and the volatility of fiscal account balance are not stationary in both ADF and PP tests. Other than these two variables, all other variables are stationary or I(0). However, it is assumed that all variables including volatility of financial account balance and volatility of fiscal account balance are stationary or I(0) for the same nature of data i.e. standard deviation of each variables.

ANNEX TABLE 5.9

OLS Regression for South Asian Countries

Dependent variable (volatility of growth rate of):	Country													
	Bangladesh		Bhutan		India		Maldives		Nepal		Pakistan		Sri Lanka	
	Output	Income	Output	Income	Output	Income	Output	Income	Output	Income	Output	Income	Output	Income
Volatility of current	-0.5921**	-0.5844*	-0.0209	0.0139	-3.1425	-3.3497	0.2689	0.0972	0.2577	0.0833	–	–	1.2741***	1.2811***
account balances	(0.2593)	(0.2989)	(0.1089)	(0.0583)	(2.4234)	(2.4039)	(0.1869)	(0.1906)	(0.4255)	(0.4467)	–	–	(.02898)	(0.2234)
Volatility of fiscal	1.5025***	1.4930***	-0.1316	-0.1938***	6.6780**	6.9330**	-0.3692	-0.6209	0.4706	0.4622	–	–	-1.8819**	-1.6230**
account balances	(0.5077)	(0.5268)	(0.1022)	(0.0554)	(3.0141)	(3.0368)	(0.5231)	(0.6428)	(1.0241)	(0.9793)	–	–	(0.7752)	(0.5976)
Volatility of	-0.2297**	-0.2278**	0.0279	0.0462	-0.6212	-0.6075	-0.1541**	-0.0741	0.1689	0.1119	0.1374**	0.1156*	-0.0811	-0.0603
M2/GDP	(0.0897)	(0.0944)	(0.0559)	(0.0412)	(0.4475)	(0.4538)	(0.4725)	(0.0681)	(0.1850)	(0.1753)	(0.0512)	(0.0520)	(0.0692)	(0.0533)
M2/GDP	-0.2160**	-0.2139*	-0.0058	-0.0150	-0.1341	-0.1479	–	–	0.0259	0.0185	–	–	-0.2401***	-0.2343***
	(0.0978)	(0.0976)	(0.04186)	(0.0307)	(0.2313)	(0.2310)	–	–	(0.1501)	(0.1563)	–	–	(0.0734)	(0.0566)
Volatility of	0.0665	0.0659	0.2210	0.0934	0.6132	0.5978*	-0.0835	-0.0345	-0.0209	-0.0059	-0.1461	-0.2829	0.8739***	0.8443***
inflation rate	(0.0964)	(0.0963)	(0.1971)	(0.1279)	(0.3404)	(0.2984)	(0.1766)	(0.2449)	(0.4268)	(0.4432)	(0.2151)	(0.2178)	(0.1194)	(0.0920)
Volatility of	0.0182	0.0178	–	–	-0.2241***	-0.2356**	–	–	–	–	-0.0679	-0.0289	0.4011***	0.3673***
terms of trade	(0.0323)	(0.0322)	–	–	(0.0841)	(0.0895)	–	–	–	–	(0.0599)	(0.0606)	(0.0903)	(0.0696)
Volatility of	0.6956***	0.6887**	-0.9323	-1.4556	-0.6713	-0.6909	–	–	0.07802	0.0151	0.2063	0.1612	-1.8097***	-1.8252***
exchange rate	(0.2124)	(0.3119)	(1.3969)	(1.2239)	(0.6078)	(0.6144)	–	–	(0.2431)	(0.2325)	(0.2184)	(0.2212)	(0.3856)	(0.2973)
Volatility of financial	-0.1804	-0.1813	–	–	-0.3425	-0.4574	–	–	-0.0799	-0.0576	–	–	-0.1296	-0.1414
account balance	(0.4309)	(0.4303)	–	–	(5.1934)	(5.1907)	–	–	(0.2845)	(0.2571)	–	–	(0.1882)	(0.1451)
Volatility of	1.7699***	1.7645**	0.7079	0.5810	1.7367	1.0711	0.2067	-0.4258	4.9164***	3.9076**	-0.8024	-1.1828*	-2.1974***	-2.1101***
foreign financing	(0.6454)	(0.7443)	(0.9309)	(0.8131)	(3.0142)	(2.9754)	(0.7264)	(0.7491)	(1.5856)	(1.7548)	(0.6715)	(.5100)	(0.4223)	(0.325)
Constant	2.4728*	2.4449*	0.9471	1.9778*	5.0172	5.4298	1.6718*	2.4264**	-1.7937	-0.8739	1.4859*	1.8927**	7.5469***	0.6975***
	(1.3835)	(1.3015)	(1.4122)	(1.0252)	(6.2795)	(6.2085)	(0.7987)	(.09178)	(3.8896)	(3.9146)	(0.7703)	(0.7814)	(1.5836)	(1.2207)
R-squared	0.8908	0.8898	0.8075	0.9011	0.7379	0.7407	0.6275	0.5545	0.6309	0.5612	0.5249	0.5393	0.9772	0.9858

Note: The dependent variables are the standard deviation of the growth rate of the real GDP and per capita GDP. The explanatory variables are volatility measures constructed as the standard deviation of the growth rate of relevant variables or the standard deviation of changes in the relevant ratios. Hetersecdasticity-consistent robust standard errors are reported in parentheses. The symbols *, **, and *** indicate statistical significance at the 10 per cent, 5 per cent and 1 per cent levels respectively.

Chapter 6

SAFTA ACCORD: SALIENT FEATURES, AND CHALLENGES OF REALISING THE POTENTIALS

6.1 INTRODUCTION

6.1.1 The Context

Establishment of a South Asian Free Trade Area (SAFTA) was formally announced at the twelfth summit of SAARC Heads of States held in Islamabad in January 2004. The Summit endorsed a *Framework Agreement* for SAFTA which, through its 25 articles, articulated a road map for the creation of a Free Trade Area (FTA) encompassing the seven SAARC member countries. The FTA was to come into operation in January 2006. This left the respective governments with less than two years to complete the relevant negotiations which were to be carried out by the Committee of Experts (CoE). After protracted negotiations, consensus on a number of crucial issues on the table was reached at the twelfth meeting of the CoE, held in Kathmandu during 29 November to 01 December 2005. This paved the way for the establishment of the SAFTA as was planned under the Framework Agreement. No doubt, the political direction coming out of the thirteenth SAARC Summit in Dhaka two weeks earlier (12-13 November 2005) had played a crucial role in imparting a sense of direction and urgency to reach a consensus in Kathmandu.[1] The SAFTA accord has now been ratified by most of the member countries and the trade liberalisation plan under the accord is expected to be operationalised from July 2006.[2]

This paper has several objectives: it presents a review of the theoretical underpinning of Regional Trading Arrangements (RTAs) which are emerging as a major force in the global trading system, undertakes a critical examination of some of the key negotiating

1 The Summit also decided to extend membership of SAARC to Afghanistan. This would mean that at some future stage Afghanistan would also join SAFTA. China and Japan were accorded observer status in SAARC. In March 2006 Republic of Korea also expressed its interest to be an observer in SAARC.

2 Pakistan and Sri Lanka were yet to ratify the Agreement at the time of writing of this paper. It is expected that SAFTA trade liberalisation plan will be operationalised by all members beginning from July 2006 once the budgets for FY2007 have been prepared and fiscal measures are amended in view of the SAFTA accord.

issues in SAFTA agreement, investigates implications of the major agreements under SAFTA for Bangladesh and other Least Developed Country (LDC) members of the SAARC and puts forward some suggestions towards realising the potential benefits emanating from the accord. Section 6.2 situates SAFTA in the context of the increasing trends towards establishment of RTAs both in South Asia and in other regions. Section 6.3 presents the results of a modelling exercise carried out at the CPD to assess the possible impacts of regional economic cooperation for the SAARC countries. Section 6.4 draws lessons for SAFTA based on the SAPTA, and reviews negotiations on some of the most important articles of the SAFTA Framework Agreement, and analyses and assesses how these issues were resolved. Section 6.5 presents key agreements that were reached under the accord and puts forward, from Bangladesh perspective, a number of suggestions towards realising the potential benefits from the accord.

6.2 SAFTA IN THE CONTEXT OF RTAs

6.2.1 The Case for RTAs

In view of the signing of the SAFTA agreement, it is important to understand the logic that drives the RTAs. To be true, in going for closer economic cooperation, the SAARC members were not doing something that was novel. The last decade, following the establishment of the WTO in 1995, has seen a proliferation of Regional Trading Arrangements (RTAs) at a pace that was unprecedent compared to the preceding decades.[3] RTAs were common features of global trade scenario during the GATT days. However, in spite of the current move towards accelerated multilateral liberalisation under the WTO, there is a visible trend towards establishment of RTAs of various types in recent years. Perceived slow pace of trade liberalisation under multilateral trading system, willingness to go beyond trade and into services, investment and other areas of cooperation and the desire to speed up economic cooperation among neighbouring countries have contributed to a renewed interest in the RTAs. It is to be noted here that RTAs are WTO compatible as long as they promote deeper (compared to MFN) liberalisation. Perceived cost of non-cooperation and prospects of *peace dividend* emerging out of regional economic cooperation have also contributed to a perception where regional trade blocs were seen by many countries to be necessary parallel initiatives alongside the multilateral liberalisation in the WTO.

The literature on RTA is rich and varied. Viner's 1950 study (Viner, 1950), considered a classic in RTA literature, was founded on the assumption that *trade-creating* (welfare-enhancing) effects of an RTA need to be pitted against *trade-diverting* (welfare-reducing) effects. Justification for any Preferential Trading Arrangement (PTA) should be assessed from their trade creating and trade diverting capacities. Empirical evidence on PTAs has generally tended to support that PTAs have in general been net welfare enhancing – they have generally enhanced intra-regional trade albeit often at the cost of trade between members and non-members (Warr, 2005). It has also been noted that the magnitude of trade diversion and trade creation would also depend on levels of the initially applied tariffs, whether external tariffs (with extra-RTA trading partners) are raised once PTA has been formed, whether the pre-PTA trade was already substantial, and whether trade

[3] Out of the more than 200 RTAs, about half were signed during post-WTO era.

complementarities exist among partner countries. In this sense, each RTA is unique and its potential in terms of generating economic benefits ought to be evaluated and assessed by taking cognisance of its specificities.

Recent writings have attempted to capture the *dynamic impacts* of RTAs along with the traditionally captured *static effects* (of the Viner type) arguing that as intra-regional trade grows the expanded market size promotes investments, both domestic and intra-regional, as well as extra-regional. This, by raising income, stimulates demand for goods from outside the region. These dynamic effects, by creating opportunities for economies of scale, could offset a large part of the potential *trade diversion effects*. Thus, recent literature makes the point that even when on the basis of static analysis RTAs may appear to be trade-diverting; these may in effect turn out to be economic welfare enhancing for both members and non-members when the dynamic effects are factored into the discourse (Warr, 2005).[4]

In this connection, it is relevant here to also distinguish between the concepts of *regionalisation* and *regionalism*, and clarify the concept of *open regionalism*. As tariffs come down, neighbouring countries, taking advantage of proximity and complementarities, tend to trade more. Thus, there is a natural tendency for trade among neighbouring countries to rise with the opening up of economies. This is *regionalisation* of international trade, as against *regionalism* which is a conscious effort to increase intra-regional trade through promotion of a set of trade related and non-trade related policies. RTAs are often seen as drivers of "regionalism" in trade. On the other hand, *open regionalism* refers to policies that pursue regionalism in a manner that does not limit or constrain closer economic cooperation with non-member countries (e.g. by raising tariffs, or raising non-tariff barriers). The current trend globally is to go for *open regionalism*. It is in the context of open regionalism that the dynamic effects of RTAs are more likely to be economic welfare enhancing, a point that was raised earlier.

In view of the above, it is not surprising that the number of RTAs has continued to rise – total number of RTAs notified to the WTO, which were in force in August 2004, was 206. In addition, around 30 agreements were signed between 2003 and 2004 which are at present awaiting entry into force; around 60 RTAs are in the negotiation/proposal stage. It is estimated that more than a-third of the global trade takes place between countries which are members of various RTAs – in the European Union (EU), intra-regional trade constitutes two-thirds of global trade of member countries; in the North American Free Trade Area (NAFTA), it is almost 50.0 per cent; and in the ASEAN, it is about 26.0 per cent. To contrast, intra-regional trade constitutes only about 4.8 per cent of the global trade of the SAARC countries. Although the rise in the number of RTAs is visible across all regions, their presence in Asia-Pacific, along with the Latin American and Caribbean regions, is notable by their visibility. There are more than 50 RTAs in which Asia-Pacific countries are members, of which 48 were notified to the WTO (World Bank, 2005). Many RTA member countries also look at regional cooperation as a strategic move towards strengthened global integration of their economies. However, the RTAs tend to vary widely in terms of depth of cooperation (with varying degrees of

[4] Winters (1996), Bhagwati et al. (1998) and others have also pointed out the need for inclusiveness of PTAs – when PTAs exclude countries that are geographically close or which use common languages with members, the magnitude of *trade diversion* tends to increase.

inclusion of goods, services, investment cooperation, and movement of factors of production). It is pertinent to recall here that proliferation of RTAs in recent years has also attracted attention of the WTO. The Ministers in Doha had agreed to launch negotiations aimed at "clarifying and improving the disciplines and procedures under the existing WTO provisions applying to regional trade agreements." The objective of undertaking this exercise was to ensure conformity with WTO rules. The work of this group is also aimed at assisting the work of the WTO Committee on Regional Trade Agreements (CRTA) with respect to ensuring compliance with WTO rules and provisions.

6.2.2 SAFTA in the Context of the GEP Report

There is no doubt that the decision to create an FTA in South Asia was a bold major policy initiative by the SAARC political leaders. Indeed, the idea to establish such an FTA was first mooted by the Group of Eminent Persons (GEP) which was entrusted by the SAARC Heads of States to come up with a *Vision Paper* articulating a road map for regional economic cooperation among SAARC countries. In their report (the *GEP Report*),[5] which was placed at the tenth SAARC Summit held in Colombo in 1998, the GEP recommended establishment of an FTA in South Asia which was to come into operation by 2008 for the three developing countries, and by 2010 for the four LDC members of the SAARC.[6] The FTA thus was expected to be only a step, albeit an important one, towards an integrated South Asian economy based on comparative advantage-driven economic cooperation. Such an economic entity was also envisaged as a strategic bloc that would facilitate strengthened global integration of the regional countries. South Asia is a region with a population of 1,500 million (about a fourth of global population) and a combined GDP of $610.0 billion (less than 6.0 per cent of global GDP in PPP$). SAARC countries also had the largest concentration of poverty, with more than 400 million people living below the poverty line. What perhaps influenced the propositions of the GEP was that business as usual was not going to help South Asia to do away with the curse of economic and human deprivation, and that there was a need for a bold vision if South Asia was to be a region of economic prosperity, peace and harmony. The GEP envisaged the FTA to be a part of a *strategic move* towards greater economic integration among countries of the SAARC that would eventually take the shape of a *Customs Union*, and move forward towards the creation of an *Economic Union*. The idea was to move along the line of European Union through a process of graduation (as indicated in Figure 6.1), to be implemented over the next several years.

As it stands, the pace of tariff liberalisation envisaged under the SAFTA Framework Agreement is much slower than the one proposed in the GEP report, perhaps reflecting the current state of affairs in terms of economic cooperation in the region. It is true that SAARC countries are members of several RTAs and Bilateral FTAs (BFTAs) which they have signed in recent years (Table 6.1).[7] However, in the context of the geo-political

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[5] The *GEP Report* was prepared by some of the leading thinkers of the SAARC countries. Professor Rehman Sobhan, Chairman of CPD, was a member of the GEP from the Bangladesh side.

[6] Bangladesh, Nepal, Bhutan and Maldives are the four LDC members of the SAARC, while India, Pakistan and Sri Lanka are the three developing country members. If Afghanistan is to join SAARC subsequently, the number of LDCs in the group will rise to five.

[7] During the visit of Bangladesh Prime Minister to Pakistan during 13-16 February 2006, an agreement was reached to sign a BFTA by September 2006.

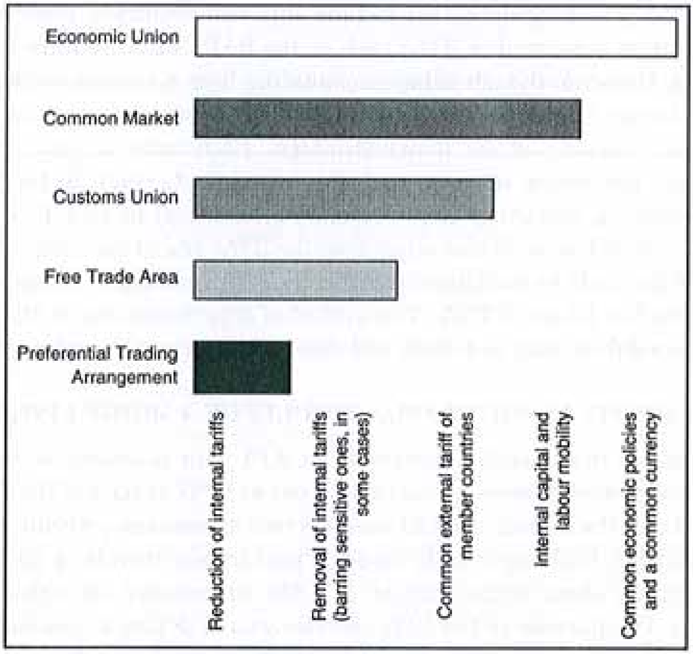

Figure 6.1: Hierarchy of RTA

realities in the region, the SAFTA accord must be seen as an important development that has potential to foster the much needed economic cooperation among the countries of the region.

TABLE 6.1

Current and Ongoing Regional Trade Arrangements Where South Asian Countries are Members

South Asian Countries	Bilateral FTAs	Regional Trade Arrangements: SAPTA (est. 1993)	SAFTA (prop. 2006)	BIMSTEC (est.1997)	D-8 (est. 1997)	IOR-ARC (est. 1997)	Bangkok Agreement/ APTA (est. 1975)	SAGQ (1998)
Bangladesh	India* Pakistan* Sri Lanka*	√	√	√	√	√	√	√
Bhutan	India	√	√	√				√
India	Bangladesh* Bhutan Nepal Sri Lanka	√	√	√		√	√	√
Nepal	India	√	√	√				√
Maldives		√	√					
Pakistan	Bangladesh* Sri Lanka*	√	√		√			
Sri Lanka	Bangladesh* India Pakistan*	√	√	√		√	√	

Note: *indicates ongoing negotiations.

There is a growing trend in recent times for the SAARC countries to sign BFTAs. Evidently, BFTAs, which by definition include only two countries, could go for deeper levels of cooperation compared to RTAs such as the SAFTA that require concurrence of seven countries. However, the advantages emanating from economic cooperation within the ambit of a regional agreement, with a common set of rules of game covering a large regional market, should not be underestimated. Economies of scale, market size, opportunities of promotion of intra-regional investments that foster vertical and horizontal cooperation and integration are more pronounced in an RTA compared to a BFTA. Besides, the BFTAs could also strengthen the RTAs and at one stage the accelerated pace of cooperation could be multilateralised in the RTA enabling it to move forward and graduate into higher forms of RTA. The upshot of this discussion is that the SAFTA accord needs a careful scrutiny and study and that it is important to explore its potentials.

6.3 BENEFIT OF RTA IN SOUTH ASIA: RESULTS OF A MODELLING EXERCISE

In order to capture the possible impacts of an RTA with countries of the SAARC as members, a gravity model exercise was carried out at CPD as part of the current study. As was pointed out, the impact of RTAs varies across agreements, within an agreement, and across countries. Building models based on past trends provides a good opportunity to make projections about future impact of RTAs on member countries, *albeit* at an aggregate level. The purpose of the CPD exercise was to deploy a standard augmented gravity model to capture the impact of free trade on the economies of the regional countries. The exercise was not limited to only SAPTA but also studied the impact of BIMSTEC and the Bangkok Agreement on the member countries.

6.3.1 Methodology in Brief

The gravity model originates from the notion of Newton's Law of Gravitation, which was first applied by Tinbergen (1962) and Poyhonen (1963) to analyse international trade flows.[8] Since then, gravity model has been used extensively to test for the trade effects of the RTAs. Over the years, the model has gone through substantial modifications and improvements, both in terms of establishing conceptual relations between the empirical model and its theoretical justifications and estimation techniques and also through inclusion of new variables. A large number of researchers and academicians including Soloaga and Winters (2000), Cernat (2001), Martinez-Zarsoso and Nowak-Lehmann (2003), Coulibaly (2004), and others have made valuable contribution in this regard.

A number of studies have tried to capture the impact of closer economic cooperation in South Asia. Jayaraman (1978) looked at the static effects of a hypothetical customs union in South Asia. The study suggests that a customs union would become effective if the post-union common external tariff will be fixed at the lowest pre-union rate. However, the gains were found to be of small magnitude. Another study on the static welfare effects of a South Asian customs union computed common external tariff by taking the weighted average rates of all country averages, and found that the expected

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[8] In general, the gravity model attempts to make projections based on the assumption that the volume of trade between two countries should increase with their economic size (proxied by GDP or GNP) and decrease with transaction cost (measured as bilateral distance).

welfare gain for the region as a whole was likely to be quite modest, not exceeding 0.07 per cent of the region's total regional product (Rahman et al., 1981).

Empirical research by Srinivasan and Cononero, using gravity model, suggested that although potential gains from preferential liberalisation are less than those from unilateral liberalisation, these would be quite substantial, and that the smaller countries are likely to gain more than the larger countries from regional integration. However, according to their results, the magnitude of overall gains would be quite substantial. Their simulation shows that the effect of removing all tariffs would be to increase total trade between 3.0 per cent of GDP for India and 59.0 per cent of GDP for Nepal and in between for other countries (Srinivasan and Cononero 1993). Mukherji (1998), on the basis of 1994-95 data and import demand elasticity, estimated that in the case of a free trade area intra-regional imports would increase by 26.0 per cent. However, this is expected to increase only by 15.0 per cent in the case of a 50.0 per cent reduction in the tariffs.

As was mentioned, for the purpose of this study an augmented export gravity model has been used to investigate the impact of the three RTAs (SAFTA, Bangkok Agreement and BIMSTEC) on the member countries.[9] The model, built for the purpose of this study, incorporates some relevant and important variables which are not commonly used in gravity models. These include bilateral exchange rate of exporting and importing countries and extent of liberalisation of the importing country (as measured by import-GDP ratio), along with the traditional gravity model variables [(a) GDP of exporting and importing country, (b) distance between partner countries, (c) common language, and (d) common border]. Apart from this, following Coulibaly (2004), three dummy variables for each RTA have been incorporated in the model to capture the welfare effects of forming the RTAs. Furthermore, to capture the effect of bilateral trade agreements among countries, another dummy variable has also been introduced. A *two-stage* panel regression (following Coulibaly, 2004) with country-pair specific and year specific fixed effects has been applied. At the first stage, all variables were included except distance, common language and common border. Country-pair specific effects and year-specific effects were introduced at this stage. The second stage regression on pooled data uses the estimated country-pair specific effects as dependent variable and includes left out variables at the first stage and, in addition, all the regressions included in the first stage. Regression coefficients at the first stage measure the *time dimension effect* of the variables, and those of the second stage measure the *cross section specification effects*.

A sample of 61 countries has been considered in the model; observations cover the period between 1991 and 2003.[10] Accordingly, the data relate to 3660 country-pairs with 47,580 observations. While working with this huge dataset, a significant number of zero trade flows between countries were observed. This could have posed an econometric problem in estimating the regression with Ordinary Least Square (OLS) technique. To address this concern, use of Tobit model was thought to be the best way.[11] Thus, Tobit

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9 The analysis reported here presents some of the findings of an ongoing study at CPD titled *Impact of RTAs on Member Countries in SAARC, BIMSTEC and Bangkok Agreement: An Augmented Gravity Model Approach*. The study is being conducted by Wasel Bin Shadat, Senior Research Associate and Narayan Chandra Das, Research Associate, CPD.

10 These 61 countries are members of 10 RTAs: SAPTA, AFTA, EU, NAFTA, MERCOSUR, CAN, EAC, SADC, Bangkok Agreement and BIMSTEC. Some of the countries including Bangladesh have multiple membership.

11 However, as empirical literature on Gravity models shows, the use of Tobit model is quite limited because of the quite high computer speed and lengthy time required to perform the analysis. As a result, use of Heckman approach is a more common practice.

model was used in the first stage of the estimation. However, as Tobit coefficients are not directly interpretable, corresponding marginal and impact effects were estimated to interpret the results.

6.3.2 Analysis of the Results

Common Gravity Variables

Regression results are presented in Tables 6.2-6.5. Test statistics for overall significance of the model follows *F-distribution* for the second step and *Chi-square* distribution for the first step. It appears that both tests are highly significant, implying the rejection of the *null hypothesis* of all coefficients simultaneously being equal to zero (Table 6.2).

TABLE 6.2

Two Way Fixed Effect Model Estimation Results

Variable	First stage (Tobit)		Second Stage (OLS)	
	Coefficient	Marginal effect	Coefficient	Total Effect
IM-GDPR	1.066	1.043*	–0.981*	1.064
lnGDPEX	0.179	0.175*	0.797*	0.972
lnPOPEX	0.033	0.032	–0.113*	–0.113
lnGDPIMP	0.419	0.410*	0.485*	0.895
lnPOPIMP	–0.070	–0.068*	–0.020*	–0.088
lnEXCHEX	0.095	0.093*	–0.015*	0.077
lnEXCHIMP	0.034	0.033*	–0.038*	–0.005
lnDISTANCE	–	–	–0.868*	–0.868
Dummy Variables	Coefficient	Impact effect	Coefficient	% equivalent
LANGUAGE	–	–	0.997*	171.0
BORDER	–	–	0.415*	51.4
BILATERAL	-0.337	-0.322*	1.492*	222.1
No. of Observations	47580	–	47580	–
R^2 or Pseudu R^2	0.59	–	0.75	–
Pro>F or Pro>Chi-square	0.000	–	0.000	–

Notes: 1. *denotes significant at 5 per cent level of significance.
2. Two regression coefficients are added at 5 per cent level of significance.
3. Results are corrected for heteroscedasticity.
4. Dummy coefficients are reported in the last column by taking [(exp(coefficient)]-1]*100 after adding the two stage results.
5. IMP-GDPR coefficient is reported as exp (coefficient) in the last column following summation of two stage results.
6. ln is the natural logarithm operator.
7. First stage is estimated using Tobit model while the second stage is estimated using OLS.

All common gravity variables are of expected sign and are in line with theoretical justification. For example, the increase in *economic size* of both the exporting and importing countries (as measured by the GDP) should have positive impact on bilateral export flows; accordingly, the analysis reveals significant positive impact of the GDP of both exporting and importing countries on the bilateral exports. For one per cent increase in GDP of exporting country, bilateral export flow would increase by 0.9 per cent, while for one per cent increase in GDP of importing country, bilateral export flow would increase by 0.9 per cent. Intuitively, if two countries share a common border and/or common language, bilateral trade among these countries should increase. Both the coefficients of common border and language are found to be positive and statistically significant. If two countries share common border, export flows between these countries are expected to be 171.0 per cent more than two otherwise similar countries which do not share common borders. Likewise, two countries having common language tend to trade 51.0 per cent more than two otherwise similar countries.

On the other hand, *distance*, which is considered as a proxy for transportation costs, should have negative impact on exports; our result shows a significant negative impact of distance on bilateral exports. If distance between capital cities of two countries increases by one per cent, bilateral export decreases by about 0.9 per cent. However, the coefficients for population could take either positive or negative sign and there are theoretical explanations either way. In our case, the estimation results show that population of both the exporting and importing countries have negative impact on bilateral export flows. In other words, increasing population of the exporting country results in rise of absorption capacity of the domestic market, thereby having a dampening impact on import; to the contrary, increasing population of importing country contributes to economies of scale of the domestic industries.

Theoretically, *import-GDP ratio* of importing country, which is a proxy indicator of importing country's degree of *openness*, should have a positive impact on bilateral trade flows. Our empirical findings show that openness has significant positive impact on bilateral export flows, to the tune of 1.0 per cent for each percentage point rise in openness.

Bilateral dummy variables were incorporated to see the impact of the four bilateral trade agreements, of which some of the 61 sample countries are members, on export performance. Interestingly, and as would be expected, the result indicates that export between two countries will be 222.0 per cent more if there exits a bilateral trade agreement between countries compared to country-pairs without having bilateral trade agreements.

Movement in exchange rate has significant impact on export performance. According to conventional thinking, depreciation of exporter's currency and appreciation of importer's currency should boost the bilateral export flows. This is strongly supported by our findings. Exporter's exchange rate has a positive impact (0.07) on bilateral exports which means that one per cent increase in exchange rate (i.e. depreciation of exchange rate) would result in a 0.077 per cent increase in bilateral exports; although the magnitude is small, the sign, as expected, is positive. Similarly, importer's exchange rate has a significant negative impact (–.005) indicating that one per cent decrease in exchange rate (i.e. appreciation of exchange rate) would increase exports by 0.005 per cent from the partner country. The results indicate that an active exchange rate depreciation policy is likely to have only an insignificant impact on regional trade.

6.3.3 Implications of Preferential Market Access

The results from the modelling exercise tend to suggest that SAPTA is associated with *intra-block export creation* and *net export diversion*. The coefficient of dummy variable SAPTA1 is positive, which indicates intra-block trade creation. On the other hand, the negative coefficient of dummy variable SAPTA2 indicates net export diversion. This means that intra-block export increases at the cost of global export of RTA member countries. Intra-block export creation and net export diversion are reported by cross section specification of the data (i.e. result of second stage regression).

However, all members of the RTA will not be equally impacted upon by the creation of SAPTA. A close inspection of Table 6.3 reveals that Bangladesh, India and Pakistan are likely gainers from an RTA in South Asia. For Bangladesh and Pakistan, positive impacts are reported by cross section specification (second stage regression) rather than time dimension (first stage regression). Though at 10.0 per cent level of significance, impact of time dimension on Bangladesh's export was also found to be positive. Other countries are negatively affected due to the creation of SAPTA which is a direct consequence of net export diversion, and is captured mainly in cross section specification.

TABLE 6.3

Impact of SAPTA on Its Members

Variable	First Stage (Tobit)		Second Stage (OLS)		Summary	
	Coefficient	Impact Effect	Coefficient	Total Effect	Net Effect	[[Exp (net effect)]-1]*100
SAPTA1	–0.113	–0.111*	0.967*	0.856	0.856	135.4
SAPTA2	–0.038	–0.037	–0.327*	–0.327	–0.327	–27.9
Bangladesh	0.250	0.246**	0.600*	0.600	0.273	31.4
India	0.346	0.341*	–0.079	0.341	0.014	1.4
Maldives					–0.327	–27.9
Nepal	–0.134	–0.130	–0.621*	–0.621	–0.948	–61.3
Pakistan	–0.058	–0.057	0.711*	0.711	0.384	46.8
Sri Lanka	0.086	0.085	–0.072		–0.327	–27.9

Notes: 1. * and ** denote that results are significant at 5 per cent and 10 per cent levels respectively.

2. Total effect is found by summing impact effect at the first stage and coefficient at second stage at 5 per cent level of significance.

3. Net effect for each country is found by adding SAPTA2 coefficient and each country coefficient.

4. Results are corrected for heteroscedasticity.

5. As the dependent variable appears as natural logarithm, net effect is also reported as [[Exp(net effect)]-1]*100 for interpretational convenience.

6. First stage is estimated by using Tobit model while second stage is estimated by using OLS.

6.3.4 BIMSTEC[12]

BIMSTEC is associated with intra-block export diversion as is evident from the negative sign of net effect of BIMSTEC1. This intra-bloc export diversion arises from cross section specification. However, there is no evidence of net export diversion under BIMSTEC since BIMSTEC2 was found to be insignificant (Table 6.4).

12 The BIMSTEC (Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation) Agreement has Bangladesh, India, Myanmar, Sri Lanka and Thailand as founding members; Nepal and Bhutan have joined later. The BIMSTEC Framework Agreement, signed in 2004, covers three areas of cooperation under three Separate Agreements: (a) Agreement on Trade in Goods; (b) Agreement on Trade in Services, and (c) Agreement on Investment.

TABLE 6.4

Impact of BIMSTEC on Its Members

Variable	First Stage (Tobit)		Second Stage (OLS)	Summary		
	Coefficient	Marginal/Impact Effect	Coefficient	Total Effect	Net Effect	[(Exp (net effect)]-1]*100
BIMSTEC1	0.043	0.042	-0.865*	-0.865	-0.865	-57.9
BIMSTEC2	-0.053	-0.052	0.094			
Bangladesh	0.290	0.281	-0.153			
India	0.131	0.128	-0.228**			
Myanmar	0.065	0.064	-3.188*	-3.188	-3.188	-95.9
Sri Lanka	0.068	0.067	-0.171			
Thailand						

Notes: 1. * and ** denote that results are significant at 5 per cent and 10 per cent levels respectively.

2. Total effect is found by summing impact effect at the first stage and coefficient at second stage at 5 per cent level of significance.
3. Net effect for each country is found by adding BIMSTEC2 coefficient and each country coefficient.
4. Results are corrected for heteroscedasticity.
5. As the dependent variable appears as natural logarithm, net effect is also reported as [(Exp(net effect)]-1]*100 for interpretational convenience.
6. First stage is estimated by using Tobit model while second stage is estimated by using OLS.

As Table 6.4 shows, only Myanmar is negatively affected due to creation of BIMSTEC. No significant effect on Bangladesh, India and Sri Lanka was observed as both the country coefficients and BIMSTEC2 are found to be insignificant.

6.3.5 Bangkok Agreement[13]

Bangkok agreement is associated with intra-block export diversion and net export diversion (Table 6.5). Intra block export diversion, as measured by BANGKOK1, is the effect of cross section specification. On the other hand, stronger negative time dimension effect offsets the positive cross-section effect resulting in an overall negative net coefficient for BANGKOK2 (net export diversion).

As regards the country specific effects, only China and Korea have shown positive coefficients; rest of the members were found to be negatively affected due to the Bangkok Agreement. The result implies that economically powerful countries could be dominant players in RTAs. It is to be noted that China became a member of the Bangkok agreement in 2002; 90.0 per cent of total intra-regional trade in 2003, carried out by the Bangkok agreement countries, was accounted for by China and Korea.

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13 Bangkok Agreement was signed in 1975 as the first RTA in the Asia-Pacific region. The founding members were five: Bangladesh, India, Lao-PDR, Republic of Korea and Sri Lanka. Later on, China joined in 2001. Bangkok Agreement was subsequently renamed as Asia-Pacific Trade Agreement (APTA) in the November 2005 meeting held in Beijing.

TABLE 6.5

Impact of Bangkok Agreement on Its Members

Variable	First Stage (Tobit)		Second Stage (OLS)		Summary	
	Coefficient	Impact Effect	Coefficient	Total Effect	Net Effect	[{Exp (net effect)}-1]*100
BANKOK1	0.000	0.000	–0.404*	–0.404	–0.404	–33.2
BANKOK2	–2.096	–1.867*	1.100*	–.0.767	–0.767	–53.6
Bangladesh	1.208	1.198	–0.308*	–0.308	–1.135	–67.8
China	2.770	2.758*	–0.706*	2.051	1.224	240.1
India	1.503	1.491**	–0.500*	–0.500	–1.327	–73.5
Korea	4.452	4.437*	–2.770*	1.667	0.840	131.6
Lao	–	–	–	–	–0.827	–56.3
Sri Lanka	1.540	1.524**	–0.192	–	–0.827	–56.3

Notes: 1. * and ** denote that results are significant at 5 per cent and 10 per cent levels respectively.

2. Total effect is found by summing impact effect at the first stage and coefficient at second stage at 5 per cent level of significance.

3. Net effect for each country is found by adding BANGKOK2 coefficient and each country coefficient.

4. Results are corrected for heteroscedasticity.

5. As the dependent variable appears as natural logarithm, net effect is also reported as [{Exp(net effect)}-1]*100 for interpretational convenience.

6. First stage is estimated by using Tobit model while second stage is estimated by using OLS.

Overall Observations

The augmented gravity model exercise indicates that although SAPTA is associated with net export diversion, Bangladesh will be benefited from this regional trading agreement along with two of the other larger economies of the RTA, India and Pakistan. Results of the gravity model exercise indicate that greater openness to regional countries under a free trade regime (SAFTA) is likely to benefit Bangladesh.

Though BIMSTEC is associated with intra-block export diversion, Bangladesh is not affected negatively by being a member of this agreement. However, results of the gravity model exercise indicate that economic cooperation under the Bangkok Agreement may not bring significant benefits to Bangladesh.

As was discussed earlier, empirical studies on RTAs give a mixed picture with widely varying results. It has been seen that, in general, gravity models tend to present an overtly positive scenario while those based on price elasticity tend to come with modest results. Results coming out of the present exercise are perhaps more grounded in reality than some of the other ones. However, none of the studies is able to factor-in the prevalence of non-tariff barriers that constrain trade flows in the SAARC region. Unless these are considered, it would be difficult to make quantitative estimates that are close to the reality prevailing in this region. This also draws attention to the need of addressing non-tariff issues on an urgent basis. Some of these issues are discussed in the following sections.

6.4 MOVING TOWARDS SAFTA: LEARNING FROM SAPTA

The SAFTA was envisaged to be a step forward from the SAARC Preferential Trading Arrangement (SAPTA); with the coming into being of SAFTA, SAPTA has ceased to exist.[14] However, as the South Asian countries strive to establish a free trade area, a brief review of the decade long experience and lessons of the preferential trading regime under the SAPTA could be helpful in terms of charting the way forward towards a free trade area.

It is a common knowledge that negotiations under the SAPTA have not been very effective in terms of enhancing intra-regional trade in SAARC. It is pertinent to keep in mind that compared to any time in the past the South Asian economies are more open at present. Average tariff rates in South Asia have come down from as high as 80.0-90.0 per cent in the early 1990s to about 20.0-25.0 per cent at present; exports and imports together are equivalent to about 35.0 per cent of the regional GDP. Although this opening up has led to increased global integration of south Asian economies, "regionalisation of trade" was not one of its outcomes. Consequently, intra-regional trade in SAARC continued to remain very limited.

It is to be noted that SAPTA had a number of built-in aspects, two of which were noteworthy: firstly, SAPTA was to include all products, manufactures and commodities (absence of *a-priori* exclusion) and secondly, there was a recognition of more favourable treatment for the LDCs. Trade liberalisation under SAPTA was to be carried out through such instruments as exchange of concessions on tariff and para-tariff, removal of non-tariff barriers and adoption of direct measures. The modalities would be a combination of (a) product by product approach, (b) across the board tariff reductions, (c) sectoral exchange of items, and (d) direct trade measures. Safeguard measures against import surge and adverse balance of payments impacts were also put in place; Rules of Origin (RoO) for preferential treatment were also set out. The RoO was subsequently revised, and in its final shape this was in the form of 35.0 per cent value addition for individual members and 50.0 per cent value addition for *regional cumulation* (with a derogation of 10.0 per cent for the LDCs). The system of exchanges was based on exchange of *offer lists* and *request lists* among the member countries.

Although the exchange of items was highly limited in the First Round of Concessions, (only 226 items), it was carried out on the basis of product by product exchange among member countries and did not mention about Non-Tariff Barriers (NTBs). The second round had a more extensive coverage (1,871 items) and included additional items for LDCs; the tariff cuts were also deeper, and NTBs were withdrawn on many items for which preferential treatment was extended (Table 6.6). A novelty of the third round was that it adopted a *product by product* approach, which enhanced the coverage substantially (Khan, 2005). Under the fourth round (concluded in October 2002) Bangladesh received preferential treatment for another 258 items for which concessions were in the range of 10.0 to 75.0 per cent of the MFN tariffs (Table 6.7). Additionally, beyond what was offered under SAPTA, India also offered, on bilateral basis, duty-free access on an additional 79 items (including cosmetics, pharmaceuticals, electric cable and electric goods).[15] These items were from the list of 206 items (six-digit level items belonging to

[14] The framework agreement on SAPTA was signed at the twelfth meeting of SAARC Council of Ministers in Dhaka in April 1995 on recommendation of the Intergovernmental Group set up at the time of Colombo Summit in December 1991. The SAPTA was formally approved at the Delhi summit in May 1995.

[15] In 1999, Bangladesh identified 25 categories of items for which it requested duty-free access in the Indian market. India had provided duty-free access to 79 items from this list.

the oft-cited 25 categories) which was submitted by Bangladesh for duty-free access in the Indian market.[16] Besides, Pakistan had also extended duty-free access (under certain QRs) to tea and raw jute exports from Bangladesh.[17]

TABLE 6.6

Number of Products for which Tariff Concessions have been Extended by SAARC Member States in the Three Rounds of Trade Negotiations under SAPTA

Countries	First Round (1995)			Second Round (1997)			Third Round (1998)			Total in the Three Rounds
	For LDCs	For All	Total	For LDCs	For All	Total	For LDCs	For All	Total	
Bangladesh	1	11	12	11	215	226	143	338	481	719
Bhutan	7	4	11	10	37	47	101	23	124	182
India	62	44	106	514	390	904	1874	43	1917	2927
Maldives	0	17	17	3	2	5	0	368	368	390
Nepal	4	10	14	67	166	233	137	52	189	436
Pakistan	15	20	35	131	227	358	271	24	295	688
Sri Lanka	11	20	31	23	72	95	54	28	82	208
Total	100	126	226	759	1109	1868	2580	876	3456	5550

Source: SAARC Secretariat.

TABLE 6.7

Tariff Concessions Granted by Other SAARC Countries to Bangladesh under SAPTA Fourth Round

Countries	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total
Numbers of Products	24	107	44	8	150	25	
Rate of Concession (%)	10, 15, 20, 25	15, 20, 25, 60, 75	15	10, 15	10, 15, 30	10, 20	258

Source: SAARC Secretariat.

As Table 6.8 and Table 6.9 reveal, about 57.0 per cent of Bangladesh's export to India was carried out under preferential treatment, while only 4.6 per cent of India's export to Bangladesh received similar treatment. Although given that Bangladesh's export to India was only a fraction of India's export to Bangladesh, the difference in value terms

TABLE 6.8

Bangladesh's Preferential Export to India under SAPTA

Preferential Trade	Preferential Treatment						
	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03
Preferential Import to India (in mln US$)	25.9	31.6	49.5	52.5	52.4	38.5	35.7
As % of total Export	41.9	64.2	80.3	67.6	66.2	65.9	57.1

Source: Based on Mukherji (2004).

16 Out of these 206 items, 185 were covered under SAPTA; tariff concessions for these ranged between 50% and 60% under SAPTA. These included several apparel items including men's shirts, women's trousers, plastic flower, jute yarn carpets, ceramic tableware, footwear, kitchenware, biscuits, etc. Initially, India offered duty-free access for 40 items on this list; subsequently, duty-free access was offered for an additional 39 items.

17 The quota was set at 10 thousand tons for tea.

between preferential export to India and India's preferential export to Bangladesh is not significant. SAPTA's inability to address the NTBs in a comprehensive manner also undermined the effectiveness of the tariff concessions.

TABLE 6.9

Bangladesh's Preferential Import from India under SAPTA

Preferential Trade	Preferential Treatment						
	1996/97	1997/98	1998/1999	1999/2000	2000/01	2001/02	2002/03
Preferential Import from India (in mln US$)	30.1	26.8	23.2	27.6	43.0	55.6	54.6
As % of total Import	3.5	3.5	2.4	4.4	4.7	5.6	4.6

Source: Based on Mukherji (2004).

In spite of the SAPTA, and notwithstanding the increasing global integration of South Asian economies, in terms of intra-regional trade cooperation South Asia continued to be one of the least successful regions in the world. Even after exchanging thousands of (6-digit level) items under the four rounds of preferential market access provided under the SAPTA (tariff reduction ranging from 10.0 to 100.0 per cent), the level of intra-regional trade in South Asia as percentage of global trade of the regional countries has seen only negligible change over the past ten years. The share had increased from about 3.6 per cent prior to the introduction of SAPTA to about 5.0 per cent in 2003. Table 6.10 and Table 6.11 bear testimony to this. Out of US$86.1 billion of global exports of SAARC countries, only US$5.3 billion or 6.2 per cent constituted intra-regional exports; out of US$108.7 billion import by the regional countries, only US$4.9 billion or 4.5 per cent constituted intraregional imports.

TABLE 6.10

Intraregional Exports of South Asian Countries in 2003

(in million US$)

Reporting Country	Partner Country									Intraregional Export as Share of Global Export of SAARC Countries
	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total (SAARC)	World	
Bangladesh	–	1.6	47.1	0.0	3.3	32.7	3.3	87.9	4787.8	1.8
Bhutan*	n.a.	–	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
India	1719.2	88.4	–	41.7	660.9	283.4	1302.8	4096.5	63028.8	6.5
Maldives	0.0	0.0	0.3	–	0.0	0.0	15.3	15.7	112.9	13.9
Nepal*	6.1	1.4	341.8	n.a.	–	0.9	1.2	351.4	652.7	53.8
Pakistan	194.4	0.4	95.8	1.9	4.6	–	97.6	394.8	12695.1	3.1
Sri Lanka	10.4	0.0	241.1	54.2	1.6	36.1	–	343.6	4867.8	7.0
Total								5290.0	86145.2	6.1

Note: *Not reported in 2003.

Source: COMTRADE, UN.

TABLE 6.11

Intraregional Imports of South Asian Countries in 2003

(in million US$)

Reporting Country	Partner Country							Total (SAARC)	World	Intraregional Import as Share (%) of Import of SAARC Countries from the World
	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka			
Bangladesh	–	2.7	1349.4	0.9	5.5	68.4	7.9	1435.0	7069.5	20.3
Bhutan*	n.a.	–	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
India	76.7	51.7	–	0.4	282.6	56.9	192.4	660.7	77201.3	0.8
Maldives	0.0	0.0	47.6	–	0.0	1.7	64.6	113.9	470.8	24.2
Nepal*	4.8	0.6	954.9	n.a.	–	3.3	1.9	965.6	1801.6	53.6
Pakistan	45.8	0.1	381.1	0.2	3.4	–	48.2	478.9	15549.4	3.1
Sri Lanka	5.6	0.0	1076.4	22.6	0.0	70.9	–	1175.7	6514.2	18.0
Total								4829.9	108606.9	4.4

Note:* Not reported in 2003.

Source: COMTRADE, UN.

India dominates SAARC trade accounting for 77.0 per cent of intra-regional export (Figure 6.2). On the other hand, India's import from the region was only 12.8 per cent of regional imports while that of Bangladesh, Nepal and Sri Lanka were 36.4 per cent, 14.5 per cent and 26.6 per cent respectively (Figure 6.3).

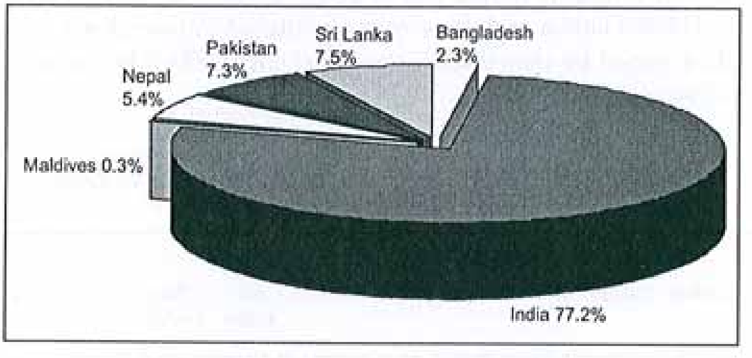

Figure 6.2: Countrywise Share (%) in Intra-SAARC Exports in 2003

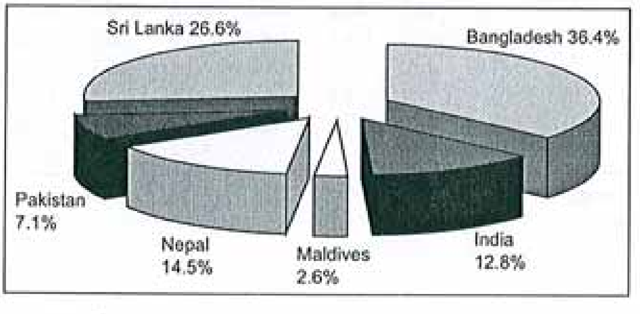

Figure 6.3: Countrywise Share (%) in Intra-SAARC Imports in 2003

However, it should also be taken into account that the size of informal intra-regional trade in South Asia continues to be quite significant, particularly between India and Bangladesh (estimated variously to be in the region of US$2.0 billion to US$3.0 billion).[18] A study carried out in 2002 estimated total air-borne and sea-borne informal trade between India and Sri Lanka to be US$208.0 million; informal trade between India and Nepal was estimated at US$408.0 million (Taneja et al., 2002). Informal trade between India and Pakistan is also estimated to be significant (estimated to be between US$1.0 billion and US$1.5 billion, often through Dubai). An FTA has thus the potential to reduce informal trade and increase formal trade substantially.

Many of the goods belonging to the *offer lists* submitted by various SAARC countries were not traded at all, or traded at very low levels. The product by product approach followed under SAPTA was cumbersome, depth of tariff cuts and coverage of products were shallow, non-tariff barriers had not been dealt with comprehensively and other complementary initiatives had not been taken. The potentials of trade with north-east states of India, where Bangladesh enjoyed comparative advantage in export of a number of items, could not be realised because of absence of adequate banking and insurance facilities and also on account of visa restrictions. Lack of adequate transit facilities for Bangladesh (from Nepal and Bhutan via India), for India (from north east states to western states of India through Bangladesh) and for Pakistan (to Bangladesh through India) had severely limited trade flows within the SAARC. The result of all this was that SAPTA remained largely ineffective; its impact in terms of tariff reduction was a paltry US$9.0 million (Mukherji, 2004).

A review of the relevant documents and studies helps to come to the following conclusions as regards implementation of SAPTA under the four rounds of exchange of concessions. These observations are important as learning points in terms of raising the efficacy of SAFTA.

- Firstly, a positive list approach based on product by product approach was found to be both time-consuming and cumbersome; it appeared that a negative list approach was a better way to go forward.
- Secondly, as would be expected, if the depth of tariff cuts is not substantial, its impact on influencing trade flow tends to remain insignificant.
- Thirdly, non-tariff barriers need to be removed, without exception, if the benefits of preferential market access are to be realised fully.
- Fourthly, there are various standardisation, certification, laboratory testing requirements which need to be complied with as per the mandatory regulations of the importing countries; these should not be perceived as NTBs. Rather, the attendant tasks need to be addressed through adequate trade related capacity building measures in the exporting countries.
- Fifthly, rules of origin have to be crafted in a manner that balances market access opportunities, domestic capacities, trade diversion apprehensions and opportunities for attracting intra-regional investment.

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[18] A study on Bangladesh-India informal trade carried out in the mid-1990s found the ratio between formal and informal import by Bangladesh from India to be 1:1.4.

- Sixthly, a major lesson from SAPTA experience is that countries, even when provided with preferential market access, will be able to realise the potential opportunities only when they have the required supply-side capacities. Accordingly, export capacity building and export diversification and attracting both extra and intra-regional investment targeted to the regional market were of critical importance if any potential opportunity was to be translated into reality.
- Seventhly, adequate trade facilitation measures in the form of customs cooperation in such areas as information exchange, administrative cooperation, harmonisation of nomenclature, customs rules and procedures, and also banking and insurance support to traders, adequate infrastructure at the border are necessary complimentary measures that would need to be put in place if the market access initiatives are to result in greater trade flows. In the context of the nature of geographical proximity of SAARC countries, cooperation in the field of transit and transport connectivity would play a critically important role if the dormant comparative advantages are to be realised in the form of increased intra-regional and extra-regional trade.

The issue of *transition* and *graduation* from a preferential trading arrangement to the establishment of a free trade area should be discussed in the context of these aforesaid observations.

6.4.1 A Review of the SAFTA Framework Agreement

It needs to be recognised that the establishment of an FTA is not likely to automatically lead to economic gains. Much depends on how the Agreement is crafted, how it is able to cater to and reconcile the often conflicting interests and concerns of member countries, and most important of all, how other parallel complementary activities, often outside the ambit of the narrow limits of trade cooperation, are put in place with a view to translating the potential opportunities into actual gains. The SAFTA Framework Agreement itself talks of the free trade area as a stepping stone towards a closer economic cooperation.

A departure of the SAFTA Framework Agreement was that it was underpinned by the premise that in order to make the FTA successful, trade cooperation will need to be complemented by several additional measures. Thus, the SAFTA Framework Agreement refers to such measures as: (a) Harmonisation of standards, reciprocal recognition of tests and accreditation; (b) Harmonisation of customs clearance and customs cooperation; (c) Transit facilities, particularly for land-locked contracting states; (d) Removal of barriers to intra-SAARC investments; (e) Development of communication system and transport infrastructure; (f) Rules of fair competition and promotion of venture capital; and (g) Simplification of procedure for business visas. The Framework Agreement recognises that cooperation in the area of investment is an important key to enhancement of trade cooperation in the region, and it gives high priority to trade facilitation. Dispute Settlement Mechanism, a key provision in any FTA, has been spelt out in some detail and safeguard measures, their application, duration and withdrawal have also been elaborated in terms of their implementation.

One of the salient features of the SAFTA Framework Agreement was that it accorded the LDCs an explicit recognition as a separate group of countries among the contracting states; the Framework mentions that the LDCs in the SAARC will be provided with Special and Differential (S&D) treatment. Thus, in all key articles of the SAFTA Agreement, there are S&D provisions in support of the LDCs in the form of (a) *derogation,* (b) *two-track* trade liberalisation schedule, (c) safeguard measures, (d) compensation for possible revenue losses, (e) technical assistance support, and (f) prior consultations.

To translate the Framework into an implementable FTA accord, member countries were to arrive at agreement with regard to a number of key areas in the Framework Agreement. Of critical importance among these were: (a) Trade Liberalisation Plan (TLP); (b) Rules of Origin (RoO); and (c) a mechanism for revenue compensation.

According to the TLP, each country was to design three lists of goods: (i) a *negative or sensitive list* of goods that would remain outside the ambit of trade liberalisation schedule; (ii) a *positive list* for which duties on goods will be brought down to the level of 0.0-5.0 per cent at the very outset; and (iii) a *residual list* for which tariffs would be brought down to 0.0-5.0 per cent in a staggered manner: over a period of 10 years by the LDCs beginning January 2006 (up to 30.0 per cent in first two years, and up to 0.0-5.0 per cent in next eight years), and over a period of seven years by the developing countries (up to 20.0 per cent in first two years, and up to 0.0-5.0 per cent in next five years) (Table 6.12). It is to be noted that as per the TLP, the developing contracting members are to bring down their tariff for the LDCs to 0.0-5.0 per cent in three years.

TABLE 6.12

Tariff Reduction Schedule under SAFTA Framework Agreement

Country Category	First Stage	Second Stage	Target Year for FTA
LDCS	From existing tariff to 30% over 2 years	From 30% or below to 0-5% over 8 years	2016 (0-5% for items outside negative list) 2013
Non-LDCs	From existing tariff to 20% over 2 years	From 20% or below to 0-5% over 5 years	(0-5% for items outside negative list)

Source: SAFTA Framework Document (2004).

Negotiators were confronted with enormous difficulties in bringing down the size of the negative list, particularly which items to include and which to exclude in view of the *offer* and *request* lists of the partner countries. A simple arithmetic would show that the seven initial negative lists of member countries had to be reacted with 42 offer lists and 42 request lists in total. Arriving at a common set of negative list under the SAFTA, which would then be multilateralised, proved to be an extremely difficult exercise. Obviously, by definition, a long negative list would undermine the effectiveness of an FTA from the very start. However, it was only to be expected that negotiating strategies of member countries would be influenced by such factors as revenue concerns and domestic competitiveness implications. However, the other view was that the SAFTA should serve to correct the anomalies of a distorted trade regime that was promoted through protectionist policies and that an FTA would allow development of sectors based on revealed comparative advantages. This required that the negative lists should be very carefully crafted. It is pertinent to state here that according to the Framework Agreement, the negative lists are to be reviewed every four years.

The negotiations on rules of origin also proved to be difficult. Several modalities were considered: (a) value addition, Change of Tariff Heading (CTH); (b) Change of Tariff Sub-Heading (CTSH); and (c) a combination of the above. LDCs had requested for *derogation* in the RoO in the case of items where their limited supply-side capacities constrained market access. Separate RoO criteria for *regional cumulation*, aimed at providing incentives for regional sourcing, were also discussed. It was not altogether unexpected that LDCs were interested to have flexible RoO given their weak domestic capacities while the developing members, India and Pakistan, were interested in more stringent RoO. Their apprehension was that a lower value addition would encourage import-intensive exports to the region that could undermine the very logic of such facilities. It is to be recognised that there was a consensus as regards the need for a two-track approach here (derogation for LDCs) in the spirit of the Framework Agreement. However, the moot issue was as to where the initial reference point was to be set and at what level the combination of value-addition criteria and CTH would be determined.

The other important issue which had to be resolved was the identification of an acceptable modality for *compensation of possible revenue losses* on the part of the LDCs. The important issues here included (a) the method of estimation of revenue loss, (b) whether overall revenue loss or loss of revenue arising from imports from only member countries should be estimated, (c) in what form the compensation would be made, and (d) whether there would be a sunset clause (limiting the period for which such compensation would be considered by the partner countries).

6.4.2 Dynamics of Negotiation and Key Agreements

Designing the negative lists was always going to be a most challenging task. In various FTAs, these lists are generally arrived at by considering one or at least some of the following factors: (a) revenue loss consideration; (b) protection of key domestic industries; (c) avoidance of trade diversion; (d) interests of the farm sector and sectors providing large-scale employment; (e) consumer interests; and (f) stage of production (with an understanding that level of protection should decrease with the degree of processing between raw materials, intermediates and final goods). However, a long negative list could undermine and defeat the very purpose of the establishment of an FTA. Accordingly, it was initially agreed that the list would cover about 10.0 per cent of total tariff lines at 6-digit level. Anticipating difficulties this was later raised to the level of around 25.0 per cent, with further flexibilities for the LDCs. Considering that at 6 digit level about 5,226 items are traded (in the case of Bangladesh), a 25.0 per cent list would constitute more than 1,306 items. Given the low level of intra-regional trade in SAARC, this could essentially keep most of the tradables out of the ambit of the SAFTA. However, it was agreed that member countries would subsequently withdraw from the negative list items for which partner countries had put up requests by way of exchange of offer lists and request lists. In the end, the initial indicative negative lists covered a substantial number of tradable items, and also a large number of other items which were included in the negative list because of other considerations. Table 6.13 provides information about the initial Negative Lists submitted by member countries and the Request Lists that were submitted by Bangladesh in response.

TABLE 6.13

Initial Sensitive Lists Submitted, and Bangladesh's Request List

Country	Items in SL	As Share of Total TL (%)	Bangladesh's Request	
			Items in RL of Bangladesh vis-à-vis Partner	Share in Respective Country's NL (%)
Bangladesh	1306	25.0	–	–
India	927	17.8	318	34.3
Pakistan	1157	22.2	286	24.7
Sri Lanka	1065	20.4	144	13.5
Nepal	1315	25.2	393	29.9
Bhutan	132	0.03	36	27.3
Maldives	582	11.1	134	23.0

Note: TL = Tariff Lines; NL = Negative List; RL = Request List.

Source: Submissions made by SAARC members.

These long negative lists included a large number of items in which partner countries had export interests. There were a number of common items in the sensitive lists initially submitted by Bangladesh, India and Pakistan. An exercise carried out by the MCCI shows that there were 258 items that were common for Bangladesh, India and Pakistan, 396 items were common for Bangladesh and India, 557 items were common for Bangladesh and Pakistan and 464 items were common for India and Pakistan.[19] These included many agro-products, cosmetics and toiletries, plastic and rubber articles, almost all types of cotton fabrics, synthetic filaments, polyester staple fibres, knitter/crocheted fabrics, articles of apparels and clothing accessories, footwear, table wear and many types of electric apparatus. Thus, it is not surprising that the sensitive lists also generated substantially long request lists. This is corroborated by the number of requests submitted by Bangladesh which identified a list of 592 tariff lines in which it had export interest and wanted these to remain outside the negative lists of partner countries. Table 6.13 provides information on Bangladesh's request lists submitted for consideration by the partners. For example, India's initial negative list included such items of export interest as knitted fabrics, garments and accessories, leather footwear, ceramic tableware, plastic, melamine, kitchenware, etc., while Pakistan's negative list included woven/knit fabrics, garments, ceramic wares, melamine, tablewares, etc.

Bangladesh wanted 318 items to be out of the negative list of India, which was more than one-third of the total number of items in the Indian negative list.[20] Similarly, other

[19] This information was extracted from a background paper prepared by the Metropolitan Chamber of Commerce and Industry (MCCI) as part of work for the *Free Trade Group* set up by the Ministry of Commerce, GoB.

[20] Since Maldives did not have much to export (except tourism services and fish) and Nepal and Bhutan had bilateral FTAs in place with their major trading partner, which was India, it was in effect Bangladesh which was most interested to have greater market access for the LDCs under the SAFTA. Because of its relatively strong supply-side capacities, it was also in a much stronger position compared to other LDCs in realising the potential benefits emanating from any market access under SAFTA.

SAARC members also made submissions to Bangladesh with respective requests for exclusion: India – 318 items, Sri Lanka – 37 items, Nepal – 119 items, and Bhutan – 63 items. The participating countries had to respond by submitting their own respective offer lists. As was mentioned earlier, the exchange of offer lists and request lists gave rise to a total of 42 offer lists and 42 request lists which had to be reconciled to arrive at a unique set of negative list to be drawn up by each of the seven SAFTA member states. This, by any measure, was not an easy task; however, SAFTA could not be operationalised before a consensus could be reached on this crucial element.

In the end, items earmarked for tariff reduction (non-NL items) did include a substantial number of goods of export interest to Bangladesh. In terms of access to Indian market these were raw jute, raw cotton/yarn, chemical fertiliser, frozen fish, shrimp, cement, leather, few items of pharmaceuticals, stainless steel, few items of dry food, battery, few items of textile fabrics, zipper, glycerine, jute yarn, betel leaves, *jamdani sharee*, home textile, etc.; for access to Pakistani market these included raw jute, chemical fertiliser, betel nuts, betel leaves, frozen fish, shrimps, cement, leather, cotton yarn, few items of dry food, few items of printed materials, glycerine, jute yarn, zipper, ceramic tiles, tea, bamboo poles, etc.

6.4.3 Rules of Origin

Rules of origin is of critical interest in any FTA. Some of the SAARC countries were apprehensive that extra-regional countries might take advantage of market access under the SAFTA if the RoO are not strict enough, or not enforced adequately. They rather argued for more flexible regional cumulation to stimulate regional sourcing. They also argued that stringent RoO would encourage countries to put in place incentives to attract intra-regional as well as extra-regional flow of investment. To the contrary, other countries felt that stringent rules of origin could seriously undermine any market access provided under the SAFTA. This apprehension particularly informed the stance of weaker economies, the LDCs.

Although, in accordance with the stipulations of the SAFTA framework, a two-track approach was taken during the negotiation, the discussion on RoO proved to be difficult. The RoO for SAPTA referred to a single criteria, value addition, with derogation for LDCs – 40.0 per cent of f.o.b. value addition for non-LDCs and 30.0 per cent for LDCs; in the case of *regional cumulation* the RoO criteria required 50.0 per cent value addition for developing SAARC countries and 40.0 per cent for LDC members.

The proposals submitted in the course of negotiations were varied. A new element was the introduction of Change of Tariff Heading (CTH) and Change of Tariff Sub-Heading (CTSH) as reference points for RoO in addition to the criterion of value addition.[21]

The initial positions of various member countries as regards the criteria for SAFTA Rules of Origin were as follows:

- Bangladesh, Bhutan and Maldives: 35.0 per cent value addition on f.o.b. + Change in Tariff Sub-Heading (CTSH) with 10 percentage-point relaxation as S&D Treatment for the LDCs.

[21] CTH refers to the requirement of transformation of an item at 4-digit HS tariff heading level, while CTSH refers to change at 6-digit HS tariff heading level.

- Nepal: 30.0 per cent value addition on f.o.b. + CTSH with 10 percentage-point relaxation as S&D Treatment for the LDCs.
- Sri Lanka: 35.0 per cent value addition on f.o.b. + CTSH with 5 percentage-point relaxation as S&D Treatment for the LDCs.
- Pakistan: 50.0 per cent value addition on f.o.b. + Change in Tariff Heading (CTH) with 5 percentage-point relaxation as S&D Treatment for the LDCs.
- India: 40.0 per cent value addition on f.o.b. + CTH with 10 percentage-point relaxation as S&D Treatment for the LDCs.

As would be seen from the above, most of the LDCs were interested to have 30.0-35 .0 per cent value addition plus CTSH with 10.0 per cent relaxation on value addition for the LDCs. On the other hand, some of the developing country members proposed higher value addition of 50.0 per cent (Pakistan) and 40.0 per cent (India) with relaxation for the LDCs (5.0 per cent and 10.0 per cent respectively), along with CTH. In the case of number of products of export interest to Bangladesh including woven apparels, pharmaceuticals, cement, etc., a combination of VA and CTH could seriously undermine potential market access opportunities and this apprehension has induced Bangladesh to ask for selective derogation in the form of CTSH.

6.4.4 Modalities for RLCM

The Revenue Loss Compensation Mechanism (RLCM) was somewhat of a novelty in the SAFTA framework agreement. In one sense, the concept of revenue compensation runs contrary to the spirit of an FTA since the notion that informs the formation of an FTA is that in the long run liberalisation of trade would be welfare enhancing for all the participants. However, it is true that countries which import more could suffer revenue losses in the short-run. For example, Bangladesh, which accounts for about 40.0 per cent of intra-SAARC import, could suffer substantial revenue loss if items which are imported in large volumes are to be put out of the negative list under tariff liberalisation plan. On the other hand, a RLCM could induce member states to put larger number of items in the free list (out of the negative list) and could thus encourage speedy trade liberalisation.

A number of contentious issues emerged during the negotiations on the RLCM. These included: (a) definition of revenue loss; (b) parameters for computing revenue loss; (c) forms of compensation; (d) distribution of compensation; (e) modalities for implementation; and (f) collation of relevant information. There were diversity of opinions and approaches as regards (a) whether the loss is to be compensated in full (the developing countries were reluctant to agree to this), (b) whether other (non-monetary) forms of compensation would be admissible (developing states would like to keep this option open), (c) whether estimation of revenue loss should cover only products under TLP and duties and levies on those, (d) whether import of inputs for export to non-LDCs should be excluded from the revenue loss estimation (there appeared to be an agreement on this), (e) whether there should be a *sunset clause* i.e. termination of compensation mechanism after a stipulated period of time. The apprehension of LDCs was that since the TLP would be implemented over a prolonged period (till 2016 for the LDCs), the impact of revenue loss will continue to be felt for a long time. Some of the developing countries proposed for a five year time-frame for RLCM, but LDCs preferred that RLCM should be in place during the entire implementation period of TLP, with a provision for review every four years.

A Protocol Establishing the Mechanism for RLCM for LDCs was prepared and submitted by Maldives for consideration by the COE. The draft protocol stipulated that customs revenue would be defined to include: (a) all taxes and levies collected on imports; (b) the reference exchange rate would be the exchange rate of domestic currencies of member states against dollar as of 1 January 2006; and (c) the year preceding the year of implementation of the TLP would serve as the base year.

The total revenue collected from the 1306 items in Bangladesh's initial negative list (covering 25.0 per cent of total tradable items) was about 1,425.0 crore taka (average for three years, 2002-04).[22] Thus, any reduction in the negative list, particularly if the excluded items included those with significantly higher tariffs, would entail some revenue loss for Bangladesh. Because of trade diversion, the actual revenue loss could be higher.

However, the issue of revenue loss should not be over-emphasised. Firstly, as was pointed out, there would be benefits accrued to producing sectors arising from lower cost of input items included in the non-sensitive list placed in the TLP. Secondly, any revenue loss is expected to take place only gradually. For example, in the case of Bangladesh the tariffs are to be brought down to 0.0-5.0 per cent over the ten years. Thus, even when the tariff on a particular item is 25.0 per cent, the tariff reduction would, on average, be to the tune of 2.0 per cent per year, indicating that, from a static perspective the revenue loss would not come as a shock, neither would it be highly significant. Besides, as Bangladesh continues to pursue MFN tariff liberalisation on an autonomous basis, the magnitude of potential revenue loss is expected to decrease further in any case. Additionally, if import elasticity is high, the reduction in tariffs will not necessarily lead to lower revenue collection at the border.

6.5 SAFTA AGREEMENT, KEY CONCERNS AND THE WAY FORWARD

6.5.1 Key Negotiated Agreements

After protracted negotiations the key provisions of the SAFTA Agreement have now been finalised. As regards the size of the sensitive list, some of the countries have agreed to a single list, while others have come up with two lists.[23] Pakistan, Sri Lanka, Bhutan and Maldives have submitted single lists for all partner countries, while Bangladesh, India and Nepal have submitted separate negative lists for developing members and LDCs.

An analysis of the items in the sensitive lists reveals that these items constitute a substantial share in the number of total tradable items, and also in terms of total amount of trade value. Many of the most important tradables that had export interest of partner countries have remained in the negative lists. For example, apparels, a major item of Bangladesh's export interest, has continued to remain in the negative list of partner countries such as India. However, it is important to note that despite stiff

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[22] This was equivalent to roughly 23.0 per cent of the import duty collected over the corresponding period by Bangladesh.

[23] Countries which have submitted two lists have included some additional items in their respective negative lists for non-LDC members.

TABLE 6.14

Number of Sensitive Goods in SAFTA

	No. of Items in the SL for LDCs	No. of Items in the SL for DCs	Total No. of Items in the SL of Member Countries	Additional SL Items for the DCs
Bangladesh	1249	1254	1254	5 items (2701.12, 4412.14, 4412.22, 5403.20, 7407.21)
Bhutan	157	157		0
India	763	884	884	121
Maldives	671	671		0
Nepal	1299	1335	1335	36
Pakistan	1183	1183	1183	0
Sri Lanka	1079	1079		0

Note: All items are defined at 6 digits HS Level. LDCs = Least Developed SAARC Countries. DCs = Developing SAARC Countries.

resistance in the beginning, India has agreed to provide Tariff Rate Quota (TRQ) to Bangladesh, up to a maximum amount of six million pieces of readymade garments, which will be allowed to enter the Indian market at zero-tariff (half of this from fabrics imported from India, and the rest half from fabrics sourced within Bangladesh).[24] The ceiling was enhanced further by another 2 million pieces at the time of its ratification by India. It has been agreed that further flexibility will be considered in terms of sourcing of inputs (for inputs imported from third country). However, it needs to be appreciated that a quota does not give a guaranteed market access and Bangladesh's goods have to be competitive in the Indian market (albeit with the added advantage of zero-tariff treatment) if the quota is to be fulfilled.

It is of importance for Bangladesh to note that even when items are in the negative list of partner countries, SAPTA concessions provided earlier on those items will hold. Jute has been kept out of the sensitive list of India and Pakistan and the concessions provided by Pakistan to Bangladesh in terms of zero-tariff for jute and tea (up to 10 thousand tons per year) will continue.

As was mentioned, the negative lists are to be reviewed every four years. Much will depend on how member states perceive the results of SAFTA. If there is a common perception as regards benefits, subsequent reviews could scale down the size of the negative lists substantively.

The RoO which have been agreed under the SAFTA are rather stringent – a blend of value addition, at 40.0 per cent, and CTH, with a derogation for LDCs in the form of lower value addition requirement (30.0 per cent) and product-specific derogation from CTH requirement.[25] The SAPTA regional cumulation rule stipulates a 50.0 per cent regional value addition, inclusive of at least 20.0 per cent domestic value addition. This would mean that LDCs such as Bangladesh will need to comply with either the national RoO or the regional cumulation rules if they are to get preferential treatment for items outside of the negative list.

[24] A TRQ provides for multiple tariff rates for an item imported to the country. Beyond this ceiling, additional items will enter the Indian market at MFN tariff (or lower if eligible earlier under SAPTA treatment).

[25] The derogation will be in the form of CTSH for items for which LDCs find it difficult to comply with the RoO in the form of CTH. LDCs are to submit a list of such items to their trading partners.

With respect to the RLCM, it appears that as far as Bangladesh's interests are concerned not much benefit will accrue from the formula that was agreed in Kathmandu. The formula does not allow for compensation for revenue losses arising out of trade diversion. India has agreed to compensate Maldives on actual loss basis; however, for other LDCs there is a cap of 1 per cent of revenue income as compensation for revenue loss. A number of issues still need to be clarified and it was agreed that a SAFTA Ministerial Council will be set up to oversee implementation of the Agreement.

According to the agreement, NTBs were also to be eliminated on an urgent basis. In this context, it is important to distinguish "real" and "perceived" NTBs and get on with addressing the attendant issues. It is well recognised that there is a need for adequate investments in the area of standardisation and certification, compliance with Sanitary and Phytosanitary Measures (SPS), laboratory testing, etc. to ensure conformity with importing country requirements. It is to be recalled here that Bangladesh also has a list of 142 products for which there are mandatory standards requirement. However, these have not been incorporated in the import policy. India has a list of 159 items (many of these include food items) import of which are subject to compliance with mandatory Indian quality standards that are also applicable to domestic goods.

As was stated earlier, the SAFTA Framework Agreement stipulated that the developing countries would provide technical assistance to the LDCs. LDCs had earlier identified ten areas for such support including capacity building in trade matters. A number of these relate to capacity building in the areas of laboratory testing, certification, SPS-TBT compliance and standards. Strengthening of capacities in these areas would remove concerns about many of the "perceived-NTBs." SAARC will need to give attention to framework agreements concerning mutual recognition of certifications and standards, bilaterally or within the ambit of regional agreements. However, in the absence of a dedicated fund created exclusively for these types of capacity building, such provisions may end up being empty intentions.

6.5.2 SAFTA Agreement in the Context of Other RTAs and BFTAs

As was pointed out in Section 6.2, South Asian countries are at present members of a number of RTAs. Some of the RTAs are more aggressive.[26] The BFTAs by definition go for deeper cooperation and it is relatively easier to go for further deepening and inclusion of other areas for cooperation in the context of a BFTA. The tariff liberalisation plan is also implemented in an accelerated pace in a BFTA. For example, the negative lists in the Indo-Sri Lanka BFTA is of much smaller size.[27] BFTAs could be fashioned in such a manner that it is geared towards stimulating bilateral investment flows that could reduce trade deficit.[28] The example of Indian investment in Sri Lanka, geared towards

26 For example, BIMSTEC Agreement includes provisions for services cooperation along with cooperation in terms of trade in goods.

27 Under the agreement, India and Sri Lanka agreed to offer zero-tariff concession on 1351 and 319 products respectively. India submitted a negative list of 429 products (24.0 per cent of the total number of products Sri Lanka exported to India at the time); Sri Lanka's negative list comprised of 1,183 items (about 50.0 per cent of the total number of products India exported to Sri Lanka at the time).

28 The ratio of bilateral exports by India and Sri Lanka has been reduced from 15:1 to 6:1 since the establishment of Indo-Lanka BFTA in 2000.

the Indian market, could be cited in this connection. Where does the SAFTA Agreement situate itself in this plethora of RTAs of various kinds and shades with participation of SAARC countries?

It goes without saying that an emphasis on BFTAs may lead to lack of focus on SAFTA. Since an RTA such as SAFTA, with participation of several countries, reflects the "lowest common denominator approach," cooperation in the context of any BFTA would naturally be more deeper (otherwise countries would not go for BFTAs and would be satisfied with SAFTA). BIMSTEC-FTA Agreement could also shift the focus from SAFTA.

However, the contradictions between SAFTA and other RTAs and BFTAs should not be overplayed. These could be rather mutually reinforcing. At one point of time, all BFTA provisions could be multilateralised in an RTA through gradual and incremental expansion of the SAFTA provisions. This may become necessary particularly also because implementation of the RoO could become extremely complex and time-consuming.[29] Furthermore, SAFTA would provide access to a larger market compared to any BFTA in South Asia.

In this context, the proposal of a BFTA between India and Bangladesh should be carefully examined.[30] However, for Bangladesh this type of BFTA will only be rewarding if it does not include a Sensitive List (barring perhaps a mutually agreed few items), immediate zero-tariff access for all goods, and rules of origin that suits Bangladesh's production capacities. However, since SAFTA provides for a two-track approach (a differentiated treatment for LDC products), and since India already has a virtual free trade with Bhutan and Nepal (Maldives is a small player), it should be possible to extend such market access even under SAFTA through subsequent revisions of the TLP.

6.5.3 SAFTA Agreement and Implications of Preference Erosion

It is to be kept in mind that all SAARC countries which had undertaken substantial tariff reforms in the 1990s are continuing to reduce their MFN tariffs, either unilaterally, or as part of WTO commitment. Although LDCs are not required to undertake tariff reduction commitments under the WTO, they are reforming their tariff regimes as part of their respective reform programmes, often as part of donor conditionalities. However, of more importance is the reduction commitment by India, Pakistan and Sri Lanka as part of the ongoing WTO negotiations on Agriculture and NAMA.[31] India's industrial tariff rates, brought down from around 35.0-40.0 per cent a decade back to the present level of 15.0 per cent, are set to come down still further in the coming years. Accordingly, the preference margin from zero-tariff access (actually beyond the 0.0-5.0 per cent range) is expected to suffer gradual erosion in the coming years. On the other hand, it is also true that tariffs on items in the negative list, for which there is no preferential treatment, are also set to come down and to that extent it will facilitate market access for sensitive items as well.

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29 This is what Bhagwati had termed the *Spaghetti bowl* as regards RoO.

30 A proposal for an Indo-Bangladesh BFTA has already been put on the table by India. Bangladesh has already agreed to have a BFTA with Pakistan.

31 It is becoming increasingly clear that under the Non-Agricultural Market Access (NAMA) negotiations of the WTO industrial tariff in the developing countries will come down by applying one of the variants of the Swiss coefficient.

6.5.4 Realising the Potential Opportunities

From Bangladesh's perspective, the extent of benefits that the country could draw from RTAs such as the SAFTA will depend crucially on its capacity to (a) promote export diversification, (b) enhance productivity, and (c) strengthen export competitiveness. It is to be recalled that though SAFTA is primarily focused on trade issues, there are provisions in the SAFTA Framework Agreement which could contribute to this. Article 8 stipulates other complementary initiatives which could strengthen trade cooperation among the SAARC countries. These include: (a) harmonisation of standards, reciprocal recognition of tests and accreditation of testing laboratories of Contracting States and certification of products; (b) simplification and harmonisation of customs clearance procedure; (c) harmonisation of national customs classification based on HS coding system; (d) customs cooperation to resolve dispute at customs entry points; (e) simplification and harmonisation of import licensing and registration procedures; (f) simplification of banking procedures for import financing; (g) transit facilities for efficient intra-SAARC trade, especially for the land-locked contracting states; (h) removal of barriers to intra-SAARC investments; (i) macroeconomic consultations; (j) rules for fair competition and the promotion of venture capital; (k) development of communication systems and transport infrastructure; (l) making exceptions to their foreign exchange restrictions, if any, relating to payments for products under the SAFTA scheme, as well as repatriation of such payments without prejudice to their rights under Article XVIII of the General Agreement on Tariffs and Trade (GATT) and the relevant provisions of Articles of Treaty of the International Monetary Fund (IMF); and (m) simplification of procedures for business visas.

It is to be borne in mind that Article 8 is only a best endeavour Article. Much will depend on the willingness of the partner countries to implement the provisions of the Framework Agreement in letter and spirit. Cooperation in these areas could also address many perceived NTBs that constrain intra-regional trade in the region. Implementation would require signing of various agreements, MOUs and protocols. Some of these could include a framework agreement on mutual recognition of certification, laboratory testing and standards, a motor vehicle agreement, customs cooperation and harmonisation agreement and transit-transport cooperation agreement. Measures to promote trade facilitation will be a major requirement. There is also a need for upgradation of customs facilities, visa procedures, port facilities. As was noted, ability to attract intra-regional and extra-regional investment will be a key factor in realising the potentials of preferential market access. Concrete initiatives towards trade facilitation and putting in place trade related infrastructure will have a crucial role to play in all these.

Bangladesh's trade opportunities with north-east states of India are considered to be quite high. Studies carried out for the South Asia Growth Quadrangle (SAGQ)[32] and the *Kunming Initiative*[33] have identified a large number of areas where there could be important synergies emerging from cooperation among the subregional countries. However, this is constrained by several impediments. A recent study (Rashid and Abbas,

[32] SAGQ included the 7 NE Indian States, Bangladesh, Nepal and Bhutan. However, although the idea of the SAGQ was mooted in 1997 it has not resulted into much.

[33] The Kunming Initiative included Bangladesh, South China province of Yunan, 7 NE Indian States, and Myanmar (alternatively known as BCIM countries).

2004) identified several such impediments that handicap Bangladesh's trade with North East (NE) Indian States. From Indian side these were perceived to be related to: (a) delays in receiving reimbursement from Bangladeshi banks; (b) high transaction costs; (c) poor communication; and (d) high margin of collateral requirements on imports to NEI. From Bangladesh side these were: (a) absence of control mechanism for import of goods; (b) problems with mail L/Cs; (c) poor communication and inquiry related delays on account of Indian banks; and (d) delay in the routing system from State Bank of India to the local branches in NEI. If the opportunities of closer trade and economic cooperation between the north-east Indian states and Bangladesh are to be realised, these constraining factors will need to be addressed in a coherent manner and on an urgent basis.

6.5.5 Identifying Products for Export to the Region

Realising the potential benefits from SAFTA will depend, to a large extent, on identifying niche markets in partner countries. The CPD has recently carried out an exercise to identify items for which Bangladesh was likely to have export interest in the SAARC market. The exercise was carried out in two stages: products belonging to the first category included items that were exported to the world by Bangladesh, but not to the SAARC countries; the second category included those items that were imported by the SAARC countries from the world, but not from Bangladesh (this exercise was carried out at 6-digit disaggregated level); at the third stage these categories were matched to identify a set of products which Bangladesh exported to non-SAARC countries and SAARC countries imported from non-Bangladesh sources. A matching of this category of products with the sensitive lists of partner countries reveals that a large number of these are included in the free list i.e. tariffs on these particular products will be gradually brought down to zero (0.0-5.0 per cent) under the TLP.

TABLE 6.15

Category 1: Bangladesh Export to World but not to SAARC Countries, and SAARC Countries' Import from the World but not from Bangladesh: Top Ten Chapters Based on SAARC's Import from World (Demand Side)

(in million US$)

		Export to World	Import From World				
HS Code	Commodity Description	Bangladesh	SAARC	India	Sri Lanka	Pakistan	Nepal
HS-85	Electrical, electronic equipment	0.9	2015.5	1927.5	38.0	35.7	8.2
HS-39	Plastics and articles thereof	0.8	397.5	77.6	69.7	215.6	31.6
HS-72	Iron and steel	5.2	256.4	53.5	11.4	149.6	41.5
HS-51	Wool, animal hair, horsehair yarn and fabric thereof	9.7	212.7	179.8	2.0	11.4	19.5
HS-07	Edible vegetables and certain roots and tubers	2.5	186.5	162.6	5.6	9.2	5.1
HS-48	Paper & paperboard, articles of pulp, paper and board	1.0	83.5	27.9	23.4	27.3	3.7
Total of Top 10 Chapters		30.3	3879.3	2972.8	192.9	572.3	116.8
Total of 78 Chapters		777.2	4996.7	3434.6	401.6	851.6	240.3

Source: Estimated from United Nations Statistics Division Data (2004).

TABLE 6.16

Category 4: Bangladesh Export to World but not to SAARC Countries and SAARC Countries' Import from World: Top 20 Six Digit HS Code Excluding 61, 62 Chapters Based on Bangladesh's Export to World (Supply Side)

(thousand US$)

		Export to World	Import From World				
HS Code	Commodity Description	Bangladesh	SAARC	India	Sri Lanka	Pakistan	Nepal
510119	Greasy wool (other than shorn) not carded or combed	3870.4	99652.0	75583.8	40.5	5165.2	18862.4
490600	Plans and drawings for architectural etc use	3472.4	24232.7	23649.0	21.5	554.9	6.7
640610	Footwear uppers and parts thereof, except stiffeners	3261.0	2582.9	1239.5	300.0	838.3	204.8
030310	Salmon, Pacific, frozen, whole	2891.4	600.2	0.8	520.7	0.3	
510129	Degreased wool ness, not carded, combed or carbonised	2665.4	88162.0	84164.1	26.9	3971.1	
270111	Anthracite, not agglomerated	2318.2	1729.7	1380.9	105.1	131.9	111.9
510111	Greasy shorn wool, not carded or combed	2084.4	19611.9	18815.3		434.0	362.6
Top Twenty 6 digit HS items		20563.2	236571.5	204833.4	1014.8	11095.7	19548.4
Total 6 digit HS items excluding Chapter 61& 62		135565.4	4946687.3	3425972.3	384228.8	844508.9	227951.0

Source: Estimated from United Nations Statistics Division Data (2004).

TABLE 6.17

Category 5: Bangladesh Export to World but not to SAARC Countries and SAARC Countries Import from World: Top 20 Six Digit HS Code in 61, 62 Chapters Based on SAARC's Import from World (Demand Side)

(thousand US$)

		Export to World	Import From World			
HS Code	Commodity Description	Bangladesh	SAARC	India	Sri Lanka	Pakistan
620891	Women's, girls wear, bathrobes etc, cotton, not knit	9749.2	3055.5		165.6	
620990	Babies garments, accessories of material ness, not knit	3461.5	2918.0	92.0	1307.3	1286.2
611190	Babies garments, accessories of material ness, knit	2783.2	2287.1		106.3	2059.6
621210	Brassieres and parts there of	4557.9	2210.1	583.2	477.5	325.7
621132	Men's, boys garments ness, of cotton, not knit	1149.0	1955.4	0.4		0.2
620311	Men's, boys suits, of wool or hair, not knit	9984.4	1285.6	1230.4	1.6	32.5
620910	Babies garments, accessories of wool or hair, not knit	3068.4	645.3	1.2	10.9	633.1
Total Twenty 6 digit HS Code		34753.6	14357.0	1907.3	2069.1	4337.2
Total 6 digit HS Code in Chapter 61& 62		641630.1	49989.6	8683.0	17414.1	7074.7

Source: Estimated from United Nations Statistics Division Data (2004).

It could be argued that in the context of a zero-tariff market access these items would enjoy comparative advantage within the region. Table 6.15 provides an idea about these items (at 6-digit level). As is seen, these include both apparel items and accessories, as also textiles, footwear and food items. Table 6.16 provides a list of some of the non-apparel items at disaggregated level.[34] Table 6.17 provides similar disaggregated level information for some of the apparels items belonging to the matched category mentioned above.

It should be stated upfront that not all products identified through the above exercise will necessarily have the capacity to penetrate the regional market. Much will depend on competitive strength of those particular items in the markets of regional countries. However, the exercise evinces that Bangladesh does have supply-side and export capabilities in many items that could potentially be exported to the region by making use of the preferential treatment under the SAFTA. Accordingly, entrepreneurs and investors may be advised to explore and exploit such opportunities.

6.5.6 Technical Assistance and Capacity Building for Exports

The SAFTA Framework Agreement calls upon the developing country members to provide technical assistance to the LDCs. LDC members were required to identify areas where they would need technical assistance. The consolidated list submitted by the LDCs includes several areas. These are:

- Capacity building for mutual recognition of technical regulations, standards and product certification.
- Strengthening capacities of testing laboratories (for agro-processed products, pharmaceutical products, etc.)
- Support for product specific R&D, particularly in the area of fashion and design, finishing and packaging.
- Support in identifying export niche for products from the LDCs.
- Support for identification of areas to stimulate intra-SAARC FDI flow to the LDCs including opportunities for guaranteed buy-back arrangements and government procurement.
- Support for product development and market promotion of export-oriented sectors including leather and footwear, jute goods and diversified jute products, jems and jewellery, ICT, light engineering, agriculture and agro-based industries and fisheries and livestock.
- Support for training and upgradation of skills in textiles, RMG and other export sectors.
- Support for development of trade related institutions.
- Human resource development in trade related areas.

It goes without saying that in order to take advantage of market access under the SAFTA, Bangladesh will need to diversify its export base, strengthen trade facilitation and enhance standardisation, laboratory testing and certification capacities. TAs for trade related capacity building could thus prove to be important. Any TRTA will also have positive implications for export to non-SAARC countries. However, it is not clear to what extent the sought for support will be financed particularly since no dedicated fund

[34] These items do not include chapters 61 and 62 which include knit and non-knit items respectively.

has been set up for this purpose. The specific provision relating to this in the Framework Agreement appears to be at best a *best endeavour* clause.

Here the proposed $300 million SAARC Development Fund (SDF) could also play an important role in terms of providing Trade Related Technical Assistance (TRTA) to the LDCs.[35] In their meeting in February 2006 SAARC financial experts have put forward a number of suggestions as regards modalities and operational aspects of the proposed SDF. The SDF will have three components: (a) social; (b) economic; and (c) infrastructure.[36] Experts stressed the need for early operationalisation of the 300 million *social window,* and implementation of poverty alleviation and social development projects. Besides, the SDF is also expected to provide support to regional projects in such areas as education, health and HRD and also extend support to vulnerable sections of the society, and address the funding needs of committees and micro-enterprises. Much will depend on whether member countries are ready to contribute sufficient resources towards the SDF.

6.6 CONCLUDING REMARKS

The analysis presented in this paper bears out that it will be unrealistic to expect that there will be substantial change in terms of intra-regional trade if the SAFTA accord is only limited to implementation of trade liberalisation plan. "Regionalisation" of trade has not occurred in South Asia and the possibilities of significant rise in intra-regional trade appear to be slim. SAFTA will have to set the tone for "regionalism" which, as was pointed out, refers to a conscious effort to expand economic cooperation among SAARC countries through a set of planned initiatives.

It was noted in the paper that the pace of tariff liberalisation under SAFTA is rather slow; the negative lists are also quite long. Hopefully, in future, with periodic reviews the lists will be gradually reduced and the pace of the tariff reduction could also be fast-paced.[37] As was mentioned in the paper, with the tariff reforms taking place in all SAARC countries in recent years, operative tariffs are already low. Thus, reduction to zero-tariff (in reality 0-5 per cent) will, in many instances, mean average tariff reduction of low significance. Nonetheless, it is to be appreciated that the present state of affairs as regards economic cooperation in SAARC has been mainly due to a lack of coherent efforts on the part of the regional countries to take the required initiatives that could foster closer economic cooperation.

By any account, the litmus test of the effectiveness of the SAFTA will be in its ability to ensure greater volume of intra-regional trade and, to a certain extent, reduced trade deficits between partner countries through concerted and comprehensive efforts. This can only be possible if the move towards an FTA is complemented by initiatives to promote cooperation in the area of investment, removal of all types of NTBs, trade and customs facilitation, and cooperation in the area of trade related capacity building. The building blocs for these complementary steps are present in the Framework Agreement,

[35] The thirteenth SAARC summit has decided to set up a SAARC Development Fund (SDF) worth 300 million dollars (including the $100 million committed earlier by India for a poverty alleviation window).

[36] These recommendations were scheduled to be considered by the SAARC Finance Ministers in their meeting in March 2006.

[37] In ASEAN there was a stipulation that negative lists would be reduced by certain percentages each year.

albeit only in the form of *best endeavour* clauses. As was pointed out earlier, the Framework Agreement looks at cooperation in these areas as important parallel initiatives along with the FTA Agreement. If there is no forward movement in these areas, the potentials of the FTA will remain largely unrealised. Agreements signed at the thirteenth Summit in the areas of customs cooperation, arbitration and avoidance of double taxation are important initiatives in this context. However, it will be pertinent to recall here that the Investment Protection and Promotion Agreement, which was scheduled to be signed at the time of the Dhaka Summit, had to be deferred.

There is now an urgent need for putting in motion complementary initiatives which would create trade opportunities by taking advantage of the SAFTA. Without building appropriate supply-side capacities, given the current export structure, it will be very difficult for South Asian LDCs such as Bangladesh to take advantage of the potential market openings under the SAFTA. The win-win scenario, which member countries are hoping for, will largely hinge on the next steps that SAARC countries will take in the near future, both individually and collectively.

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Chapter 7

SOUTH ASIAN FINANCIAL COOPERATION: LONG WAY TO GO

7.1 BACKGROUND

The economic cooperation among the South Asian countries is a dream yet to be realised. Recent progress in establishment of South Asian free trade zone through signing and ratification of South Asian Free Trade Agreement (SAFTA) raises the barometer of hopes among the policymakers and common citizens in the member countries. This is a good context to think about financial cooperation among the SAARC countries and beyond. Although there is little research on financial cooperation in the region, the issues of regional monetary cooperation and common currency are in discussion for quite some time (Mundell, 1961; McKinnon, 1963; Bhowmik, 1998; Jayasurya et al., 2003; Maskay, 2003, 2001; and Saxena, 2002) among the researchers.

At present the focus of regional cooperation is on trade liberalisation alone–ignoring the basic wisdom that trade expansion in the regional context can occur only when there is an enabling environment provided by a conducive investment climate and an environment of monetary and financial cooperation. The text of SAFTA includes some elements, which are related to financial cooperation among the member states at a very superficial level. In Article 8 of the agreement, member countries agree to simplify banking procedures for import financing and remove barriers on intra-SAARC investments. The agreement text allows member states to apply exemption of Article XVIII of General Agreement on Trade and Tariffs (GATT) and relevant provisions of articles of treaty of International Monetary Fund (IMF) related to foreign exchange restrictions for payments under SAFTA trade. However, the Article 15, which is related to Balance of Payment (BOP) measures, inhibits application of measures, which may address BOP crisis in any member states through financial and monetary cooperation. Article 15 allows a member state to suspend implementation of free trade for a certain period due to BOP mismatches. The SAFTA text hints that financial cooperation is not an issue, which is among immediate agenda of economic cooperation of the member states. Considering the importance of the issue, there is a need for deep investigation of various dimensions of financial cooperation, which may be pursued in the future for achieving closer integration of economies in South Asia.

The paper focuses on importance of financial cooperation among the South Asian nations and proposes a road map for it. Section 7.2 of the paper deals with the concept of regional financial cooperation, which ranges from simple banking arrangements between two or more countries to monetary union. The rationale of financial cooperation is discussed in the Section 7.3. There are some prerequisite for establishment of financial cooperation, which are presented in Section 7.4. Section 7.5 presents global experiences of financial cooperation. Essential elements of financial cooperation are discussed in Section 7.6, where mitigation of financial crisis centres the discussion. Section 7.7 deals with the state of readiness of South Asian countries for initiating financial cooperation among them. A road map of financial cooperation is presented in Section 7.8, where an attempt has been made to draw an institutional framework for such cooperation.

7.2 THE CONCEPT

Financial cooperation is a concept which ranges from simple banking arrangement between to countries for facilitating trade and investment to currency swapping arrangement for prevention of banking or financial crisis, and, up to monetary integration through formation of monetary union. Monetary union is essentially a collection of nations in which exchange rates are permanently fixed and a single monetary authority conducts a common monetary policy for the countries of the union. In economics, a monetary union is a relationship where several countries have agreed to share a common currency among them. The East Caribbean Dollar is a manifestation of arrangement by a monetary union. A monetary union differs from an economic union, where it is not just currency but also economic policy that is pooled or coordinated (as in the European Union Eurozone, for instance).

7.3 RATIONALE FOR FINANCIAL COOPERATION

7.3.1 Reduction of Transaction Cost

If the potential members of a union trade a lot with each other, monetary union would reduce transaction costs among the economies. Both buyers and sellers are hedged against the foreign exchange risk, which may go in favour of one of the partners. As the arbitration cost is absent due to presence of a common currency, the ultimate beneficiary is the consumer of the monetary union.

7.3.2 Addressing Financial Crisis

Lessons learnt from the 1997-1998 Asian financial crisis and its devastating economic aftermath show that individual countries' foreign reserves alone could not deal with the abrupt and sudden consequence of large and volatile short-term international capital reversals. An understanding among the South Asian countries central banks can come on rescue quicker than any support from the international financial institutions. The total foreign exchange reserve of South Asian countries increased significantly during the last five years thanks to the reserve boom in India and Pakistan. Thus, a pool of foreign exchange reserve can significantly reduce volatility in the currency market in South Asia.

7.3.3 Boosting up Intra-regional Trade

The greatest benefit of financial cooperation through a common currency can be experienced through intra-regional trade. The countries sharing same currency trade three times greater among them than what they would have with different currencies (Rose, 1999). Glick and Rose (2001) show, under ceteris paribus, bilateral trade rises (falls) by about hundred per cent as a pair of countries form (dissolve) a currency union. Frankel and Rose (2000), by using economic and geographic data, show that trade triples for each of the members belonging to a currency union.

7.4 PREREQUISITES FOR FINANCIAL COOPERATION

Theoretically any region that has high intra-regional trade, fiscal transfers, high labour and capital mobility, and that experience the same economic shocks should have a common currency (Mundell, 1961; McKinnon, 1963).

7.4.1 Similar Level of Economic Development

A similar level of economic development is a prerequisite for deeper financial cooperation. In terms of level of economic development apparently there are two groups of countries among the South Asian nations: 3 developing countries and 4 least developed countries. The level of economic development in these countries is not the same, but the difference is not too wide. South Asia is the host of more than 50 per cent of poor population of the world. Given the growth trend in recent years, it is obvious that India will go far ahead of other South Asian nations. Such rising difference in economic development may create reluctance among the policymakers of India to deal sophisticatedly the issue of regional cooperation including financial cooperation.

7.4.2 Sound Macroeconomic Indicators

Solid macroeconomic policies and performances are required for deep financial cooperation leading towards monetary union. Low inflation, low current account deficits, similar GDP growth, trade and production structure are few of macroeconomic indicators which are essential for the first step towards closer financial cooperation. Annex Table 7.1 shows that major economic indicators are sound for most of the countries in South Asia. Inflation rate and foreign exchange reserve are two parameters where countries like Bangladesh, Maldives and Sri Lanka will have to work. The surplus in foreign exchange reserve in India and Pakistan creates though a ground for cooperation, particularly in mitigating currency crisis.

7.4.3 Extent of Trade

High intra-members trade is a prerequisite for deeper financial cooperation like currency union. The current trade volume among South Asian neighbours is not very high (Table 7.1). In 2001 intra-SAARC trade volume was only 4.0 per cent of total trade of the SAARC nations. India is the biggest trading partner among the SAARC countries.

TABLE 7.1

Intra-SAARC Trade, 2001

(in million US$)

Reporting Country	Partner Country									Share (%) of SAARC Countries in World Exports
	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	Total (SAARC)	World	
Bangladesh	–	1.3	59.7	0.0	0.9	32.5	3.3	97.9	5681.7	1.7
Bhutan*	n.a.	–	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
India	1013.1	7.7	–	27.1	216.7	145.6	637.7	2048.0	44306.5	4.6
Maldives	0.0	0.0	0.3	–	0.0	0.0	14.8	15.1	76.6	19.7
Nepal*	n.a.	n.a.	n.a.	n.a.	–	n.a.	n.a.	n.a.	n.a.	n.a.
Pakistan	118.7	0.2	54.5	1.7	2.3	–	74.6	252.1	9246.5	2.7
Sri Lanka	10.0	0.0	71.9	50.3	0.3	24.8	–	157.5	4672.0	3.4
Total								2570.7	63983.3	4.0

Note: *Data not available.

Source: Rahman (2004).

Only Maldives and Nepal trade a lot within the SAARC region. The high trade figures for Nepal are due to a nearly free trade treaty between India and Nepal since 1996. India has started exporting a lot more to the SAARC nations in the 1990s, while Bangladesh and Sri Lanka have started importing a lot more. A meaningful implementation of SAFTA can change the scenario and move the odd. India is not yet open to its neighbours – being the largest trading partner in the region the lack of openness is a barrier to closer financial cooperation.

One can argue that the low intra-regional trade does not reflect the true picture, as the actual trade that takes place among these countries is high due to high illegal trade. For example, the magnitude of formal and informal trade between Bangladesh and India is roughly the same, while informal trade forms almost a third of the value of formal trade between India and Sri Lanka (Taneja, 2001, 2002). The low intra-regional trade is a supportive argument for enhanced cooperation in the area of financial cooperation. However, it is assumed that implementation of SAFTA will boost trade among the member countries.

It is also argued that the low volume of trade is caused by trade and non-trade barriers which include poor financial linkage among the banking institutions of the member countries.

Intra-regional Investment

South Asia's intra-regional Foreign Direct Investment (FDI) in most countries is less than 5 per cent of the total FDI flow, while intra-regional flow of FDI in South East Asia is much higher. Among South Asian countries, India is the major investor within the region but at a very small amount, especially compared to its outsourcing in other regions. India's FDI outflow in 1996-97 was on average US$96.0 million, which in 2003 increased up to US$913.0 million (World Investment Report, 2003). In 2003, India's investment in Sri Lanka, Nepal and Bangladesh was only 0.7 per cent, 0.5 per cent and

0.1 per cent respectively of its total outward investment. Interestingly, during 1996-2003, India's average investment in USA was 19.0 per cent, and in Russia 18.0 per cent, and it is becoming an important investor for UK and France. However, outward flow of FDI from other South Asian countries is either low or not directed to the region. It is perceived from the recent development of trade and investment agreements that South Asia's importance as a strategic location for investment will gradually increase, especially when SAFTA will start to operate (Moazzem 2006).

In 2004, India, Pakistan and Sri Lanka have invested about US$ 4.7 million, which was only 1.6 per cent of the total investment in Bangladesh. In July-June of 2003-04, India has formally submitted investment proposal worth of US$10.14 million for agro based (copara oil), service (cargo service, computer software), engineering (railway track fitting), chemical (ball point pen), and food and allied (bakery) sectors. Pakistan has formally submitted proposal worth of US$0.4 million for services (test tube baby, kits and cylinder fixation in vehicles, telecom, computer software), while Sri Lanka has proposed to invest an amount of US$0.1 million in engineering products (steel products). It is evident that South Asian investment in Bangladesh has mainly targeted the country's growing market, while there is not much of investment noticeable in the export-oriented sectors. It is expected that Tata's investment in Bangladesh would induce other big investors of the region to invest and there are some signals in that direction as evidenced in registering new investment proposals with Bangladesh.

7.4.4 Nature of Economic Shocks

If the countries experience similar shocks, the cost of giving up monetary policy independence would decrease. The routes of economic shocks may be diversified (see Annex Table 7.2). It is not clear whether the nature of economic shocks for the South Asian countries would be similar like countries of ASEAN. Such analysis would be important as the discussion on financial cooperation gathers momentum.

7.5 GLOBAL EXPERIENCE

The European Union (EU) countries evolved from a single market into a single currency (the euro) union in January 2002. North American countries have formed North American Free Trade Area (NAFTA) and are moving ahead with plans for a larger Free Trade Area of Americas (FTAA). In Asia, Association of South East Asian Nations (ASEAN) is emerging as an important regional grouping with implementation of ASEAN Free Trade Area (AFTA). In fact, the members of ASEAN have now set before themselves a goal of creating an ASEAN Economic Community in the coming decades (Saxena and Baig, 2004).

7.5.1 Chiang-Mai Initiative

Following the Asian Crisis of 1997 the ASEAN countries attempted to form even an Asian Monetary Fund, which did not take off due to the opposition by the United States and the IMF. The crisis led to the launch of a regional initiative, namely the Chiang-Mai Initiative (CMI) involving creation of a network of bilateral swaps among the ASEAN and other three countries as a way to ensuring exchange rate stability. In addition to expanding the existing ASEAN Swap Arrangement (ASA), the CMI is designed to create a new network of bilateral swap and repurchase arrangements among Japan, China and

South Korea as well as between each of these and any one of the ASEAN countries. By the end of March 2003, twelve Bilateral Swap Arrangements (BSAs) had been concluded in line with the main principles, reaching a total of US$39.0 billion. Twenty Seven negotiations for two BSAs are under way.

7.5.2 ASEAN Swap Arrangement

The enhanced mechanism was possible to build on the previous swap arrangement among the member countries. In August 1977 the original five ASEAN central banks and monetary authorities – Indonesia, Malaysia, the Philippines, Singapore, and Thailand – signed the first memorandum of understanding on the ASA. The total facility was US$100.0 million, with each member contributing US$20.0 million. In 1978, the total was increased to US$200.0 million, with each member contributing US$40.0 million. The objective was to provide immediate, short-term swap facilities to any member facing a temporary liquidity shortage or a balance of payments problem.

7.6 ELEMENTS OF FINANCIAL COOPERATION

7.6.1 Crisis Prevention

Financial crisis prevention is the driving motive for financial cooperation. A number of instruments are in use for prevention of financial crisis and its contagion. Among the instruments, regional information sharing, policy dialogue, consultation, surveillance and monitoring are instrumental to crisis prevention at the regional level.

The process of crisis prevention include sharing of information on both macroeconomic and structural issues, such as monetary and exchange rate policies (including domestic and foreign assets and liabilities of the central banks), fiscal positions and debt management, capital flows and external debts, financial system conditions, and corporate sector developments.

Monitoring capital flows at the regional level is particularly important. Developing a reliable early warning system is useful in detecting macroeconomic, external and financial sector vulnerabilities and preventing currency and financial crises in the future.

With effective surveillance mechanisms in place, each economy in the region is expected to be under peer pressure to pursue disciplined macroeconomic and structural policies that are conducive to stable external accounts and currencies.

The consultation process may include efforts toward intra-regional exchange rate stability for economies that are highly integrated with, or complementary to, one another through trade and FDI.

Avoiding competitive currency depreciation and mutually incoherent exchange rate policies is essential to preserving financial stability for mutually interdependent economies. These economies may wish to support an informal arrangement for stable exchange rates, introduce a formal mechanism for intra-regional exchange rate stability, or form a regional currency union (Haruhiko and Masahiro, 2003).

7.6.2 Crisis Management

Once an economy is hit by a currency crisis, appropriate policy responses and timely provision of international liquidity are needed to prevent the economy from slipping into a serious economic contraction of systemic proportions. The pace of liquidity disbursement at the global level may be slow in times of crisis or contagion because of cumbersome bureaucratic processes and disagreements over policy conditionality. To avoid long delays and to augment globally available resources, a regional financing facility can help close the gap. This need is particularly apparent today because the IMF appears to be moving away from large-package operations to smaller packages with Private Sector Involvement (PSI) (Kenen, 2001).

A financing facility that can rapidly mobilise a large amount of liquidity to head off a speculative attack is an obvious benefit if the attack is the result of irrational herd behaviour. For such a financing facility to be effective, its provision must be accompanied by appropriate policy measures to address the problem and restore investor confidence in the market.

7.6.3 Crisis Resolution

To resolve a crisis, international efforts are needed to ensure that a crisis-affected economy returns to a sustainable growth path. In the face of a systemic crisis in the banking, corporate and social sectors, fiscal resource mobilisation is essential for the quick resolution of the crisis. Fiscal resources that are needed to recapitalise weak banks, facilitate corporate debt restructuring and strengthen social safety nets may be limited by the lack of fiscal headroom or constraints to external financing on market terms. Because the resources from the multilateral development banks are also limited, regionally concerted action to mobilise such resources, particularly from the core countries like India, should contribute greatly to crisis resolution.

7.7 ARE SOUTH ASIAN COUNTRIES READY?

A set of challenges is prominent for any financial cooperation in the South Asia region. The most serious challenge reflects the fact that the regional economies are diverse in terms of stage of economic development, sound macroeconomic indicators, diversity in production and trade, institutional capacity, and economic systems and structures. Such diversity creates obvious difficulties for any attempt to agree on coordinated policies. In order for the economies to take joint action at the regional level, there must be a substantial economic convergence.

The second challenge is how to create conditions for political leadership to emerge. Currently there is no strong political leadership in the region due to differences in political systems and the lack of full mutual trust. In South Asia rivalry between India and Pakistan is a major impediment to deeper cooperation.

The third challenge is how to go beyond the so-called "consensus" culture. Cooperation in South Asia has been characterised by consensus decision-making and a presumption of non-intervention in domestic affairs. The emphasis on consensus, non-interference and good manners has nurtured a shallow form of regional financial cooperation so far. For much deeper policy cooperation, the economies in the region must be ready to accept constructive comments and criticisms on their policymaking and, hence, a certain degree of friendly intrusion from their peers.

The fourth challenge is how to create sufficient incentives for regional financial cooperation given that the region is economically open to the rest of the world. While intra-regional trade and investment interdependence are rising, South Asia is not self-contained in terms of trade and financial flows. The region needs North America and Europe as destinations for its export products. The region also allocates a substantial amount of financial wealth in US dollar denominated assets. Essentially, the challenge is how to make South Asian regionalism attractive when it is embedded in the larger global system.

The difficulties underlying these challenges may prevent the economies in South Asia from pursuing serious financial (as well as broader economic) cooperation in the future.

7.8 ROAD MAP FOR SOUTH ASIAN FINANCIAL COOPERATION

The proposed South Asian Economic Union is seen as a logical culmination of the South Asian Free Trade Area and a South Asian Customs Union, which are envisaged over a specific and fiscal policy among member countries. The union is envisaged to play a role of greater policy coordination in exchange rates, interest rates and inflation (Sobhan, 2005). Such macroeconomic policy coordination, if practiced perfectly, prepares appropriate ground for the eventual monetary union, which would include a common currency within the region. Available literature however shows that opinion is divided on whether South Asia does provide the appropriate environment for a full-fledged monetary union.

A framework for regional financial cooperation may include three areas: regional surveillance and monitoring for crisis/contagion prevention; schemes to augment international liquidity for crisis management; and programmes to assist crisis-affected countries to resolve the systemic impact of the crisis and accelerate the recovery process. Any regional framework must be consistent with the global framework in order to secure efficient responses to, and management and resolution of, future crises.

7.8.1 Regime Setting

Regime setting is a joint exercise to agree on a set of rules within which individual countries can conduct independent policymaking to pursue their own economic interests. This type of policy cooperation includes agreements on such issues as regional trade and FDI arrangements, regional exchange rate regimes, regional financing arrangements, other regional frameworks for action at the time of a crisis, and initiatives for regional bond market development.

7.8.2 Joint Exchange Rate Policy

Joint setting of exchange rate policies for intra-regional exchange rate stabilisation can prevent competitive depreciation at the regional level.

7.8.3 Regional Financing Facilities

Creation of a regional financing facility can contain regional currency attacks and contagion quickly, supplement IMF roles and resources, and economise on resources through reserve pooling at the regional level.

7.8.4 Regional Bond Market

Yet another step is an initiative for regional bond market development, which encourages the economies in the region to make concerted efforts to develop national bond markets as well as regional infrastructure, including clearance, settlements, and rating agencies.

7.8.5 Information Sharing

Another profitable approach for interdependent economies in the region would be to establish a cooperative framework that encourages frequent information sharing.

7.8.6 Regional Dialogue

Regional policy dialogue and surveillance mechanisms facilitate greater information sharing, closer monitoring of regional economic conditions and short-term capital flows, and peer pressure to develop better policies. These improve each country's understanding of its peers' economic performance, macroeconomic and structural issues, policy objectives, and policy choices.

7.8.7 Cooperative Framework

A cooperative framework enhances the economic welfare of the countries concerned because it enables each country to use more accurate information about other countries in its own policymaking. Though policy optimisation is an unrealistic option at this stage, there is scope for the South Asian economies to pursue at least two types of policy cooperation: regime setting and information sharing. These would probably be the most productive mechanisms for cooperation at present. Given the already strong economic interdependence among the region's economies, they will benefit by establishing a framework for exchange rate stabilisation and then gradually moving toward collective efforts in monetary–fiscal policy coordination based on policy exchanges.

7.8.8 Harmonising Economic Indicators

Thorough research is required before initiating any formal discussion on common currency in the region. It may take 50 years before having a currency union in place, but it should be under an integrated plan of building economic union. Some empirical studies conducted on SAARC as an Optimum Currency Area (OCA) have shown negative results which suggest that it should not pursue monetary integration immediately as that might lead to a crisis of adjustment and increase in economic costs (Maskay, 2002). It has been suggested that a slow but sure path as pursued in Europe should be followed with the initial focus being on meeting the convergence criteria on broad macroeconomic indicators.

One of the critical components of an Economic Union is harmonisation of monetary and fiscal policy among member countries which leads to greater policy coordination in exchange rates, interest rates and inflation (Sobhan, 2005). Such macroeconomic policy coordination, if practiced perfectly, prepares appropriate ground for the eventual monetary union, which would include a common currency within the region. Available literature however shows that opinion is divided on whether South Asia does provide the appropriate environment for a full-fledged monetary union.

7.8.9 Parallel Currency

There has also been a logical extension of the idea at the broader Asian level, particularly in meeting the challenges similar to the Asian financial crisis of the late 1990s. This includes creation of a parallel currency which could be used by all Asian countries that may retain their individual currencies, yet link it to the former. Under this dispensation, individual currencies could vary in relation to parallel currency within a broad band depending on the circumstances prevailing (Agarwala, 2002).

The creation of a parallel currency i.e. a regional currency used parallely with the currencies of the individual member countries. This currency would amount to a Supplementary Drawing Rights (SDR) at the regional level. It can be used as a unit of account for settling transactions under regional arrangements like payments under a clearing system, or contributions to a regional fund or programme. It can also be used for funding the creation of regional public goods in the area of transport and communication, energy, information technology, biotechnology, food security, tourism and science and technology (RIS, 2004).

7.8.10 Optimum Currency Area

For a region to be suitable for experimenting with common currency and therefore a common monetary policy, it should satisfy the OCA criteria which presuppose free mobility of labour and inflexibility of wages in the region. Some empirical studies conducted on SAARC as an OCA have shown negative results which suggest that it should not pursue monetary integration immediately as that might lead to a crisis of adjustment and increase in economic costs (Maskay, 2002).

7.8.11 Institutional Framework for Financial Cooperation

There is a need for a greater mandate to SAARCFINANCE which is an organisation of Governors of Central Banks and Secretaries of SAARC's member countries. If given a political mandate, the forum could do more than just discussing and sharing monetary and exchange rate developments in the region and come out with some action plans with regard to achieving greater harmonisation of policy and creating reserve facilities that meet the short-term requirements of member nations. It has been noted that the existing facility in the form of South Asian Development Fund (SADF) has been languishing in the absence of adequate resources and leadership (Dubey, 2005).

7.9 CONCLUSION

The discussion above shows that the readiness of South Asian nations for initiating financial cooperation is not at the level, which can be termed as adequate. However, it is expected that implementation of SAFTA and increased exchange of goods will create an environment to move forward the agenda for initiation of financial cooperation. The emphasis should be given on harmonisation of macroeconomic fundamentals and cooperation among the member states of South Asia in the area of facilitating trade related issues of financing at the initial stage. The wish for a monetary union and economic union has been uttered during the last summit of SAARC. It is clear now that since the inception of the organisation for regional cooperation that the major barrier in bringing in the South Asian nations into closer cooperation is mutual mistrust. Removal of this stumbling block largely depends on big neighbours. It is hoped that small pieces of initiatives will create environment for bigger move, including cooperation in the area of finance and investment.

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Annexure

ARTICLES IN SAFTA AGREEMENT RELEVANT TO REGIONAL FINANCIAL COOPERATION

Article 3

Objectives and Principles

d. establishing a framework for further regional cooperation to expand and enhance the mutual benefits of this Agreement.

Article 8

Additional Measures:

f. simplification of banking procedures for import financing;

h. removal of barriers to intra-SAARC investments;

l. making exceptions to their foreign exchange restrictions, if any, relating to payments for products under the SAFTA scheme, as well as repatriation of such payments without prejudice to their rights under Article XVIII of the General Agreement on Tariffs and Trade (GATT) and the relevant provisions of Articles of Treaty of the International Monetary Fund (IMF).

Article 15

Balance of Payments Measures:

1. Notwithstanding the provisions of this Agreement, any Contracting State facing serious balance of payments difficulties may suspend provisionally the concessions extended under this Agreement.
2. Any such measure taken pursuant to paragraph 1 of this Article shall be immediately notified to the committee of experts.
3. The committee of experts shall periodically review the measures taken pursuant to paragraph I of this Article.
4. Any Contracting State which takes action pursuant to paragraph 1 of this Article shall afford, upon request from any other Contracting State, adequate opportunities for consultations with a view to preserving the stability of concessions under SAFTA.
5. If no satisfactory adjustment is effected between the Contracting States concerned within 30 days of the beginning of such consultations, to be extended by another 30 days through mutual consent, the matter may be referred to the committee of experts.
6. Any such measures taken pursuant to paragraph 1 of this Article shall be phased out soon after the committee of experts comes to the conclusion that the balance of payments situation of the Contracting State concerned has improved.

ANNEX TABLE 7.1

Major Economic Indicators of SAARC Countries, 2004

Indicators	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Structure of Output (% of GDP at current factor cost)							
Agriculture	20.2	26.1	21.1	...	38.7	23.1	17.8
Industry	25.5	43.5	27.2	...	20.9	24.6	26.8
Services	54.3	32.3	51.7	...	40.4	52.3	55.4
GDP at 1993/94 market prices (billion of local currencies)	2519.7	26375.0	16726.2	9283.5	310996.0	4445.8	1081699.0
Growth of Output (annual change, %)							
GDP	6.3	8.7	6.9	10.8	3.5	6.0	5.4
Agriculture	4.1	3.1	1.1	2.6	3.9	2.6	-0.7
Industry	7.6	12.7	7.8	9.8	1.0	13.1	5.2
Services	6.5	7.9	-4.9	9.4	4.3	5.2	7.6
Savings and Investment (% of GDP at current prices)							
Gross domestic saving	19.5	46.7*	24.9*		12.5	17.9	15.9
Gross national saving	24.8	37.8*	24.3*		15.1	20.1	14.9
Gross domestic capital formation	24.0	63.1*	22.9**		27.3	18.1	25.0
At Current Market Prices, unit of local currencies							
Per capita GDP	24628.0	38886.0*	28624.0	33298.0	20022.0	36700.0	104277.0
Per capita GNP	25926.0	35428.0*	25711.0	31800.0	20545.0	37495.0	103214.0
Price Indexes (annual change, %)							
Consumer price index	5.8	1.3 f/	3.7	6.4	3.9	4.6	7.6
Food price index	6.9		2.8		4.4	7.2	7.8
Implicit GDP Deflator	4.2	3.4	5.4	-1.6	4.9	6.8	9.4
Government Finance (% of GDP)							
Overall budgetary surplus/deficit	2.1*	1.9 k/	4.5	-1.8	-1.5	-2.4	-7.7
External Trade (Mln of local currencies by respective fiscal year)							
Exports, total	7856.0		79807.0	201.6	640.5	13115.3	5989.0
Imports, total	11364.0		94828.0	622.3	1554.1	19622.0	8172.0
External Trade (annual change, %)							
Exports	22.1	7.4*	15.0*	24.5*	6.4*	11.9	17.9
Imports	14.9	29.9*	20.8*	20.2*	15.8*	25.7	26.0
Trade balance	-4.4	-72.7*	-56.3*	-18.9*	-23.1*	-178.4	-53.2
Balance of Payments (Mln US dollars; calendar year)							
Current Balance	176.0	48.9	-1596.0	-90.2	197.4	1811.0	-648.3
Overall Balance	171.0	8.2	23555.0	24.5	591.3	781.0	-205.0
Balance of Payments (% of GDP)							
Exports	13.4	22.9 k/	11.3	22.8	11.1	13.3	28.7
Imports	-17.6	-35.7 k/	-15.7	-71.9	-26.8	-14.7	-39.9
Trade Balance	-4.1	-12.8 k/	-4.3	-49.1	-15.7	-1.4	-11.2
Current Account Balance	0.3	7.1 k/	-0.2	-12.0	2.9	1.9	-3.2
Overall Balance	0.3	1.2 k/	3.4	3.3	8.8	0.8	-1.0
International Reserves (Mn US dollars; as of end of period)	3222.4	398.6	130401.0	204.3	1468.6	11674.0*	1705.1**
Debt service as % of exports of goods and services	6.0	4.6**	18.1*	3.8*	6.0*	16.0*	7.5*

Note: *Data of 2003, **Data of 2002.

Source: Compiled from Saxena, Sweta and Baig (2004) and Country Statistics of World Bank (2004).

ANNEX TABLE 7.2

Generalisation of Causes, Symptoms and Outcomes of Financial Crisis

Causes	Symptoms	Outcomes	
		Short run	Long run
• Implicit government guarantee • External sector vulnerability in the form of export/ import price expectation failure • Falling foreign aid flow due to failure in economic reform and diversion of aid fund to new more important destinations • Trade liberalisation in the form of drastic removal of tariff barriers • Half-hearted/unprepared/ill – sequenced external financial liberalisation • Imprudent policy imposition by international organisations and IMF bailout policy • Lack of transparency (disclosure norms) and market discipline in corporate governance • Lax prudential regulation and supervision • Poor risk management in FIs • Excessive government expenditure • Political interference in FIs/CB • Natural calamity induced disruption in production	• Moral hazard problem in the form of excessive risk taking by FIs (locally and internationally) • CAD sustainability risks real exchange rate appreciation rising /high CAD export slow downs • High inflation • High interest rate • Failure in having desirable outcome of policy reforms • Fall in government expenditure in social sector • Huge NPA and other poor financial ratios of FIs • Fiscal gap .	• Insolvent financial institutions Banking crisis • Foreign exchange scarcity, Currency crisis, Exchange rate crisis • Liquidity/ debt crisis • Fiscal insolvency of government for bailing out FIs	• Growth crisis • Development crisis

Source: Choudhury and Raihan. 2000. Global Financial Crisis: Implications for the Banking Sector in Bangladesh, SAARCFINANCE.

Chapter 8

OPPORTUNITIES AND CHALLENGES OF INTRA-REGIONAL INVESTMENT IN SOUTH ASIA: WITH SPECIAL REFERENCE TO BANGLADESH

8.1 INTRODUCTION

In the backdrop of low domestic savings and low investment in South Asian countries, Foreign Direct Investment (FDI) is considered to be an alternative source for financing domestic economic activities. It is felt that FDI could contribute to enhancement of domestic production of goods and services, increase in export and ensuring high level of employment. Taking these considerations into account, South Asian countries have adopted private sector friendly industrial policies since the early 1980s, under which all major sectors have been made accessible to both domestic and foreign private investment. South Asian foreign investment policy regime is considered as one of the most liberal in the world.

However, countries of the region did not achieve noteworthy benefits from undertaking such policy measures. The flow of FDI in South Asia has not increased as much as was expected – it just crossed the US$7.0 billion in 2004, which is less than 30.0 per cent of the total FDI flow to the neighbouring South East Asia. Different studies have argued that the major reason for substantial FDI flow in South East Asia is not only the liberalisation of investment regimes; a strong economic integration among the countries of the region is also considered vital. The linkage between economic integration and investment is also evident in varying degrees in the case of other regional economic blocs such as European Union (EU), North American Free Trade Agreement (NAFTA) and Southern Common Market Agreement (MERCUSOR). In this context, the lack of strong economic integration within the region has been argued to be one of the major reasons for South Asia's poor performance in attracting FDI.

It is strongly perceived that with closer integration and resultant larger potentialities in terms of market as well as availability of physical, natural resources and technological resources, foreign investment from both within and outside the region would increase many fold in different South Asian countries and would resolve the problem of much needed capital for development. Under the present circumstances, major Transnational Corporations (TNCs) of developed countries could not find much interest for investment in the region. In their strategic investment plan for 2004-2007, they showed little interest on South Asia except India (UNCTAD, 2004). Moreover, their major interest of investment is in service sector, which is a less preferred area of FDI by the countries of the region.

It is argued that intra-regional cooperation for investment can ensure more appropriate and cost effective transfer of resources and technology (RIS, 2004). To this end, it is highly desirable to develop a framework for regional cooperation in investment which could articulate an effective mechanism to attract higher level of intra-regional FDI. Discussion and analysis on the issue of FDI has so far largely focused on policies related to areas restricted for foreign investment, incentive structures, transfer of profit and income, investment treaties, avoidance of double taxation treaties, etc. mainly in relation to FDI from outside South Asia; intra-regional investment has not received much attention. Hence, this paper primarily focuses on the scope of intra-regional FDI in South Asia under different trade and investment agreements. It explores possible investment opportunities and operational mechanisms to enhance intra-regional FDI flow and also discusses the future challenges that need to be dealt with in this regard.

The paper comprises six sections. Section 8.2 will discuss FDI policies of South Asian countries to understand the incentives and support for foreign investors; it will also analyse the composition and trend of FDI inflow in South Asia, especially highlighting uneven distribution and concentration of FDI, poor performance of intra-regional FDI flow, etc. Section 8.3 will explain trade-investment linkage in South Asia, mainly it will analyse impact of regional integration on FDI flow through extended "Gravity Model" and thereby the probable impact of the South Asia Free Trade Agreement (SAFTA) on enhancing FDI in South Asia. Section 8.4 will identify opportunities for intra-regional FDI flow based on the comparative advantage of each country in different areas. Section 8.5 will discuss prospects of regional cooperation for investment in Bangladesh, especially investment by Indian TNCs like Tata. Section 8.6 will highlight the challenges for the development of regional investment cooperation arising from issues that have emerged recently as well as long standing ones, which caused major impediments to investment. Finally Section 8.7 will summarise the findings and give some concluding remarks.

8.2 FDI REGIME OF SOUTH ASIA

8.2.1 Policies Related to FDI

South Asian countries have liberalised investment regime since the mid-1980s to attract more investment by the private sector in all major sectors. Countries have liberalised major manufacturing and service sectors for foreign investors with the expectation of large-scale investment, mainly in (a) export-oriented industries, (b) industries in the Export Processing Zones (EPZs), (c) high technology products that will be either import substitute or export-oriented. Major liberalisation of FDI policies has been observed in relation to entry barrier, extent of foreign ownership, performance requirement, profit transfer, etc. Notable features of FDI policies of South Asian countries are given in Table 8.1.

TABLE 8.1

Opportunities and Incentives for FDI in South Asia

	Bangladesh	India	Pakistan	Sri Lanka
FDI Forbidden Sectors	Very limited	Limited	Very limited	Very limited
Ownership	Full	Full	Full	Full
Repatriation of Profit	Full	Partial-Full	Full	Full
Taxation	Tax holiday	Tax holiday	Tax holiday	Partial Tax holiday
Signing BITs (No. of countries)	20	57	23	39
Signing DTTs (No. of countries)	20	63	52	52

Source: Prepared by author.

Entry Barrier

Most of the manufacturing sectors have been opened for foreign investment in all South Asian countries, except a few areas which are considered sensitive such as security printing, atomic energy, arms and ammunition. Some areas are restricted to facilitate local investment or local employment such as agriculture, plantation and real estate in India; air transport, railway and forestry in Bangladesh; small and cottage industries in Nepal; and fishing and mining in Sri Lanka.

Full Ownership and Repatriation of Profit

Most of the countries have allowed almost full foreign ownership in all eligible areas in different sectors. Besides, all countries more or less allow repatriation of earnings by foreign investors.

Performance Requirement

There is no strict rule for performance requirement as regards utilisation of local raw materials or capital machineries.Thus, foreign investors are allowed to import raw materials or capital machineries in full amount from any sources they like.

BITs with Other Countries

South Asian countries have signed a sizable number of Bilateral Investment Treaties (BITs) with other countries, mainly with developed countries. Until 1 January 2000, Bangladesh has signed 19 BITs, India 35, Pakistan 39, Nepal 4, and Sri Lanka 23, mainly with Organisation of Economic Cooperation and Development (OECD) and other developed and developing countries. However, there is not much interest among South Asian countries to sign BITs with other countries of the region: Bangladesh has BIT with Pakistan, India has BIT with Sri Lanka, and Pakistan has BIT with Sri Lanka.

Intellectual Property Rights

Most of the countries do not rigorously apply intellectual property laws, especially as envisaged under Trade Related Aspect of Intellectual Property Rights (TRIPS) of WTO, although they are signatory to various intellectual property related agreements, such as World Intellectual Property Organisation (WIPO), Paris Convention, Madrid

Agreement, etc. This has created an opportunity for foreign investors not to fear about intellectual property act to invest in South Asian countries, at the same time this discourages FDI related to mainly innovative products.

Dispute Settlement

There is no uniform dispute settlement mechanism so far developed in South Asian countries. India is not a member of the International Centre for Settlement of Investment Disputes (ICSID) and New York Convention of 1958 and commercial arbitration or other Alternative Dispute Resolution (ADR) is not so popular there. Maldives allows overseas arbitration of disputes, while Nepal is a signatory of the Chartered Institute of Arbitrators (CIArb).

8.2.2 Current State of FDI Flow in South Asia: Trend and Composition

Liberalisation of FDI regime in South Asia has positively contributed to significant increase in overall FDI flow to the region, rising from a mere US$0.2 billion in 1980-85 to US$1.7 billion in 1991-96 and US$7.0 billion in 2004 (Table 8.2). However, South Asia's performance in relation to flow of FDI at global and Asian level is not very remarkable so far. It received less than 5.0 per cent of total flow of FDI that to Asia and 1.0 per cent of total world FDI flow until 2002, and it exceeded those levels only in 2003. Compared to South East Asia, FDI flow has steadily increased in South Asia, rising from only 5.0 per cent of flows to South East Asia in 1991-96 period to 35.0 per cent in 2003, but dropped to 27.0 per cent in 2004.[1] Inward FDI stock in South Asia was a mere of US$44.0 billion until 2003, which is only 13.0 per cent of South East Asia, 3.0 per cent of Asia and 0.5 per cent of global FDI stock.

TABLE 8.2

FDI Inflow in South Asia (million of US$)

Countries	Inflow of FDI (million US$)							Per capita FDI (US$), 2004	FDI-GDP ratio 2004
	1980-85 average	1986-91 average	1991-96 average	1997-2001 average	2002	2003	2004		
Bangladesh	-0.1	6.0	8.0	229.0	328.0	268.0	460.0	3.3	0.8
India	62.0	177.0	1085.0	2828.0	3449.0	4269.0	5335.0	4.9	0.8
Pakistan	75.0	188.0	501.0	488.0	823.0	534.0	952.0	6.0	1.1
Sri Lanka	42.0	41.0	125.0	208.0	197.0	229.0	233.0	12.1	1.1
Bhutan	–	–	1.0	–0.2	–	1.0	1.0	0.4	0.1
Maldives	–0.3	5.0	8.0	12.0	12.0	14.0	13.0	44.4	1.8
Nepal	0.2	2.0	8.0	12.0	10.0	15.0	10.0	0.40	0.1
South Asia	179.0	419.0	1736.0	3722.0	4581.0	6066.0	7004.0	4.92	0.9
% of South East Asia			4.8	15.0	31.6	34.9	27.3		
% of Asia	3.5	2.5	2.9	3.3	4.8	5.6	4.7		
% of World	0.3	0.2	0.7	0.4	0.7	1.1	1.1		

Source: 1. World Investment Report, different issues.
2. UNESCAP (2004).

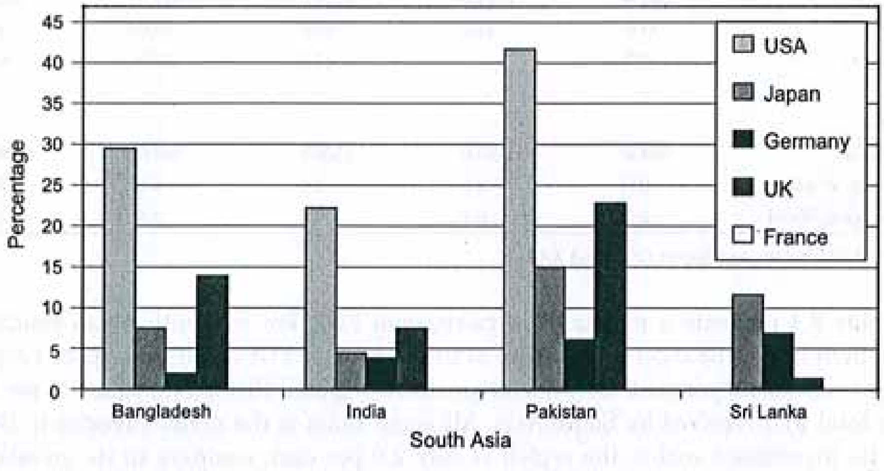
[1] In 2004, some of South East Asian countries, such Singapore, Malaysia and Indonesia, have received significantly higher amount of FDI.

Distribution of FDI in South Asia is highly uneven and heavily concentrated – India alone received about 70.0 per cent of the total FDI flow in South Asia, and only two countries (India and Pakistan) received more than 90.0 per cent of the total FDI flow. Of the rest, 3.8 per cent was received by Sri Lanka and 2.0 per cent by Bangladesh. Average per capita FDI flow is as low as US$5, which indicates its small contribution to the economy. FDI-GDP ratio is higher for Pakistan and Sri Lanka than that for larger economies like India. This wide divergence in FDI distribution raises question on the efficacy of almost-similar type of liberalisation policies followed by the countries of the region. The contribution of FDI to Gross Fixed Capital Formation (GFCF) is marginal for all South Asian countries; in Bangladesh it contributed only 2.7 per cent to GFCF (in 2000), the ratio for India was 4.0 per cent (in 2003), for Pakistan it was 15.4 per cent (in 2003), and for Sri Lanka it was 6.0 per cent (in 2003). In contrast, this ratio is significantly higher for most of the South East Asian countries.[2] Thus, current FDI policy could not ensure a high level of FDI flow in South Asia and thus failed to generate expected capital and employment.

8.2.3 Sources of FDI in South Asia

Investment from Outside South Asia

A small number of developed countries such as USA, Japan, UK, Germany, France and Korea have contributed major part of FDI flow to South Asian countries, indicating a narrow range of FDI sources (Figure 8.1). Some developing such as Korea, and Hong Kong are major investors in Sri Lanka; while India is the major source of FDI to Nepal. Small number of source countries to meet huge FDI demand may lead to high



Source: Institute of Policy Studies (IPS) (2000).

Figure 8.1: Major Sources of FDI of South Asian Countries

[2] In 2003, FDI's contribution to GFCF for Singapore was 45.7 per cent, in Malaysia it was 10.8 per cent, and in Thailand it was 5.2 per cent.

competition among the countries, and this may cause investment diversion effect within the region. It is important to note that some South East Asian countries could become good sources of FDI, especially Malaysia and China as they are increasingly investing in various potential sectors of their interest across the world.[3] Increasing investment from developing countries of Asia could enhance the possibility of South-South cooperation in the region and thereby help reduce the dependence on a small number of sources from the developed world.

Intra-regional Investment

Outward flow of capital from South Asian countries is either absent or very small. Table 8.3 shows that outward flow of FDI from South Asia reached US$2.3 billion in 2004, almost fully contributed by Indian investors (97.0 per cent). However, the most important destinations of Indian FDI till date have USA, which accounted for 19.0 per cent of total cumulative outflows during the period of 1996-2003, and Russia with 18.0 per cent of the cumulative outflows. India is also becoming an important investor for the UK and France, mainly targeted to IT, biotech, food and drink and film production. France is now trying to woo actively such Indian TNCs as Tata, Reliance, Godrej and Mahindra & Mahindra. In contrast, only a limited amount of Indian investment is targeting South Asian countries, such as Nepal and Sri Lanka.

TABLE 8.3

Outward Flow of FDI from South Asia (US$ million)

Countries	2000	2001	2002	2003	2004
Bangladesh	2.0	21.0	3.0	3.0	4
India	509.0	1397.0	1107.0	913.0	2222
Pakistan	11.0	31.0	28.0	19.0	56
Sri Lanka	2.0	–	11.0	27.0	6
Bhutan	–	–	–	–	..
Maldives	–	–	–	–	..
South Asia	524.0	1449.0	1149.0	962.0	2288
Percentage of Asia	0.6	2.9	3.0	5.6	3.30
Percentage of World	0.0	6.7	0.2	0.1	0.31

Source: World Investment Report (2003 and 2004).

Table 8.4 presents a matrix of intra-regional FDI flow in South Asian countries. Other than Nepal (38.0 per cent) share of intra-regional FDI is within a mere range of 0.04 per cent to 4.0 per cent. On an average, intra-regional FDI is less than 1.0 per cent of the total FDI received by South Asia. Although India is the major investor in South Asia, its investment within the region is only 2.0 per cent, compare to its investment outside the region. In 2003, India's investment in Sri Lanka, Nepal and Bangladesh was only 0.7 per cent, 0.5 per cent and 0.1 per cent respectively of its total outward investment.

[3] During 1992-97 on average, US$9.3 billion was sourced from South East Asia; the amount rose to its peak to US$17.5 billion in 2001; following the attacks of 9/11 in 2003, it declined to US$7.5 billion.

TABLE 8.4
Intra-regional FDI in South Asia

Hosts of FDI / Sources of FDI	Intra-regional FDI (US$ million)				
	India	Pakistan	Sri Lanka	Bangladesh	Nepal
India		n.a.	6.0 (2.6%)	6.8 (1.5%)	5.1 (51%)
Pakistan	n.a.		0.6%	3.7 (0.82%)	0.03%
Sri Lanka	0.01%	n.a.		3.45 (0.75%)	n.a.
Bangladesh	0.6 (0.01%)	0.8 (0.08%)	0.4 (0.18%)		n.a.
Nepal	n.a.	n.a.	n.a.	n.a.	
Share of South Asia	0.04%	n.a.	2.1%	3.9%	37.6%

Note: % indicates share of total FDI inflow.

Source: IPS (2000), World Investment Report (2003), Bangladesh Bank (2005).

In 2004, Bangladesh received US$14.0 million from three South Asian countries, which was a mere 3.0 per cent of total FDI inflow in the country. The amount of investment of India, Pakistan and Sri Lanka was US$6.8 million, US$3.7 million and US$3.4 million respectively. Such a poor intra-regional investment condition discourages extraregional investment as well. TNC's worldwide influence in FDI is rather less observed in South Asia. In 1999, TNCs covered only 3.1 per cent of India's total manufacturing sales and 1 per cent of its total value added. In this context, TNCs of the region can play proactive role by investing in various potential sectors in the region.

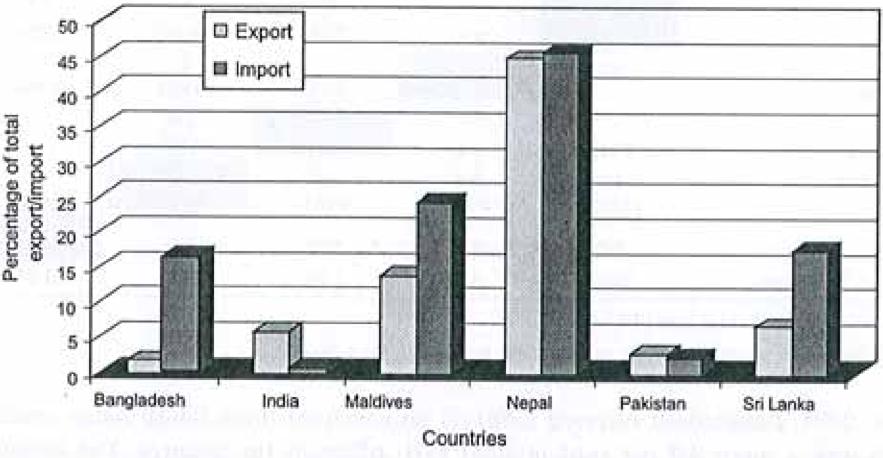
8.2.4 Sectoral Distribution of FDI

FDI received by South Asian countries is largely concentrated in service sector, mainly in power, telecommunications and energy, etc. The predominance of FDI in services is observed in Bangladesh, India and Sri Lanka. On the other hand, FDI in manufacturing sector is mainly found in textiles, particularly in Bangladesh and Sri Lanka, while chemicals and petrochemicals are important sectors of FDI in Bangladesh, India, Pakistan and Sri Lanka. Thus, region's demand for FDI in labour-intensive and export-oriented manufacturing industries is less targeted by FDIs from developed countries. In this context, South Asian investors especially TNCs can invest in export-oriented manufacturing sectors through developing vertical linkages between different potential industries of the region.

8.3 TRADE-INVESTMENT LINKAGE IN SOUTH ASIA

8.3.1 Current State of Intra-regional Trade

Intra-regional trade of South Asian countries is very insignificant, 4.8 per cent of its overall trade of US$186.0 billion in 2003. The share of intra-regional export and import was only 5.5 per cent and 4.4 per cent respectively. While large economies such as India and Pakistan do not engage much in intra-regional trade, small economy like Nepal had about half of its trade with South Asian countries, mainly with India. India has shared only 3.0 per cent of its overall trade with South Asia, and similar situation is observed in the case of Pakistan (2.6 per cent), Bangladesh (3.2 per cent) and Sri Lanka (13.0 per cent). Relatively higher amount of bilateral trade between India and Nepal, and India and Sri Lanka is mainly the outcome of the effective operation of bilateral trade agreements.



Source: Based on IMF (2004).

Figure 8.2: Intra-regional Trade of South Asian Countries, 2003

It has been pointed out that production sharing has become a major factor for regional trading arrangements; approximately 30.0 per cent of the world trade of manufactured goods comprises largely intra-industry categories (Yeats, 1998). Besides, the proportion of intra-industry trade is very low for most of the products of South Asian countries. The pattern of intra-industry trade among the South Asian countries is highly erratic, and there are only a few products in which intra-industry trade has occurred on a sustained basis, such as leather products, textiles and clothing, and some basic machinery and tools. In South East Asia, the rising intensity of trade has been accompanied by increasing intra-industry trade, mainly due to sharp increases in component production and trade in the region.[4] This sharp rise in parts and components trade is a reflection of the deepening and widening of production networks in the region. According to Intal (2005), TNCs and their affiliates in South East Asia are important catalysts to increase intra-regional trade. This has been accomplished by developing vertical intra-industry trade which, in turn, originates mainly from vertical investment linkages.

8.3.2 Linkages of Trade and Investment (Gravity Analysis)

Most of the studies related to FDI have given importance to trade agreements with sufficient provision for investment as a major determinant of FDI flow. Such studies are

[4] During 2001, intra-regional trade in East Asia was 8.8 per cent of global trade, which was 10.1 per cent for NAFTA and 20.2 per cent for EU countries.

widely available in the context of North American, European and South East Asian countries (Gorg and Greenaway, 2002; Loungani, Mody and Razin, 2002; Blonigen, Davies and Head, 2003). A few studies deal with such issues in South Asian context, among these are Kumar (2001) and Quazi (n.d.). In all these cases an extended "Gravity Model" is applied, taking into account a number of variables like size of the economy of host and source country, distance between home and host country, trade openness, return on capital, quality of infrastructure, political stability, and macroeconomic condition, etc. In most of the abovementioned studies, FDI flow to a particular region is found strongly related with the strength of the regional trade agreements, especially in terms of market access, tax structure, etc.[5]

Taking all these variables in consideration, the present study formulated the following equation to analyse the impact of different factors on the flow of FDI. Detail of the function is given in Annexure 1.

$$\text{FDI} = f(\text{GDP}_h, \text{GDP}_s, \text{Distance}_{sh}, \text{Trade openness}_h, \text{Trade openness}_s, \text{FDI openness}_h, \text{Lag FDI difference}, \text{Urban population}_h, \text{Telephone density}_h, \text{Inverse return}_h)$$

Using the OECD database on international flow of direct investment from 1991 to 2003, "Gravity Model" analysis has been conducted with fixed pair effect. Table 8.5 shows the regression of FDI based on "Gravity Model" analysis.

The results of the "Gravity Model" analysis show significantly high level of influence of regional trade agreements as a determining factor for FDI flow in a particular country. EU as a region caused a rise of FDI inflow by 4.4 per cent per year and NAFTA caused FDI to rise by 0.6 per cent per year, while ASEAN caused FDI flow to rise by 2.8 per cent per year in the region. Besides, most of the variables of the regression have shown expected sign with high significance level.[6]

A panel corrected standard error technique has been applied only for India, as data for other South Asian countries is not available. The sign of most of the typical "Gravity Model" variables, such as host country's GDP, source country's GDP, and distance, etc., has remained unchanged for INDIA. In contrast to the overall findings, distance is not a significant determinant of FDI flow to INDIA which can be explained in two ways. First, it is because of significance of domestic market oriented FDI instead of export

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[5] Bolstrom and Kokko (1998) have found significant impact of regional investment agreements on FDI inflow. Sancez and Karp (1999) quantified NAFTA's effect on FDI flow in Mexico. Globerman and Shapiro (1999) turned their attention to Canada focusing on Canada-US FTA, and NAFTA. Blonigen and Davies (2000) focused on US FDI and their effects on bilateral tax treaties. They use both a "Gravity Model" and a "Knowledge-Capital Model." MacDermott (n.d.) investigates relationship between NAFTA and FDI, and find evidence for each of the NAFTA member countries.

[6] The size of the host economy (GDPH) has significant positive impact on FDI flow, as is evident in other studies, while the coefficient of source GDP is positive but insignificant. The distance coefficient is negative and statistically significant, which indicates importance of distance in the location decision of FDI flow. Positive and significant value of the lagged changes in FDI flow (DFDI_{t-1}) implies significance of good track record as it provides confidence among foreign investors. Trade openness of source country is an important determinant having positive coefficient, while trade openness of host country is negatively related. However, the nature of relationship between the dependent variable and these two variables could not be conclusively inferred. FDI openness of host country has significant positive impact, as is evident in the case of high FDI flow in developing countries after lifting of restrictions on foreign investment. The sign of investment return is positive but insignificant. Telephone density used here as a proxy of host country's infrastructure does not significantly affect FDI flow, however, it is not a good proxy because of wide variance in the available data.

TABLE 8.5

"Gravity Model" Analysis

LNFDI (OVERALL) Regression with Robust Standard Errors		LNFDI (INDIA) Regression with Panel Corrected Standard Error	
LNDFDI**	0.02437	LNGDPH	1.2109
LNGDPH***	0.94103	LNGDPS ***	0.7488
LNGDPS	0.34808	LNDIS	-0.6383
LNDIS**	-0.77237	LNTELDEN	-1.0862
LNINVR	0.00213	LNTOPS	1.4208
LNTOPS	0.72091	LNTOPH	-1.9448
LNTOPH	-0.07917	LNFDIOP ***	1.0512
LNUPOP	-0.40469	JK***	3.0184
LNTELDEN	-0.20760	US***	3.0450
LNFDIOPH***	0.15086	EU**	1.2118
EU**	2.27610	CONS	-40.6131
NAFTA*	0.51530	ρ	0.2071
MERCUSOR	-0.32821	Number of observation	208
ASEAN*	2.19661	Wald χ^2 (10)	732.35
CONS	-20.62781	Prob $>\chi^2$	0.000
EU** (adj)	4.38	R^2	0.4241
NAFTA*(adj)	0.61		
ASEAN*	2.79		
Number of observation	9594		
F (756, 8837)	92.78		
Prob > F	0.00		
R^2	0.393		

Note: ***, ** and * denote significance levels of 1 per cent, 5 per cent and 10 per cent.

Source: Based on the OECD Database.

market-oriented FDI in India, as is evident in other South Asian countries as well. Second, FDI may be seeking to utilise low cost resources. In so far as FDI is market-seeking, expansion of market access through different trade agreements would increase extra regional FDI substantially not only in India but also in other countries.

It is important to note here that lack of panel data on source wise FDI flow to other South Asian countries impedes the test of the hypothesis for the region as a whole.

8.3.3 Prospect of Trade-investment Linkage In South Asia under Different Trade Agreements

The proliferation of trade agreements at regional, subregional and bilateral levels within and outside South Asia may significantly contribute to enhance trade and investment in the region. According to different estimates, with the operation of South Asian Free Trade Agreement (SAFTA) from January 2006, intra-regional trade will substantially increase (by about 35 per cent) from the existing level (Mehta and Bhattacharya, 1999; RIS, 2004). Operationalisation of BIMSTEC (Bay of Bengal

Initiatives for Multisectoral Trade and Economic Cooperation) will be another way to move forward region's trade and investment and a number of areas have been identified for preferential trade arrangements, such as textiles and clothing, drugs and pharmaceuticals, gems and jewellery, horticulture and floriculture, processed food, automotives and parts, rubber, tea and coffee, coconut and spices. Similarly, Bangkok Agreement (Bangladesh, India, Laos, Korea, Sri Lanka and China) has served as a forum for exchange of tariff concessions on goods following a positive list approach. It is expected that total intra-regional trade would increase almost fivefold between member countries (UNESCAP, 2004). Bangladesh, Bhutan, India, Nepal-Growth Quadrangle (BBINGQ) has prioritised sectors such as multi-modal transportation and communication, energy, optimal and sustainable utilisation of natural resources, trade and investment facilitation and promotion of tourism and environment which possesses the potentiality for implementing trans-border investment projects (Sobhan, 2002).

A slow progress in implementing Regional Trade Agreements (RTAs) has led member countries to sign more Bilateral Trade Agreements (BTAs) with other regional members. India has signed a number of bilateral trade agreements with its neighbouring countries, such as Bhutan, Nepal, and Sri Lanka. Bhutan and India have free trade agreement that increases bilateral trade between these two countries. India and Bhutan have extended cooperation in investment also. India and Nepal have a joint economic cooperation agreement, mainly in the nature of an FTA, which provided non-reciprocal, duty-free access to Nepalese manufactured goods to Indian markets.[7] India-Sri Lanka Bilateral FTA started operation since 2000, both countries have enjoyed its benefit. Bilateral free trade agreements are being currently discussed between Bangladesh and India, Bangladesh and Pakistan and Bangladesh and Sri Lanka, which could also increase scope of investment in the region.[8]

LDCs including those of South Asian countries enjoy duty-free market access to EU, Canada, Japan, Australia and some other countries. Under WTO, LDCs will get duty-free market access of 97 per cent of their products in the markets of developed countries by 2008. Under TRIPs agreement, LDCs have been exempted from the obligations regarding pharmaceutical industry until 2016. Such options have enabled countries, especially Bangladesh, to increase the competitiveness of their major exportable items and pharmaceutical sector, and could attract intra-regional and extra-regional FDI.

8.4 OPPORTUNITIES FOR INTRA-REGIONAL INVESTMENT IN SOUTH ASIA

Countries of the region do not have a large number of products in which they enjoy comparative advantage, and in most of the cases comparative advantage can be found only in a narrow range of products.[9] Out of 71 commodity groups, Bangladesh, Nepal and Pakistan have revealed comparative advantage in only 7, 5 and 12 commodity

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7 Under the treaty Nepalese products get the duty-free market access of certain sensitive items into India on the basis of a fixed quota.

8 Outside the region, India has signed draft framework bilateral free trade agreement with ASEAN countries. All parties will reduce their tariffs following a mutually agreed timeframe, over a period from 2006 to 2016.

9 According to Kemal (2004), Bangladesh has comparative advantage in fish, vegetables, jute, tea, leather textile, yarn, RMG, clothing and woven fabrics. India has comparative advantage in food, beverages, and other products including meet, fish, crustaceans, rice, fruits and nuts, tea and spices, and tobacco products; a wide range of crude materials, iron ore, basic metals, chemical products, pharmaceuticals, cosmetics, pesticides, leather and

groups, while India and Sri Lanka have comparative advantage in 26 and 21 product categories; and no countries have comparative advantage in capital intensive and high value products (Kemal, 2003). Despite having similarity in comparative advantages, there is an indication for increasing intra-regional trade. Based on the comparative advantage and other major exportable items, a matrix is prepared to explore a comprehensive list of potential investment opportunities of each country of the region (see Annexure Table 8.1). It is found that a large number of areas where South Asian countries have similarities and diversities in investment potentials.

8.4.1 Investment Potentials of Different Countries – Similarities and Diversities

According to the information collected from different sectors (as shown in Annexure Table 8.1), India demands investment in following sectors, such as agro-based industries, plastic and rubber, fisheries, transportation, electrical equipments, ICT, trading activities, financial and non-financial services, pharmaceuticals, food processing and telecommunications. Pakistan has potentiality in agro-based industries, pharmaceuticals, textiles, leather, fisheries, food-processing, infrastructure, tourism, housing and construction and ICT. Sri Lanka enjoys investment potentials in processing of agricultural products, mining, timber, textiles, ceramic, leather, fishing, mass communication, education, shipping, air transport, coastal, etc. Bangladesh has potentiality in textile, ceramic, fertiliser, fisheries, light engineering, natural-gas based industries, leather, agro-processing, ICT, etc. Maldives has potentiality in fisheries, financial sector, transport and infrastructure. Nepal seeks FDI in textile, leather, paper, tea, energy-based industries, tourism, mineral resources and agro-based industries. Bhutan demands FDI in plastic and rubber industries, fisheries, finance, transport, infrastructure, and management. The above findings imply that there are a large number of economic activities that are common to South Asian countries, from the point of view of attractiveness to FDI which may create competition between the countries to attract FDI from outside. At the same time, there are a number of areas where countries have unique potentialities. With coordinated efforts intra-regional and extra-regional investment can be increased with least competition between the countries, taking into account the diversities and similarities.

Countries have potentiality in some sectors that are unique, as shown in Table 8.6. Bangladesh has unique potentiality in fertiliser and light engineering. India has unique potentiality in electrical equipment and telecom. Pakistan's uniqueness is in housing and construction. In the case of Sri Lanka, it is in mining and processing of non-renewable, mass communication and freight forwarding, etc. Nepal has unique potentiality in hydropower-based projects, while Bhutan in cement production. It appears that developing countries of the region (India, Pakistan and Sri Lanka) have uniqueness in relatively capital-intensive sectors, while LDC members have it in relatively labour intensive ones. Instead of competing for FDI in all sectors, from within and outside of South Asia, countries could focus primarily on those sectors in which they

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textiles, machine tools, household equipment, motor cycles, bicycles, etc. Nepal has comparative advantage in men and women's clothing, knit, floor coverings, textile clothing accessories, etc. Pakistan has revealed comparative advantage in vegetables, fish, fresh and dried fruits, sugar, molasses, crude materials including cotton, stone, gravel, textile and clothing, leather, floor coverings, toys and cutlery. Sri Lanka's comparative advantage is in fish, crustaceans, cereals, fruits and nuts, tea and spices, rubber, fuel wood, paper, crude vegetable materials, rubber tires, textile yarn, woven fabrics materials and electric power machinery.

have competitive advantages. A common source of information regarding investment potentiality of the region could help investors to obtain a clear picture on unique potentialities of each country.

TABLE 8.6

Unique Potential Sectors for Investment of South Asian Countries

Countries	Sectors					
India	Electrical Equipment	Telecommunication				
Pakistan	Housing & Construction					
Sri Lanka	Mining	Primary processing of non-renewable	Mass Communication	Education	Freight Forwarding	Travel Agency
Bangladesh	Fertiliser	Light Engineering				
Nepal	Hydro-power					
Bhutan	Aquaculture	Cement	Mineral resources			

Source: Based on Annexure Table 8.1.

On the other hand, there are similarities in potential sectors of different countries of the region. Table 8.7 shows that both India and Pakistan enjoy comparative advantage in ICT; while Pakistan, Maldives and Bhutan have investment potentiality in infrastructure; in Sri Lanka, Maldives and Bhutan fishing is a common sector; agro-based industries area is a potential sector in Bangladesh and Nepal; transport is a potential sector in India, Sri Lanka, Maldives and Bhutan; food processing bears potentiality in India and Sri Lanka; tourism in Pakistan and Nepal; and banking in India, Maldives and Bhutan. Similarity in sectoral potentials would be fruitfully converted into complementarities through utilising country's differentials in terms of resources and skill endowments that would ultimately create vertically linked opportunities for investment. This will ensure more efficient use of resources in most potential areas and thereby enhance growth and development.

TABLE 8.7

Common Potential Sectors of South Asian Countries

Sectors	Countries						
	India	Pakistan	Sri Lanka	Bangladesh	Nepal	Maldives	Bhutan
Textile		√	√	√	√		
Pharmaceuticals	√			√			
Agro-based industries				√	√		
Food processing	√		√				
Fisheries			√			√	√
Infrastructure		√				√	√
Transport	√		√			√	√
Tourism		√			√		
Banking	√					√	√
ICT	√	√					

Source: Based on Annexure Table 8.1.

It is better for technologically developed countries to concentrate high-tech part (high value component) of a particular industry considering their competitive advantage, while low-tech part of production and export could be left for least-developed countries. Thus, horizontal and vertical linkages could be established within industrial sector of the region. For example, ICT is equally preferred by India and Pakistan. Since India is historically advanced in ICT related activities, it may focus on high-end part of ICT sector (such as hardware development) and may leave low-end part of ICT sector (training, software development) for investment in Pakistan and thereby mutually benefit through investment in both countries in the ICT sector. Table 8.7 shows that such a mechanism can be developed in other common sectors between two or more countries, such as in agro-based industries (between Bangladesh and Nepal) and food processing (between India and Sri Lanka), etc. Such a mechanism could be properly functioning if the region were well integrated under various trade and investment agreements having minimum barriers to trade. And there is an increasing indication for such development – for example, increasing investment of Indian companies in Sri Lanka and Nepal is the result of development of FTAs, under which market seeking and efficiency seeking FDI have shifted from India to these countries.

Inception of India-Sri Lanka FTA has stimulated new FDI in Sri Lanka from India, mainly in rubber-based products, ceramics, electrical and electronics, wood-based products and consumer goods, amounting to US$145.0 million (RIS, 2004). During the past three years, leading Indian companies, such as Gujarat Ambuja, Asian Paints and Larsen and Toubro, have committed substantial investments, while CEAT and Taj Hotels, for example, have expanded their operations. It implies that a large amount of Indian investment is targeting in areas where Sri Lanka has unique potentials as well as similarity in investment potentials which they share with India through complementary manner. The potential for buy back arrangements exists in various sectors where cost advantages and generous fiscal incentives are made available for such ventures (Board of Investment of Sri Lanka). The upshot of the above is that in the context of India-Sri Lanka bilateral economic linkages, efficiency seeking industrial restructuring process is underway and investment flows from India to Sri Lanka.

The freer trade and investment relations between India and Nepal appear to have contributed to diversification of exports from Nepal to India, especially through efficiency seeking joint ventures that were set up in Nepal. A large number of joint ventures have been set up in the readymade garments sector and have contributed to Nepal's export dynamism. Moreover, some Indian companies such as Colgate-Palmolive, Eastern-Kodak of the US, Kodak India have shifted their factories to Nepal in order to be nearer to some potential Indian markets (RIS, 2004). This illustrates the possibilities of cross-border trade and investment cooperation between India and Bangladesh, and India and Pakistan as well.

8.4.2 Strategies for Entering South Asian Market

To utilise the investment potentialities in the region, companies have to adopt strategies based on a variety of considerations such as company objective, company size, availability of resources, product specialisation, competition, middlemen characteristics, environmental characteristics, control, marketing costs, availability of required personnel, non-market risks, etc.

TNC's of the region may choose one or more strategies from a range of alternatives including joint venture, greenfield, or acquisition, etc. based upon the possible advantages and disadvantages in terms of core operational issues to invest in South Asian market.[10] The number of greenfield projects has been increasing in South Asia; in 2002 it was 282, in 2003 the number was 508 and in 2004 it went up to 721. However, most of the greenfield projects were found in India (95.0 per cent), while Pakistan, Bangladesh and Sri Lanka received only 17, 7 and 11 respectively.[11] Unfortunately, there is no information available on the greenfield investment of South Asian companies within the region.

According to Lama (1997), India being the biggest investor in Nepal has participated in 53 joint ventures having a share of 37.0 per cent in the authorised capital. Among other regional investors in Nepal, Pakistan contributed to 2 units worth 0.3 per cent of Nepal's inward FDI and Bhutan contributed to another 2 units (0.1 per cent). In the 53 Indian joint ventures operating in Nepal, the participating investors are a combination of well known groups and lesser individual investors. Indian well known groups such as Asian Paints, Dabur India Limited, Kwality Icecream (India) ltd, Shaw Wallace and Company Ltd., Godrej Soaps Pvt. Ltd., Hoechst India Ltd., Britannia Industries Ltd., Hindustan Lever Ltd., Oberoi Hotels Pvt. Ltd. etc. have operated in collaboration with other local companies of Nepal. Such joint venture type of operation helped Indian companies to share risk and enabled them to combine local indepth knowledge as a first step to entry into the uncertain market.

The operational modality in the case of Indian investment in Sri Lanka is different. Both joint venture and full ownership participation of Indian companies are found in Sri Lanka. John Keells Institute of Information Technology (Pvt) Ltd. and Tata Infotech invested jointly in training IT professionals. CEAT-Kelani Associated Holdings Ltd. (ACPL) is a joint venture between CEAT India and Associated Motorways Group which manufactures cross ply rubber tyres for trucks, buses and three wheelers. CEAT India holds 60 per cent equity of ACPL (RIS 2004). Besides, Bensiri Rubber Products (Pvt.) Ltd, a subsidiary of Bengal Waterproof Ltd., Calcutta manufactures rainwear, school bags and hospital clothing in a Sri Lankan EPZ. Indian manufacturers such as Tata, Hero, and Godrej were in a way to establish plants in Sri Lanka. It seems that a stable business environment in Sri Lanka has attracted Indian investors to invest in fully owned investment to penetrate local and regional markets.

In Bangladesh, 57.0 per cent of foreign owned firms are of joint venture type. FDI registered in Board of Investment (BOI) is mostly of large-scale projects and joint venture type (75.0 per cent), while FDI registered in BEPZA involves small-scale projects and full ownership type (82.0 per cent).[12] This implies that considering the size of capital required for business, market risks, investment policies and other factors, foreign firms still prefer joint venture types of investment, while investing outside EPZ, targeting local market.

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10 In the case of green field entry, firms have to incur the cost of putting together the resources that are required to build a company and the business networks that are required to enable this company to function profitably. If it opts for acquisition of an existing company, it has to incur the cost of adapting the company's production process, organisational, structural and management style. A partnership with a local firm in a host country enables foreign firms to minimise the costs associated with acquisition of knowledge about local policy and business environment, production and marketing.

11 In South East Asia, total number of greenfield projects in 2004 was 726, close to that in South Asia, mainly received by Vietnam (161), Malaysia (125), Singapore (175) and Thailand (121).

12 In case of joint venture projects registered under Board of Investment (BOI), the distribution of assets between foreign and local entrepreneurs is 67:23. It implies that foreign firms hold more risks originated from asymmetric information and other ways.

8.5 OPPORTUNITIES OF REGIONAL INVESTMENT IN BANGLADESH

In Bangladesh, Industrial Policy 1999 acknowledged private sector as the engine of growth. Under the policy, private investment both local and foreign or joint venture between local and foreign private investors with public sector is allowed. Private investment is allowed in all industrial sectors except five reserved sectors. Policy framework for foreign investment in Bangladesh is based on Foreign Investment (promotion and protection) Act, 1980 which provides for non-discriminatory treatment between foreign and local investment, protection of foreign investment from appropriation by the State and repatriation of proceeds from sale of shares and profit. Moreover, fully foreign owned firms or joint ventures are not obliged to sell their shares through public issues, irrespective of the amount of the paid-up capital.

After economic liberalisation in the early 1990s, the country received relatively high amount of FDI (which is still very low by any standard).[13] Reinvested earnings and equity are accounted for the major share of FDI (47 per cent each). The contribution of FDI in the forms of capital machinery is one-third of the total, which needs to be increased in view of poor technological condition of the industrial sector. The share of FDI in EPZs in the overall FDI distribution has been increasing, and has been increasing export-contribution of FDI.

In recent times, an increasing number of foreign firms with high amount of FDI have registered with BOI. Major FDI proposals during 2005 included Tata Group (India) with an investment proposal of US$ 3.0 billion, Hightech Group (Saudi Arabia) with US$2.0 billion, Asia Energy (UK) with US$1.0 billion, Dhabi Group (UAE) with US$1 billion, and Luxon Global (Korea) with US$1.0 billion, etc. According to Table 8.8, recent FDI is targeting country's prospective opportunities in energy and textile industries, along with chemical and fertiliser, pharmaceuticals, infrastructure, financial sector and telecommunication. If these potential investments are realised, it will partially meet the

TABLE 8.8

Prospective FDIs in Bangladesh by Selected Countries

Countries	Chemical and fertiliser	Pharma-ceutical	Steel	Finan-cial	Energy	Infras-tructure	RMG	Textile	Leather	Cera-mics	ICT	Agro pro-cessing	Others
India	√		√		√								
Pakistan							√	√					√
Taiwan							√	√					
France	√	√						√	√	√	√		
Turkey					√	√						√	√
UAE		√		√		√							√
Malaysia		√	√	√	√	√		√	√	√	√	√	√
USA	√				√								

Note: Others include jute, tea, transport and hotel and tourism.

Source: BOI, various issues of daily newspapers.

[13] Government has recently taken initiatives to increase FDI flow, mainly through Board of Investment (BOI), the major FDI facilitator. It has set targets of FDI flow for different years. In 2003 target was US$400.0 million (actual flow was US$328.0 million), in 2004 target was US$600.0 million (actual flow was US$350.0 million) and targets for 2005 and 2006 are US$800.0 million and US$1.0 billion respectively.

required investments in those sectors. Bangladesh is considered as an attractive location for investment in diversified areas due to its potentiality in resources, preferential market access, etc. For example, FDI proposals for RMG, textiles by Taiwan, France, Pakistan, and Malaysia are mainly targeting duty-free market access facility to different developed countries. FDI in fertiliser, steel, and energy by countries like India, France, Turkey and USA is targeting mainly the domestic market.

Needless to say, most of these investments are coming from outside South Asia; a notable exception here is India, which has recently showed increasing interest for investing in different sectors. Major Indian Investors are Asian Paints, Apollo Hospital, Reckitt Benchiser, VIP-Nitol, Sun Pharma, Cello-GQ Industries, Berger Paints and Datasoft Systems, etc.[14] However, Indian investors can feel comfortable in Bangladesh because of cultural similarity, in addition to usual economic factors that influence the choice of investment location. India is ranked 3rd in textile and 27th in clothing in terms of specialisation in the world market; on the other hand, Bangladesh is ranked 18th in textile and 4th in clothing. Therefore, Indian investors can set up joint venture as well as 100.0 per cent owned enterprises in Bangladesh, especially investing in synthetic and polyester fabric plant. Similarly, India is the 9th largest producer of steel in the world and it has technology and capital, which can be invested in Bangladesh, as the latter has a sizeable domestic market supported by a vibrant construction industry and offers promising export possibilities because of preferential market access in developed country markets. However, rate of implementation of proposed Indian investment projects is much lower than the average implementation rate of foreign owned projects (Rahman, 2005). This needs to be examined to understand the problem associated with Indian investments in Bangladesh.

8.5.1 Tata's Proposed Investment in Bangladesh

Bangladesh received a formal proposal from Indian TNC-Tata Group with an investment worth US$2.5 billion, which is close to total FDI stock of the country.[15] Tata has expressed a formal interest to set up a steel plant with a capacity of 2.4 million ton, a power generation plant of 1,000-megawatt and a fertiliser factory targeting local and neighbouring regional markets. According to Tata, these investments would create about 24,000 direct and indirect employment opportunities, which would benefit about 0.1 million families.[16] According to the report published by the Economist Intelligence Unit (2005), in the years 2010-2015, Tata's investment would result in moving the overall current account to a surplus of 0.6 per cent of GDP by 2014-2015. The additional power that would generate under the project would increase GDP by 0.1-0.2 per cent. The report also mentioned that Tata's investment would contribute to GDP by an amount of 1.9 per cent of nominal GDP. Apparently, if Tata's investment were to actually contribute

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14 One of the single largest cross border investment projects, Lafarge Surma Limited is going to start its operation. The company, an associate of Lafarge of France, invested a total of US$240.0 million in Bangladesh to produce cement by collecting stones from Meghalaya, India. This single largest cross-border investment project is a good example intra-regional cooperation in investment where countries have varied level of factor endowments in proximate border regions. It will supply high quality cement in local market as well as in neighbouring states of India and China.

15 According to World Investment Report 2005, Bangladesh's total stock of FDI is US$3.4 billion.

16 Manzar Hossain, Project Chief of Tata gave an interview in the *Daily Prothom Alo* on 5 February (2006).

to employment generation, improvement in BOP, reduction of power shortages, and increase in GDP, as mentioned above, this investment would be notably beneficial for the country. Unfortunately, the government has not initiated any indepth study to evaluate Tata's investment proposal considering its economic impact in the overall economy, as well as the shadow cost of natural resources, physical facilities, fiscal incentives, etc. During four rounds of negotiations it is found that in the absence of a benchmark study regarding Tata's multisectoral investment proposal, government could not comfortably dealt with major issues and concerns, relating especially to long term supply of gas, price of gas, coal mining from Boropukuria through open pit system, electricity supply infrastructure, etc. Negotiations are lingering in the absence of appropriate policies and guidelines (such as in case of coal mining). In April 2006, Tata submitted a revised proposal of US$3.0 billion. This new proposal has several interesting features which make Tata's offer more lucrative. These are: product specific, price of gas to be fixed at US$4.0, assured gas supply until investment related loan be fully repaid (i.e. 10-14 years), 10.0 per cent ownership to be given to Bangladesh government and floating public share at country's capital market. After passing three months time without reviewing the proposal, government has informed Tata about their disinterest as Tata's investment would be 'political tool' during election by the opposition party. It would give a 'negative' signal to the international investors about the business environment of Bangladesh. In future, Bangladesh should develop a "package deal" as regards natural resources, physical infrastructure, and fiscal incentives, etc. that investors want to utilise in order to be able to undertake informed negotiation with large scale foreign investors. At the same time, government should ensure that political issues will not destroy foreign investment in the country.

8.6 CHALLENGES FOR ENHANCING REGIONAL INVESTMENT

8.6.1 Small and Big Partners in Regional Blocks and Its Adverse Impact on Small Economies

According to Sobhan (2002), under a comprehensive free trade arrangement, the smaller countries could suffer, especially in the short run. This is particularly evident in the case of South East Asia. Although South East Asian countries have taken steps to work as a single market and production base through intra-regional trade and investment, in reality highest intra-regional FDI recipients are the larger economies like Malaysia, Singapore and Thailand. Intra-regional FDI fell to small economies like Myanmar and Laos with growing regional integration in the region. In the case of NAFTA, according to Browne (2000), although sizes of the member economies are divergent, smaller countries have enjoyed almost similar kinds of benefits. Between 1993 and 1998, Canada's export to USA has increased by 80.0 per cent, while at the same time US export to Canada has increased by 78.0 per cent.[17] In the case of investment, a similar trend was observed. Canada's investment in the USA took a leap of 185.0 per cent; in turn, USA's investment in Canada rose by 165.0 per cent.[18] Therefore, there is no unique pattern of distribution

[17] Similarly, Canada's export to Mexico has increased by 65.0 per cent, while at the same time Mexico's export to Canada shot up by 105.0 per cent.

[18] In Mexico, Canada's investment rose by 434.0 per cent, while Mexico's investment in Canada went up over 300.0 per cent.

of benefit between large and small economies of a regional bloc. In the case of South Asia, it is projected that smaller economies would not be benefited much.

8.6.2 Diverse Standard Requirements

Even signing a FTA would not ensure a high level of intra-regional trade unless various kinds of non-tariff barriers are eliminated. These include different kinds of standardisation and certification processes, different customs rules and regulations, different tax laws and regulations, duty structure, etc. Therefore, harmonisation of rules and procedures at customs points, mutual recognition of standards, testing and certification, prior consultation in the case of imposing any Countervailing Duty (CVD) and Antidumping Duty (ADD), etc. are essential (Rahman, 2005). In the absence of a harmonised trade regime in South Asia, investors would not be encouraged to invest much within the region.

8.6.3 Restriction over Outward FDI Flow from South Asia

Along with other reasons, restriction over outward flow of FDI from South Asian countries is a major stumbling block for enhancing intra-regional flow of FDI. According to Habib and Moazzem (2003), South Asia's FDI regime is either controlled (outflows permitted with control in almost all sectors having notable restrictions like minimum holding periods, classes of investors, etc.), as is evident in India and Pakistan, or is highly restricted (complete prohibition on outflows without permission) as is evident in the case of Sri Lanka and Bangladesh (Table 8.9). Such a restrictive regime hinders the development of investment linkage in the region.

TABLE 8.9

Openness Index of South East Asian and South Asian Countries

Country	Foreign Direct Investment	Portfolio Investment	Private External Debt	Exchange Rate System
India	Controlled	Controlled	Controlled	Managed Float
Pakistan	Controlled	Controlled	Partly Restricted	Managed Float
Sri Lanka	Partly Restricted	Partly Restricted	Controlled	Managed Float
Bangladesh	Partly Restricted	Partly Restricted	Partly Restricted	Independent Float

Note: For explanation of the scales used in the table, see Annexure 2.

Source: Habib and Moazzem (2003).

8.6.4 Regional vs. Bilateral Investment Treaties

Although South Asian countries have signed bilateral investment treaties in large number, they have so far signed a limited number of BITs within the region: Bangladesh has BIT with Pakistan, India has BIT with Sri Lanka, and Pakistan has BIT with Sri Lanka only, which largely entails member countries' lack of interest in enhancing intra-regional investment (Annexure Table 8.2).[19] Notwithstanding the poor record of the

19 However, there are academic debates over the extent of impact of BITs on FDI flow. Lim (2005) found positive contribution of BITs to FDI flow as they provide flexibility to the home country allowing the possibility to screen and channel FDI while at the same time extending the necessary protection to foreign investors. UNCTAD

number of BITs within the region, the recent initiative of signing Regional Investment Treaty (RIT) among South Asian countries would help to meet the demand of investors both from the region and outside to get the protection and security of their investments in the region.[20] However, it is important to ensure coherence between BITs and RIT to avoid complications.

In this connection, treaty for avoidance of Double Taxation (DTTs) is considered necessary to avoid tax evasion. During the Dhaka SAARC Summit 2005 SAARC countries have signed regional agreements on DTTs which will help to reduce complications in this regard.

8.6.5 Poor Infrastructure Network in South Asia

Development of intra-regional investments would not be possible without having sufficient linkages in different infrastructural facilities of the region. It is necessary to develop regional transport network, regional power grid, and access to all ports by all regional investors to successfully operationalise intra-regional investment initiatives.

However, in most instances, infrastructural facilities provided to the investors in South Asia are moderately or highly expensive compared to those offered to investors of South East Asian countries (Annexure Table 8.3). The cost of industrial land is the highest in Dhaka, even compared to those of South East Asian countries; moreover, there are serious problems of finding a suitable location for setting up an industrial plant in South Asia. The cost of electricity for business use is the highest in Colombo, which is also burdensome for the development of manufacturing industries. However, the cost of gas for business use is relatively low in South Asia, which is a positive side for establishing gas-based industries. The telecommunication system has developed well because of huge amount of local and foreign investment, its overall standard is near the world level. South Asia's ports are roughly 15.0-20.0 per cent more expensive than Chinese ports. Among the South Asian ports, the least competitive one is Chittagong port, where the cost of freight handling is roughly 25.0 per cent higher than other ports in South Asia and China.[21] To increase intra-regional investment, transport network within the region needs to be developed, and all the ports of the region need to be opened for use of regional investors.

8.7 CONCLUSION

After two decades of the liberalised trade and investment policy regime, it is observed that FDI flow to South Asian countries has remained concentrated in a few locations; has been sourced from a limited number of developed countries; and has been directed to mostly domestic market-oriented and service sectors, instead of highly demanding

(1998), on the other hand, studied the impact of 200 BITs examining years prior to and after their conclusion and found a weak correlation between the signing of BITs and changes in FDI flows. There are evidences where some developing countries have received huge amounts of FDI in the absence of BITs. See also Hallaward-Driemeier (2003).

20 Establishing a regional investment area in South Asia as like ASEAN Investment Area (AIA) in South East Asia is a far cry as most of the countries are not yet ready to open all the sectors for intra-regional and extra-regional investment.

21 According to JETRO (2004), relative cost of transporting containers to Yokohama is very high for New Delhi (about US$1,500.0), Karachi and Dhaka. Electricity cost for business use is not so low for India and Pakistan.

manufacturing and export sectors. In this context, it is expected that intra-regional investment can effectively meet the demand for FDI to a large extent, especially if effective operations of a number of regional and subregional trade agreements (mainly SAFTA) within a short period of time could be ensured.

It has been found that different trade agreements signed by South Asian countries, if effectively implemented within a short period of time, would increase intra-regional trade at a substantial amount, and could enhance intra-regional investment. An "Extended Gravity Model" analysis indicates that regional integration in trade has substantially increased FDI flow, especially in the case of EU, NAFTA and ASEAN. Such a positive impact is likely to emerge in South Asia, as these countries have signed different trade and investment agreements, including SAFTA. Considering the huge potentials of intra-regional investment, the present paper has attempted to find out possible investment opportunities in different sectors and mechanisms for entering the South Asian market.

Investment potential in South Asian countries emerges from resource availability, access to market, strategic locational advantage, and technological aspects, etc. Such potentials are sometimes complementary to one or more countries and sometimes diverge between countries. Under a common investment framework, investment potentials of all South Asian countries could be developed in a coordinated manner. Our analysis has revealed some of the potential sectors where strategic partnerships could be built. A strong political commitment from all countries of the region is necessary to avail of the scope and opportunities for investment by each other, thereby achieving positive gains in the long run.

There are lots of challenges to the effective operation of intra-regional investment initiatives in South Asia. The problem related to disparate size of the economies could be resolved through more investment initiatives from large economies. South Asian countries may allow intra-regional investment by scaling down the restrictions applicable to outward flow of capital. Considering the potential importance of regional investment, countries have to sign a regional investment treaty immediately. In this context, signing of double taxation treaties between member countries of SAARC is a positive step forward to reduce the obstacles to investment. South Asia's poor infrastructures, such as power, transport, utilities, and port facilities, create obstacles to large-scale investment in the region, these need to be improved in a coordinated manner. To improve the infrastructure at the regional level, South Asian countries need to implement large-scale projects of common interest to more than one country.[22] Such large-scale projects can be easily implemented by using South Asian Development Fund (SADF). Finally, unless South Asia could properly respond to the challenges that have emerged in the dynamics of FDI flow, industrial restructuring and unless it can improve its major structural bottlenecks, it would be difficult for South Asia to enhance FDI flow both from within and outside the region to the detriment of its development objectives.

[22] Some projects have been identified by GEP of South Asian countries. Countries like Nepal, Bangladesh and India have complementarities in water resources; India and Bangladesh have complementarities in natural gas. There are other areas of complementarity between member countries, such as in road network, rail and water ways, etc.

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Annexures

Annexure 1

DESCRIPTION OF THE VARIABLES INCLUDED IN THE EXTENDED GRAVITY MODEL

Foreign Direct Investment (FDI) = f(GDP$_h$, GDP$_{s,}$ Distance$_{sh}$, Trade openness$_h$, Trade openness$_{s,}$ RTA$_h$, FDI openness$_h$, Lag FDI difference, Urban population$_h$, Telephone density$_{h,}$ Inverse return$_h$)

In which:

GDP$_h$ = GDP of the host country; (GDPH)

GDP$_s$ = GDP of the source country, (GDPS)

DIST$_{sh}$ = Distance between the source and host country, (DIS)

Trade openness$_h$ = Trade openness of host country, i.e. (export+import)$_h$/GDP$_{h,}$ (TOPH)

Trade openness$_s$ = Trade openness of source country, i.e. (export+import)$_s$/ GDP$_s$(TOPS)

RTA$_h$ = 1, if the host country belongs to a particular trading block = 0, if otherwise

FDI openness$_h$ = FDI openness of host country, i.e. (Inflow+outflow) $_h$/ GDP$_{h,}$ (FDI)

Urban population$_h$= Urban population of the host country, (UPOP)

Telephone density = Number of telephone use per thousand population, (TELDEN)

Inverse return$_h$ = Return of investment of host country, (INVR)

Annexure 2

EXPLANATION OF VARIOUS SCALES USED IN TABLE 8.9

a. FDI covers provisions on FDI inflows, liquidation, remittances of profits and FDI outflows. The economies have been classified into Free (no or very limited control on outflows and inflows); Relatively Free (inflows, liquidation and outflows permitted subject to a few conditions); Controlled (inflows, liquidation and outflows permitted with control in almost all sectors having notable restrictions like minimum holding periods, classes of investors etc); Partly Restricted (complete prohibition on inflows or outflows) and Restricted (inflows and outflows prohibited).

b. Portfolio investments cover provisions on wide range of instruments: capital market instruments (equities, bonds), money market instruments (short-term bonds, CDs, commercial papers etc.), and collective investment securities (mutual funds, unit fund etc.). The economies have been classified into Free (no or very limited control on purchase, sale and issue of portfolio instruments); Relatively Free (controls on purchase, sale and issue of portfolio instruments are allowed subject to some conditions); Controlled (limited purchase, sale or issue permitted or subject to approval); Partly Restricted (purchase or sale/issue not allowed or substantial restrictions); and Restricted (transactions prohibited).

c. External private debts cover mainly provisions on financial lending/borrowing. The economies have been classified into Free (no control/ or a very negligible controls on lending and borrowing operations); Relatively Free (a few controls on lending and borrowings); Controlled (controlled borrowings and lending); Partly Restricted (either lending or borrowings prohibited); and Restricted (transactions prohibited).

ANNEXURE TABLE 8.1

Potential Sectors for Investment of Different South Asian Countries

India	Pakistan	Sri Lanka	Bangladesh	Maldives	Nepal	Bhutan
Agro-based industries	Agro-based industries	Growing and Processing of tea, rubber, coconut, cocoa, rice, sugar, spices	Textiles	Fisheries	Textiles	Plastic & Rubber industries
Plastic & Rubber industries	Pharmaceuticals	Mining and primary processing of non-renewable resources	Ceramic	Financial Sector	Leather	Textiles
Fisheries	Textiles	Timber based industries	Fertiliser	Transport and other services	Paper	Timber based industries
Transportation	Leather	Textiles	Fisheries	Infrastructure development	Tea	Financial sector
Electrical equipments	Fisheries	Ceramic	Light Engineering		Energy based industries	Transport and other services
ICT	Food Processing	Leather	Frozen foods		Tourism	Infrastructure development
Trading Activities	Infrastructure	Fishing	Natural gas based industries		Mineral Resources	Cement
Financial Services	Tourism	Mass communication	Leather		Agro-based industries	Food Processing
Drugs and Pharmaceuticals	Housing and Construction	Education	Agro-based industries			
Food Processing	Information Technology	Freight forwarding	Information technology			
Telecommunication		Travel Agencies				
		Shipping Agencies				
		Air Transport				
		Coastal shipping				

ANNEXURE TABLE 8.2

Countries that have Concluded BITs with South Asia and South East Asia
(as of 1 January 2000)

Countries	Developed Countries			Developing Countries				Total
	Western Europe	United States	Other Developed Countries	Africa	Asia and the Pacific	Latin America and the Caribbean	Central and Eastern Europe	
South Asia								
Bangladesh	6	1	1	–	9 (1)	–	2	19
India	10	–	2	4	13 (1)	1	5	35
Pakistan	11	–	2	2	20 (2)	–	4	39
Sri Lanka	11	1	1	1	8 (2)	–	1	23
Nepal	3	–	–	1	–	–	–	4

Note: Figures in the parentheses indicate number of BITs signed with South Asian countries.

Source: United Nations (2000). Bilateral Investment Treaties, 1959-1999.

ANNEXURE TABLE 8.3

Costs of Various Infrastructural Facilities of Selected Asian Countries

Main Heads	Subheads	Unit	Dhaka	New Delhi	Karachi	Colombo	Kuala Lumpur	Bangkok
			cost (US$)	cost (US$)	cost (US$)	cost (US$)	cost (US$)	cost (US$)
Land Price	Industrial Land Purchase Price	per sq.m	64	13.24	4.31	12.36	49-99	56.42
Office Rents	Industrial Land Rent	sq.m/month	0.08-0.17	–	0.04	0.87	–	4.51
	Office Rent	sq.m/month	1.83-7.39	15.45-26.15	5.50-7.07	11.6	9.92-17.68	11.03
Telecom	Telephone Installation Fee	per telephone	171.48	66.20-661.96	31.12	205.46	48.68-160.53	84.0
Public Utilities	Electricity Rate For Business Use	per kwh	0.02-0.09	0.1	0.09	0.07-0.31	0.05	0.04
	Water Rate for Business Use	per cu.m	0.32	0.26-0.53	0.42	0.44-0.73	0.47	0.24-0.40
	Gas Rate for Business Use	per cu.m	0.08	0.09	3.39	0.53/kg	0.13	4.83-5.34
Automobiles	Regular Gasoline Price	per liter	0.6	0.7	0.59	0.55	0.36	0.4

Source: JETRO.

Chapter 9

REGIONAL COOPERATION FOR AGRICULTURAL DEVELOPMENT IN SOUTH ASIA: A PERSPECTIVE FROM BANGLADESH

9.1 INTRODUCTION

Agriculture is the most important sector in South Asia contributing 26 per cent to the total GDP of South Asia and employing three-fourth of total labour force. Agricultural population constitutes two-third of total population in South Asia. In 2003, South Asia's agricultural trade amounted to US$26 billion which is about 4 per cent of global agricultural trade. Thus, performance of agriculture sector is important for economic growth and food security at the national and household levels. South Asian agriculture has great potential to prosper through cooperation among the countries. South Asian Association for Regional Cooperation (SAARC) leaders emphasised the issue of regional cooperation in agriculture in all the SAARC Summits. Agriculture was identified as one of the five areas for cooperation (agriculture, rural development, telecommunications, meteorology, and health and population activities) at the time of the establishment of SAARC. Areas of cooperation among SAARC members have been broadened and merged over time. At present cooperation in agriculture and rural development is considered as one Integrated Programme of Action (IPA). Though SAARC is committed to cooperation for agricultural development but there is little progress in this regard. More than two decades have passed after the establishment of SAARC in 1985. Therefore, it is important to review the commitments and progress in agricultural cooperation in South Asia. It is also pertinent to know the prospects and challenges of further cooperation in the region so that measures can be taken to promote cooperation for agricultural development in South Asia.

9.1.1 Objectives of the Study

Broad objective of the study is to review the progress in regional cooperation in agriculture among South Asian countries and suggest strategies for promoting cooperation. Specific objectives of the study are as follows:

i. to review the performance of South Asian agriculture during the last two decades;

ii. to document the commitments as well as existing level of cooperation in agriculture among South Asian countries;

iii. to review Association of South-East Asian Nations (ASEAN) experience particularly evolution of their plans, programmes and implementation mechanism for agricultural development in South-east Asia;

iv. to identify potential areas for cooperation and challenges in agricultural development in South Asia; and

v. to suggest strategies for developing agricultural sector in South Asia in a manner that could build on cooperation, coordination and complementarities.

9.1.2 Scope of the Study

The study is limited to identifying areas for cooperation in agricultural development in South Asia, based on a review of past performance of South Asia's agriculture sector and cooperation in agriculture as well as the experience of similar cooperation existing in other regional organisations, such as ASEAN.

9.1.3 Layout of the Paper

The paper is divided into six sections. Following introduction, Section 9.2 discusses structure and performance of South Asian agriculture. Section 9.3 describes promises and achievements in agricultural development cooperation in South Asia. Experiences of ASEAN particularly evolution of their plans, programmes and implementation mechanisms for agricultural development in South-east Asia are discussed in detail in Section 9.4 so that lessons for South Asia can be made. Prospective areas for cooperation in agricultural development in South Asia are identified in Section 9.5. Section 9.6 puts forward the conclusions and policy implications.

9.2 STRUCTURE AND PERFORMANCE OF SOUTH ASIAN AGRICULTURE

9.2.1 Performance of Agriculture Sector

Performance of agriculture sector may be analysed on several aspects such as contribution of the agriculture sector to the overall economy, growth in agricultural production, sources of growth particularly growth in yield of agricultural products and diversity in agricultural production. In addition to these factors, it is also important to look at the public investment in agriculture. We have carried out such analysis to have a clear idea about the performance of South Asian agriculture during the last two and a half decades.

Contribution of Agriculture to the Economy

Agriculture sector contributed between 20.0 and 26.0 per cent to the total GDP in South Asian countries in 2003-04 except Maldives and Nepal (Table 9.1). Contribution of agriculture sector to the total GDP of Nepal was about 39.0 per cent while it was 9.0 per cent in Maldives. Till now, crop is the dominant sector among all the sub-sectors of agriculture. South Asian countries experienced a general decline in share of the agricultural sector to their GDP during the last two and a half decades (Table 9.2). In the early 1980s, share of agriculture in South Asia ranged between 27.0 per cent (Sri Lanka) and 60.0 per cent (Nepal). However, decline in share of agriculture to the GDP does not mean decrease in importance of agriculture, rather it indicates other sectors of the economy have also flourished in South Asia.

TABLE 9.1

Composition of the Agricultural Sector in South Asia, 2003-2004

Country	GDP (million US$)	AGRIL. GDP (million US$)	% Contribution of the Sub-Sector to GDP				
			Crop	Livestock	Fisheries	Forestry	ALL
Bangladesh	56628	11429	11.7	2.4	4.4	1.7	20.2
Bhutan	611	156	11.1	7.7	–	7.4	26.1
India*	469623	106452		20.3	1.2	1.2	22.7
Maldives	732	66		3.0	6.0	–	9.0
Nepal	6393	2481					38.8
Pakistan	230528	53713	11.4	11.9	0.3	0.7	24.3
Sri Lanka	61245	10963		17.9	2.3	1.7	21.9

Note: For India, data relates to 2002/03.

Source: ADB (2005); GoB (2005); GoP (2005); CBoS (2005); and GoM (2005).

TABLE 9.2

Trends in Share of the Agriculture Sector in South Asia, 1981-2004

(%)

Country	1981	1985	1990	1995	2000	2004
Bangladesh	40.9	41.8	29.4	25.3	24.6	20.2
Bhutan	52.8	52.6	43.2	34.4	28.5	26.1
India	36.8	33.0	31.3	28.2	24.6	21.1
Maldives						18.0
Nepal	59.8	51.7	50.6	40.7	39.6	38.7
Pakistan	30.8	28.5	25.9	26.1	26.2	23.1
Sri Lanka	26.9	24.4	22.9	18.7	19.9	17.8

Source: Author's calculation, based on FAO Data; and GoM (2005) for Maldives.

Agricultural Production Situation

Economic growth in all South Asian countries during the last two decades was very impressive (Table 9.3). Annual compound rate of growth in GDP ranged between 4.2 per cent (Sri Lanka) and 7.6 per cent (Bhutan) in the 1980s and 3.6 per cent (Pakistan) and 6.1 per cent (India) in the 1990-2003 period. During the last two decades, growth in agricultural GDP in all South Asian countries was generally positive but lower than overall GDP growth. Annual compound rate of growth in agricultural GDP in the 1980s was 3.5 per cent in South Asia while it varied between 2.9 per cent (Sri Lanka) and 7.6 per cent (Maldives). During 1990-2003, growth in agricultural GDP was 2.8 per cent in South Asia and ranged between 1.5 per cent (Sri Lanka) and 3.7 per cent (Pakistan).

TABLE 9.3

Annual Compound Rate of Growth in GDP and Agricultural GDP in South Asia: 1971-2003

(% per annum)

Country	Growth in GDP			Growth in Agricultural GDP		
	1971-80	1981-90	1990-2003*	1971-80	1981-90	1990-2003*
Bangladesh	1.8	4.8	4.9	0.2	3.2	3.4
Bhutan	–	7.6	6.2	–	4.8	3.9
India	3.1	5.8	6.1	1.8	3.5	2.95
Maldives	–	–		–	7.6	–
Nepal	2.1	4.8	4.6	0.2	4.7	2.8
Pakistan	4.7	6.3	3.6	2.4	4.1	3.7
Sri Lanka	4.4	4.2	4.7	2.5	2.9	1.5
South Asia	3.1	5.7	5.4	1.6	3.5	2.8

Note: *For Bhutan and India data relates to 1990-2001 and for Maldives related to 1991-1999.

Source: Author's calculation (1990-2003), SAARC (2004), Table 4.1 and Table 4.5.

During 1981-2004, cereal production had a growth rate of 2.3 per cent per annum in South Asia at the aggregate level (Table 9.4). At the country level, all countries except Bhutan and Maldives had positive growth ranging between 0.8 per cent per annum (Sri Lanka) and 2.7 per cent per annum (Bangladesh). Cereal production in Bhutan and Maldives declined at the rate of 1.4 per cent and 5.7 per cent per annum respectively. In the case of pulses, production growth in South Asia was 0.5 per cent per annum. During the same period, pulses production had positive growth in three countries (Maldives, Nepal and Pakistan) ranging between 0.6 per cent (Pakistan) and 3.1 per cent (Maldives). Four other countries (Bangladesh, Bhutan, India and Sri Lanka) experienced decline in pulses production ranging between 0.5 per cent (India) and 4.7 per cent (Sri Lanka) per annum.

Production of oil crops, during 1981-2004, had an annual growth of 3.8 per cent in South Asia. All South Asian countries except Bhutan experienced an increase in production of oil crops ranging between 0.3 per cent (Bangladesh) and 4.7 per cent (Maldives) per annum. In Bhutan, production of oil crops declined at the rate of 1.9 per cent per annum. Production of vegetables increased at the rate of 3.3 per cent per annum in South Asia. All South Asian countries except Bhutan had growth in vegetable production ranging between 1.01 per cent (Sri Lanka) and 5.1 per cent (Nepal) per annum. Vegetable production in Bhutan declined at the rate of 1.9 per cent per annum. During the same period, production of fruits in South Asia had an annual growth rate of 3.47 per cent. All countries except Sri Lanka experienced an increase in fruit production annually at the rate of 0.5 per cent (Bangladesh) to 4.5 per cent (Nepal).

TABLE 9.4

Annual Compound Growth Rates (%) in Production of Major Commodity Groups in South Asia, 1981-2004

Country	Cereals	Pulses	Oil crops	Vegetables	Fruits
Bangladesh	2.7	-2.1	0.30	2.58	0.5
Bhutan	-1.4	-2.1	-1.69	-1.93	1.8
India	2.2	-0.5	3.95	3.28	3.8
Maldives	-5.7	3.1	4.68	3.17	2.7
Nepal	3.1	2.7	2.54	5.11	4.5
Pakistan	2.5	0.6	3.72	4.65	2.9
Sri Lanka	0.8	-4.7	0.39	1.01	-1.1
South Asia	2.3	0.5	3.78	3.35	3.5

Source: Author's calculation, based on FAO Data.

During the last two and a half decades (1981-2004), total milk production in South Asia had an annual growth of 4.4 per cent (Table 9.5). All countries except Sri Lanka experienced increased production of milk within the range of 1.9 per cent (Bhutan) to 5.4 per cent (Pakistan). Milk production declined at the rate of 1.8 per cent per annum in Sri Lanka. In Sri Lanka, both production of cow milk and buffalo milk experienced a decline. In all other countries, except Bhutan, production of both cow and buffalo milk has increased over time. In the case of Bhutan, buffalo milk production declined at the rate of 9.3 per cent per annum. Annual growth in cow milk production was in the range of 0.3 per cent (Bangladesh) to 6.8 per cent (Pakistan). On the other hand, annual growth in buffalo milk production ranged between 0.8 per cent (Bangladesh) and 5.0 per cent (Pakistan). Total meat production in South Asia experienced an annual increase of 3.5 per cent while chicken meat production increased at the rate of 10.1 per cent per annum. All South Asian countries had positive growth in chicken meat production ranging between 0.8 per cent (Bhutan) and 11.9 per cent (India). Total meat production also had a positive growth in all South Asian countries and ranged between 0.9 per cent (Bhutan) to 4.2 per cent (Sri Lanka) per annum. Fish production in South Asia had an

TABLE 9.5

Annual Compound Growth Rates (%) in Production of Livestock and Fish in South Asia, 1981-2004

Country	Cow Milk	Buffalo Milk	Total Milk	Chicken Meat	Eggs	Total Meat	Fish
Bangladesh	0.3	0.8	3.1	4.6	4.9	3.4	4.6
Bhutan	2.3	-9.3	1.9	0.8	1.6	0.9	1.6
India	4.3	4.1	4.2	11.9	5.5	3.4	4.9
Maldives							
Nepal	2.9	2.2	2.3	5.3	3.1	2.4	10.2
Pakistan	6.8	5.0	5.4	8.5	4.8	3.9	3.5
Sri Lanka	-1.1	-4.4	-1.8	8.0	2.3	4.2	2.1
South Asia	4.6	4.3	4.4	10.1	5.2	3.5	4.6

Source: Author's calculation, based on FAO Data.

annual growth of 4.7 per cent. All South Asian countries experienced growth in fish production. Highest rate of growth in fish production was observed in Nepal (10.2 per cent) while lowest rate of growth was in Bhutan (1.59 per cent per annum).

Yield of Agricultural Products

There was a general decline in yield of cereal crops in all South Asian countries (Table 9.6). Annual rate of growth in cereal yield in South Asia during 1981-2004 was 1.7 per cent. At the country level, yield of cereal crops increased annually within the range of 0.9 per cent (Bhutan) to 2.5 per cent (India). Yield of pulses has increased in all South Asian countries. At the South Asia level, yield of pulses increased at the rate of 1.13 per cent. Annual growth in yield of pulses was between 0.7 per cent (Bangladesh) and 1.9 per cent (Nepal). Yield of oil crops increased in all countries except Bhutan. Annual growth in yield of oil crops in South Asia was 0.7 per cent and it ranged between 0.3 per cent (Sri Lanka) and 2.6 per cent (India). Bhutan experienced a decline in yield of oil crops at the rate of 2.9 per cent per annum. Yield of vegetables has increased in all South Asian countries except Bangladesh and Bhutan. Yield of vegetables grew at the rate of 0.9 per cent in South Asia while countries experienced an increase in vegetable yield within the range of 0.1 per cent (Maldives) to 1.8 per cent (India). Decline in vegetable yield in Bhutan was 0.8 per cent per annum while it was marginal for Bangladesh (0.02 per cent annually). Yield of fruits has increased in South Asia at the rate of 0.2 per cent per annum. All South Asian countries except Bangladesh and Pakistan experienced an increase in fruit yield in the range of 1.1 per cent (India) to 4.6 per cent (Sri Lanka) per annum. Decline in fruit yield in Bangladesh was 0.8 per cent per annum while Pakistan experienced a marginal decline (0.02 per cent per annum) in fruit yield.

TABLE 9.6

Annual Compound Growth Rates (%) in Yield of Major Commodity Groups in South Asia, 1981-2004

Country	Cereals	Pulses	Oil crops	Vegetables	Fruits
Bangladesh	2.4	0.7	0.9	-0.02	-0.8
Bhutan	0.9	1.1	-2.9	-0.8	2.0
India	2.5	0.8	2.6	1.8	1.1
Maldives	1.4	1.5	0.7	0.1	1.9
Nepal	1.6	1.9	0.7	1.8	n.a.
Pakistan	1.9	0.9	2.2	0.8	-0.02
Sri Lanka	0.9	1.1	0.3	1.5	4.6
South Asia	1.7	1.1	0.7	0.8	0.2

Source: Author's calculation based on FAO Data.

Yield of livestock products (milk, meat and egg) increased over time (Table 9.7). Annual increase in yield of cow and buffalo milk in South Asia was 1.3 per cent and 0.7 per cent respectively. Yield of eggs and chicken meat in South Asia increased at the rate of 0.6 per cent and 0.4 per cent respectively. Yield of cow milk was almost stagnant in Bangladesh, Bhutan and Sri Lanka. On the other hand, annual increase in yield of cow milk in India, Nepal and Pakistan was 2.6 per cent, 1.2 per cent and 1.9 per cent respectively. In the case of yield of buffalo milk, annual increase was observed in Bangladesh (0.3 per cent), India (1.7 per cent), Nepal (0.2 per cent) and Pakistan (1.1 per cent) but it declined in Sri Lanka (0.7 per cent) and remained stagnant in Bhutan. Yield of chicken meat increased in all countries of South Asia except Bangladesh and Bhutan. Increase in yield of chicken meat was in the range of 0.2 per cent (India) to 1.3 per cent (Pakistan). Bangladesh experienced an annual decrease in yield of chicken meat at the rate of 0.2 per cent while it was stagnant in Bhutan. Yield of eggs increased in all countries except Bangladesh and Bhutan. Yield of eggs declined in Bangladesh at the rate of 0.5 per cent and remained constant in Bhutan. Nepal experienced a slow growth (0.05 per cent per annum) in yield of eggs while it increased at the rate of 1.2 per cent in India, 0.9 per cent in Pakistan and 0.4 per cent in Sri Lanka.

TABLE 9.7

Annual Compound Growth Rates (%) in Yield of Livestock and Fish in South Asia, 1981-2004

Country	Cow Milk	Buffalo Milk	Total Milk	Chicken Meat	Eggs
Bangladesh	0.01	0.3	-1.2	-0.2	-0.5
Bhutan	0.0	0.0	-0.1	0.0	0.0
India	2.6	1.7	1.8	0.2	1.2
Maldives					
Nepal	1.2	0.2	0.7	0.4	0.05
Pakistan	1.9	1.1	1.8	1.3	0.9
Sri Lanka	0.02	-0.7	-0.5	0.5	0.4
South Asia	1.3	0.7	1.0	0.4	0.6

Source: Author's calculation based on FAO Data.

Diversity in Agricultural Production

Levels and trends in agricultural diversification are considered very important for long-run performance of agricultural sector. Joshi et al. (2002) studied the trends in diversity in crop production in South Asian agriculture. As a measure of diversity, the study used the Simpson Index of Diversity (SID) which was defined as in equation (1):

$$SID = 1 - \sum_{i=1}^{n} p_i^2 \tag{1}$$

where, SID is the Simpson Index of Diversity, and P_i is the proportionate area of i^{th} crop in the gross cropped area. The index ranges between 0 and 1. If there is complete specialisation, then the index moves towards 0.

The Simpson Index of Diversity (SID), as estimated by Joshi et al. (2002), for South Asia was 0.64 in Triennium Ending (TE) 1999-2000, up from 0.59 in TE 1981-82, indicating that South Asia was gradually diversifying in favour of high value enterprises, namely fruits, vegetables, and livestock and fisheries products (Table 9.8). Among South Asian countries, Bangladesh, Bhutan and Nepal show less diversity as compared to other countries. The report added that Bangladesh has specialisation in rice. More than three-fourth of the area in the country is under rice. But the remaining one-fourth area is highly diversified, which was a result of some policy initiatives taken-up in different plan periods. Nepal and Bhutan are aiming to have higher degree of self-sufficiency in basic food than what it is today, and therefore, concentrating more towards cereals, particularly rice, wheat and maize (Joshi et al. 2002).

TABLE 9.8

Trends in Agricultural Diversification and Its Sources in South Asia, 1981-2001

Country	Simpson Index of Diversity in Triennium Ending			Sources of Diversification (%)*, 1991-92 to 1999-01	
	1981-82	1991-92	1999-2001	Cropping Intensity	Crop Substitution
Bangladesh	0.4	0.3	0.3	64.7	35.3
Bhutan	0.4	0.5	0.4	97.8	2.2
India	0.6	0.6	0.6	36.6	63.4
Maldives	0.8	0.8	0.8	83.2	16.8
Nepal	0.4	0.4	0.4	84.8	15.2
Pakistan	0.5	0.6	0.6	76.5	23.4
Sri Lanka	0.7	0.8	0.7	78.9	21.1
South Asia	0.6	0.6	0.6	42.9	57.0

Note: *The columns were computed as follows: Gained in Cropped Area (A) = Change in Gross Cropped Area (B) + Crop Substitution (C). Since (A) and (B) are known, (C) is the residual.

Source: Joshi et al. (2002).

The study also identified and estimated two sources of crop diversification: (i) area augmentation, and (ii) crop substitution. The study elaborated that area augmentation comes through utilisation of fallow lands and rehabilitation of degraded lands, or increasing cropping intensity. Their estimation revealed that crop diversification was coming from area expansion, with some exception of crop substitution in India and Sri Lanka. Incidentally, in Nepal, Pakistan and Sri Lanka, area expansion is also coming from deforestation, which is a cause of concern from environmental point of view (Joshi et al. 2002).

Agricultural Trade Liberalisation

South Asian agriculture has been liberalised to a large extent. All SAARC member countries except Bhutan are members of the World Trade Organisation (WTO). Bhutan is in the process of accession to the WTO. Bound tariff for agricultural commodities in South Asia ranges between 41.4 per cent (Nepal) and 188.5 per cent (Bangladesh). On the other hand, applied tariff rates for agricultural commodities in 2004 were between 13.5 per cent (Nepal) and 41.2 per cent (Bhutan). Agricultural trade constitutes 2.3 per cent of total GDP of India while share of agricultural trade to total GDP was 30.7 per cent in Maldives (Table 9.9).

TABLE 9.9

Extent of Agricultural Trade Liberalisation in South Asia

Country	Bound Tariff for Agricultural Goods (AOA) (%)	Applied MFN Tariffs (%) for Agricultural Goods (AOA), 2004*	Agricultural Trade as % of GDP, 2004	% of Agricultural Exports in Total Exports
Bangladesh	188.5	20.6	5.2	6.7
Bhutan	n.a.	41.2	15.8	n.a.
India	114.5	37.4	2.3	13.9
Maldives	48.0	18.3	30.7	n.a.
Nepal	41.4	13.5	8.7	10.1
Pakistan	97.1	18.7	4.6	12.3
Sri Lanka	49.7	22.5	11.1	20.8

Note: 1. * Data for Maldives relate to 2002 and that of Nepal relate to 2003. For MFN applied tariffs it refers to the simple average of ad-valorem MFN applied HS 6-digit duties, taking into account AV equivalents if submitted for WTO's Integrated Database (IDB).

2. For MFN bound tariffs, the simple average of ad-valorem (AV) duties refers to the simple average of AV final bound HS 6-digit duties.

3. Volume of agricultural trade refers to total of agricultural exports and agricultural imports.

Source: International Trade Statistics (2005), WTO; and Trade Profiles, WTO Statistical Database.

Government Spending on Agriculture

Government spending on agriculture as per cent of total government expenditure has declined in Bangladesh, Bhutan, Maldives, Nepal and Sri Lanka in 2001-02, compared to that of 1985-90 (Table 9.10). Data on government spending on agriculture was not available for India and Pakistan. It has declined from 4.9 per cent to 4.1 per cent in Bangladesh, 6.1 per cent to 5.6 per cent in Bhutan, 6.6 per cent to 2.7 per cent in Maldives, 18.7 per cent to 11.2 per cent in Nepal and 10.9 per cent to 3.6 per cent in Sri Lanka. This general decline in relative spending on agriculture may constrain the development of agricultural sector in South Asia.

TABLE 9.10

Government Spending on Agriculture (as % of Total Spending) in South Asia: 1985-2002

Country	1985-90	1991-95	1996-00	2001-02
Bangladesh	4.9	5.2	4.9	4.1
Bhutan	6.1	5.2	4.2	5.6
India	–	–	–	–
Maldives	6.6	8.7	1.9	2.7
Nepal	18.7	18.2	12.9	11.2
Pakistan	–	–	–	–
Sri Lanka	10.9	5.2	3.8	3.6

Source: World Bank, WDI CD-ROM 2001 as cited in SAARC (2004). Regional Poverty Profile 2004: Changing Face of Poverty in South Asia. Table 4.16, p.90.

9.2.2 Food Demand in South Asia in 2030

South Asian agriculture had performed well in the past. However, the challenge for South Asia's agriculture is not yet over. It has to feed a growing population with an increasing level of income. If the level of growth continues as was in the 1990s and in the early 2000s, then South Asia may achieve growth rates around 5.5 per cent or even more. A recent study (Paroda and Kumar, 2000) has projected demand for different

TABLE 9.11

Projected Food Demand (at 5.5% GDP Growth) and Required Increase in Food Production in South Asia in 2030

(million tonnes)

Food Item	Bangladesh	India	Nepal	Pakistan	Sri Lanka	South Asia
Project Demand (Million tonnes)						
Rice	31.0	114.0	4.9	6.0	2.7	160.0
Wheat	4.0	80.0	1.6	37.0	1.2	124.0
Total Foodgrains	37.0	260.0	10.0	49.0	4.2	360.0
Pulses	1.1	26.0	0.5	2.1	0.2	30.0
Vegetables	3.3	193.0	4.4	11.3	1.7	215.0
Fruits	4.5	106.0	2.1	24.0	1.7	138.0
Milk	5.7	158.0	3.6	63.0	1.3	232.0
Meat	1.2	13.0	0.8	6.3	0.2	22.0
Eggs	0.4	4.7	0.1	1.0	0.2	6.4
Fish	3.4	14	0.1	1.3	0.9	20.0
Production in 2004 (Million tonnes)						
Rice	25.8	84.6	2.9	5.1	1.7	120.2
Wheat	1.2	72.0	1.4	19.5	0.0	94.2
Total Foodgrains	27.1	186.5	6.2	27.2	1.7	248.9
Pulses	0.3	14.5	0.2	1.0	0.02	16.1
Fruits	1.6	47.0	0.6	5.3	0.8	55.5
Milk	2.2	92.0	1.3	28.6	0.1	124.3
Meat	0.4	6.0	0.2	1.9	0.1	8.8
Eggs	0.1	2.4	0.03	0.4	0.05	3.1
Fish	1.7	5.9	0.03	0.6	0.2	8.7
Required Increase in Production by 2030 (%)						
Rice	20.2	34.7	67.6	16.5	58.2	33.1
Wheat	219.2	11.0	15.3	89.7		31.6
Total Foodgrains	36.5	39.4	60.3	79.8	141.6	44.6
Pulses	229.3	79.3	91.7	110.4	747.4	86.1
Vegetables	57.4	139.7	139.1	138.1	210.4	139.4
Fruits	180.4	125.4	225.5	352.6	100.0	148.7
Milk	161.9	71.7	174.8	120.1	694.8	86.6
Meat	172.3	115.5	211.4	222.6	71.3	149.8
Eggs	149.2	90.7	266.3	157.6	302.9	107.1
Fish	101.5	134.7	200.6	108.5	212.5	129.3

Source: Projected demand, Paroda and Kumar (2000); Existing Production in 2004, FAO; and Required Increase in Production, Author's calculation.

agricultural products in 2029/30 by South Asian countries if the countries grow at the rate of 5.5 per cent per annum (Table 9.11). However, the base level of production relates to the 1990s. Therefore, existing level of production in 2004 from FAO agricultural statistics is used to have an idea about the required increase in production to meet up the demand in 2029/30. According to Paroda and Kumar (2000), demand for total foodgrains in South Asia in 2030 would be 360.0 million tonnes while demand for rice and wheat would be 160.0 and 120.0 million tonnes respectively. On the other hand, demand for all other crops would be substantial: pulses 30.0 million tonnes, oil seeds 19.0 million tonnes and vegetables 215.0 million tonnes, fruits 138.0 million tonnes. Demand for other agro-products would also be high: milk 232.0 million tonnes, meat 22.0 million tonnes, eggs 6.4 million tonnes and fish 20.0 million tonnes.

Considering the level of agricultural production in South Asia in 2004, total production of foodgrains in South Asia in 2030 would have to be increased by 45.0 per cent to meet up the domestic demand for foodgrains (Table 9.11). On the other hand, required increase in rice and wheat would be 33.0 and 32.0 per cent respectively. Production of other crops needs to be increased by: 86.0 per cent for pulses, 139.0 per cent for vegetables, 149.0 per cent for fruits, 87.0 per cent for milk, 150.0 per cent for meat, 107.0 per cent for eggs and 129.0 per cent for fish. At the country level, production increase for total foodgrains would be in the range of 37.0 per cent (Bangladesh) to 142.0 per cent (Sri Lanka); rice (17.0 per cent in Pakistan to 68.0 per cent in Nepal); wheat (11.0 per cent in India to 219.0 per cent in Bangladesh); pulses (79.0 per cent in India to 747.0 per cent in Sri Lanka); vegetables (57.0 per cent in Bangladesh to 210.0 per cent in Sri Lanka); fruits (100.0 per cent in Sri Lanka to 353.0 per cent in Pakistan); milk (72.0 per cent in India to 695.0 per cent in Sri Lanka); meat (71.0 per cent in Sri Lanka to 223.0 per cent in Pakistan); eggs (91.0 per cent in India to 303.0 per cent in Sri Lanka); and fish (102.0 per cent in Bangladesh to 212.0 per cent in Sri Lanka).

This is a huge challenge which the South Asian countries have to meet. In this context, it is needed to review the past sources of growth in South Asian agriculture. A recent study by FAO (2002) reported that yield increase contributed 80.0 per cent to growth in crop production in South Asia during 1961-1999 while expansion in crop area through increase in arable land and increased cropping intensity accounted for 20.0 per cent of crop output growth. The study also projected that role of yield would also be crucially important in the future. According to the study, increase in yield would contribute 81.0 per cent to the growth in crop production during 1997/99-2030 period. In the case of growth in production of major cereals like rice and wheat, yield is expected to contribute more (about 88.0 per cent). So it would be very crucial for South Asia to develop new technologies to have growth in future crop production. It is well known that agricultural technologies generated in South Asia in the 20th century were in most cases developed through the partnership of public institutes at the national level and international agricultural research institutes. Role of private sector and NGOs in agricultural technology development and dissemination in South Asia during the 20th century was very limited. However, private sector and NGOs are expected to play a more prominent role in development and exchange of agricultural technologies in the coming years.

9.2.3 Agro-Ecoregions of South Asia

Agriculture has special characteristics and location specificity for production of various crops and animals. Therefore, necessary conditions for effective regional cooperation include existence of similar agro-ecoregions, socio-economic conditions and common goals to be achieved. It is already mentioned that South Asian agriculture is going to face a common challenge of increasing production through increase in yield which is going to come from development, dissemination and adoption of new technologies. So it is essential to identify common agro-ecoregions and complementarities in capacities and facilities for delineation of a strategy for cooperation in agricultural development. In this context, a review of major agro-ecoregions of South Asia is made.

South Asia has six major agro-ecoregions (AERs): (i) Hot Arid, (ii) Semi-Arid, (iii) Irrigated Sub-Humid, (iv) High Rainfall Humid, (v) Sub-Humid to Humid Coasts, and (vi) Sub-Humid to Cold Arid Mountains. Regional spread, climate, major cropping systems and economic significance of these AERs, as mentioned in Mruthyunjaya et.al. (2003), are reported in Table 9.12. Among these, three AERs (Semi-Arid, High Rainfall Humid, and Irrigated Sub-Humid) are quite large and occupy 38.1 per cent, 26.4per cent

TABLE 9.12

Important Agro-Ecoregions of South Asia

Particular	Hot Arid Agro-ecoregion	Semi-Arid Agro-ecoregion	Irrigated Sub-Humid Agro-ecoregion	High Rainfall Humid Agro-ecoregion	Sub-Humid to Humid Coastal Agro-ecoregion	Sub-Humid to Cold Arid Mountain Agro-ecoregion
Regional Coverage	Desert of India and Pakistan; arid and plateau region of Baluchistan in Pakistan	Rainfed peninsular and west India; rainfed region of Pakistan Punjab and Sindh; part of Sri Lanka	Irrigated region of north-west India (upper Indo-Gangetic Plains) and irrigated region of Pakistan (Punjab and Sindh); part of tarai region of Nepal	Eastern India (irrigated or lower Indo-Gangetic region, and rainfed or eastern Plateau region); Bangladesh; part of tarai region of Nepal	Coastal regions of India and Bangladesh; part of Sri Lanka; Maldives	Hill and mountain region of India, Nepal and Pakistan; Bhutan
Rainfall (mm)	<300	500 - 1000	500 - 1200	1000 - 2000	900 - 3200	<150 - 4000
Dominant Cropping Systems	Millets, pulses and oilseed-based	Coarse cereal-pulse-based; cotton-based; oilseed-based; rice and sugarcane-based in irrigated areas	Rice-wheat; sugarcane-wheat; cotton-wheat; maize-wheat	Rice-rice; rice-wheat; rainfed rice-based; rice-vegetables; rice-fish; fruits	Rice-coconut-based; plantation crops; fruits; brackish water shrimp and fish	Millets and wheat in cold arid; rice, coarse cereals and wheat-based
Share in the total net Sown area (%)	7.3	38.1	19.0	26.4	5.8	3.4
Share in total value of agricultural production (%)	2.91	25.40	28.59	26.63	10.36	6.11

Source: Mruthyunjaya et al. (2003).

and 19 per cent respectively of the total net sown area in South Asia. Each of these three regions contributes more than one-fourth of total value of agricultural output in South Asia. Bangladesh's major interests are related to two AERs, namely, High Rainfall Humid, and Irrigated Sub-Humid. Therefore, Bangladesh should be more concerned about plans and programmes for these regions so that it can promote its national interest through regional cooperation.

9.3 COOPERATION FOR AGRICULTURAL DEVELOPMENT IN SOUTH ASIA: PROMISES AND ACHIEVEMENTS

9.3.1 Institutional Setup for Agricultural Development

Under SAARC, decisions making and implementation of decisions are carried out at different levels. *The Summit* is the top most authority where Heads of State/ Government participate. *The Council of Ministers* (Foreign Ministers) is the next tier of power in SAARC which is followed by *the Standing Committee* (Foreign Secretaries) and *Programming Committee*. Under Programming Committee, there are seven *technical committees* and five *working groups*. Out of seven programming committees, one is on agriculture and rural development while two technical committees (Biotechnology and Intellectual Property Rights) have direct relevance for agricultural development cooperation.

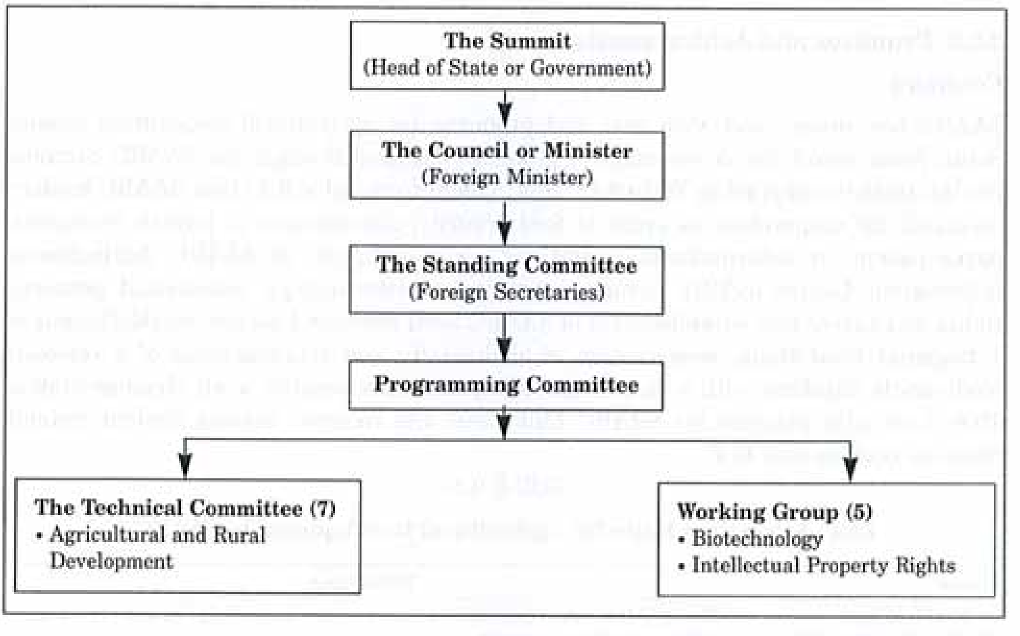

Figure 9.1: Institutional Setup of SAARC

9.3.2 Present State of Cooperation in Agriculture

There is very limited cooperation for agriculture development in SAARC. Present areas of cooperation for agriculture development include exchange of germplasm and breeding materials of livestock and fishery, exchange of prototypes of farm tools and equipments, and multi-location trial for various crops. For exchange of germplasm and breeding materials, countries are following the quarantine regulations in force in their respective countries. They are also involved in improvement of livestock through exchange of animals, frozen semen and vaccine. There is cooperation for enhancing productivity of rice and wheat-breeding programmes.

There is discussion on water resources management for agriculture in SAARC Countries. So far, progress is limited to the development of theme paper. There is willingness about establishment of SAARC Quadrangle Milk Grid. However, the progress is limited to the development of TOR. The idea of "Exchange of Rural Development Volunteers in the SAARC Countries" has not yet progressed beyond the phase of concept paper.

SAARC with support from Food and Agriculture Organisation (FAO) of United Nations is going to implement three projects: (a) Control of Trans-boundary Animal Diseases, (b) Enhancement of Integrated Pest management, and (c) Regional Strategy and Regional Programme of Food Security. Under the project on "Control of Trans-boundary Animal Diseases," three diagnostic laboratories for three priority diseases (Foot and Mouth Diseases, Peste des Petite Ruminant (PPR) and Highly Pathogenic Avian Influenza (HPAI) i.e. "Bird-flue"), one Epidemiological Centre and a Regional Support Unit would be established.

9.3.3 Promises and Achievements

Promises

SAARC has many good wish lists and promises for agricultural cooperation among South Asian countries. A summary of promises declared through the SAARC Summit Declarations is compiled in Table 9.13. It is evident from Table 9.13 that SAARC leaders promised for cooperation in areas of food security, development of human resources, participation in international initiatives, establishment of SAARC Agricultural Information Centre (SAIC), poverty eradication, biotechnology, intellectual property rights and patent law, establishment of SAARC Seed Security Reserve, establishment of a Regional Food Bank, conservation of biodiversity and establishment of a regional biodiversity database with a view to providing equitable benefits to all Member States. They have also planned for SAARC Milk Grid and common actions against animal diseases such as bird flue.

TABLE 9.13

List of Promises Made for Agricultural Development in SAARC

Summit	Declarations
1st SAARC Summit (Dhaka, 8 December 1985)	• The SAARC Members expressed concern over precarious world food security situation affecting developing countries.
2nd SAARC Summit (Bangalore, 17 May 1986)	• Members agreed to consult and cooperate in relevant international economic conferences and institutions to promote the objectives of trade liberalisation in textiles and agriculture for least developed SAARC countries. They recognised that an important opportunity in this context would be provided by UNCTAD VII.
	• Agreed to establish an Organised Volunteers Programme in SAARC under which volunteers from one country would be able to work in other countries in the fields of agriculture and forestry extension work.

(Contd.)

(Contd of Table 9.13)

Summit	Declarations
3rd SAARC Summit (Kathmandu, 4 November 1987)	• SAARC members reviewed the outcome of UNCTAD VII and observed signing of the Agreement establishing a South Asian Food Security Reserve.
4th SAARC Summit (Islamabad, 31 December 1988)	• Members agreed to launch "SAARC-2000-A Basic Needs Perspective" which calls for a perspective regional plan with specific targets to be met by the end of the century in areas of core interest such as food, clothing, shelter, education, primary health care, population planning and environmental protection.
	• Pakistan offered to host a Centre for Human Resource Development.
	• Members welcomed the establishment of the SAARC Agricultural Information Centre (SAIC).
5th SAARC Summit (Male, 23 November 1990)	• Members decided to extend cooperation to biotechnology to the exchange of expertise in genetic conservation and maintenance of germplasm banks.
	• Members welcomed India's offer of training facilities and observed that cooperation in the cataloguing of genetic resources stored in different SAARC countries would be mutually beneficial. Members agreed to participate in the Group of Fifteen Developing Countries (G15) proposal for the establishment of a gene bank for developing countries.
6th SAARC Summit (Colombo, 21 December 1991)	• Noting the decision of the Standing Committee concerning the time frame to finalise the regional study on the "Greenhouse Effect and its Impact on the Region," SAARC Members urged to consult each other on key issues concerning climate change, biodiversity and biotechnology, a global consensus on forestry principles, transfer of environmentally sound technology, management of waste and other issues for discussion at Intergovernmental Negotiating Committee and the UNCED in 1992.
7th SAARC Summit (Dhaka, 11 April 1993)	• Members committed unequivocally to the eradication of poverty in South Asia by the year 2002 through an Agenda of Action, which would, *inter alia*, embody a policy of decentralised agricultural development and would sharply focus on household level food security through universal provision of 'Daal-Bhaat' or basic nutritional needs.
8th SAARC Summit (New Delhi, 4 May 1995)	• Members reaffirmed their commitment to work for guaranteeing the realisation of the rights of all, in particular those of the poor, to food, work, shelter, health, education, resources and information.
9th SAARC Summit (Male, 14 May 1997)	• SAARC Members agreed to launch an Initiative on Nutrition aimed at promotion of availability of food of essential nutritional value to individual household.
10th SAARC Summit (Colombo, 31 July 1998)	• Members emphasised the principle of sustainable development of bio-resources and the provisions of the UN Convention on Biodiversity which provided for regulated access to resources like foodgrains, plants and herbs, on terms and conditions to be agreed upon with the State in which such resources are located.
	• They pointed out that many of the food and nutritional needs of the SAARC region could be met by the application of bio-technology. Contemporary developments in intellectual property and patent law, moreover, heightened the need for vigilance against encroachment on the regional biodiversity heritage by external entities.
11th SAARC Summit (Kathmandu, 6 January 2002)	• Members decided to enhance cooperation in agricultural research, extension and adoption to promote agriculture to address the incidence of rural poverty.
	• They also stressed the need to develop a cooperative mechanism for the protection, enrichment and utilisation of biodiversity as provided for in the UN Convention on Biological Diversity and to establish a regional biodiversity database with a view to providing equitable benefits to all Member States.
	• Members directed the Council of Ministers to explore the possibility of establishing a SAARC Seed Security Reserve to strengthen cooperation in the field of agriculture and to protect IPRs of the seeds of the Reserve.
12th SAARC Summit (Islamabad, 4-6 January 2004)	• They emphasised the arrangements for making the SAARC Food Security Reserve more effective. They also recommend the establishment of a Regional Food Bank for which a concept paper should be prepared.
13th SAARC Summit (Dhaka, 12-13 November 2005)	• SAARC Members agreed to examine India's proposal (Article 21) for the establishment of a Regional Food Bank.

Source: Author's Compilation from SAARC Declarations.

Achievements

Real achievements in cooperation for agricultural development are very limited. Achievements include the following:

- *Establishment of SAIC:* SAARC Agricultural Information Centre (SAIC) was established in Dhaka in 1988. SAIC serves as a central information institution and it has network with relevant national information centres of SAARC member countries. Major functions of the SAIC include collection of information on agricultural literature, ongoing research and development projects, research and development institutions, education and training opportunities and resource persons in various fields of agriculture. SAIC does it through member countries' focal points in the SAIC network. It also produces and publishes bibliographies, directories and provides library and information services and organises training on information and communication services. SAIC has successfully prepared directories of agricultural institutions and scientists and developed useful databases on a number of crops and agricultural topics including potato, fish diseases, biotechnology, post-harvest technology, renewable energy resources, improved equipment, problem soils, and transfer of technology, hybrid and high yielding crops and innovative technologies.
- *SAARC Food Security Reserve:* The SAARC Food Security Reserve was established on 12 August 1988 with the goal of having a reserve of foodgrains to meet emergencies in member countries. The Reserve is administered through the SAARC Food Security Reserve Board (SFSRB). It may be recalled that an agreement in this regard was passed during the third SAARC Summit held in Kathmandu in 1987. The Board, comprising of representatives from member countries, meets once a year before the annual Summit and reports to the council of ministers. The Board periodically reviews the food situation and assesses prospects of production and consumption. It also monitors food trade, prices, quality and stocks of foodgrains. The Reserve has 241,580 tonnes of foodgrains in stock. To expedite the functions of the SAARC Food Security Reserve and making it more effective, 12th SAARC Summit declaration recommend the establishment of a Regional Food Bank and India was asked to prepare a concept note. The initiative is moving forward and it was further followed up during the 13th Summit.
- *Common Position on World Food Summit:* SAARC Agriculture Ministers met in Islamabad in 1996 and arrived at a common SAARC position before the World Food Summit in Rome (1996). Prior to the World Food Summit (2002), SAARC Ministers of Agriculture met in Kathmandu (May 2002) and arrived at a common SAARC position.
- *Strengthening Networks:* Agricultural cooperation requires close link and network among agricultural scientists. SAARC countries have prepared list of counterpart scientists in the twelve agreed areas of crops and disciplines which have been finalised for networking. These are: rice and millet, wheat, oilseeds, horticulture (potato, vegetables and fruits), fisheries, forestry, transfer of technology, livestock (animal health and production), farm machinery and

implements, post harvest technology, agriculture economics and policies, and soils. Progress has been made towards establishing a network on amelioration of problem soils.

9.4 ASEAN EXPERIENCE: LESSONS FOR SOUTH ASIA[1]

9.4.1 Areas of Cooperation for Agricultural Development

The Association of Southeast Asian Nations (ASEAN) was established on 8 August 1967 in Bangkok with five founding members: Indonesia, Malaysia, Philippines, Singapore and Thailand. Later on five other countries (Brunei Darussalam, Vietnam, Laos, Myanmar and Cambodia) joined to the ASEAN and thus it has currently 10 member countries. ASEAN has broad based economic cooperation in trade, investment, industry, services, finance, agriculture, forestry, energy, transportation and communication, intellectual property, small and medium enterprises, and tourism.

Cooperation for agricultural development in ASEAN had started in 1968 and initially it was limited to food production and supply. In 1977, scope of cooperation for agricultural development was broadened to all sub-sectors of agriculture including forestry. At present specific areas of cooperation in agriculture include food security, food handling, crops, livestock, fisheries, agricultural training and extension, agricultural cooperatives, cooperation in agricultural trade, joint approaches in global and regional negotiations. ASEAN has seven priority areas for cooperation in agricultural development, which were agreed during the fifteenth meeting of the ASEAN Ministers on Agriculture and Forestry (AMAF) in Bandar Seri Begawan on 28 October 1993. These include (i) Strengthening food security in the region; (ii) Facilitation and promotion of intra- and extra-ASEAN trade in agriculture, fishery and forest products; (iii) Technology generation and transfer to increase productivity and develop agribusiness and salvo-business; (iv) Agricultural rural community and human resources development; (v) Private sector involvement and investment; (vi) Management and conservation of natural resources for sustainable development; and (vii) Strengthening ASEAN cooperation and joint approaches in addressing international and regional issues. All programmes for agricultural development in ASEAN are around these seven priority areas.

9.4.2 How ASEAN Operates?

Organisation and Coordination

The highest decision-making organ of ASEAN is *ASEAN Summit* which is convened every year and the Heads of State and Government of ASEAN countries participate in these meetings. Next to the Summit is *ASEAN Ministerial Meeting* where foreign ministers of ASEAN countries meet on an annual basis. Annual Ministerial meetings on several sectors including agriculture and forestry, economics, rural development and poverty alleviation are also held regularly. Ministerial bodies are supported by 29 committees of senior officials and 122 technical working groups. ASEAN has well organised structure for cooperation in food, agriculture and forestry (Figure 9.2). The ASEAN cooperation in food, agriculture and forestry is guided by the AMAF which is

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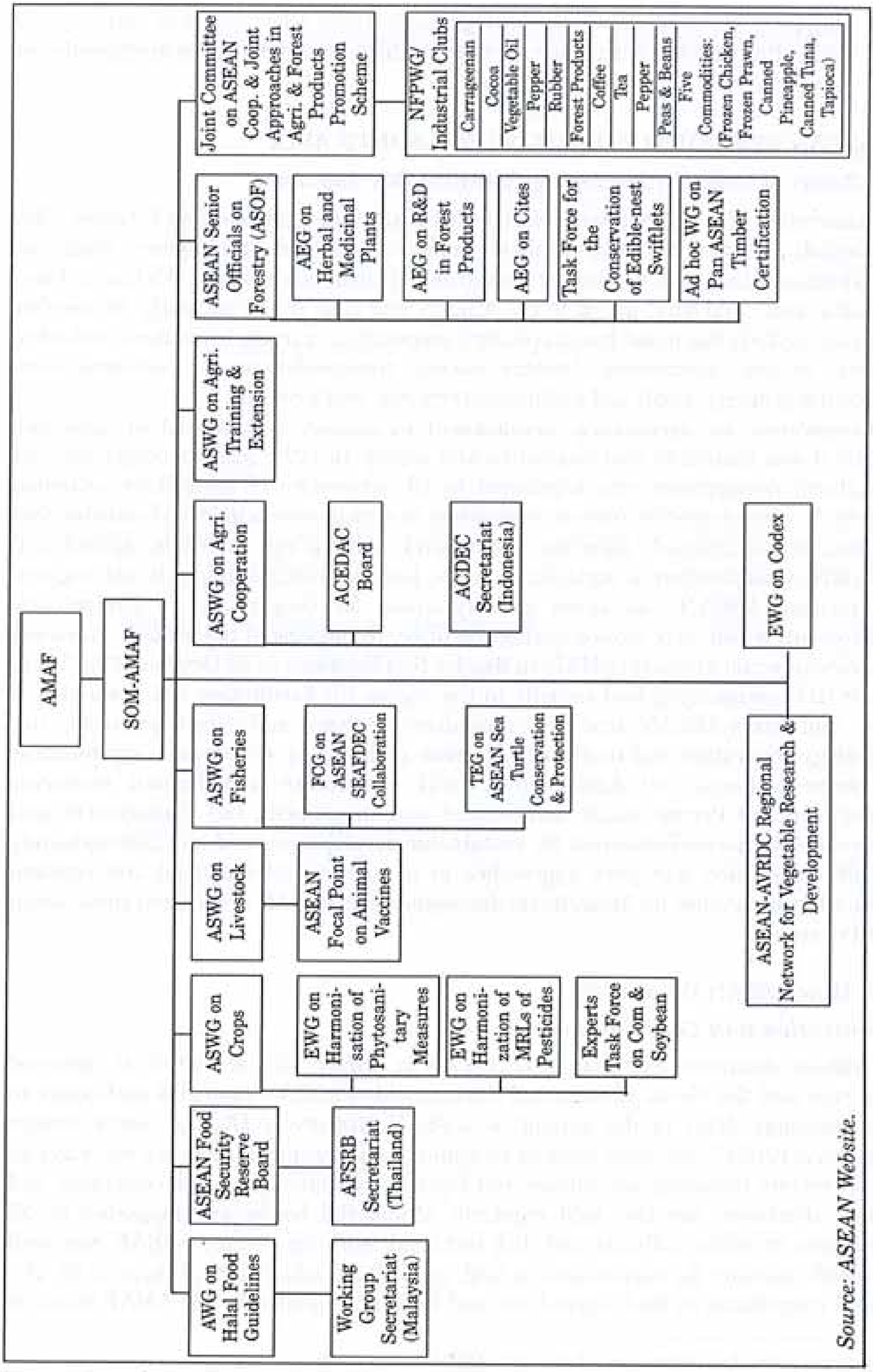
1 This section is based on information obtained from ASEAN website (www.aseansec.org).



Source: ASEAN Website.

Figure 9.2: Structure of the Organisation of ASEAN Cooperation in Food, Agriculture and Forestry

supported by the Senior Officials Meeting (SOM). Under the SOM, several permanent subsidiary bodies – Board, Sectoral Working Group and Committee – are in-charge for the respective cooperation sectors. Under the permanent subsidiary bodies, *Task Forces* and *Experts Groups* are established to undertake planning and implementation of specific activities within a specific time-frame. For promoting intergovernmental cooperation in agriculture and forestry, ASEAN has several specialised bodies and arrangements. These include ASEAN Agricultural Development Planning Centre, ASEAN Poultry Research and Training Centre (APRTC), ASEAN Regional Centre for Biodiversity Conservation, ASEAN Rural Youth Development Centre, ASEAN Specialised Meteorological Centre, ASEAN Timber Technology Centre (ATTC), ASEAN Centre for the Development of Agricultural Cooperatives (ACEDAC) and ASEAN Institute of Forest Management, and ASEAN Forest Tree Seed Centre.

Existing working groups, committees and boards are responsible for planning and implementing all the activities, utilising the assistance of national institutions through networking arrangements. AMAF, with the support of its SOM, provides the policy guidelines to these subsidiary bodies in accordance with declarations, agreements and statements made by ASEAN Summits. The ASEAN Secretariat provides administrative support to SOM-AMAF and AMAF and coordinates closely the implementation of the activities by the working groups. All submissions of progress reports and evaluations of implementation of activities from the working groups are channelled through the Secretariat. The working groups depend on clear terms of reference and strategic action plans which are approved for implementation by AMAF or SOM-AMAF. The establishment of experts groups and task forces under the major subsidiary bodies is task-oriented with specific time frames, unless otherwise decided by SOM-AMAF and/or AMAF.

Implementation

The implementation of action programmes and activities is carried out by the working groups or committees or boards concerned, with the assistance of task forces or experts groups established and full support from member countries through the national focal point institutions involved. The tasks of the working groups include planning and preparation of work plans, implementation, coordination and management, monitoring and evaluation, and reporting the progress of activities under their purview. The working groups and all their subsidiary bodies ensure timely implementation and completion of all the activities in accordance with the work plans. Planned activities are actively pursued between annual or semi-annual meetings and there is continuous coordination with the ASEAN Secretariat.

For successful implementation of agriculture development programmes, ASEAN also involves NGOs. There are 57 accredited NGOs including ASEAN Fisheries Federation (AFF), ASEAN Vegetable Oils Club (AVOC) and ASEAN Forest Products Industry Club (AFPIC). For accreditation purpose, it follows "Guidelines for ASEAN Relations with NGOs."

Detailed Plan

For successful implementation of policies and achieving the goals of agricultural cooperation, ASEAN prepares Strategic Plan of Action (SPA) for five years. First SPA was implemented during 1999-2004. At present the second SPA "Strategic Plan of Action on ASEAN Cooperation in Food, Agriculture and Forestry (2005-2010)" is in operation. Strategic plans are supported by agreements and work plans. A chronological list of formal agreement on specific issues related to agricultural development is reported in Table 9.14.

TABLE 9.14

Chronology of Major Agreements on Agriculture and Forestry in ASEAN

Year	Agreement
1979	Agreement on the ASEAN Food Security Reserve
1980	Declaration of Objectives regarding the ASEAN Agriculture Development Planning Centre
1981	ASEAN Declaration to Eradicate Foot and Mouth Disease
1981	ASEAN Declaration on Specific Animal Disease Free Zone
1982	ASEAN Ministerial Understanding on the Standardisation of Import and Quarantine Regulation on Animal and Animal Products
1982	ASEAN Ministerial Understanding on the Standardisation of Import and Quarantine Registration on Animal and Animal Products
1982	ASEAN Ministerial Understanding on Plant Quarantine Ring
1982	Protocol to Amend the Agreement on ASEAN Food Security Reserve
1983	ASEAN Ministerial Understanding on Fisheries Cooperation
1984	ASEAN Ministerial Understanding on ASEAN Cooperation in Agricultural Cooperatives
1988	Memorandum of understanding between the Government of the Kingdom of Thailand, the Association of Southeast Asian Nations, and the Government of Canada regarding the ASEAN Grain Post-harvest Programme
1993	Ministerial Understanding on ASEAN Cooperation in Food, Agriculture and Forestry
1994	Programme of Action for ASEAN Cooperation in Food, Agriculture and Forestry, 1995-1999
1994	Memorandum of Understanding on ASEAN Cooperation and Joint Approaches in Agriculture and Forest Products Promotion Scheme
1997	Second Protocol to Amend the Agreement on the ASEAN Food Security Reserves
1997	Memorandum of Understanding on ASEAN Sea Turtle Conservation and Protection
2002	Memorandum of Understanding between the Association of Southeast Asian Nations (ASEAN) Secretariat and the Ministry of Agriculture of the People's Republic of China on Agricultural Cooperation

Source: ASEAN website.

Work plans chalk out specific activities under different areas of cooperation, for example, food, crops, livestock, fisheries, agricultural training and extension, agricultural cooperatives, forestry, standards (codex), agriculture and forest product promotion scheme and biotechnology. A detailed list of cooperation in each of these areas is reported in Table 9.15. Detailed plans take care of all related activities. For an easy understanding, cooperation for livestock sector is discussed in the Table 9.15.

Cooperation for livestock development includes: (i) Establishment of common ban on the importation of live ruminants and products of ruminants originating in countries infected with Bovine Spongiform Encephalopathy (BCE) or mad cow disease; (ii) Regularisation of production and utilisation of animal vaccines; (iii) Promotion of international trade in livestock and livestock products; (iv) Strengthening of animal diseases control programme; (v) Strengthening of Animal Health and Production Information System for ASEAN (AHPISA); (vi) Initiated a number of new initiatives, including

TABLE 9.15

List of Areas of Cooperation for Agricultural Development in ASEAN, 2004

Broad Areas of Cooperation	Specific Activities
Food	• Preparation of draft ASEAN Scheme for the Accreditation of Halal Food Establishments. • Workshop on Food Security and Rice Reserve Management System. • Technical Meetings on Rice Reserve System. • The ASEAN Halal Food Programme: Halal food preparation, processing, certification and quality assurance, promoting ASEAN Halal Food Guidelines, trainings for Halal food auditors and Halal food inspectors.
Crops	• Cooperation with Asian Vegetable Research Development Centre (AVRDC) to improve vegetable productivity in the region. • Establishment of an "ASEAN Network on Plant Health Cooperation". • Six key areas were identified as priorities for cooperation on plant health namely: (i) revision of the existing country host pest list and development to SPS standards; (ii) development of regional diagnostic standards for market access; (iii) development of surveillance protocol for pests and diseases of regional importance (International Standards on Phytosanitary Measures (ISPM); (iv) management of pest fruit flies; (v) repository and dissemination of information on phytosanitary import requirements; and (vi) clearing house on market access technology. • Adoption of Harmonised Maximum Residue Limits (MRLs) of pesticides.
Livestock	• Establishment of common ban on the importation of live ruminants and products of ruminants originating in countries infected with Bovine Spongiform Encephalopathy (BCE) or mad cow disease. • Regularisation of production and utilisation of animal vaccines. • Promotion of international trade in livestock and livestock products. • Strengthening of animal diseases control programme. • Animal Health and Production Information System for ASEAN (AHPISA). • A number of new initiatives, including common stand on codex issues and veterinary drug residues in food are being initiated. • In an effort to control and minimise the economic impact and to safeguard public health, ASEAN established a Task Force on Avian Flu to formulate and help implement definite measures and areas of cooperation in the control of this disease. The Task Force would be expanded to include the Plus Three Countries of China, Japan and ROK. • To support ASEAN activities to control and to eradicate animal disease, ASEAN developed a "Mechanism on the Establishment of an ASEAN Animal Health Trust Fund."
Fisheries	• The Plan of Action on Sustainable Fisheries for Food Security for the ASEAN Region deals with fisheries management, aquaculture, and sustainable utilisation of fish and fishery products, fish trade, and regional and international policy formulation. • The cooperation to promote the application of appropriate technologies for sustainable aquaculture development and aquatic resources management include the harmonisation of fisheries Sanitary and Phytosanitary (SPS) measures and strengthening of national and regional capacities to control aquatic animal disease. • The ASEAN Network of Fisheries Post-Harvest Technology Centre continues its cooperation with the Marine Fisheries Research Department (MFRD) of the Southeast Asia Fisheries Development Centre (SEAFDEC) to implement activities on: (i) HACCP Training Programmes; (ii) Regional Code of Conduct on Post-Harvest Practices and Trade; and (iii) ASEAN-Australia Development and Cooperation Programme (AADCP) on "Quality Assurance and Safety of ASEAN Fish and Fishery Products."
Agricultural Training and Extension	• Pest Management (IPM) programmes on various crops.
Agricultural Cooperatives	• Various Strategic Alliances (SA) Projects among agricultural cooperatives in ASEAN member countries have shown some progress.

(Contd.)

(Contd. of Table 9.15)

Broad Areas of Cooperation	Specific Activities
Agricultural Cooperatives	• Indonesia looks forward to forming joint cooperation with agricultural cooperatives from other ASEAN member countries in the area of marketing or producing its own brand dairy products.
	• Brunei Darussalam and Malaysia agreed to exchange marketing of selected commodities, implementation of highland vegetable project in Kundas ang, Sabah, and cooperation in citrus production.
	• Indonesia and Malaysia would pursue business cooperation on the importation of calves for Project on Integration of Beef Cattle in Oil Palms. A preliminary approach was undertaken by the State of Pahang Farmers Organisation (PASFA) of Malaysia and several agricultural cooperatives in Indonesia.
	• Brunei Darussalam hosted the first ASEAN Cooperatives Business Forum (ACBF) in 2005 with the objective to establish business linkages and to promote direct investment and strategic partnership among potential agricultural cooperatives in ASEAN Member Countries.
Forestry	• Development of national Criteria and Indicators (C&I) for Sustainable Forest Management (SFM), including national forest policy review, and forest plantation.
	• The development of the initiative on a Pan ASEAN Timber Certification has moved towards using internationally recognised criteria to ensure the acceptability of ASEAN certified timber products in the international market.
	• Under the ASEAN-German Regional Forest Programme, an ASEAN Forestry Clearing House Mechanisms (CHM) is being established.
	• The ASEAN Experts Working Group on International Forest Policy Process was established to serve as a dialogue mechanism for regional cooperation in the implementation of the international forest regime.
Codex	• To strengthen and improve the ASEAN position in Codex fora, individual ASEAN member countries have been assigned as ASEAN Focal Points in Codex Committees in the General Subject Committees and the Commodity Standard Committees.
	• ASEAN had developed the ASEAN Food Safety Network website (www.aseanfoodsafetynetwork.net) to provide useful information on food safety, such as SPS measures of various countries, issues in the international standards setting bodies (Codex, OIE, IPPC, etc.), as well as the works of various ASEAN bodies related to food safety.
Agriculture and Forest Products Promotion Scheme	• To promote trade in agriculture and forest products, ASEAN extended the implementation of the Memorandum of Understanding (MOU) on ASEAN Cooperation in Agriculture and Forest Products Promotion Scheme for another five years, viz. 2004 to 2009.
Biotechnology	• Organised the 4th ASEAN-ILSI training workshops on Safety and Risk Assessment of Agriculture Related GMOs on 31 August-2 September 2004 in Jakarta which conducted case studies on certain crop varieties to demonstrate the safety and risk assessment criteria used by various international organisations.
	• Having produced the ASEAN general guidelines on the Release of Agriculture related Genetically Modified Organisms, ASEAN member countries are building up their testing capabilities to detect agriculture GMOs.

Source: ASEAN.

common stand on codex issues and veterinary drug residues in food; (vii) Established a task force on avian flu to formulate and help implement definite measures and areas of cooperation in the control of this disease. The task force would be expanded to include the plus three countries of China, Japan and Korea; (viii) Developing a mechanism on the establishment of an ASEAN Animal Health Trust Fund to support ASEAN activities to control and eradicate animal disease by ASEAN; (ix) ASEAN established several procedures and guidance related to vaccine production with a view to the development of Livestock; (x) Criteria for accreditation of livestock establishment; and (xi) Criteria for accreditation of livestock products establishment. Thus, it is clear that ASEAN has integrated and detailed work plan which contributes to successful cooperation in agriculture.

Financing

ASEAN has two types of financing for projects: (i) projects funded by ASEAN networks, and (ii) projects funded by third party. For the first type of projects, fundings are generated from ASEAN own source through network of existing institution within the respective member countries. In the case of "Projects Funded by Third Party," the need, trends and priorities are determined jointly by the third parties and ASEAN.

9.4.3 Cooperation in Agricultural Development: A Comparison of Regions

This section compares cooperation strategies and mechanisms followed for agricultural development in other regional organisations such as: Common Market for Eastern and Southern Africa (COMESA), European Union (EU), Free Trade Area of the Americas (FTAA), and Association of Southeast Asian Nations (ASEAN). Regional comparison reveales that all of these organisations have clearly stated objectives and areas of cooperation (Table 9.16). They have identified specific products for cooperation for all sub-sectors of agriculture (crop, livestock, fisheries and fishery). There is programme for technology transfer and rural development. COMESA, EU and ASEAN have common agricultural policies in place and are involved in harmonisation of policies and acts. These organisations have action plans supported by working bodies and clearly delineated funding mechanism. For successful implementation of programmes, they have a monitoring and evaluation system in place. They are also engaged in Standardisation in agriculture and have common stands on WTO negotiations. COMESA and ASEAN have also been able to establish regional institutes and they have formal collaboration with international agricultural research centres.

TABLE 9.16

Comparison of Cooperation in Agriculture Development in Different Regional Organisations

Particulars	COMESA	EU	FTAA	ASEAN
Clearly stated objectives	Yes	Yes	Yes	Yes
Areas of Cooperation	COMESA Agricultural Policy	CAP		CAP
	Sustainable regional food security	Secured food supplies	Elimination of trade barriers	Food security
	Marketing and export of agricultural commodities	Stabilise agricultural markets	Application of SPS agreement	International competitiveness of agricultural products
	Development of agro-industries	Agricultural productivity	Elimination of export subsidies	Joint approach in international and regional issues

(Contd.)

(Contd. of Table 9.16)

Particulars	COMESA	EU	FTAA	ASEAN
	Agricultural research, training and technology exchange		Identification of trade distorting measures	Development and transfer of technologies
	Plant and animal disease and pest control			Plant and animal disease and pest control
	Drought and desertification management and irrigation	Farm payment linked to sustainable agriculture		Sustainable use and conservation of natural resources
	Exploitation of marine and forestry resources			
Identification of products	Yes	Yes	Yes	Yes
Product coverage	Crop, livestock, fish and forest products	31 products	All products	All agricultural products
Crop	Yes	Yes; 21 crops		Yes
Livestock, Fisheries and Forestry	Yes	Yes		Yes
Agricultural research	Yes	Yes		Yes
Technology transfer	Yes	Yes		Yes
Rural development	Yes	Yes		
Common agricultural policy	Yes	Yes		Yes
Harmonisation of policies and acts	Yes	Yes		Yes
WTO negotiations	Yes	Yes	Yes	Yes
Action Plan	Yes	Yes		Yes
Working Body	Council of Ministers, 12 Technical Committees, several Advisory Bodies	EU Council of Agricultural Ministers		ASEAN Secretariat, SOM-AMAF and several permanent subsidiary bodies
Funding Mechanism	Clearly delineated	Yes, European Agricultural Guidance and Guarantee Fund		Clearly delineated
Regional Institutions	Yes (6)			Yes (12)
Monitoring and Evaluation	COMESA Secretariat			Working groups, committees and boards
Standardisation in agriculture	Yes	Yes		Yes
Collaboration with IARCs and other organisations	Yes			Yes

Note: COMESA = Common Market for Eastern and Southern Africa; EU = European Union, FTAA = Free Trade Area of the Americas, and ASEAN = Association of Southeast Asian Nations.

Source: Author's compilation.

9.4.4 Lessons for South Asia

South Asia can be benefited from the experiences of ASEAN particularly in areas such as organisational structure of cooperation, areas of cooperation, preparation of work plan and strategy and development of coordination system and national focal point. SAARC can also learn from implementation mechanism, monitoring and evaluation system, funding strategy, partnership and coordination with third party especially with international agricultural research centres followed by ASEAN.

Organisations

For agricultural development in South Asia, SAARC has one technical committee on agriculture and rural development and two related working groups on biotechnology and intellectual property rights. SAARC needs to be more organised and set up expert groups for priority areas of cooperation.

Areas of Cooperation

Priority areas of cooperation need to be identified through participatory process. Identified priority areas need to be strengthened through an integrated and a detailed plan of action which needs to incorporate production, processing, marketing, certification system and harmonisation of policies so that South Asian countries can get effective access to the world market.

Preparation of Plan and Strategy

Detailed action plan and implementation mechanism would be essential for successful cooperation in agricultural development among SAARC countries.

Coordination (National Focal Point)

All the SAARC countries have agricultural research institutes and also have apex bodies (for example, ICAR in India, BARC in Bangladesh, PARC in Pakistan and NARC in Nepal). These apex bodies may be designated as national focal points for overall coordination. On the other hand, for commodity specific research national institutes dealing with the crop or species may be the focal point. Among these institutes coordinator may be identified for specific priority areas of cooperation.

Implementation Mechanism

Implementation mechanism needs to be time bound with monitorable indicators. Successful implementation would also require specific assignment of activities to the institutions and follow-up on a regular basis. Progress needs to be reported at the annual and semi-annual meetings. Establishment of new institutions at the same time being strengthening of the existing institutions such as SAARC Agricultural Information Centre (SAIC) would be necessary.

Monitoring and Evaluation System

SAARC would require an efficient monitoring and evaluation systems to monitor the progress of planned activities and provide feedbacks for modifications and interventions. Information and communication technology based tools may be useful in this regard.

Funding Strategy

All the SAARC countries have formal links and programmes with international organisations like FAO, IFAD and international agricultural research centres like IRRI, ICRISAT, CIMMYT and World Fish Center. Therefore, SAARC may think of having projects funded by SAARC Secretariat and SAARC countries from their own resources as well as from third party sources. For these, SAARC would have to clearly identify the resource requirement and availability for such projects.

Partnership and Coordination with IARCs

SAARC needs to delineate strategies for partnership and coordination with International Agricultural Research Centres (IARCs). At present there is collaboration of IARCs with individual countries. Considering potentials for research and technology spillovers, greater efficiencies may be achieved if SAARC can act together for agricultural development in South Asia.

9.5 PROSPECTIVE AREAS OF COOPERATION IN SOUTH ASIA

Cooperation for agricultural development in South Asia may be strengthened in five major areas. These are related to agricultural research and technology development, technology exchange, capacity building through development of human resources and development of regional facilities, harmonisation of policies and acts, and participation in WTO negotiations in agriculture. Under each of the areas, it is possible to delineate cooperation strategy with a view to attain specific targets.

9.5.1 Agricultural Research and Technology Development

As mentioned earlier, South Asia has to increase its productivity for crops, livestock and fish to meet future food demand and ensure food security. Major source of growth in agricultural production is likely to come from increased yield and reduced per unit cost of production. Past growth in South Asia was primarily from new cultivars (varieties and hybrids), breeds, crop and animal husbandry practices which were the direct outcome of agricultural research. Therefore, South Asian countries should cooperate in development of new varieties, hybrids and breeds; development of water and natural resource management techniques; cooperation in remote sensing and GIS, biotechnology; and weather, flood forecasting and disaster management (flood and drought) research.

Mruthyunjaya et al. (2003) identified research priorities for agricultural commodities in different agro-ecoregions of South Asia. For the priority setting exercise, they used modified congruence approach. It is pertinent to mention that the congruence model allocates research resources in proportion to the relative value of production by region or commodity. The congruence model implicitly assumes that opportunities for research are equal across commodities, and the value of new knowledge generated by research is proportional to the value of output. In this exercise they have considered three important parameters – efficiency (value of output, growth in AgGDP), sustainability (arable land, extent of ground water withdrawal), and equity (number of poor people, per capita income) – and given equal weights for these three parameters. For identification of commodity priorities they had estimated priority scores which is the share of a commodity/group to the AES. According to Mruthyunjaya et al. (2003), in the case of irrigated sub-humid agro-ecoregion high priority should be given to rice, wheat, cotton, sugarcane and buffalo while cattle should get medium priority and rapeseed, potato, orange and goat should get low priority in research (Table 9.17). In the case of high rainfall humid agro-ecoregion, rice and cattle should get high priority while wheat should get medium priority and potato, banana, sugarcane, jute, inland fish, buffalo, goat and poultry should get low priority in research. It may be recalled that Bangladesh could directly benefit from SAARC agriculture research conducted for these two agro-ecoregions, namely, irrigated sub-humid and high rainfall humid. Therefore, it would be in Bangladesh's interest to ensure that regional cooperation in agricultural research proceeds further and crops having relevance for Bangladesh get due share in terms of allocation of research resources through SAARC.

TABLE 9.17

Research Priority of Commodities by Agro-Ecoregion in South Asia

Agro-ecoregion	High Priority (priority score 7)	Medium Priority (priority score between 4 and 7)	Low Priority (priority score between 2 and 4)
Hot Arid Agro-ecoregion	Goat, wheat, millets, cattle, buffalo	Chickpea, rapeseed, dates, sheep	Rice, inland fish, poultry
Semi-Arid Agro-ecoregion	Banana, rice, cattle, buffalo	Chickpea, groundnut, cotton, sugarcane, tobacco	Sorghum, beans, orange, pulses, mango, poultry
Sub-Humid to Cold Arid Mountain Agro-ecoregion	Rice, tea, cattle	Wheat, maize, buffalo, sheep, goat	Potato, apple, tobacco, poultry
Irrigated Sub-Humid Agro-ecoregion	Rice, wheat, cotton, sugarcane, buffalo	Cattle	Rapeseed, potato, orange, goat
High Rainfall Humid Agro-ecoregion	Rice, cattle	Wheat	Potato, banana, sugarcane, jute, inland fish, buffalo, goat, poultry
Sub-Humid to Humid Coastal Agro-ecoregion	Rice, banana, tea, marine fish	Coffee, rubber	Coconut, mango, sugarcane, buffalo, poultry, cattle
South Asia	Rice, wheat, cattle	Banana, cotton, sugarcane, buffalo	Tea, tobacco, potato, chickpea, poultry, goat

Source: Mruthyunjaya et al. (2003).

The aforementioned study has also identified areas of common interest and partnership in agricultural research among national and international research institutes (Table 9.18). SAARC may set up partnership with International Agricultural Research Centres (IARCs) following the priorities and partnership suggested by Mruthyunjaya et al. (2003). Bangladesh may take part and press for collaboration with IARCs for poverty mapping and investment priorities, improving water-use efficiency, reclamation/ management and use of salt affected soils and saline water, and system diversification. Collaboration in research with IARCs for animal health and nutrition, commercialisation and post-harvest processing, market integration and trade liberalisation, sustainable seed and technology systems, and risk management would also be beneficial for Bangladesh.

TABLE 9.18

Areas of Common Interest and Partnership in Agricultural Research

Research Area	Priority agro-ecoregion	Partnership
Poverty mapping and investment priorities	Semi-Arid; High Rainfall Humid; Sub-Humid to Cold Arid Mountains	NARS (public), IARCs
Improving water-use efficiency	All ecoregions of South Asia	NARS (public and non-profit private), IARCs
Reclamation/management and use of salt affected soils and saline water	Irrigated and coastal ecoregions of South Asia	NARS (public) and IARCs
System diversification	Hot Arid, Semi-Arid ecoregions	NARS (public and private), IARCs
Animal health and nutrition	All ecoregions of South Asia	NARS, IARCs, private
Commercialisation and post-harvest processing	All ecoregions of South Asia	NARS (public and private), IARCs
Market integration and trade liberalisation	All ecoregions of South Asia	NARS (public), private sector, IARCs
Sustainable seed and technology systems	All ecoregions of South Asia	NARS (public and private), IARCs
Risk management	Hot Arid; Semi-Arid; High Rainfall Humid; Humid Coastal	NARS (public), IARCs

Source: Mruthyunjaya et.al. (2003).

9.5.2 Technology Exchanges

SAARC countries may exchange different agricultural technologies which may include exchange of germplasm, exchange of variety and breed, crop and animal husbandry practices, and water and natural resources management techniques.

Exchange of Germplasm and Breeding Lines

South Asia as a region has diverse agro-eco region and also has vast germplasm resources. SAARC countries can strengthen their existing level of cooperation and exchange of genetic resources and can benefit through such exchanges. It is pertinent to note that rice breeding lines developed by the Bangladesh Rice Research Institute (BRRI) have been released as varieties in many countries including India, Nepal, China, and Bhutan. Bangladesh has also been benefited through such exchanges.

Exchange of Varieties and Breeds

Exchange of released varieties and hybrids would also be beneficial for agricultural development in South Asia. Rice varieties such as Swarna, Parijat and rice hybrid Lokenath were developed in India which are now widely cultivated in Bangladesh. Sonar Bangla hybrid rice was developed in China which is a major hybrid now in

Bangladesh. Thus, SAARC countries may be benefited through exchange of varieties, hybrids and breeds of different crops and animal species.

Crop Husbandry Practices

Crop husbandry practices increase the efficiency of different inputs and thus increase yield and reduce per unit cost of production. SAIC has identified some of the crop husbandry practices. SAARC needs to identify more technologies and should exchange all potentially beneficial technologies among SAARC countries.

Animal Husbandry Practices

Production of livestock products has increased in South Asia during the last two and a half decades. However, there is an increasing threat for "Bird Flue" and other animal diseases. Increased productivity of livestock may also be obtained through exchange of better rearing and feeding techniques. Collaboration in this regard would be beneficial for sustained growth of livestock in South Asia.

Fisheries Management Techniques

Fish production and fish demand is going to increase in South Asia. Fisheries are an important sub-sector of South Asian agriculture. SAARC countries can be benefited through exchange aquaculture techniques, production and rearing of fingerlings, better cultural and management techniques for shrimps, etc. Cooperation for sustainable management of coastal resources would also promote growth of this industry.

Water and Natural Resource Management Techniques

Water is increasingly becoming a scare resource in South Asia. SAARC countries may mutually benefit through exchange of water efficient technologies. Degradable and renewable natural resources can be utilised in a sustainable manner through exchange of appropriate management techniques. These may include management of problem soils, arrest of soil erosion and erosion of river banks, and reclamation of salinity affected lands.

Post-harvest and Processing Technologies

Value addition is much higher for processed agricultural products than in production of raw products. Exchange of post-harvest processing and management techniques would be helpful to reduce post-harvest losses and preserve agro-products for a longer period. It would also be helpful for diversification, value addition and employment creation in the region.

9.5.3 Capacity Building

South Asian countries have enormous scope to cooperate for capacity building. Cooperation for capacity building may be for development of human resources and development of regional facilities (SPS compliant facilities and certification system for organic farming and promotion of environmental goods).

Development of Human Resources

South Asian countries have different levels of capacities for human development. Successful implementation of plans and programmes to be carried out under SAARC would obviously require development of human resources. It may be achieved through formal training and educational programmes. In addition, there may be formal opportunities to provide on-the job training on different aspects of new sciences such as biotechnology, remote sensing and GIS techniques, early forecast, etc. Specialised research centres and departments can play an important role in this regard. India's proposal during the 13th SAARC Summit about establishment of a South Asia University also recognises the need of bringing South Asian scholars and students together for the development of South Asia, albeit much beyond the development of the agriculture sector.

Establishment of SAARC Gene Bank

Genetic resources have been eroding in South Asia. Establishment of a SAARC Gene Bank can be beneficial in this regard. National Gene Banks, Gene Banks of different research institutes may be supported through this process. SAARC may also strengthen present links with International Plant Genetic Resources Institute (IPGRI), other international agricultural research centres and FAO.

Common Vaccination System against Livestock Diseases

Livestock diseases are increasingly becoming a threat for sustainable growth of livestock sector in South Asia. SAARC may undertake common vaccination strategy against livestock diseases. This will not only help to reduce possibility of disease out break but also to develop better image of our livestock sectors and increase export possibility of livestock products.

SPS Compliant Facilities and Certification System

Agricultural producers are numerous in South Asia where productions take place in mostly in small farms. Liberalisation of agricultural trade globally has created an opportunity for more export of agricultural products from South Asia to the developed countries. However, compliance to sanitary and phytosanitary requirement is a major challenge for export of agricultural commodities. A common challenge for all SAARC countries is to develop SPS compliant production and certification system without jeopardising the existing production structure. It is because realisations increased export opportunities of production system with large number of producers has the virtue of equitable distribution of benefits from trade. Development of a system and related facilities may be developed through cooperation among SAARC countries.

Promotion of Environmental Goods

South Asia has many environmental goods such as jute and jute-based products. Cooperation for production, promotion and marketing of environmental goods would be beneficial for SAARC countries.

9.5.4 Harmonisation of Standards, Policies and Acts

Protection of Plant Variety, Biodiversity and Indigenous Knowledge

The WTO Agreement on TRIPS holds that the WTO member countries are required to make patents available for any inventions, in all fields of technology without discrimination, be it a product or a process, subject to the normal tests of novelty, inventiveness, and industrial applicability. The said agreement also requires that patents be available and patent rights be enjoyable without discrimination as regards the place of invention and whether products are imported or locally produced. It is pertinent to note that there is permissible exception to the basic rule of patentability where the governments may exclude plants and animals other than micro-organisms and essentially biological processes for the production of plants or animals other than non-biological and micro-biological processes. However, it is mandatory for the countries to adopt an *effective sui generis* system in case they exclude patents. Most of the developing countries including India have accepted the *sui generis* system for the protection of new plant varieties. Indian Act was able to maintain a balance between plant breeder's rights and farmers' rights.[2] Relevant section on farmers' rights, inserted in Section 39, Clause (iv) of the Plant Variety Protection and Farmers' Rights Act 2001, India, reads: "The farmer shall be deemed to be entitled to save, use, sow, re-sow exchange, share or sell his farm produce including seed of a variety protected under this Act in the same manner as he was entitled before the coming into force of this Act; provided that the farmer shall not be entitled to sell branded seed of a variety protected under this Act."

Considering the TRIPS obligation and advantage from the rising investment in the biotechnology research, South Asian countries must enact two related acts soon. These are: (i) plant variety protection act, and (ii) biodiversity and community knowledge preservation act. These acts should balance the right between incentives to the inventors and also protect farmers' right and preservation and benefit sharing mechanism for traditional knowledge. An effective *sui generis* system may fulfil the need of such laws mentioned in Article 27(3)b of the Agreement on TRIPS. Cooperation among South Asian countries would help to develop a common strategy to protect genetic resources, biodiversity, indigenous knowledge, farmers' right and at the same time provide incentives to the plant breeders.

Setting Standards for SPS, Facilitation of Quarantine Procedure

Cooperation for development of common South Asian standards for SPS would be helpful. It would be helpful to promote trade among SAARC countries and reduce trade disputes. It would also be helpful to promote export of agro-products from South Asia. Harmonisation of quarantine procedure and mutual support for doing so would be required.

Setting Standards and Packaging Requirements

South Asia may also cooperate to develop common standards for agro-products and packaging requirements. These would facilitate trade among South Asian countries and also to promote export from South Asia to other countries of the world.

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[2] Farmers rights are the rights arising from the past, present and future contributions of farmers in conserving, improving and making available plant genetic resources particularly those in the centres of origin/diversity.

Bio-safety Protocol

South Asia needs to develop regional bio-safety protocol. Harmonisation of bio-safety protocols among SAARC countries is needed. Without harmonised bio-safety protocols future research and application of biotechnology would be limited.

Regional Adaptation Trials and Variety/Breed Release Systems

With increased participation of private sector in development of new varieties, it would be helpful if there is regional adaptation trial of advanced lines among South Asian countries before release. It would not only reduce cost of research but also save time and expedite the process of technology generation and dissemination.

9.5.5 Participation in WTO Negotiation on Agriculture

South Asian countries have some common interests in different negotiating proposals at the WTO. Bangladesh and Nepal have both defensive (no reduction commitment for tariffs, domestic support and export subsidy) and offensive interests but India, Pakistan and Sri Lanka have offensive interests (getting market access to the developed country market, reduction in domestic support and export subsidy in developed countries and ensuring market-based price for agricultural products in developed countries). Since all South Asian countries have common offensive interests, they may negotiate for these together. South Asian developing countries (India, Pakistan and Sri Lanka) may also show solidarity to the following demands of LDCs which will benefit Bangladesh, Maldives and Nepal.

Preferential Access of Agro-products from LDCs

All South Asian countries should support the demand that developed countries should provide preferential access for agricultural commodities from LDCs to their markets by allowing duty-free and quota-free access for the agro-products from LDCs.

Technical Assistance and Capacity Building

Trade capacity building of LDCs must be a mandatory activity under WTO. Developed countries must contribute substantial amount to the WTO for technical assistance and the capacity building of LDCs, particularly in the areas of market information, human resource development, and development of facilities and systems for compliance with SPS requirements in developed countries, especially in the case of exports of shrimp and other agricultural commodities.

9.6 CONCLUSION

South Asian agriculture performed well during the last two and a half decades. Though it will face a major challenge to meet up the growing demand for agricultural commodities from less land, water and other inputs, cooperation among SAARC members may help to face this challenge. The present study has delineated five major areas for strengthening regional cooperation in South Asia. These are related to: (i) *agricultural research and technology development* (development of new varieties, hybrids and breeds, and water and natural resources management techniques; cooperation in new sciences such as remote sensing and GIS, biotechnology, weather and flood forecasting and disaster management; common data standard for GIS, etc.; (ii) *technology exchange* (exchange of germplasm, exchange of variety and breed, crop and animal husbandry practices, water and natural resources management techniques, etc; (iii) *capacity building* through development of human resources and also development of regional facilities (SPS compliant facilities and certification system for organic farming and promotion of environmental goods); (iv) *harmonisation of policies and acts* (such as protection of plant variety, bio-safety protocols, biodiversity and indigenous knowledge); and (v) *participation in WTO negotiations in agriculture*. As regards to future emphasis for agriculture sector, it is suggested that South Asian countries would have to continue due focus on food crops such as rice, wheat and pulses provided in the 1990s. However, considering increased domestic demand and export opportunities ushered through globalisation, these countries should have to emphasise on horticultural, fish, livestock and animal products. Effective cooperation for agricultural development in South Asia would essentially require: (a) establishment of working bodies and networks, (b) detailed work programmes, (c) series of agreements on specific issues, (d) regular monitoring and evaluation system, (e) strengthening of existing organisations such as SAARC Agricultural Information Centre (SAIC), and (f) establishment of regional institutes (designate existing institutes with regional mandates). Most importantly, agricultural development strategy should be implemented through public-private-NGO partnership rather than through public agencies only.

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Chapter 10

REGIONAL COOPERATION IN THE ENERGY SECTOR OF SOUTH ASIA*

10.1 INTRODUCTION

Cooperation among the countries, irrespective of size, population and resource in a region, in the past few decades has proved to be beneficial for members through adoption of common strategy and policy for economy, agriculture, natural resource, trade, tariff, technology, environment and so forth. This has given rise to multilateralism by replacing bilateralism in different regions of the world.

Cooperation today among the countries in a region provides an opportunity in ending mistrust, power rivalry and cultural barrier that exist historically or are due to political divide. Cooperation like EEC eventually enables its citizens to be the citizen of the community by removing the geographical boundaries among constituents with opportunities for job and investment in the region as a whole. This leads to uniform regulatory frameworks, fiscal policy, etc. without undermining political sovereignty, rather it enhances political stability nationally as well as regionally as a result of economic stability, growth of trade and efficient use of natural resources and technological advantages. Cooperation among the countries in a region strengthens its bargaining power as a region and people with global organisation and movement (Sierra, 1995).

The South Asia region comprising of India, Bangladesh, Nepal, Bhutan, Pakistan, Maldives and Sri Lanka has all the potentials of making a successful and viable cooperation (Rahman, 1986). The region with about 20 per cent of world's population and with per capita GDP of about US$430.0 challenges the leadership for forging a cooperation by giving up political divide and power rivalry for economic growth, sustainable development and poverty alleviation. This region, what was once one subcontinent, can become a regional cooperation for greater political and economic stability? The leadership of the South Asia region should strive for expanding the cooperation by including Iran and Myanmar to make it a great cooperation in the world.

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The economic development depends heavily on combined inputs of capital, technology, energy and human resource. Sustenance of economic development leads to economic growth that is what the developing countries must strive for. Reliable energy supply in different forms, such as fuel, power, heating media and prime mover, is vital for sustained growth of a modern economy. Although energy may constitute a small fraction of cost in many industry, manufacturing and service sectors, its interruption, unreliability and poor quality can play havoc not only on the related sectors but also on the economy as a whole in the form of chain reactions. Energy today is no longer an input or prerequisite for economic development, it is rather an infrastructure. In addition to ensuring availability of energy, its efficient use and management can make all the difference to a country's economy and people's welfare.

For the South Asia region with more than 1.4 billion population, cooperation in the energy sector is a worthwhile endeavour for building an energy infrastructure for sustaining the economy and its growth, including enhancement of energy security and efficiency of economy.

10.1.1 Scope of the Paper

The materials presented cover issues such as sustainable development, energy security, energy policy and regulatory framework, structure of energy sector, energy trade, energy cooperation and development of institutional framework in the context of regional cooperation in the energy sector of South Asia, comprising of Bangladesh, India, Pakistan, Sri Lanka, Nepal, Bhutan and Maldives. In view of the size of economy, resource endowments and preparedness in dealing with energy crisis, energy trade and cooperation, different countries received varied degree of analysis.

The data and information have been obtained from available sources such as government publications, Energy Information Administration (EIA), World Bank documents, UN publications and other publications. Data used and presented are indicative of the state of affairs that will act as marker for assessing significance of trade, sustainable development and security, and cooperation among the countries in South Asia to appreciate underlying reasons for forging a South Asia regional cooperation in the energy sector.

10.2 SUSTAINABLE DEVELOPMENT

10.2.1 Meaning of Sustainable Development

There had been till recently two perceptions of sustainable development; one reflects IUCN's perception of sustainable development, and the other is based on Brundtland Commission (Nishat, 2002). IUCN's perception focuses on the well-being of ecosystem along with human well-being; and development to be sustainable shall improve the quality of life by conserving the earth's vitality and diversity (ecosystem). The 1987 report of Brundtland Commission, Our Common Future, was instrumental in popularising the term sustainable development defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." This definition was qualified by requiring to meet "the essential needs of the world's poor, to which overriding priority should be given, and to the limits imposed by technology and social organisation on the environment's ability to meet present and future needs."

Today sustainability has become a recognised tool for assessing development policies and programmes by governments, donor agencies and NGOs. Sustainability implies prudent management of natural and environmental resources and calls for active role by government. Ongoing promotion of privatisation and deregulations that ask for greater assertion by the private sector, by diminishing government role, may, however, undermine the government's responsibility for prudent management of natural and environmental resources.

The environmental impact of human activity can be expressed as a product of three contributors: population size, per capita consumption of resources and the resultant environmental pollution and degradation. A rough estimate shows that a six-fold increase in the overall environmental impact of human activity on the global environment could have probably taken place over the 40-years period between 1950 and 1990 (Pearson, 2000). The energy use, agriculture and industry sectors all have serious impacts on the earth's ecosystem contributing to global warming, depletion of stratospheric ozone, depletion of surface and ground water, pollution of air, water and soil, loss of biodiversity, etc.

Poverty and inequalities lead to inefficient, wasteful and over harnessing of natural resources, while affluence with high level of consumption causes significant air, water and soil pollution, and depletion of non-renewable resources such as energy, minerals, and fresh water. If the poor and the rich, the developed and the developing continue to exploit the earth's non-renewable resources at will, the earth's natural ecosystem will be unsustainable, leading to environmental collapse. This is to be avoided by producing not less but by sustaining production differently (Pearson, 2000).

Today sustainable development requires sustainability of ecology and economy together. Any natural resource driven economy comprising of resource harvest to waste disposal strains an ecosystem and it makes sustainability doubtful. In view of acknowledging social equity element by the World Bank in the late 1970s, the protection and conservation of natural and environmental resources for sustained economic growth, dependent on natural resources, is a practical necessity. This prompted concept like self-sufficiency, appropriate technology and eco-development (Pearson, 2000). Today sustainable development has become an issue for poor countries, while the developed nations, being unwilling to compromise their prosperity by meeting global environmental goals, have made sustainable development a near lost movement.

Sustainable development would require certain changes and meeting conditions, which includes governance and transparency, deregulation, privatisation, removal of subsidies and tariff barrier, social equity and poverty reduction. These changes and conditions are conflicting; however, a compromise is to be made for integrating economic policy and planning with environmental considerations.

10.2.2 Sustainable Development in South Asia

The South Asia region, comprising of India, Bangladesh, Nepal, Bhutan, Pakistan and Sri Lanka, is still a developing economy and beset with a number of economic issues, such as poverty alleviation/reduction, education, health, housing, etc. including social equity and fulfilment of entitlement. These are all indicators for measuring economic and social progress.

The South Asia region emphasises on environment and its protection in the context of sustainable development. With about half the population living below the poverty level or at subsistence level, sustenance of income or welfare is yet an unattainable goal, while the infrastructures, such as roads, waterways, power, gas, water supply, etc., have not reached a satisfactory level yet.

Bangladesh

Bangladesh views sustainable development in terms of environment and its management for improving the quality of life. The Fifth Five-Year Plan (Fifth Plan, Bangladesh) aimed at the following:

- promoting sustainable environment management in pursuit of quality of livelihood and alleviating poverty;
- promoting participatory community-based environmental resource management and environmental protection;
- promoting environment friendly activities in development interventions;
- preserving, protecting and developing natural resource base;
- strengthening capabilities of public and private sectors to address environmental concerns;
- controlling and preventing environmental pollution and degradation related to soil, water and air;
- conserving non-renewable resources;
- sustaining auto and eco-generation of renewable resources.

It is recognised that rapid economic development will excessively strain natural resources, such as land, water, energy, etc. along with increased discharge of pollutants to the environment. So, development effort must aim at an "efficiency and quality culture" in planning process. Sustainability is to be a balance among long-term economic growth and efficiency, ecological unity and human well-being, including social equity. The concept looks for an alternative approach to mend the failures of the past development strategies to halt growing inequality and deprivation of decent living for a sustainable livelihood and environmental conservation.

Several policy and plan documents at the national and sectoral levels have outlined policies and plans pertaining to sustainable development and environment (Nishat, 2002). These include National Environmental Policy (NEP), Environment Conservation Act 1995, (ECA-95), National Conservation Strategy, National Environmental Management Action Plan (NEMAP), National Energy Policy, Flood Action Plan (FAP), Sustainable Environmental Management Plan (SEMP), etc. NEP and ECA-95 specifically require the completion of Environmental Impact Assessment (EIA) for development projects, including industry.

India

Conservation and sustainable use of natural resources, based on indigenous knowledge systems and practices, are deep-rooted in Indian values and life style. India is well ahead of other countries of the South Asia region in developing and formulating legislations, regulations, policies, and programmes for conservation and sustainable use of resources for meeting the challenge of sustainable development (UN Agenda 21-India). It has also addressed matters concerning cooperation for sustainable development at subregional, regional and international levels by framing legislations, regulations and policy documents. These include:

- The Environment Protection Act, 1986.
- The National Conservation Strategy and Policy Statement on Environment and Development, 1992.
- The National Forest Policy, 1998.
- The National Action Plan on Biodiversity.
- The Energy Conservation Bill.

India has always emphasised the importance of public investment for sustainable development by providing fiscal concessions and incentives. For encouraging protection level of atmosphere by employing energy-efficient technology and non-conventional energy technologies, various tax concessions, 100 per cent depreciation allowance and investment subsidies have been made available (Tenth Plan, India).

India discourages environmentally unsound processes and over-exploitation of natural resources. It strongly promotes environment friendly technologies to assure sustained economic growth as well as sustainable development.

Environmental Impact Assessment (EIA) for assessing the environmental compatibility of the development projects was introduced in 1978. Public hearings have been made mandatory since 1997 for development projects. Industry has adopted Environment Management System (EMS) on voluntary basis to achieve more sustainable production. India attaches importance to sustainable development in bilateral trade agreement.

India's national strategy and policies include:

- National Conservation Strategy.
- Environment Action Programme.
- Statement of Abatement of Pollution and Control.
- National Forest Policy.

These strategies and policies address the following issues:

- increasing energy and material efficiency in the production process;
- reducing waste from production and promoting recycling;
- using environmentally sound technologies for sustainable production;
- reducing wasteful consumption;
- increasing awareness for sustainable development;
- promoting using of new and renewable energy sources.

The government, to encourage pollution control by installing ETP, CETP and appropriate pollution abatement equipment, provides fiscal incentives. For promoting sustainable consumption and production, government, in cooperation with industries, consumer associations and others, have introduced the Ecomark scheme, Green Rating and ISO 14001 certification.

The Ministry of Environment separately evaluates the environmental impacts of new power plants through various interministerial committees. Effort is made to integrate the views of business and industry, S&T community, NGOs and local authorities. Programmes for promoting energy conservation include energy audit, renovation and modernisation of selected plants, adoption of clean coal technology, etc.

Pakistan

Pakistan views sustainable development in the context of environment and its management for improving the quality of life. Pakistan, soon after the conference on Human Environment in Stockholm in 1972, has been developing and formulating policies, legislations, regulations and programmes for conservation and protection of the environment and natural resources, thereby achieving the goals of sustainable development and economic growth.

Development strategies of Pakistan in the 1990s included food security, energy efficiency and conservation, conservation of environment, abatement of industrial pollution, etc. These strategies are consistent with the fourteen core issues highlighted in the National Conservation Strategy (UN Agenda 21-Pakistan). Pakistan has in place a number of legislations, policies and regulations that include the Pakistan Environment Protection Act, 1996; National Environmental Policy; National Environmental Quality Standards, etc. The development projects require preparation of EIA reports and assessment of environmental issues and management thereof.

Development projects are required to look into the financial sustainability, meaning a welfare economic surplus by making projects environmentally sound. The government actively encourages clean production processes by providing financial incentives, including lower import tariffs on anti-pollution equipment.

Nepal

Nepal with its current political difficulties has endeavoured to establish social equality by making the outcomes of development reach the targeted groups. The objective of the Tenth Plan is to embrace all the groups, communities and regions in the development process by institutional and policy reforms in the economic and social sector, and to ensure that the benefits of development reach in all regions and groups in a just manner (Tenth Plan, Nepal). Major strategies to achieve this objective include:

- emphasis on poverty-oriented programmes and result-oriented economic management;
- accessing the development efforts and its benefits to the less privileged;
- making the basic services and income-generating programmes reach the public timely at low cost;

- rehabilitation of the people affected by violence and reconstruction of damaged physical infrastructure by the violent activities;
- operation of security and development together.

Nepal views sustainable development in the context of environment and its conservation. Nepal has a number of legislative and policy programmes, such as Environment Protection Act, 1996; Water Resources Act, 1992; Industrial Policy, 1992; Forestry Act, 1995; Electricity Regulations, 1993; Hydropower Development Policy, 1995; Mines and Mineral Regulations, 1999, etc. These cover sustainable development issue from the viewpoint of conservation, efficiency and minimisation of waste generation and pollution reduction. Development projects in Nepal require EIA to appreciate impacts on environment and its conservation.

Bhutan

Bhutan's development philosophy is based on the concept of "gross national happiness" that stresses the importance of economic growth, cultural preservation, environmental conservation, good governance and respect for local conditions and values (Ninth Plan, Bhutan). Its development policies reflect Buddhist concerns for social equity and compassion. The government views happiness a policy objective for assuring people's well-being. Bhutan looks forward to development investment without producing "Dutch disease."

Bhutan with its rich biodiversity, its soil, water and air, not yet polluted, is concerned to preserve the environment and mountain ecosystem. The goals of environmental preservation are sustainable use of natural resources, maintaining biological diversity, ecological process and life support systems, pollution abatement and mitigation of the adverse impacts of modernisation and industrialisation (Ura and Kinga, 2004).

Bhutan has limited legislations and regulations encompassing sustainable development and conservation of environment. These include The Environmental Assessment Act, 2000; the Mines and Minerals Management Act, 1995; National Environmental Strategy, 1998, etc. Environmental impact assessment is required for road, hydro and industrial projects. Mining projects look for sustenance of supply of raw materials.

10.2.3 Common and Conflicting Issues

The countries in the South Asia region consider sustainability of development and economic growth in the context of conservation of natural resources and environment. Aided projects require sustainability to be in-built in the planning, implementation and operation stages. These countries being signatories to many international treaties, conferences and conventions are continuously framing legislations, regulations, policies and rules pertinent to environmental conservation and protection encompassing sustainable development. They have made efforts to incorporate sustainability in development strategy and policy. Compared to other countries India has equipped it with a large number of legislations, regulations, policies and programmes to address sustainable development issues along with conservation of natural resources and environment.

The region as a whole can have a common set of policies, programmes, legislations and regulations to achieve the common goals of sustainability of development and economic growth. This would strengthen its ability to access donor funds for common development projects benefiting the region as a whole.

10.2.4 Energy and Sustainable Development

Energy is an important input under all kinds of socioeconomic structures. When sustainability of development and economic growth in the context of food supply, social equity and quality of life become critically dependent on energy supply and its sources, energy becomes a strategic ingredient in development planning. Although the contribution of energy as fuel or power as a percentage of cost in many economic activities like agriculture, manufacturing, transport or infrastructure building may not be significant compared to other components, its disruption and quality can seriously affect food production, industrial output, environment, employment, commerce and trade, transport and other services (Quader and Gomes, 2003).

The traditional biomass source consisting of firewood, animal dung, crop residues, leaves and twigs, etc. is the only or major energy source for the most rural population of the South Asia region. Table 10.1 shows the composition of energy sources in the region in the 1990s (Lama, 2003). Dependence on firewood has badly affected the sustainability of the forest resource plus the negative impact on environment due to deforestation is no less disastrous.

The per capita consumption of commercial energy in the region is quite low. Table 10.2 shows the consumption and growth trend for the 1990-2001 period. Per capita GDP and per capita commercial energy consumption are difficult to correlate because of use pattern of energy and quality of life.

TABLE 10.1

Composition of Energy Sources in South Asia Region (%)

Country	Traditional				Commercial			
	Crop Residue	Animal Dung	Firewood	Total	Oil and Coal	Natural Gas	Hydro	Total
India	21.8	5.3	5.9	33.0	39.0	0.7	27.0	67.0
Bangladesh	32.6	12.4	10.0	55.0	10.0	34.0	1.0	45.0
Nepal	3.0	6.0	78.0	87.0	12.0	–	1.0	13.0
Bhutan	17.0	4.0	59.0	80.0	7.0	–	13.0	20.0
Pakistan	21.0	–	15.0	36.0	34.0	23.0	7.0	64.0
Sri Lanka	–	45.7	24.3	70.0	24.0	1.0	5.0	30.0

Source: Lama (2003).

Tables 10.3 and 10.4 show the import and export data of commercial energy in the region for the year 2001. The region is greatly dependent on import of petroleum products and crude oil. The middle distillates consisting of diesel and kerosene constitute about 45.0-80.0 per cent of total petroleum products consumed in the region. The petroleum products consisting of diesel and motor spirit fuelling the transport sector and irrigation constitute 39.0-63.0 per cent of total petroleum products consumed in different countries.

Though per capita consumption or generation of electricity in the region is low by the world average, its generation is to a large extent dependent on indigenous natural resources, such as coal, gas or hydro. Table 10.5 shows the electricity generation type for the region in per cent of total generation.

TABLE 10.2

Energy Use (per capita) in South Asia Region During 1990-2001

Country	Electricity (kWh)		Electricity Average Annual Growth, (%)	kg oil equivalent (kg oe)		kg oil equivalent Average Annual Growth, (%)	Per capita GDP, 2002 US$-PPP
	1990	2001	1990-2001	1990	2001	1990-2001	
India	249	365	3.5	427	515	1.8	2540
Bangladesh	43	94	7.3	118	153	2.5	1700
Nepal	33	61	5.7	320	357	0.9	1400
Pakistan	267	358	2.7	402	456	1.3	2100
Sri Lanka	160	285	5.4	339	423	2.5	3700
World	1744	2159	1.9	1677	1686	0.1	–

Source: World Development Indicators 2004, The World Bank; South Asia Regional Overview September 2004, The Energy Information Administration (EIA).

TABLE 10.3

Import of Commercial Energy, 2001

Country	Oil (000 bbl/day)		Coal (million t/yr)		Electricity	Natural gas
	Crude	Refinery Products	Coal	Coke	(Billion kWh)	(BCM/yr)
India	1574.1	156.0	22.65	2.518	1.50	–
Bangladesh	28.0	50.9	0.772	–	–	–
Nepal	–	15.2	0.5	–	0.120	–
Bhutan	–	1.0	0.055	–	0.010	–
Pakistan	141.5	182.3	1.011	–	–	–
Sri Lanka	39.1	33.8	–	0.001	–	–
Maldives	–	2.0	–	–	–	–

Source: Bangladesh Country Analysis Brief; India Country Analysis Brief; Nepal Country Analysis Brief; Bhutan Country Analysis Brief; Pakistan Country Analysis Brief; Sri Lanka Country Analysis Brief; and Maldives Country Analysis Brief of the Energy Information Administration (EIA).

TABLE 10.4

Export of Commercial Energy, 2001

Country	Oil (000 bbl/day)		Coal (million t/yr)		Electricity,	Natural gas
	Crude	Refinery Products	Coal	Coke	(Billion kWh)	(BCM/yr)
India	–	213.48	2.098	0.007	0.300	–
Bangladesh	–	0.95	–	–	–	–
Nepal	–	–	–	–	0.180	–
Bhutan	–	–	–	–	1.380	–
Pakistan	4.91	13.83	–	–	–	–
Sri Lanka	–	1.85	–	–	–	–

Source: Bangladesh Country Analysis Brief; India Country Analysis Brief; Nepal Country Analysis Brief; Bhutan Country Analysis Brief; Pakistan Country Analysis Brief; Sri Lanka Country Analysis Brief; and Maldives Country Analysis Brief of the Energy Information Administration (EIA).

TABLE 10.5

Electricity Generation Based on Fuel/Energy Source, 2001

Country	Total Electricity Generated (Billion kWh)	% of Generation based on				
		Coal	Natural Gas	Oil	Hydro	Nuclear
India	576.5	78.3	3.6	1.2	12.8	3.4
Bangladesh	16.3	–	84.6	9.4	6.0	–
Nepal	1.9	–	–	1.0	99.0	–
Bhutan	1.9	–	–	–	100.0	–
Pakistan	72.4	0.4	34.3	36.0	26.2	3.2
Sri Lanka	6.6	–	–	53.0	47.0	–

Source: Bangladesh Country Analysis Brief; India Country Analysis Brief; Nepal Country Analysis Brief; Bhutan Country Analysis Brief; Pakistan Country Analysis Brief; Sri Lanka Country Analysis Brief; and Maldives Country Analysis Brief of the Energy Information Administration (EIA).

India's 78.0 per cent power generation capacity is based on coal; Bangladesh's 84.6 per cent power generation is natural gas based; Nepal's 99.0 per cent power generation is hydro and for Bhutan 100.0 per cent is hydro; Pakistan's 61.0 per cent power generation is based on natural gas (34.3 per cent) and hydro (26.2 per cent) and Sri Lanka's 47.0 per cent generation is hydro. Except Sri Lanka and Pakistan whose 36.0-53.0 per cent power generation is oil based, other countries are tied to indigenous fuel or energy sources. All these countries need to consider power sector growth in the context of indigenous resource base and long-term sustainability.

10.3 ENERGY SECURITY

10.3.1 Meaning of Energy Security

Different countries view energy security differently considering spatial, temporal and economic dimensions (Islam, 2002). A stable and cost-effective supply of energy is desired in any economy. Resources, supply and demand factors plus stable access to supply sources are considered basic ingredients of energy security by many countries, both developed and developing. Energy security is now a global concern.

Energy security issues surfaced in the early 1970s with the imposition of the Arab oil embargo in 1973, along with rise in crude prices from US$ 2/bbl to more than US$ 10/bbl. The 1973 oil price hike did hurt the developing countries more than the developed countries that managed to offset the price hike by increasing their costs for services, materials and capital goods procured by the developing countries. Since then the world have encountered four oil shocks due to disruption of crude supply as well as price hike. The adverse impact of the oil price hike in South Asia in 1990/91 ranged from 1.2 per cent (India) of the GDP to as high as 4.5 per cent (Sri Lanka) (TERI Report No. 2000 EM 22).

Policymakers across the world have viewed energy security in terms of price hike and vulnerability of oil supply disruption. Energy security issues encompass vulnerability to oil-supply disruptions, stable operation of energy market at reasonable prices and environmental protection. Countries particularly dependent on import of oil and gas, irrespective of the size of economy and population, have become deeply concerned with supply and price.

Ever increasing demand for oil, by not matching augmentation of production and development of oil resources, has made oil supply vulnerable to price speculation. Geographical diversification of energy imports, along with an "energy mix" and technological advances, may help alleviate energy security issues of some countries for sometime (Ivanov and Smith, 2000).

A shared view of the meaning of energy security in national context is stable and cost-effective supply of energy. For countries in the South Asia region, a third dimension is availability of energy to the vast poor population at an affordable price.

10.3.2 Strategy for Energy Security

Energy security, as discussed today, encompasses internal and international dimensions. Dependence on imported oil and geographic locations of oil supplies have made energy security a complex issue and it is to be dealt by accessing all feasible options. Some of the strategies proposed and tried in different countries and regions are listed below (Invanov and Smith, 2000; Downs, 2000):

a. Diversification of import sources of oil and LNG.
b. Building strategic petroleum/crude reserve.
c. Energy mix.
d. Accelerated exploration and development of indigenous hydrocarbon resources.
e. Product substitution.
f. Deregulation/internationalisation of energy sector (for exploration, development, production and marketing).
g. Efficient use.
h. Incorporation of technological advances in production and use.
i. Development of indigenous energy sources, such as Coal Bed Methane (CBM), gas hydrates, tar sands, etc.
j. Acquisition of Equity hydrocarbon through exploration, development and production globally in different geographical areas.
k. Bilateral and regional cooperation.
l. International cooperation with international funding for developing and distribution of energy from common sources.

The countries in the South Asia region can adopt some of these strategies, provided adequate funds and political will could be in place.

10.3.3 Perception of Energy Security in South Asia

The region being a net importer of crude oil and petroleum products is concerned with energy security because of unstable price (price hike) and disruption of supplies, especially supplies from the Middle East. The dependence of the transport sector on petroleum products in the region is a common concern. The region does not have common strategy to deal with energy security. India has deeply looked into various aspects of energy security and has set some goals to achieve it (TERI Report No. 2000EM22, TERI 1998/99). Other countries, though concerned about it, have not worked out strategies to deal with energy security.

Bangladesh

Bangladesh is virtually dependent on imported oil and petroleum products. Current consumption of oil products in transport sector is 1.7 million tons against about 45,000 t equivalent from CNG. Transport sector accounts for around 50.0 per cent oil products while agriculture (irrigation) and power generation account for about 15.0 per cent and 8.0 per cent respectively. More than 90.0 per cent power generation is based on indigenous natural gas. Dependence on imported petroleum products and crude plus power generation, based on limited indigenous natural gas reserves, have made sustenance of energy supply a security issue for the country.

Bangladesh does not have a laid-down strategy for energy security and the shared views include (Tenth Plan, Bangladesh; Islam, 2002; and Quader et al., 2003):

- diversification of energy mix;
- diversification of import sources for oil;
- augmentation of gas resources through indigenous exploration;
- non-export of gas by pipelines from the fields discovered by IOCs;
- adoption of technological advances in use and production of energy;
- energy cooperation in the region.

India

India views energy security in terms of supplies to meet demand at a reasonable price. It is worried with long-term supply security and to lessen the risk. It desires a balance between indigenous and outside energy sources, along with technological advances. Seventy per cent of crude requirements are met by import from the Middle-East. Current annual import of about 85.0 million ton crude will rise to 151.0 million ton by the end of the tenth Plan. The demand for gas is rising continuously. Strategies adopted by the Government of India, to attain energy security, include the following (Tenth Plan, India; TERI, 2002; Blueprint for Power Sector Development 2001; Naik et al. 2003; and TERI, 1998/99):

- enhancement of domestic oil reserves through accelerated exploration;
- development of new oil fields and additional development of existing fields;
- integrated energy planning;
- diversifying energy mix;
- deregulation of energy sector;
- substitution of oil by gas;
- increased strategic oil reserve (45 days of crude oil requirement);

- import of LNG;
- promoting nuclear and hydro power;
- investment in oil equity abroad by Indian companies, such as ONGC, Reliance, etc.;
- gas import through pipelines;
- developing indigenous Coal Bed Methane (CBM) and gas hydrates;
- improving efficiency in use and production of energy;
- flexibility in refinery operations;
- adoption of clean coal technology;
- energy cooperation both bilateral and regional.

Pakistan

Pakistan views energy security in terms of supplies to meet demand at reasonable price. The imports of crude oil and refined products are on the rise. About 36.0 per cent of power generation is oil-fuelled and about 86.0 per cent of petroleum products consumed is imported (Aminuddin, 2003). These make Pakistan vulnerable to disruption of oil supply and price hike.

Shared views of energy security for Pakistan reflect the following (Raza et al. 2003; and Pakistan Perspective Plan, 1998-2003):

- diversification of supply resources;
- FDI in energy sector including oil, gas and power;
- diversification of energy mix;
- substitution of oil by gas;
- gas import through pipelines;
- improving efficiency in use and production of energy;
- flexibility in refinery operations;
- deregulation of energy sector;
- energy cooperation both bilateral and regional.

Nepal

Nepal has no reserves of oil or gas and only about 2.0 million tons of coal reserves. Nepal meets its demand for oil products of about 15,000 bbl/d through import from India. Nepal's electricity generation is hydroelectric (about 99.0 per cent). Nepal though concerned with its energy supply and resources, it does not have action plans to deal with its energy security. Some of the programmes envisioned by Nepal will help enhance its energy security and these include (Malla, 2003 and 2002; Tenth Plan, Nepal):

- development of hydroelectric potential;
- exploration of oil/gas by IOCs;
- improving efficiency in use and production;

- energy cooperation both bilateral and regional;
- deregulation of energy sector.

Sri Lanka

Sri Lanka produces no oil or gas. It imports crude and oil products. More than 71.0 per cent of electric generation capacity is hydroelectric and the rest is thermal (oil). Sri Lanka's commercial energy consumption consisted of oil (76.0 per cent) and hydroelectricity (24.0 per cent) in 2001. Severe drought in 1996 resulted in a major power shortfall because of low hydropower production, and this affected economy (Siyambalapitiya, 2002).

Sri Lanka, though concerned with its energy security because of dependence on imported oil and indigenous hydropower, does not have a stated strategy to deal with it. Some of the programmes in place will improve energy security (South Asia Regional Overview, 2004) and these include:

- diversification of "energy mix," especially for power generation;
- exploration of oil and gas by IOC;
- improving efficiency in use and production;
- deregulation;
- energy cooperation (bilateral).

Bhutan

Bhutan produces no oil or gas and does not have any significant reserves. Biomass, mainly firewood supplies about 98.0 per cent of Bhutan's energy consumption. Oil products (i.e. kerosene, diesel, gasoline, jet fuel) need is met by import from India and the need was about 1000 bbl/d in 2001. Ninety seven per cent of electric generation is hydroelectric and the rest is thermal (oil). Its coal reserve is estimated to be 1.3 million ton and it produces about 1000t coal/year against the annual consumption of 24,000t. Bhutan's view of energy security is not yet developed but its energy and environment development programmes relate certain aspects of energy security and these include (Ninth Plan, Bhutan; Ura and Kinga, 2004):

- improving efficiency in use and production;
- development of its hydropower potential;
- energy cooperation both bilateral and regional;
- conservation of forest.

Maldives

Maldives has no reserves of oil, gas or coal. Firewood accounts for about 55.0 per cent of its energy consumption. Imported oil products (about 2000 bbl/d in 2001) meet the energy requirements for transport and power generation. It has attempted to improve its energy supply through programmes such as (Maldives Country Analysis Brief, 2001).

- improving efficiency in use and production;
- exploration of oil/gas by IOC.

10.3.4 Common and Conflicting Issues

The South Asia region as a whole is a net importer of crude and oil products; and a large segment of economic activities, such as transportation, manufacturing and power generation, are also tied to oil products. The countries in the region view energy security in their respective national perspectives. Strategies drawn by them independently are common in many respects and only India has got some strategies that will enhance its energy security long term, for example equity hydrocarbon through exploration, development and production abroad, increasing strategic reserves of oil, etc. Irrespective of the size of economy and energy need base of individual country, a set of strategies for the region listed below can be taken up and this will allow the region to bargain in long-term energy import and diversification of supplies:

- common energy planning and energy development projects;
- improving efficiency in use and production of energy;
- regional energy trade, especially oil products, power and gas;
- flexibility in refinery operations to meet regional needs of oil products;
- gas import through pipelines from countries outside the region;
- long-term sourcing of crude and oil products;
- a common fund for energy development projects and programmes.

Energy security for the region has become a common concern that should be dealt from a common platform.

10.4 ENERGY POLICY AND REGULATORY FRAMEWORK

10.4.1 Energy Policy and Regulatory Framework in South Asia

Policy and regulatory frameworks are essential for planning, development and growth, production, pricing, transmission and distribution, conservation, environmental protection, etc. for the energy sector. The energy sector in this region had been a state-owned sector for several decades; and only during the past decade both local private and international investors have become active in the sector (Lama, 2003; Quader et al., 2003). The hydrocarbon sector, though still a state sector, the local private and International Oil Companies (IOCs) have become involved in exploration, development, production, transportation and marketing. The power generation sector has been opened to private investors, both local and international, under a wide range of licensing arrangement. The need for regulatory frameworks was felt as soon as the local private companies, IPPs and IOCs had begun their operations. The existing policy and regulatory frameworks are likely to be revamped in the light of deregulation.

Bangladesh

The 1972 Constitution of Bangladesh states that the ownership of natural resources, including gas, oil and mineral resources, lies with the republic (Article 143); and the rural population are entitled to have electricity (Article 16). The entitlement of electricity by the rural population obligates the government to expand electricity supply to the rural population (Quader et al., 2003).

In September 1995, Bangladesh adopted its National Energy Policy (NEP) to ensure "proper exploration, production, distribution and rational use of energy sources, to meet the growing energy demand of different zones, consuming sectors and consumer groups, on a sustainable basis." The objectives of NEP are:

i. To provide energy for sustainable economic growth so that economic development is not constrained due to energy shortage;
ii. To meet the energy needs of different zones and socioeconomic groups;
iii. To ensure optimum development of all the indigenous energy sources;
iv. To ensure rational use of total energy;
v. To ensure sustainable operation of energy utilities;
vi. To ensure environmentally sound sustainable energy development programmes;
vii. To encourage public and private sector participation in the development and management of energy sector.

Important recommendations of NEP include:

a. assessment of indigenous resources;
b. supply and augmentation of indigenous resources;
c. fuel mix (indigenous and imported);
d. conservation;
e. pricing (overall and specific);
f. system loss reduction;
g. emergency stock (for petroleum products, coal and standby gas wells);
h. resolution of legal issues related to NEP;
i. investment and lending terms.

The recommendations in different places have strongly stressed the participation of local and foreign private investments in hydrocarbon sector in exploration and development, both on-shore and off-shore.

The NEP documents envisage competitive participation of the public and private sector for a healthy growth of the entire sector, including corporatisation and unbundling. It recognises the possibility of power trade and cooperation among the SAARC members and exchange of experience in power sector. Revision of the NEP is now in progress.

The Private Sector Power Generation Policy of 1996 outlines the procedure for participation of private sector for Independent Power Producers' (IPP) projects on Build-Own-Operate (BOO) basis. Each IPP project, as per policy, is to be executed based on agreed Implementation Agreement (IA), Power Purchase Agreement (PPA) and Fuel Supply Agreement (FSA); and the Government of Bangladesh will guarantee performance obligations of the concerned utility, including gas supply. The policy provides fiscal incentives to IPPs in the form of exemption of corporate income tax for 15 years, VAT on capital equipment, repatriation of equity and dividends for foreign investment and avoidance of double taxation.

The policy guidelines for Small Power Plant (SPP) in Private Sector of 1998 will assist the private sector to build and operate small capacity plants of the order of 10 MW or less on BOO basis. The operator can sell power directly to the consumer using existing transmission and distribution facilities on agreed terms. The policy provides fiscal incentives and benefits similar to those provided to IPPs under the private sector power generation policy.

The Energy Regulatory Commission Bill 2003 provides for an Independent Energy Regulatory Commission (ERC), a statutory body to regulate the activities of the entire energy sector. Major functions of ERC include (Energy Regulatory Commission Bill, 2003):

- regulate generation, purchase, transmission, distribution, supply and utilisation of electricity and energy;
- regulate quality of service and tariff;
- approve programme of licenses for generation, transmission, distribution and supply of electricity and energy;
- apply uniform accounting procedure for all the licenses;
- settle disputes and differences between the licenses and between consumers and licenses and referring to arbitration if necessary;
- enforce codes and standards including safety, quality and reliability of services for the sector;
- coordinate with the Department of Environment on environmental matters.

The report prepared for CPD (Task Force Report on Development and Governance of the Energy Sector, 2003) has critically looked into the energy sector of Bangladesh and made a number of suggestions to bring governance and to expedite the development of the sector.

India

The energy sector in India consists of these broad categories, namely, power, coal, petroleum and natural gas, nuclear and non-conventional sources; and a separate ministry at the centre administers each sub-sector. The Government of India through its cabinet and Planning Commission coordinate and integrate the activities of ministries. Each ministry coordinates and integrates with state governments with the National Development Council being the facilitator. The Five-Year Plans at preparation stage look into the sector in its totality in national perspective.

Successive Five-Year Plans and recommendations of different working groups or expert committees, such as Energy Survey Committee, Fuel Policy Committee, etc. have contributed to India's energy policy. India's Tenth Plan (2002-2007) has identified areas that reflect its short-term and long-term policy for the energy sector and these are:

i. Oil Security
   a. accelerated exploration efforts, especially in deep off-shore and frontier areas;
   b. improved oil recovery/enhanced oil recovery;
   c. equity oil and gas abroad;
   d. strategic reserves of crude oil;
   e. alternate fuels such as coal bed methane or gas hydrate.
ii. Infrastructure Development
   a. flexibility in refinery operation;
   b. refining capacity;
   c. regulatory mechanism to safeguard consumer interest;
   d. marketing and distribution facilities commensurate with demand.
iii. Efficiency Improvement
   a. benchmarking the hydrocarbon sector with international standards;
   b. oil conservation;
   c. demand side management.
iv. Environment and Quality Improvement
   a. improvement of product quality in line with international standards;
   b. environmental conservation and protection (clean coal technology, Integrated Gas Combined Cycle (IGCC)).
v. Reforms
   a. dismantling of Administered Pricing Mechanism (APM);
   b. restructuring and disinvestments.
vi. Regulatory Mechanisms
   a. a regulatory mechanism for the downstream and gas sector;
   b. setting up of regulatory authority for the coal sector;
   c. setting up of Central Electricity Regulatory Commission;
   d. enacting Electricity Bill.

Activities in power, both thermal (coal/oil) and hydro, oil and gas, and coal sectors today involve three key players, namely, the centre, the state and the private/joint venture operators. The operations in these sectors are quite complex with defined roles for generation/production, transmission/transportation, distribution/marketing.

The Central Electricity Regulatory Commission (CERC) now in place regulates the central sector and interstate electricity linkage (The Electricity Regulatory Commission India 1998). The State Electricity Regulatory Commissions (SERCs), functioning at the state level, are responsible for unbundling and privatisation of State Electricity Boards and for dealing with electricity tariffs and disputes that may arise.

Reform measures undertaken for private sector participation by both local and foreign investors include reducing constraints in foreign equity participation; easing licensing and approval procedures; and other fiscal incentives that would make investment lucrative; foreign investment with 100.0 per cent foreign equity in thermal, hydro and wind or solar energy without any limitation to size; automatic approval of foreign equity participation up to 100.0 per cent for generation, transmission and distribution for foreign equity investment not over Rs 1,500.0 crore; private companies allowed a debt equity ratio up to 4:1; licenses granted for longer durations 30 years in the first instance; plants over 1000 MW allowed free imports of capital goods, etc. (Tenth Plan, India; TERI, 2003; Blueprint for Power Sector Development India, 2001). The emphasis now is in the distribution sector reform at the state level to improve quality of utility, revenue collection, and reducing technical and unaccounted losses.

The salient features of the Electricity Act of 2003 are:

- The central government to prepare a National Electricity Policy in consultation with state governments.
- A thrust to complete rural electrification and provide for management of rural distribution by *panchayats*, cooperative societies, non-government organisations, franchises, etc.
- Generation to be delicensed and captive generation to be freely permitted. Hydro projects would, however, need approval of the state governments and clearance from the Central Electricity Authority.
- Transmission utility at the central as well as state level, to be a Government company with responsibility for planned and coordinated development of transmission network. Provision for private transmission licenses.
- Open access in transmission from the outset with provision for surcharge for taking care of current level of cross subsidy with the surcharge being gradually phased out.
- Distribution licenses would be free to undertake generation, and generating companies would be free to take up distribution licenses.
- The State Electricity Regulatory Commission is a mandatory requirement.
- Provision for license free generation and distribution in the rural areas.
- The SERCs may permit open access in distribution in phases with surcharge for current level of cross subsidy to be gradually phased out along with cross subsidies and obligation to supply.
- Provision for payment of subsidy through budget.
- For rural and remote areas stand alone systems for generation and distribution would be permitted.
- Trading as a distinct activity is being recognised with the safeguard of the Regulatory Commission being authorised to fix ceilings on trading margins, if necessary.
- The State Governments have flexibility to unbundle the SEBs or continue with them as distribution licenses and state transmission utility.

This act is likely to reform the power sector exhaustively by providing legal frameworks for reforming and restructuring of the sector. It would simplify the administrative procedures by integrating the existing acts in force in the sector into a single act. It will ultimately bring stability in the sector by removing regulatory and policy uncertainties.

The oil and gas sector of India in the past decade has become less and less state controlled and is fairly market based. The upstream sector though had been opened to private investment in the late 1980s, the interest became intense with the New Exploration and Licensing Policy (NELP) of 1997. The downstream sector, i.e. refining, was opened to the private investment only in 1998 and today the private investors are very active in refinery operations (Lama, 2003; TERI, 2003).

With the dismantling of APM in 2002, it is now free market (deregulated). The natural gas sector is, however, still regulated in respect of price with a cap on international price for private producers. With the deregulation, there is a need to constitute a "Petroleum Regulatory Authority." Drafts "Petroleum Products and Natural Gas Pipelines Policy" are under scrutiny.

Pakistan

The energy sector in Pakistan consists of three broad categories, namely, oil, gas and coal, power (thermal and hydro) and nuclear. Independent ministry excluding coal, which is the domain of provinces while the federal government performs coordination function, administers each category. The successive Five-Year Plans have laid down sectoral development and growth strategies that have been viewed as national policies (Pakistan Perspective Plan 1998-2003). Pakistan plans to have a National Policy for the entire sector in the near future.

The power sector strategic plan of 1992 outlines the long-term goals of providing power to all the people through private, efficient and competitive system with three major goals:

a. Enhance capital formation for the sector outside the government budget and without sovereign guarantees;

b. Improve the efficiency of the sector through competition, accountability, managerial autonomy and profit incentives; and

c. Rationalise prices and social subsidies for social equity.

Since the 1990s four power policies, namely, "Private Power Policy Framework, 1994," "Hydel Power Policy Framework, 1995," "Policy for New Private Independent Power Projects, 1998" and "Policy for Power Generation Projects, 2002" have been announced for promoting private investment. The first two policies were based on tariff, announced upfront; the third policy was based on setting a tariff competitively, and the policy of 2002 encompasses private and public sector projects, public-private partnership projects and public sector projects to be developed and then disinvested. The important objectives of 2002 policy are:

- to provide sufficient generation at least cost and to avoid shortfalls;
- to encourage and ensure exploitation and use of indigenous resources in all forms;
- to provide a level play field (a win-win situation for all);
- to ensure environmental conservation and protection.

The Private Power and Infrastructure Board (PPIB) has been providing one window service for private power generation projects since the introduction of 1994 Power Policy. The National Electric Power Regulatory Authority (NEPRA), functioning since 1997, regulates and oversees:

i. Licensing for generation, transmission and distribution;

ii. Prescribing procedures and standards for investment;

iii. Setting and enforcing performance standards for ensuring security, safety, quality of power supply and environmental protection;

iv. Fixing tariff.

The Privatisation Commission has initiated the privatisation of generation and distribution entities under the public sector; some of the entities have already been privatised.

WAPDA's Hydropower Development Plan Vision 2025 envisages private sector hydel projects on the basis of Build-Own-Operate-Transfer (BOOT) and thermal power projects on the basis of BOOT or Build-Own-Operate (BOO) while the Government will guarantee that the terms and conditions of executed agreements are maintained during the term of the agreements for projects above 50 MW.

Since 2000 Pakistan has been pursuing a policy of deregulating the oil and gas sector by making it pro-market by reducing government control (Raza et al., 2003). Major measures taken include promoting private investment in the upstream, deregulating most of the market for petroleum products, regulatory agency for oil and gas sector, and introducing market related price-caps for petroleum products.

Four petroleum policies have been announced since 1990, with continuous improvement of terms and conditions to accelerate exploration through the private sector, especially by IOCs, both on-shore and off-shore. The Petroleum Exploration and Production Policy 2001 is more investor friendly (Raza et al., 2003).

The Oil and Gas Regulatory Authority (OGRA) was created in 2002, by renaming the Gas Regulatory Authority of 2000, to regulate both gas and oil sectors. OGRA is responsible for the safety standards and enforcement of product specifications, competition and anti-trust. OGRA is not yet empowered like NEPRA to deal with licensing and tariffs. Deregulation and reforms in oil and gas sector have led to (Raza et al., 2003; Aminuddin, 2003):

- market-oriented pricing of oil products;
- privatisation of government equity in joint ventures;
- market-oriented gas pricing;
- private refineries to import crude and blending components freely based on commercial consideration.

Nepal

Nepal's main indigenous energy resources being fuel wood and hydropower, it has made efforts to formulate policy and rules covering these resources. The reform initiatives in energy sectors are taking shape slowly. The successive Five-Year Plan documents have outlined some of the goals of Nepal's energy policy and strategy. The main policy thrust is to develop its hydropower potential for domestic use and for export; and export earning from hydropower will be used to fund the economic development programmes. The Tenth plan expects development of renewable energy resources for sustained development of rural economy as well as poverty alleviation (Tenth Plan, Nepal).

The Hydropower Development Policy 2001 plans to develop the country's hydropower potential for generating power cost-effectively for domestic consumption at an affordable price and for export (Malla, 2003). The policy emphasises:

- development of hydropower potential to the maximum extent for domestic consumption;
- development of hydropower projects based on BOOT;
- providing financial incentives, concessions and procedural transparency for local and foreign investors;
- export of power under both the bilateral and regional cooperation;
- energy conservation and load management.

The Water and Energy Commission (WEC) in its policy advisory capacity formulates short and long-term water and energy development policies, legislations and analyses; and advises on bilateral and multilateral energy development projects plus hydropower development treaties with neighbouring countries. Other regulatory and legal frameworks that govern the power sector include (Malla, 2003, 2002):

- Nepal Electricity Authority Act, 1984.
- Electricity Act, 1992.
- Electricity Regulations, 1993.
- Electricity Tariff Fixation Commission Regulation (ETFC), 1993.
- Water Resources Act, 1992.

Power sector reform measures aim at providing efficient, quality and affordable power for the domestic market and at the same time making it cost effective for the export market. Reform measures include unbundling of Nepal Electricity Authority, privatisation of power company, etc. Reforms are progressing slowly. Important policies and regulations that deal with coal, oil and gas in Nepal are:

- Nepal Petroleum Act, 1983.
- Petroleum Regulation, 1994.
- Mines and Mineral Regulation, 1999.

Import and sale of oil products are the responsibilities of the state corporation, Nepal Oil Corporation, while the coal import and sale lie with the private sector. Nepal is yet to have a regulatory body for the sector and the existing ETFC will be developed into a regulatory body.

Sri Lanka

The National Energy Policy, 1997 of Sri Lanka has its roots in the document "National Energy Strategy" prepared in the early 1980s by the then Natural Resources, Energy and Science Authority, what is today the National Science Foundation. The 1997 policy outlines a number of basic objectives that are listed below (Siambalapitiya, 2002):

i. Providing the basic energy needs.
ii. Reducing dependence on imported energy and diversification of supply sources.
iii. Optimising energy mix, especially energy sources and demand.
iv. Optimising the operation of available resources (hydropower, oil, renewable etc.).
v. Conservation and elimination of wasteful consumption.
vi. Developing and managing forest and non-forest fuel wood resources.
vii. Appropriate pricing policy and price stability.
viii. Continuity of energy supply.
ix. Using available capability and resources to develop and manage the sector.

The policy provides specific strategies to realise these objectives. Sri Lanka has a number of acts and regulations for the energy sector which include:

- Electricity Act
- Electricity Reforms Act, 2002
- Petroleum Act

Sri Lanka's reform programmes in power sector include unbundling of Ceylon Electricity Board; creation of separate distribution company, Lanka Electric Company Ltd (LECO); IP for thermal power plants (Diesel); small hydro projects in the private sector; fiscal incentives for the private investment in the sector, etc. (Sri Lanka Country Analysis Brief 2001, EIA).

Bhutan

The legislative, policy and regulatory frameworks of Bhutan are still at a nascent stage. The successive Five-Year Plans have been formulating strategies to develop the energy sector. Bhutan's large hydropower potential is over 30,000 MW which remains untapped (only about 1.4 per cent has been harnessed), and power generation being hydro based have led Bhutan to plan development of this potential. The Ninth Five-Year Plan (2002-2007) of Bhutan has set the following goals for the hydropower sector:

- strengthening the economic self-reliance by realising the power generation capacity;
- providing adequate, safe and reliable power through sustainable and environmentally friendly development of hydropower potential; and
- providing 100 per cent electrification by 2020.

Relevant strategies to realise above goals include (Ninth Plan, Bhutan):

- formulation of hydropower policy guidelines for independent power producers and operators;
- a comprehensive Rural Electrification Master Plan;
- strengthening the institutional capacity;
- load management;

- tariff based on trends and opportunities;
- preparation of Energy Master Plan, Water Resources Management Master Plan, and updating of Hydropower Master Plan Inventory.

The enactment of the Electricity Act 2001 has empowered the Bhutan Electricity Authority to function as a regulatory body, while the Bhutan Power Corporation be responsible for generation, transmission and distribution of the utility. The future development of Bhutan's hydropower potential through FDI or regional projects will depend on its policy and strategies for the sector.

10.4.2 Common and Conflicting Issues

The countries in South Asia region, considering their dependence on indigenous resources and imported sources to meet their current energy needs, have little chance of becoming self-sufficient in the energy sector. Irrespective of size of resource endowments of individual country, the growing demand for oil and gas makes the region vulnerable to supply disruption and price hike, leading to energy crisis that would stall the economy. India is better equipped with rules, regulations and policies to strengthen its ability to attract FDI in this sector. Its effort to acquire equity oil and gas globally is a visionary step.

10.5 STRUCTURE OF ENERGY SECTOR

10.5.1 The Energy Sector in South Asia Region

The individual country in South Asia region administers the energy sector by one or more than one ministries of the government (Table 10.6). The organisations/agencies or departments under different ministries, dealing with coal, oil and gas, thermal and hydropower are listed in Table 10.7 to appreciate how these sectors perform in different countries.

TABLE 10.6

Administrative Ministries of Energy Sector

Country	Administrative Ministry				
	Coal	Oil and Gas	Power		
			Thermal	Hydro	Nuclear
India	Ministry of Coal	Ministry of Petroleum & Natural Gas	Ministry of Power		Dept. of Atomic Energy
Bangladesh	Ministry of Energy & Mineral Resources (Energy & Mineral Resources Division)		Ministry of Energy & Mineral Resources (Power Division)		Ministry of Science & Information Technology
Nepal	Ministry of Industry, Commerce and Supplies		Ministry of Water Resources		
Pakistan	Ministry of Petroleum & Natural Resources		Ministry of Water & Power		Atomic Energy Commission
Bhutan	Ministry of Trade & Industry (Department of Geology & Mines)		Ministry of Trade & Industry (Dept. of Power)		-
Sri Lanka	Ministry of Power & Energy		Ministry of Power & Energy		-
Maldives	Ministry of Construction & Public Works				-

Source: Lama, 2003; Malla, 2003; Quader et al., 2003; Raza et al., 2003; Ninth Plan, Bhutan; Maldives, Country Analysis Brief 2001 of EIA; Sri Lanka Country Analysis Brief 2001 of EIA; and Siyambalapitiya, 2002.

TABLE 10.7

Organisations under the Ministry Dealing Each Segment of the Energy Sector

a. Coal	Agencies/Organisation
India	Coal India Ltd. & Private Producers
Bangladesh	Petrobangla
Pakistan	Provincial Matter

b. Oil and Natural Gas	
India	Oil and Natural Gas Corporation (ONGC), Oil India Ltd. (OIL), Gas Authority India Ltd. (GAIL), Indian Oil Corporation (IOC) Indian Private Companies and IOCs
Bangladesh	Petrobangla, Bangladesh Petroleum Corporation (BPC) & IOCs
Pakistan	Oil & Gas Development Co. Ltd. (OGDCL), Pakistan State Oil Corporation (PSOC), Pakistan Petroleum Ltd. (PPL), Sui Northern Gas Pipeline Ltd. (SNGPL), Sui Southern Gas & Pipeline Ltd. (SSGPL) and Pakistani Private Companies and IOCs
Bhutan	Department of Trade and Department of Geology & Mines
Sri Lanka	Sri Lanka Petroleum Corporation
Nepal	Nepal Oil Corporation and Dept. of Mines and Geology

c. Power

Country	Generation			Transmission	Distribution
	Thermal	Hydro	Nuclear		
India	National Thermal Power Corp. (NTPC), State Electricity Boards (SEB) and IPPs (Local and Foreign)	National Hydropower Corp. (NHPC)	Dept. of Atomic Energy	Power Grid Corporation of India Ltd. (PGCIL) & State Electricity Boards (SEBs)	State Electricity Boards
Bangladesh	Bangladesh Power Development Board (BPDB), Rural Power Co. (RPC) & IPPs (Local and Foreign)	BPDB		BPDB & Power Grid Company of Bangladesh (PGCB)	BPDB Rural Electrification Board (REB), Dhaka Electricity Supply Authority (DESA) and Dhaka Electric Supply Co (DESCO)
Nepal	Nepal Electricity Authority (NEA) and IPPs	NEA		NEA	NEA
Bhutan	Bhutan Power Corporation			Bhutan Power Corporation	
Pakistan	Water & Power Development Authority (WAPDA), Karachi Electric Supply Co (KESC), and IPPs (Local and Foreign)	WAPDA	Atomic Energy Commission	National Transmission Distribution (NTDC) and KESC	Distribution Companies of WAPDA and KESC
Sri Lanka	Ceylon Electricity Board (CEB), and IPPs	CEB		CEB	Lankan Electricity Co. (LECO) & CEB

Source: Lama, 2003; Malla, 2003; Quader et al., 2003; Raza et al., 2003; Ninth Plan, Bhutan; Maldives Country Analysis Brief 2001 of EIA; Sri Lanka Country Analysis Brief 2001 of EIA; and Siyambalapitiya, 2002.

The state corporation or agencies dominate the energy sector in the region. The local private and foreign investors have become welcome in this sector. The sector is likely to go through structural change and adjustment because of the private operators.

10.5.2 Energy Resources of the Region

The energy resources endowment of South Asia region is relatively small by world standard. Table 10.8 provides some relevant data on resources endowment countrywise.

TABLE 10.8

Energy Resources of South Asia Region

	Unit	Countries					
		India	Bangladesh	Nepal	Bhutan	Pakistan	Sri Lanka
Coal							
Reserve (R)	$\chi 10^6$t	83496	300	2	–	2265	–
Production (P)	$\chi 10^6$t/yr	343.5	–	–	–	3.3	–
R/P ratio	years	246	–	–	–	686	–
Crude oil							
Reserve (R)	$\chi 10^6$t	600	1	–	–	28.37	–
Production (P)	$\chi 10^6$t/yr	36.1	–	–	–	2.68	–
R/P ratio	$\chi 10^6$t	17.8	–	–	–	11.0	–
Gas							
Reserve (R)	BCM	650	300	–	–	710	–
Production (P)	BCM/yr	26.4	10.8	–	–	19.9	–
R/P ratio	years	24.5	27.8	–	–	35.6	
Hydro Power							
Total Potential	MW	90826	580	83290	21000	32000	2095
Installed Power	MW	26329	230	514	441	5010	1145
% in use (Installed total)	%	24.1	39.6	0.3	1.6	15.1	54.6

Note: BCM = Billion Cubic Meter.

Source: TERI, 2003; Lama, 2003; Quader, 2003; Raza et al., 2003; Fifth Plan, Bangladesh; Ninth Plan, Bhutan; Tenth Plan, India; Tenth Plan, Nepal; Pakistan Country Analysis Brief 2004 of EIA and Sri Lanka Country Analysis Brief 2001 of EIA.

The region as a whole has a good coal reserves and at the current production rate, with envisaged growth, the reserves will remain satisfactory for many decades. The crude oil reserves of about 630 million tons are small considering current production and envisaged growth. The region will be more and more dependent on imported crude oil and other petroleum products as time passes (Kumar, 2000). The natural gas reserves of the region are small against the projected growth of consumptions. The reserves augmentation through exploration is a necessity.

The hydropower potential of the region has remained unexploited. Only 12.5 per cent of the potential has been tapped and the hydropower potential of Nepal and Bhutan, which possess 45.0 per cent of total regional potential, has remained literally unexplored (only 0.6 per cent tapped).

The power generation capacity in different countries of the region, based on fuels/energy sources, is listed in Table 10.9. Table 10.10 shows the contribution of different fuels for thermal generation in the region.

TABLE 10.9

Power Generation Information of South Asia Region

Country	Generation Capacity, MW						Generation by IPP & Private, MW
	Total	Coal	Natural gas	Oil	Hydro	Nuclear	
Bangladesh	4713	–	3989	493	230	–	1293
India	104917	62131	13597	–	26329	2860	6250 (1997–98)
Nepal	566	–	–	51.3	514.7	–	103.5
Bhutan	444	–	–	3.57	441.43	–	
Pakistan	19258	150	13636	–	5010	462	5800
Sri Lanka	1600	–	–	455	1145	–	–
Maldives	25	–	–	25	–	–	–

Source: Fifth Plan, Bangladesh; Ninth Plan, Bhutan; Tenth Plan, India; Tenth Plan, Nepal; Maldives Country Analysis; Brief 2001 of EIA; Pakistan Country Analysis Brief 2004 of EIA; Sri Lanka Country Analysis Brief 2001 of EIA; and Quader et.al., 2003.

TABLE 10.10

Fuel Mix in Thermal Power Generation, Year 2001

Country	Fuel Mix (% of Total Generation)		
	Coal	Oil	Natural gas
Bangladesh	–	9.4	84.6
India	78.3	1.2	3.6
Pakistan	0.4	36.0	34.0
Nepal	–	1.0	–
Bhutan	–	–	–
Sri Lanka	–	53.0	–

Source: Bangladesh Country Analysis Brief 2004; Bhutan Country Analysis Brief 2001; India Country Analysis Brief India 2004; Nepal Country Analysis Brief 2001; Pakistan County Analysis Brief 2004; and Sri Lanka Country Analysis Brief 2001, EIA.

Bangladesh is virtually dependent on indigenous natural gas for power generation. More than 84.0 per cent power generation capacity of India is indigenous coal and hydro. Pakistan's more than 36.0 per cent power generation is based on oil, while natural gas makes 34.0 per cent. Sri Lanka, Nepal and Bhutan are largely dependent on hydropower.

10.5.3 Energy Consumption

The consumptions of different energy sources are discussed country wise in Table 10.11 to assess vulnerability of the consumption sectors and supply sources.

Bangladesh

Indigenous natural gas is the predominant fuel for power generation (>90%) and is the feed and fuel for all the urea fertiliser produced (100%) (Quader et al., 2002, 2003). There

TABLE 10.11

Consumption of Oil, Gas and Electricity

a. Oil Products

Country	Total Consumption x10^6 t	Use Sector (% of total)					
		Transport	Power Generation	Industry	Irrigation	Domestic	Service
Bangladesh	3.2 (2002)	46.8	11.9	5.8	15.8	19.7	–
India	98.5 (2001–02)	48.0	–	14.0	–	–	19.0
Pakistan	18.8 (2001)	48.0	35.0	11.0	–	6.0	–
Nepal	0.8 (2001)	–	–	–	–	–	–
Bhutan	0.05 (2001)	–	–	–	–	–	–
Sri Lanka	2.2 (2001)	–	–	–	–	–	–

b. Natural Gas

Country	Total Consumption	Use sector (% of total)			
	MMCMD	Power	Fertiliser	Industry	Domestic
Bangladesh	31.0 (2003)	47.5	23.9	15.9	11.2
India	76.8 (2001)	46.0	25.0	10.0*	19.0*
Pakistan	62.1 (2002)	35.0	21.0	2.1	21.0

c. Power

Country	Total Consumption,	Use Sectoral (% of total)			
	Billion kWh	Domestic	Industry	Irrigation	Commercial
Bangladesh	16.5 (2002)	44.0	43.0	4.0	7.0
India	547.0 (2002)	22.9	37.2	26.9	6.9
Nepal	1.4 (2002)	40.3	41.7	2.2	6.7
Bhutan	1.9 (1999)	–	–	–	–
Pakistan	68.0 (2001–02)	45.8	29.9	11.1	5.8
Sri Lanka	6.0 (2002)				

Note: *Sponge iron 5%, internal use 6% and others 18%.

Source: Lama (2003); Quader et.al. (2002–2003), Raza et.al. (2003); TERI (2003); Pakistan Oil and Gas Sector Review (2003); and Tenth Plan, India.

are now more than 1.3 million domestic consumers of natural gas consuming about 11.0 per cent of gas, while the industry consumes about 16.0 per cent. At the current production of gas with projected demand growth anything from 3.0 to 5.0 per cent per year, if the depleted reserve is not augmented, the sustenance of economy looks bleak in 25.0 years time.

Imports of crude oil and oil products to the tune of 3.0 million ton/year are likely to rise. Transport sector accounts for about 50.0 per cent of the consumption of oil, while irrigation makes about 16.0 per cent. Dependence on imported crude oil and oil products makes economy vulnerable to supply disruption and price hike.

When the Barapukuria coal project becomes on stream, there will be no need for coal import. Domestic consumption of electricity, natural gas, LPG and oil (kerosene) for lighting, cooking, etc. is growing, as the utilities become available.

India

Indigenous coal forms the backbone of Indian energy consumption. More than 73.0 per cent of electricity (including industrial captives) are coal fired. With the existing reserve at the current rate of consumption, including projected growth of consumption, India feels secured for coal-based power generation (generation capacity in excess of 62,000 MW).

The urea fertiliser industry, to a large extent, is based on natural gas and it consumes about 24.0 per cent of natural gas produced. The natural gas is produced from India's indigenous reserves. The power sector accounts for about 46.0 per cent of natural gas consumption. The sustenance of natural gas based economic sectors, without augmentation of depleted reserves, may be untenable in two decades.

India's transport sector consumes about 46.0 per cent of oil products, while the industry sector accounts for 14.0 per cent. Since 70.0 per cent of crude oil comes from import, the economy is vulnerable to supply disruption and price hike (TERI, 2003).

Industry sector, which consumes 37.0 per cent of power, 10.0 per cent of gas (excluding fertiliser), 14.0 per cent of oil and 19.0 per cent of coal and coke, though is based on a fuel mix with varied sources, is also susceptible to energy supply uncertainty, especially oil.

Pakistan

Indigenous natural gas makes about 43.0 per cent of total commercial energy consumption. The urea fertiliser industry is based on natural gas. It's use as a cooking fuel and fuel in industry is growing fast. At the current production rate and projected growth of demand, if the depleted reserves are not augmented, the sustenance of natural gas-based economy looks uncertain.

The transport sector of Pakistan consumes about 48.0 per cent of oil products, while the industry sector accounts for 11.0 per cent (Aminuddin, 2003). Since 90.0 per cent of crude oil and oil products are imported, the economy is vulnerable to supply disruption and price hike.

Indigenous coal accounts for only 4.6 per cent of total energy consumption and its production/consumption has remained static for the past decade.

Industry has remained a significant sector for consuming energy, (34.0 per cent on sources basis) and it consumes 30.0 per cent of power. The sector is vulnerable to uncertainty involved with supply of crude oil and oil products.

Nepal

Nepal is totally dependent on imported oil products to be consumed by transport sector mostly and the rest for domestic lighting/cooking. Domestic and industry sectors account for 40.0 per cent and 42.0 per cent of total power consumption respectively. Power generation being own hydro sources, supply of power is assured.

Bhutan

Bhutan is totally dependent on imported oil products, which are mainly used by transport sector; and a portion is used for domestic lighting/cooking. Power generation being from own hydro sources, supply of power is assured.

Sri Lanka

Sri Lanka is totally dependent on imported crude oil and products, which are mainly used by transport sector and thermal power plants. Its dependence on imported oil, because of its supply disruption and price hike, has made its economy vulnerable. Sri Lanka's hydropower was the backbone of its power supply (>55%) in the 1990s.

10.5.4 Future Projections of Supply and Demand

All the countries in the South Asia region consider energy as a crucial input for economic development and growth along with improvement of quality of life. These countries, through successive Five-Year Plans and studies, have been projecting demand growth for different types of energy from 5.0 to 10.0 per cent per year. Real achievements fell far short of the projections in many plan periods. Table 10.12 provides some data on performance in power generation in respect of planned addition and actual achievement for India and Bangladesh. The countries failed to achieve the planned targets for adding generation capacities. The achievements of other countries are about the same. Power generation being capital intensive, project implementations are subject to availability of funds and investors.

TABLE 10.12

Performance in Power Generation as per Plan

Country	Reference Plan	Generation Capacity		
		Projected Addition	Actual	% achieved
Bangladesh	5th Plan	2926	1169	40.0
India	9th Plan	40245	20420	51.0

Source: Quader et al. (2003); Fifth Plan, Bangladesh; and Tenth Plan, India.

The projected demands for some countries in the region are shown in Table 10.13 for some categories of energy. The projections as per Table 10.13 show a reasonable growth of demand. This growth, however, will depend on factors such as funds, availability of indigenous resources; for example, supply of natural gas and ability to import crude oil and oil products. No country in the region is assured that it will achieve the projected growth. Past performance is not convincing at all (Table 10.12).

TABLE 10.13

Growth Projections in Terms of Consumption, Production and Generation Capacity

Country	Oil (million t)		Natural Gas (BCF/yr)		Coal (million t)		Power Generation Capacity (MW)	
	2002*	2015	2002*	2015	2002*	2015	2002*	2015
Bangladesh	3.2	6.3 (at 5.25% growth)	365.0	947.0 (at 7.5% growth)	0.3	1.2⁺	4713.0	9039.0
India	100.4	161.0	990.0	2860.0 (at 8.5% growth)	414.0	612.0 (at 5% growth)	104917.0	190000.0
Nepal	0.7	1.8 (at 7% growth)	–	–	0.5	–	566.0	1238.0 (at 7% growth of hydropower)
Pakistan	18.7	25.7 (at 2.5% growth)	923.0	2660.0 (at 8.5% growth)	4.8	no growth	19258.0	32870.0
Bhutan	0.1 (2001)*	0.1 (at 5% growth)	–	–	0.1	–	444.0	840.0 (at 5% growth)
Sri Lanka	2.2 (2001)*	4.3 (at 5% growth)	–	–	0.001	–	1779.0	3380.0 (at 5% growth)

Note: *Base year, Consumption, Production or Capacity; ⁺because of Barapukuria coal.

Source: TERI, 2003; Lama, 2003; Malla, 2003; Quader et al., 2003; Raza et al., 2003; Fifth Plan Bangladesh; Bangladesh Economic Review 2004; Ninth Plan, Bhutan; Tenth Plan, India; Pakistan Oil and Gas Sector Review 2003; Blueprint for Power Sector Development India 2001; and Sri Lanka Country Analysis Brief 2001, EIA.

Bangladesh

Gas Sector: If the sector does not grow in terms of reserves and production capacity, there will be shortage of gas supply and it will worsen with time.

Crude Oil and Petroleum Products: With rising costs of crude and oil products, Bangladesh is not comfortable.

Coal: Once the Barapukuria coal is available, Bangladesh does not need to import coal.

Power: Availability of funds will be a problem for the public sector projects. Initial euphoria of the IPPs is on the ebb. The future of gas-fuelled power generation is uncertain if the gas sector does not grow or develop.

India

Coal: It is comfortable with its indigenous coal. Though it is importing about 10.0 per cent coal required, the development and expansion of the sector will match the projected demand.

Crude Oil: Indigenous share and actual production of crude oil has been declining in the past few years and more than 70.0 per cent crude oil is to be imported now. This makes India vulnerable to disruption of crude supply and price hike.

Gas Sector: If the sector does not grow in terms of reserves, production and transmission capacity, there will be shortage of gas supply. Import of LNG is an option to assure supply.

Power: Availability of funds will be a problem for the public sector hydropower projects. IPPs' participation is not encouraging (IPPs contribution to generation would be about 17.3 per cent of 41110 MW planned addition during the Tenth plan). Gas based power generation can be affected if the gas sector does not grow or expand.

Pakistan

Coal: It does not have problem as its demand can be met from indigenous sources.

Gas: If the sector does not grow in terms of reserves, production and transmission capacity, there will be shortage of gas supply.

Crude Oil: Pakistan is not at all comfortable with more than 90.0 per cent import of crude oil from a volatile market and supply sources.

Power: Availability of funds will be a problem for the public sector projects. Though IPPs share in generation now is about 25.0 per cent of total capacity, its future participation looks not so vibrant. Moreover, dependence on import oil and likely dwindling supply of natural gas make the growth vulnerable.

Nepal and Bhutan with their large hydropower potential can look forward to exploit it to meet their own growth and demand; and at the same time to export surplus power to India. Finding the funds for developing the projects is uncertain.

10.5.5 Refining Capacity of the Region

India, Bangladesh, Pakistan and Sri Lanka have refinery facilities to process crude oil, including product upgradation. The total refinery capacity of the region is 2.451 million bbl/d (Table 10.14).

TABLE 10.14

Refining Capacity of the Region, 2001

Country	Refinery Capacity bbl/d x 10^3	Ownership (%)			Overall Capacity Utilisation (%)
		Public	Private	Joint venture	
Bangladesh	33	100.0	–	–	100.0
India	2100	76.0	14.0	9.0	93.0
Sri Lanka	50	100.0	–	–	100.0
Pakistan	268	53.0	11.0	36.0	100.0

Source: Fifth Plan, Bangladesh; Tenth Plan, India; Pakistan Oil and Gas Sector Review 2003; and South Asia Regional Overview 2003 of EIA.

The planned additions and expansions of refinery capacity in India will produce excess middle distillates (kerosene and diesel) that can be traded in the countries of the region.

10.5.6 Power Transmission

The power transmission in South Asian countries is extensive and transmission takes place at various voltage levels. Table 10.15 lists some information on transmission system.

TABLE 10.15

Information on Transmission Network

Country	Transmission Voltage (KV)	Length of Transmission Network, ckm
Bangladesh	230 AC/132 AC/66AC	5,312
India	220 AC/400 AC/800 AC/400 HDVC	150,000
Pakistan	220 AC/500 AC	45,000
Nepal	132 AC/66 AC	1,370
Bhutan	132 AC/400 AC/66 AC	–
Sri Lanka	132 AC/66 AC	–

Source: Lama (2003); Malla (2003); Quader et al., (2003); and Raza et.al. (2003).

10.5.7 Load Management

Peak Load and Average Load

The region as a whole shows a similar daily load curves with the following trends (Lama, 2003; Malla, 2003; Quader et.al., 2003; and Raza et al., 2003):

- a pronounced lighting demand occurring in the evening;
- minimum load is about 50.0 per cent of peak demand (depending on seasonal variation);
- peak demand in the range of 150.0 per cent of the average load.

This peculiarity in demand in a day has led to setting up of base load and peaking plants in Bangladesh, India and Pakistan. IPPs are operating as base load plants in Bangladesh. The plant load factor for thermal power stations is in the range between 50.0 per cent and 70.0 per cent in the region.

Load Shedding

Load shedding is a common feature of managing load because of shortfall in generation against the demand. Although the countries like India, Bangladesh and Pakistan have installed capacity in excess of peak demand, but effective generation capacity is 10.0-15.0 per cent less. All these countries have been experiencing power shortage at peak hours in the range of 5.0 to 10.0 per cent depending on seasonal variation (Lama, 2003).

System Loss

Besides usual technical losses during generation and transmission, the region shows a significant system loss in the range of 10.0-25.0 per cent. Bangladesh is leading the table with 25.0 per cent system loss. This loss is not a waste but an unaccounted and unbilled consumption because of theft and corruption in the distribution system (Lama, 2003; Quader et al., 2003).

10.5.8 Special Features of Indian Scene

The energy sector in India is managed by dividing the country into five regions, namely, Northern, Western, Southern, Eastern and North Eastern. Each of these regions has different resource endowments, energy demands and productions plus level of economic development and growth. India makes endeavour to maximise the development and use of resources on all India bases (Lama, 2003; TERI, 2003; and Tenth Plan, India).

Regional aspects of India can have impact on energy cooperation in South Asia region. The North Eastern and the Eastern regions have potential for quadrangular cooperation consisting of Bangladesh, Bhutan and Nepal for intertransmission of power and pipeline natural gas transfer/swap.

10.6 ENERGY TRADE

10.6.1 Energy Trade in South Asia

The energy trade among the countries in South Asia region is presented below for each category of energy sources.

Coal

The countrywise trade for 2001 in non-cooking coal is shown in Table 10.16. Current trade in non-coking coal is limited and India is the supplier. With Barapukuria Coal Mine in operation, Bangladesh will not import non-cooking coal.

TABLE 10.16

Countrywise Trade in Coal, Year 2001

Country	Import, $\chi 10^3$ t	Export, $\chi 10^3$ t
Bangladesh	500	–
Nepal	531	–
Bhutan	55	–
Pakistan	10	–
India	25168	2105

Source: Same as Table 10.10.

Natural Gas

The region at this moment does not trade in natural gas. India is planning to import LNG and developing LNG handling facilities on the western coast.

Petroleum Products

The trade in petroleum products in the region is shown in Table 10.17. Nepal and Bhutan are dependent on Indian supply. There exist opportunities for trading in surplus middle distillates available in India with Bangladesh, Sri Lanka and Pakistan.

TABLE 10.17

Countrywise Trade in Petroleum Products (in thousand barrels per day), 2001

Country	Export	Import	Consumption
Bangladesh	0.9	78.9	81.2
India	213.5	1729.8	2183.7
Pakistan	18.7	323.7	367.1
Nepal	–	15.2	15.2
Bhutan	–	1.0	1.0
Sri Lanka	1.8	72.9	73.4

Source: Same as Table 10.10.

Power

Bangladesh, Sri Lanka and Pakistan at this moment do not trade in power with any country. Nepal and Bhutan have been trading power with India on bilateral basis. The Nepal-India and Bhutan-India trading in power have been in existence since 1971 and 1961 respectively. In 2001, India imported 126 GWh from Nepal and the rate was about 150 MW. Bhutan is a net exporter of power to the tune of 270 MW to India while it also imports power from India. In 1997/98, Bhutan's power export to India was 1,472 GWh and export earnings from power accounted for 11.0 per cent of GDP. India's import of power accounts for less than 0.4 per cent but it serves the demand of areas not met by indigenous supply.

10.6.2 Potential for Trade in Energy

There exists a great potential for energy trade in the region involving petroleum products and power now and in the future (Lama, 2003; Malla, 2003; Quader, 2003; TERI, 2003; and Raza et al., 2003). The refinery capacities and facilities of India can meet the middle distillate needs of Bangladesh, Sri Lanka, Nepal and Bhutan. Sri Lanka and Bangladesh that occasionally meet emergency need of middle distillates from India should explore the possibility of long-term trading partnerships with India. The partnership by 2015 may be dealing with middle distillates to the tune of 10.0 million tons.

Bangladesh has everything on its side to be involved in power trading with Bhutan by involving India. Trading with Nepal is also a possibility. There can be a trading partnership in power consisting of Bangladesh, Bhutan, Nepal and North Eastern and Eastern regions of India (Quader et al., 2003). The partnership could be as much as 5,000 MW.

10.7 ENERGY COOPERATION

10.7.1 Why?

With energy crisis at regular intervals since the 1970s either due to disruption of oil supplies or volatile oil price (from US$2.0 per bbl in 1971 to US$60.0 or more per bbl in 2005), energy cooperation among countries, developed or developing, is a recognised strategy for sustainable development. Developing countries, tied to imported energy, especially crude oil and oil products, have suffered in two ways; first, by paying high price for oil and second, by paying excessively for the import of capital goods and services from the developed countries. Energy cooperation among these countries in a region empowers them a bargaining power in forum where global strategies are formulated.

This cooperation can be very broad encompassing all the sectors. While dealing with individual sector of energy, specific and relevant issues are to be settled. The cooperation can be in various forms, such as (a) trading in the form of finished commodity like electricity, piped natural gas, LNG, petroleum products, coal, etc.; (b) building common infrastructure like power transmission system, pipelines for gas and petroleum products/crude oil; and (c) investing in common resource development projects like hydro or thermal power plants, gas and oil exploration and development, etc. (Lama, 2003; Malla, 2003; Quader, 2003; Raza, 2003; TERI, 2003; CPD Report (42), 2002; Reghuraman et al., 2003; Hossain, 2004).

Energy cooperation needs common policies and regulations. Harmonising and rationalising the existing policies and regulations of all the members gradually, as they gather experience by putting cooperation into practice, can evolve the "Common" for all its members. Since the members of cooperation are not today insulated from global trade in energy and FDI in energy sector, the "Common" for its entire member should be worked out to provide the cooperation the inner strength to strike deals globally. The countries with extensive policies, regulatory frameworks and experiences can help the cooperation in adopting a set of harmonised and standardised policies, regulations and procedures for the cooperation by doing away with duplicative efforts.

Bilateral energy cooperation in the South Asia region has been in existence since the 1960s and it began with trading in power between Bhutan and India. India is in a position to strike bilateral cooperation with any of its neighbours independently while some of its neighbours are unable to implement bilateral cooperation without involving India. India's role is crucial in promoting bilateral cooperation in this region and it will lay the foundation for regional energy cooperation. Energy cooperation in the region at the lowest level can be bilateral. For geographical reality, there can always be a triangular or quadrangular cooperation consisting of India, Bangladesh, Nepal and Bhutan, dealing with power, coal, natural gas and oil products (Quader et al., 2003).

India with its long history for endeavouring to be self-reliant and self-sufficient and its experience in dealing with trade and FDIs on its own terms can give the lead in shaping the functioning of the cooperation. The multinational character of IOCs and investors in the power sector makes dealing with them difficult for the political weight they carry as well as corruption that goes with. The cooperation involving India will strengthen its ability to deal with IOCs and FDIs in IPP projects without receding from equitable terms.

Energy cooperation can achieve the following for the cooperation as well as for its members:

- development of harmonised and standardised policies, regulations and procedures;
- becoming a recognisable stakeholder in the global trading of crude oil;
- interdependency and thereby changing mindset by removing mistrust;
- improving efficiency of economy;
- enhancing energy security and sustenance of development;
- strengthening bargaining capability with IOCs and FDIs for IPPs.

10.7.2 Energy Cooperation in the South Asia Region

Energy cooperation in the South Asia region has been a much discussed subject for about a decade and an important agenda under the umbrella of SAARC. A number of country studies on regional cooperation in South Asia are available (Aminuddin, 2003; Hossain, 2001; Kamal, 2001; CPD Dialogue Report (42), 2002; Lama, 2002, 2003; Malla, 2002, 2003; Quader et al., 2003; Raza et al., 2003; Vucetic, 2004). These studies have considered regional cooperation in details by highlighting opportunities and predicaments.

Energy resource endowments among the member countries in the region vary from very low to modest, except hydro-potentials in Nepal, Bhutan and India. Table 10.18 shows that resource base of natural gas and crude oil for the region is small against current consumption and projected growth in demand. At the current consumption of oil at 1.86 million bbl/d, the oil reserves of the region will last for only 6-7 years if no oil is imported. At the current consumption level of 2 TCF/year, the gas reserve of the region will be depleted in less than 28 years. The region has a sizeable coal reserve in the context of current consumption rate and projected consumption for several decades.

TABLE 10.18

Commercial Energy Endowments of the SAARC Countries

Country	Oil Reserve Million barrels & (R/P ratio)	Gas Reserve TCF & (R/P ratio)	Coal Reserve Million tons & (R/P ratio)	Hydropower (MW)		
				Total Potential	Installed Capacity	% Available for Exploitation
Bangladesh	8.2 (–)	12.04-15.5 (27.0)	300.0 (–)	580.0	230.0	60.3
Bhutan	–	–	–	30,000.0	444.0	98.5
Nepal	–	–	2.0	83,290.0	368.0	99.5
India	4838.0 (17.8)	23.0 (24.5)	82379.0 (246.0)	148,700.0	26000.0	82.5
Pakistan	208.0 (11.0)	22.0 (35.6)	3228.0 (686.0)	40,000.0	5010.0	87.5
Sri Lanka	–	–	–	2095.0	1145.0	45.3
Maldives	–	–	–	–	–	–

Note: Figures in the Parentheses indicate R/P ratio.

Source: Quader et al., 2003; Fifth Plan, Bangladesh; Ninth Plan, Bhutan; Tenth Plan, India; Tenth Plan, Nepal; Bangladesh Country Analysis Brief 2004; Bhutan Country Analysis Brief 2001; India Country Analysis Brief 2004; Maldives Country Analysis Brief 2001; Nepal Country Analysis Brief 2001; Pakistan Country Analysis Brief 2004; and Sri Lanka Country Analysis Brief 2001 of EIA.

The hydropower potential of the region is large, about 305,000 MW of which only 10.7 per cent has been exploited. The hydropower reserves are geographically widely dispersed located in India, Nepal, Bhutan and Pakistan with unexploited potential of 122,700 MW, 82,900 MW, 29,556 MW and 34,990 MW respectively. All the estimated hydropower potentials cannot be exploited considering size, inaccessibility and scale of operation. Nevertheless, available hydropower potential if exploited suitably, it can meet the future demands of power in the region. Pakistan's hydropower sites, with potential 500 MW or more, stand at 17 with about 23,000 MW power potential. Nepal considers 42,000 MW as economically feasible hydropower potential from 66 projects with 11 projects having potential above 200 MW totalling about 17,800 MW. About 6000 MW hydropower potential of Bhutan is exploitable and remaining exploitable hydropower potential of India is about 58,000 MW. Exploitable hydropower potential of India, Nepal and Bhutan stands around 106,000 MW.

Some key energy and economic parameters of the countries in the region indicate that the region has to go a long way before it can be called developed. Tables 10.19 and 10.20 list some key energy and economic parameters of the region. India, in size, population, GDP, power generation and oil imports, is incomparable with any of the countries in the region and Bangladesh's energy use is the lowest in the region, 153 kgoe against 515 kgoe of India. The share of petroleum products in the commercial energy consumption in the region is significant (Bangladesh 31.0 per cent, India 32.0 per cent, Pakistan 43.0 per cent, Nepal 55.0 per cent, and Sri Lanka 82.0 per cent) (Table 10.20). Dependence on imported oil products make the region's economy vulnerable due to supply sources and volatile price. Indigenous coal is the major source of commercial energy for India (55.0 per cent) while indigenous natural gas is the major source for Bangladesh (66.0 per cent) and Pakistan (41.0 per cent). Cooperation involving India and its neighbours whether bilateral or regional, however desirable, is subject to perceived mindset of Indian dominance over its neighbours. Once it is recognised that cooperation in energy and trade in the region will benefit everyone, this can be achieved by viewing it a win-win endeavour for its members.

TABLE 10.19

Key Energy and Economic Parameters of South Asia Region

Country-area (sq.km)	Population, million (2002)	GNI, current Billion US$ (2002)	Per capita GNI US$ (2002)	Per capita Energy use, kgoe (2001)	Per capita Electricity generation, kWh (2001)	Import of oil products & crude, million bbl/d
Bangladesh-144000	136.0	51.1	380.0	153.0	119	0.083 (2003)
India-3,287000	1049.0	494.8	470.0	515.0	550	1.400 (2003)
Nepal-147000	24.0	5.5	230.0	357.0	79	0.012 (2000)
Bhutan-47000	0.8	0.5	600.0	–	2200	0.001 (2000)
Sri Lanka-66000	19.0	16.1	850.0	423.0	347	0.070 (2000)
Pakistan-796000	145.0	60.9	420.0	456.0	499	0.298 (2003)
Maldives	0.3	0.6	2170.0	–	337	0.002 (2000)
Total	1374.1	629.5	458.1	–		1.866

Source: World Development Indicators 2004; The World Bank 2004; Country Energy Data Report 2001 of EIA; and Country Analysis Brief of EIA.

TABLE 10.20

Commercial Energy Consumption in South Asian Countries, 2002

Country	Commercial Energy Consumption[1]						
	Total (Quadrillion Btu)	Petroleum (%)	Natural Gas (%)	Coal (%)	Nuclear (%)	Hydroelectric (%)	Other[2] (%)
Bangladesh	0.6	29.0	66.0	1.0	0.0	2.0	0.0
Bhutan	0.02	13.0	0.0	7.0	0.0	80.0	0.0
India	13.9	34.0	7.0	55.0	2.0	5.0	0.0
Maldives	0.0	100.0	0.0	15.0	0.0	0.0	0.0
Nepal	0.0	55.0	0.0	18.0	0.0	31.0	1.0
Pakistan	1.8	43.0	41.0	5.0	1.0	10.0	0.0
Sri Lanka	0.2	82.0	0.0	0.0	0.0	17.0	0.0
Total	16.7	34.0	12.0	46.0	1.0	6.0	0.3

Notes: [1]Does NOT include such "non-commercial" energy sources as animal waste, wood, and other biomass, which account for more than half of South Asia's total final energy consumption.

[2]Other includes consumption of wind electric power for India and net imports of electricity for India and Nepal. Other does not include biomass or other "noncommercial" sources of energy. Percentages may not add to 100% because of independent rounding.

Source: South Asia Regional Overview October 2004 of EIA (International Energy Data Base, October 2004).

10.7.3 Identification of Energy Sector for Regional Cooperation

The energy sectors that deal with bilateral trading or regional trading can be handled under existing trading arrangements. This can be expanded for the region formally under the umbrella of cooperation.

Oil Products

India has surplus production capacity for middle distillates and lubes. It is practical to work out cooperation in the region for products such as middle distillates (kerosene and diesel), naphtha, furnace oil and lubes. It is estimated that the quantity involved today amounts to about 5 million ton per year (Tables 10.3 and 10.4). Trading of middle distillates in the region can make the region self-sufficient in these products.

Natural Gas

There exists no bilateral or multilateral trade or cooperation in the indigenous natural gas sector within the South Asian countries. The countries in the region, namely, Bangladesh, India and Pakistan have some natural gas reserves (about 52 TCF) from which the current production is about 2TCF/year and it is going to grow every year at least by about 5.0 per cent in the region. Current depletion of the reserves has not been augmented in the past five years by new discoveries, especially in Bangladesh. Though in the past there had been few proposals/studies to examine the gas export to India from Bangladesh, nothing significant happened except that natural gas has been recognised as a commodity for trade in the perception of Bangladesh. The IOCs operating in Bangladesh since the 1990s initiated these studies/proposals to develop and market their discovered reserves, which is not large enough for export on stand-alone basis (Quader et al., 2002 and 2003). Of IOCs' discovery of 4.355 TCF, 1.555 TCF was already committed to Bangladesh's own market when these proposals/studies were made. The IOCs having committed all its fields and reserves for developing to supply gas to the local market have today no reserves for export. For the IOCs, export of natural gas was a ploy to pressurise the government of Bangladesh to permit them to develop their fields. Gradual addition of about 1000 MW gas-engine based captive power generation in the industry sector during 2002-2004 has created an unforeseen gas demand of about 200 MMSFD at the peak; and this new demand along with some upcoming gas based plants in next five years has given the IOCs opportunity to develop all their fields under their operatorship, especially for UNOCAL (Bangladesh).

Nevertheless, there still exist opportunities for deals with natural gas between India and Bangladesh, one opportunity is pipeline transport of gas through Bangladesh from the fields of North Eastern region to Eastern India where there is demand for gas. This is a question of providing a corridor to India for the gas pipeline between North Eastern regions and Eastern India by paying rent to Bangladesh. The second opportunity is to supply natural gas to Eastern India from Bangladesh reserves by extending gas transmission line upto the border of Eastern India by swapping gas from the reserves of North Eastern reserves of India. In case of necessity, Bangladesh shall be in a position to access gas of North Eastern reserves tied to the swapping system. Realisation of any of the above opportunities would need political consensus in Bangladesh itself. One can take lesson from North American energy market, especially natural gas (Santa, 2003).

In view of the limited reserves of natural gas in the region and increased demand of gas for urea production and power generation, some countries of the region, namely, Bangladesh, Indian and Pakistan will be importing gas in the next two decades. Although India has plans to import LNG from the Middle Eastern sources, some proposals are on the table in the region for importing natural gas through pipelines at least from four sources (TERI, 2002; Aminuddin, 2003; Maleki). These are:

- natural gas from Myanmar (proven reserve 13-15 TCF) to India through Bangladesh (Kumar, 2005; TERI, 2002);
- natural gas from Qatar (proven reserve 508 TCF and current production 1027 BCF) to India via Pakistan;
- natural gas from Iran (proven reserve 812 TCF and current production 1200 BCF) to India via Pakistan;
- natural gas from Turkmenistan (proven reserve 71 TCF with current production 1642 BCF) to India via Pakistan through Afghanistan.

In 2002, Qatar and Turkmenistan exported 1,876 BCF gas. Transporting gas from these countries (Iran, Qatar and Turkmenistan) to suitable points in Pakistan requires transboundary pipelines having lengths in the range from 1,600 km to 2,700 km (Aminuddin, 2003). If these pipelines are to be extended to India and Bangladesh, additional lengths to be added are about 800 km and 2,000 km respectively.

Under the regional energy cooperation, such cross-border pipelines for delivering gas to Pakistan, India and Bangladesh from Iran, Qatar or Turkmenistan should be seriously looked into. Three such cross-border pipelines (one from each resource centre), capable of delivering a total of 3TCF gas per year, would need an investment in the range of US$12.0 to 15.0 billion which means an investment of US$0.16 to 0.20 per 1000

SCF, assuming that the supply is available for 25 years (Aminuddin, 2003; Raza et al., 2003).

All of the above four proposals as a part of energy security strategy shall be taken up under the regional cooperation by mobilising internal resources of each country and using the strength of the cooperation in arranging remainder funds from international resources. This would help change people's mindset because of political divide created through partition of united India.

Power Sector

Experiences of power trade between India and Bhutan, and India and Nepal since the 1960s have led to considerable expansion in power trade among these partners in the late 1990s. This success can be the stepping-stone for regional cooperation in power sector. India will be the key player in coordinating and implementing cooperation projects/deals whether bilateral or multilateral.

India will be expanding its power import from Nepal when the Seti Hydropower Project (750 MW) is completed. India is deeply involved in developing Nepal's hydropower by providing technical assistance and funds. The projects under consideration are Pancheswar (600 MW), Karnali (10,800 MW) and Saptakosi (3,300 MW), Arun Hydro (800 MW) and Tammr-Mewa (101MW). The Pancheswar Hydro Electric Power Project has set aside 3,000 MW for export to India.

India plans to import more hydroelectricity from Bhutan and it will get a boost with the completion of Tala project (1,020 MW). India's interest in Bhutan's future hydropower project is evident from its technical assistance and funds made available to Bhutan. Some of the projects under considerations are Wangchu (500 MW), Bunakha (180 MW), Yonglachu (4 x 48 MW), Mangdechhu (360 MW) and Punatsangchu (870 MW).

India has also plan to expand transmission capacity to import power from Nepal and Bhutan through 400 kV/750 kV interconnections by upgrading systems from generation sites. There exist opportunities for Bangladesh in trading/exchanging power in the region considering its closeness to Nepal and Bhutan, and with India as its bordering neighbour; especially by accessing exportable power of Nepal and Bhutan. This would need a triangular cooperation while India being always a common partner or a quadrangular partnership where all four countries are enjoined (Malla, 2003; Quader et al., 2003). Even today 200 MW import of power can substantially alleviate the prevailing power shortage, and an import of 1,000 MW for the industry sector, which is consuming 200 MMSCFD gas for captive generation, will remove the unnecessary burden on gas supply. The cooperation in power sector will benefit both the exporter and importer economically.

Pakistan would like to sell to India upto 2,000 MW power on long-term basis from its surplus capacity. The deal has been under consideration for some years.

Absence of interconnecting transmission systems among the countries in the region has hindered the idea of trade or cooperation involving Bangladesh, India and Pakistan. The "Four Borders Region" study initiated under USAID-SARI/Energy programme for examining the possibilities interconnecting transmission systems, involving Bangladesh, India, Nepal and Bhutan, found such interconnecting transmission systems economically viable and environmentally sound (Malla, 2003; NEXANT Study, 2001).

10.7.4 Barriers to Regional Cooperation in Energy

Cooperation in the energy sector in the region would involve cross-border trade, interconnecting power transmission systems, cross-border and transboundary pipeline transmission and common energy projects in the region. There are and there will be issues having political, techno-economic and environmental character that can impede the implementation of projects under cooperation. Lama has listed a set of potential barriers in power projects and power trade in the region (Table 10.21). Other studies also point out similar bottlenecks in energy trade and cooperation in the region (Malla, 2003; TERI, 2003; Quader, 2003; Raza et al., 2003). The issues listed hold good for other sectors such as natural gas and petroleum products with some variations. These issues can be resolved if the following can be rationally ironed out:

i. Lack of trust and so called openness (This is a problem of mindset).
ii. Outstanding disputes and competition in gaining edge in war power.
iii. Lack of political wisdom and maturity by the leadership (always pointing fingers to one's neighbours for cover-up of one's political ills and failures as government).

TABLE 10.21

Potential Barriers in Power Projects and Power Trade

Power Projects	Power Trade
a. Past history of such projects both at national and bilateral levels	a. Political necessity and compulsion
b. Sharing of water of the common rivers	b. Economic rationale for trading
c. Size of investment	c. Cost of transmission line and its sharing mechanism
d. Assessment of existing perspective rights of each side	d. Interconnection issues
e. Sharing costs and benefits of projects	e. Determination of power tariff
f. Implementation mechanism	f. The payment mechanism including the currency to be used
g. Funding arrangement including credit and guarantee mechanism	g. Power supply reliability and sustainability
h. Legislative framework	h. Regulatory framework including institutional arrangements
i. Technology and management	i. Immunisation from geo-political contingencies
j Environmental issues	j. Environmental issues
k. Cross-border institutional linkages	k. Cross-border institutional linkage

Source: Lama (2003).

The political divide created by partitioning the subcontinent and emergence of Bangladesh through bloody freedom struggle is to be removed before any kind of meaningful cooperation in the region is successful. For example, the railway links of the North Eastern India with Eastern India through today's Bangladesh, closed since the 1965-war between India and Pakistan, still remains closed when Pakistan and India have opened their suspended railway links; the North Eastern India, which was the natural hinterland of Chittagong port upto 1947, cannot access the port; accessing Nepal or Bhutan through an Indian corridor for transportation of goods to and from

Bangladesh is restricted, etc. Because of the lack of political wisdom and farsightedness, the leadership has prevented the people of the region to come together at various levels. Togetherness of the people will create and shape cooperation while the individual government will function as facilitator, moderator, promoter and regulator. India being the largest member of the cooperation has to provide impetus to the cooperation in spite of its other priorities on global scale.

In a paper titled "The Scope and Confidence Building Measures in South Asia" Asma Yakoob of Karachi University observed existence of deep rooted suspicions and fear against each other as the main obstacles in creating a congenial environment for cooperation in the South Asia region, especially between Pakistan and India. She also emphasised people to people contact and step by step in initiating the cooperation process (Yakoob, 2001). Yoshitaro Fuwa in another paper titled "New Paradigm of Security and South Asian Region" mentioned long-standing political difficulties, different size of member states and insufficient institutional framework as the lack of progress in cooperation among the SAARC members (Yoshitaro, 2000).

10.7.5 Strategy for Cooperation

The need for cooperation in the energy sector though widely discussed for its positive impact on the economy including enhancement of energy security for the countries in the South Asia region, the ground-breaking for its realisation appears distant. It will be painfully slow. But some of the stumbling blocks such as people's mindset and irrationality of political stewardship that impede cooperation are to be removed first followed by resolving other elements of barrier (Malla, 2003; TERI, 2003; Quader et al., 2003; Lama, 2003; Raza et al., 2003).

Some of the strategies to be drawn at various levels to overcome the barriers include:

i. Getting the people across the borders at all levels to discover that their common enemy is poverty and denial of social equity, and not political divide based on religion or ethnic identity or geographical boundary.

ii. Easing bilateral trade by abolishing procedural wrangling.

iii. Adopting unified tariff structures, procedures for trading and FDIs, fiscal policies, etc.

iv. Promoting bilateral trade in petroleum products on long-term basis at private and state levels.

v. Promoting bilateral cooperation with Bangladesh and Bhutan, or Bangladesh and Nepal for electricity with Indian good will; and at the same time, remove all the barriers that block the land connectivity between the North Eastern Indian and Eastern India through Bangladesh.

vi. Joining the cooperation negotiation table with commitment and at the end of each round of negotiation make endeavour to achieve some goals.

vii. Stopping uncalled for bashing of the neighbours in the media.

viii. Promoting exchange programmes at technical and institutional levels for harmonising norms and standards in energy technology as well as matters in regulatory and policy regimes, etc.

ix. Getting the proposed natural gas pipeline from Myanmar to India through Bangladesh rolling immediately.

It seems a long walk before a meaningful regional cooperation in the energy sector can be formulated. Other strategies to have the cooperation in place once formed should include (Malla, 2003; TERI, 2002; Aminuddin, 2003):

i. Identification of common power projects in Nepal and Bhutan with equity participation;
ii. Identification of interconnecting transmission systems for making a regional power grid systems for transferring electricity;
iii. Identification of transboundary natural gas pipelines serving the region, especially India, Pakistan and Bangladesh;
iv. Having a common strategic reserves of crud oil and petroleum products for the region; and
v. Mobilising technological and financial resources for exploration, development and production of hydrocarbon resources in the region.

There are now a number of regional energy cooperation across the continents dealing in integrated power systems for the members of cooperation (Malla, 2003). This cooperation has been developed over the last 50 years. Three important regional power cooperation in the developed countries are Nordal Pool, Union for the Coordination of Transmission of Electricity (UTCE) and North American Electric Reliability Council (NERC). Three important regional cooperation in the developing countries are Southern African Power Pool (SAPP), Commission of Regional Power Integration (CIER) and Arab Union of Producer, Transporters and Distributors of Electricity (AUPIDE). Nordal Pool and UTCE function in Europe, while CIER functions in South America. These cooperation have been performing upto the expectations by delivering economic benefits, improving economic efficiency in generation, transmission and use of utilities, etc. The success stories of cooperation can certainly inspire the countries of South Asia region for building cooperation in the energy sector. Examples of transboundary natural gas pipelines and oil pipelines in Europe, North America and the Middle East should encourage and provide confidence to have transboundary and cross border natural gas pipelines for the South Asia region with gas from Qatar, Iran, Turkmenistan or Myanmar.

10.8 DEVELOPMENT OF INSTITUTIONAL FRAMEWORK IN THE REGION FOR COOPERATION

The countries in South Asia region, except Sri Lanka and Maldives, constitute one landmass geographically. The people of this region historically belong to one culture and common heritage. Since the partition and ending of colonial rule in 1947, the region now consists of seven countries including two kingdoms. Each of these countries, including India, has been endeavouring to find a new identity by giving up the "common" to which they all belonged. By attempting and doing so, the countries have denied its citizens the ownership of "common" heritage and civilisation that were created and enriched from the common resources of common men and women of the region. The common rivers are divided along the political boundaries and the communication links are snapped along the political boundaries and the movement of the people are restricted in the name of new identity, by forgetting that the rivers, the railways, the roads and the air belong to the people for their well being. Some countries are military rivals and have invited super powers to the region. Except India and Sri Lanka, democracy has often remained imprisoned in the hands of military regimes and kings. Especially in Bangladesh and Pakistan freedom did disappear, transparency and governance vanished, and corruption has become institutionalised. India and Sri Lanka are locked in ethnic and interregional conflicts that often spill over the borders. Bhutan and Maldives with total population just over one million do not matter much in the geo-politics of the region. The subject of regional cooperation in the energy sector or any other sector cannot be outright divorced from the geopolitical scenes of the region and troubled political mindsets. If ethical and moral issues or ideals, which are to be upheld, are compromised and ignored, the political leaderships in the region can perhaps meet and talk. Still the big question shall hound righteous minds -- do we recognise autocratic regimes that banish democracy? Do we not to linger the sufferings of the struggling people under the autocratic regimes by legitimising these evil regimes with our association?

A logical step before embarking upon of forming lasting cooperation in the South Asia region, one needs to find out the policy documentations in place defining relationship with each other. Existing impasse in building cooperation in the region has its roots in non-existence of vision and mission statements dealing with each other. Had there been ones, the leaderships in the region would have met more often and talked coherently to build bilateral and multilateral cooperation. Empty rhetoric alone does not make cooperation. Cooperation is the culmination of a long and difficult negotiation and discussions with regular and intermittent summits of the heads of the governments followed by intensive works by the technical and subject committees, including inputs from "Think-Tanks." EEC did not happen overnight and is a good example of how to proceed for making a successful cooperation.

In the past, efforts for forming cooperation, some of the partners used these as an opportunity to be even with India. This backfired in every instance. Democratic India with its position on the world forum as one of the founders of non-align movement and Pakistan under its military sponsored democracy as a faithful ally in military pacts led by the USA did not view common issues in the regional perspective. One is unlikely to have a successful regional cooperation in the absence of common mission and vision.

In spite of the differences in the forms and norms of government, functioning of democracy, if the countries in South Asia region endeavour to make a cooperation in the energy sector or simply in energy trade, some serious background works are to be undertaken targeting relevant frameworks of each country of the cooperation encompassing constitutional bindings and obligations, legislations, policies, regulations and rules. The country/countries, which has the maximum documentation in place, can contribute the most in working out the common frameworks for the cooperation.

Under the umbrella of free market economy or free trade agreements like SAFTA (not yet materialised), the trading in consumer products will be unhindered. But trading in energy, whether power, natural gas, crude oil or petroleum products, will not be improved by free market or SAFTA in this region without a common framework encompassing legislation, rules, policies and regulations, etc.

Preparatory works that can help forming the regional energy cooperation are (Malla, 2003; TERI, 2003; Raza et al., 2003; Quader, 2003; CPD Report 42):

i. Creating consensus among the "Stakeholders" i.e. the common public of the region for regional cooperation. This would require:
   a. formal and informal meetings among the elected representatives of the countries to mould the public mindset in favour of cooperation;
   b. dissemination of cooperation ideas in the media both electronic and print;
   c. if necessary obtaining formal consent of the stakeholders through referendum.

ii. Critically assessing the existing policies, regulation, laws, legislations, rules of each country through subject committees with professionals from each country for each of these issues:
   a. constitutional bindings and obligations;
   b. existing legislations and laws;
   c. regulatory frameworks;
   d. regulatory commissions;
   e. fiscal policies and tariff;
   f. sectoral policies;
   g. approval and implementation procedures and mechanisms;
   h. instances of judicial interventions, etc.

iii. Harmonising the technical matters through subject committees:
   a. codes, standards and specification used by the industry sector-wise;
   b. pricing mechanism;
   c. accounting procedures;
   d. technical inspection and audits, etc.;
   e. standardisation in power generation and transmission;
   f. environmental standards.

iv. Getting the "Think-Tanks" of the region work together by doing groundwork to remove the obstacles by examining and analysing the related issues independently. This is a confidence building effort among the "Stakeholders."

A great deal of efforts with the approval of the "stakeholders" are a prerequisite for launching a successful cooperation in the energy sector in the South Asia region. This has to be a step-by-step effort.

10.9 CONCLUSIONS

The South Asia region comprising of India, Bangladesh, Nepal, Bhutan, Pakistan, Sri Lanka and Maldives with about 20.0 per cent of world's population with per capita GDP of US$430.0 or so has all the potentials for forging a cooperation in the energy sector by giving up political divide and power rivalry for economic growth, sustainable development and poverty alleviation. The countries in the region consider sustainability of development and economic growth in the context of conservation of natural resources and environment.

The South Asia region is a net importer of crude and oil products; and a large segment of economic activities such as transportation, manufacturing and power generation are also tied to oil products. Individual countries view energy security in their respective national perspectives. Strategies drawn by them independently are common in many respects and only India has got some strategies that will enhance its energy security in the long term, for example equity oil globally. Energy security for the region has become a common issue that should be dealt from a common platform.

The energy sector in the region is going through structural changes because of ongoing reform programmes, new policies, deregulation, etc. The sector is now open to private investors both local and foreign with incentives. Ongoing reforms and newly introduced regulatory frameworks are likely to have positive effects on energy cooperation and trade, both bilateral and regional.

The energy resources endowment of South Asia region is relatively small by world standards. All the countries do not have all types of resources. The crude oil reserves of about 650.0 million tons are small considering current production and envisaged growth. The region is today a net importer of crude oil and products to the tune of 1.8 million bbl per day. The natural gas reserves of the region are small (about 52 TCF) against the projected growth of consumption and if the depleted reserves are not augmented through new discoveries and development, the sustenance of natural gas based economy looks uncertain.

The hydropower potential of the region has remained unexploited and only 12.5 per cent of the potential has been tapped. The hydropower potential of Nepal and Bhutan, which possess 45.0 per cent of total regional potential (only 0.6 per cent tapped), if exploited, can meet the power need of India and Bangladesh in particular. Regional aspects of India can have positive impact on energy cooperation involving North Eastern and Eastern region bordering Bangladesh, Nepal and Bhutan; the partnership could be dealing as much as 5,000 MW. There exist some trade opportunities in petroleum products with India as the source.

In view of the limited reserves of natural gas in the region and increased demand of gas for urea production and power generation, some of the countries of the region, namely, Bangladesh, India and Pakistan, for the sake of energy security, both short-term and long-term, should seriously consider import of natural gas through transboundary pipelines at least from four sources, namely, Qatar, Iran, Turkmenistan and Myanmar. The four proposals mentioned hereunder can be taken up under the regional cooperation by mobilising internal resources of each country and using the strength of the cooperation in arranging remainder funds from international resources.

- natural gas from Myanmar (proven reserves 13-15 TCF) to India through Bangladesh;
- natural gas from Qatar (proven reserves 508 TCF and current production 1,027 BCF) to India via Pakistan;
- natural gas from Iran (proven reserves 812 TCF and current production 1,200 BCF) to India via Pakistan;

- natural gas from Turkmenistan (proven reserves 71 TCF with current production 1,642 BCF) to India via Pakistan through Afghanistan.

The cooperation in this region in the energy sector is a prerequisite for implementing many of the strategic projects, such as transboundary natural gas pipelines bringing natural gas from sources outside the region, cross-border inter-transmission of power, developing hydro power projects in Nepal and Bhutan with equity participation, trade in petroleum products, sharing human resources and technology.

The cooperation in the energy sector though widely acclaimed for its positive impact on the economy including enhancement of energy security and efficiency of economy for the countries in the region, its realisation is blocked by people's mindset and irrationality of political stewardship. Preparatory works that can help forming the regional cooperation include:

i. Creating consensus among the "Stakeholders," i.e. the common public of the region for regional cooperation;

ii. Streamlining policies, regulations, laws, legislations, rules, etc.;

iii. Harmonising technical matters;

iv. Getting the "Think-Tanks" initiate confidence building works among the "Stakeholders" to win their approval for cooperation.

India's role is crucial in developing cooperation in this region. India is in a position to strike bilateral deal with any of its neighbours while the other neighbours such as Bangladesh, Bhutan and Nepal are unable to make bilateral or multilateral deals without involving India. On the other hand, the smaller members of the cooperation have to be gracious with India. It is going to be a step-by-step effort and the envisaged cooperation will come by some day.

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Chapter 11

PROMOTING TRANSPORT COOPERATION IN SOUTH ASIA

11.1 INTRODUCTION

The world economy is undergoing far-reaching changes. An important aspect of the ongoing globalisation process has been the increasing integration of national economies, particularly in the economically more dynamic regions/subregions of the world. It is generally recognised that there is a need to articulate concrete steps towards mutually beneficial economic cooperation between neighbouring countries by making the best use of comparative advantages and the complementarities between them.

An increasingly integrated transport system at the regional/subregional levels is accordingly essential to facilitate and sustain the economic integration process in today's interdependent world economy. South Asia being geographically contiguous, it is much easier to strengthen its transport connectivity, provided the concept enjoys political support. In the highly competitive world economy of today, transport cost is a significant determinant of competitiveness, which makes an integrated and efficient surface transport network an essential element for enabling economic integration at any level. For various historical, political and economic reasons, surface transport networks in South Asia still continue to remain fragmented, and their potential as engines of economic growth at the regional/subregional level remains largely unrealised. This is happening despite the fact that the basic infrastructure and facilities to establish mutually beneficial intra- and interregional transport linkages already exist in many countries. Absence of such integration is having adverse impact on economic competitiveness and impedes intra-regional trade.

The European Union (EU) and, to a lesser degree, ASEAN were both successful in moving their own respective regional processes forward essentially because the peoples of those countries were convinced that such cooperation was in their larger interest, and this translated to the leadership level through the domestic and regional political dynamics that gradually strengthened a sense of regional identity. But this has been solely lacking in the South Asian region.

The economic development of Bhutan, Nepal and North-East (NE) India could be transformed by ending their landlocked status through cooperation in transport connectivity. For example, North-east India shares 98.0 per cent of its border with the neighbouring countries and only 2.0 per cent of its border is with the mainland India. So, the cross-border exchange forms an important parameter in the development strategy of North-east India (Das, 2001). Transport bottlenecks also inhibit Foreign Direct Investment (FDI). A change of mindset is required from governments to achieve cooperation in transport. To influence government's thinking, studies should be commissioned and publicised by analysing the cost and benefit of transport integration. One symbolic project that could be realised, with international financial support, could be the establishment of a transport corridor linking Islamabad, New Delhi and Dhaka.

Since the transport systems of South Asia have developed, following the partition of British India, only in a national context, there has been little consideration given to cross-border issues of compatibility, uniformity of standards in infrastructure and equipment design. System connectivity needs to be established for rail links. Transport infrastructure and capacity shall have to be upgraded and expanded to sustain a heavier traffic load for intra-regional movements. The potential of inland waterways could be developed for low value bulk cargo by establishing additional ports of call and efficient logistics linkages to provide door-to-door services. Subregional transport cooperation could be developed, as has occurred between China and Taiwan, even without full resolution of political differences.

Border-crossing of goods also needs to be improved by removing inefficiencies associated with excessive documentation, customs inspection, lack of transparency and informal payments. Human resources would have to be developed to deal competently with trade and transport facilitation issues as well as customs management practices. To facilitate movement of people, SAARC countries need to simplify visa requirements as well.

The 12th Summit of SAARC held in Islamabad in January 2004 resulted in bold and far-reaching decisions. Its decision to go for integration of the transport system of South Asia has been a very significant step forward. An improved political climate in the region appears propitious to advancing SAARC's efforts to capitalise on South Asia's potential with its growing economies and a combined market of 1.5 billion people. It is now essential for political leadership of the South Asian countries to support the implementation of the SAARC Summit decision not only to integrate the transport system but to ensure that it is operational to provide uninterrupted movement of goods and people across South Asia.

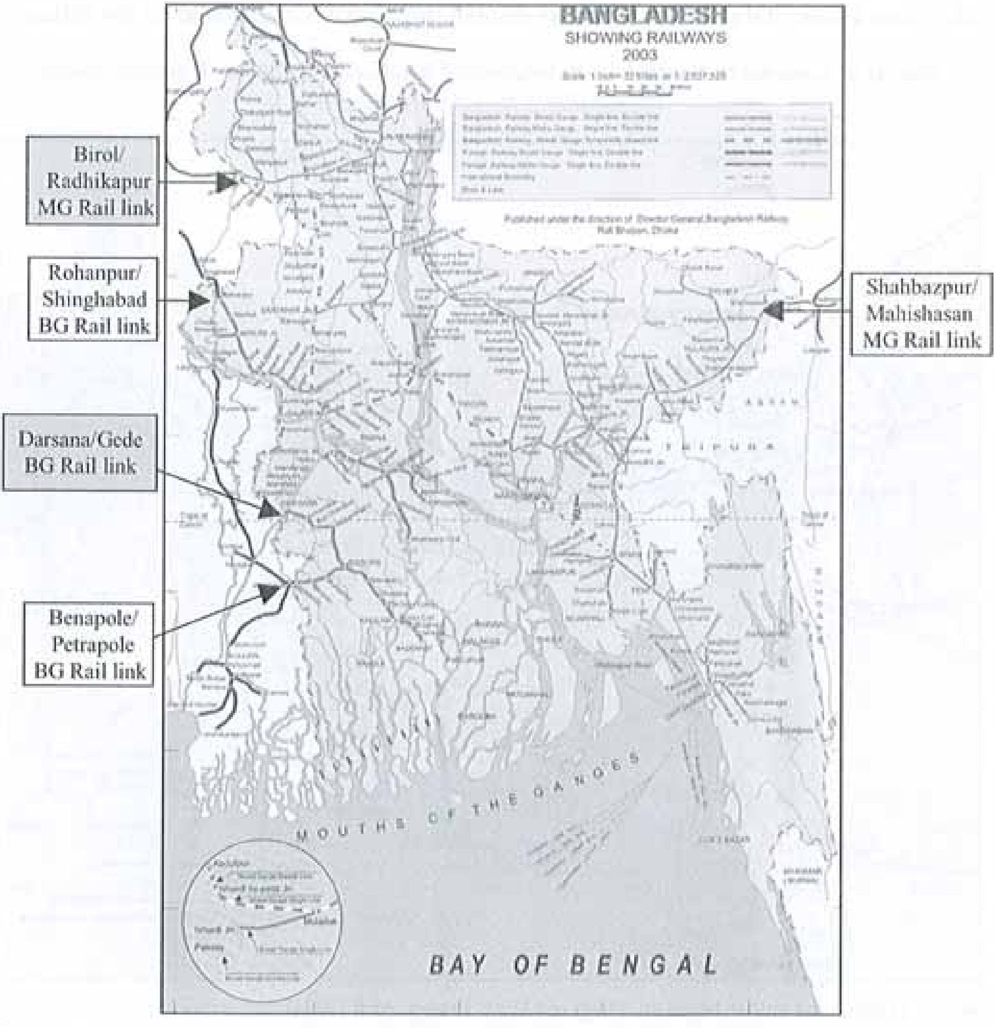
11.2 CURRENT STATE OF TRANSPORT COOPERATION IN SOUTH ASIA

SAARC member countries are geographically contiguous either overland or by virtue of sharing common waters (Bay of Bengal and the Northern Indian Ocean). The geographical contiguity is a key condition for deeper economic integration. However, the benefits of geographical contiguity are often lost due to poor transport linkages. Among the seven countries of South Asia, two are islands (Maldives and Sri Lanka) and the remaining five (Bangladesh, Bhutan, India, Nepal and Pakistan) are mainland countries. Besides air transport, there are three other modes of transport which have the potential to provide direct linkages between the mainland countries of South Asia namely, (a) Rail Transport, (b) Road Transport, and (c) Inland Water Transport. The present state of these transport modes is indicated below.

11.2.1 Rail Transport

Among the mainland countries of South Asia, Bhutan and Nepal have no rail network. Bangladesh, India and Pakistan have extensive rail networks within their respective countries. Before partition of India in 1947, the intra-subcontinental movements were mainly carried out by railway. Although these physical links are still there, very little cross-border movement by rail is taking place today between India and Bangladesh and almost no movement between India and Pakistan.

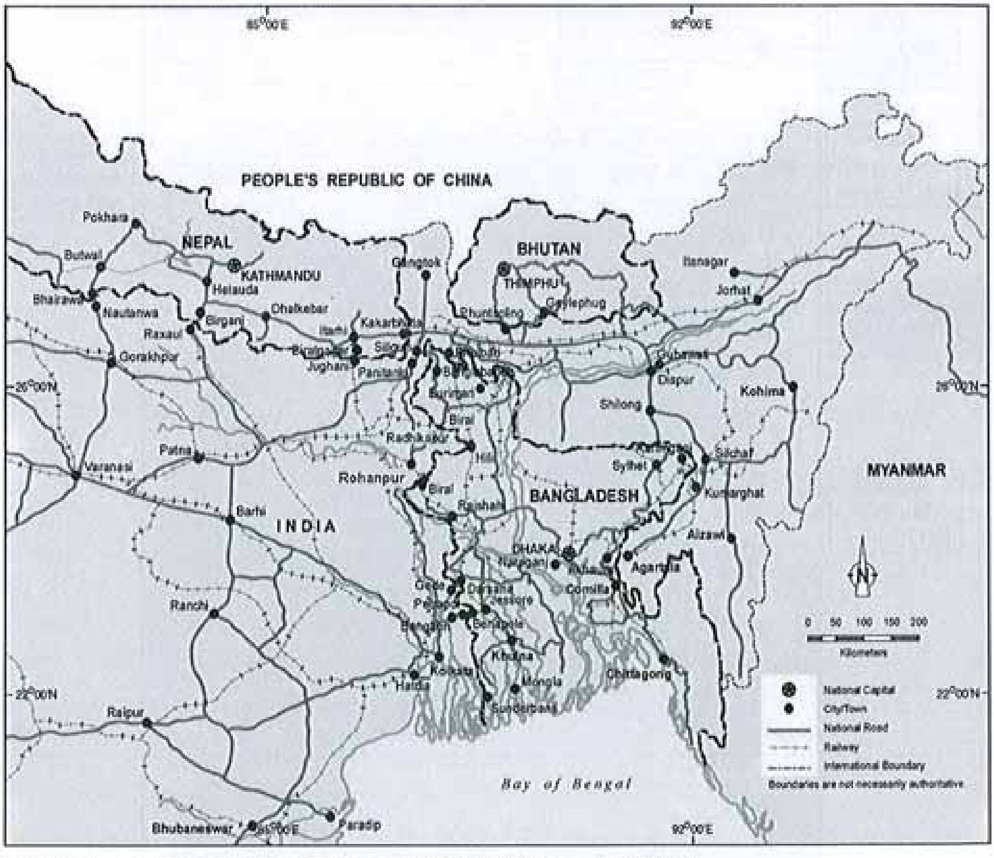
Map 11.1: Rail Based Border Crossing Point of Bangladesh with Neighbour Country



Source: Prepared by author based on a map contained in Bangladesh Railway Information Book (2003).

Presently, four rail corridors (three broad gauge and one meter gauge corridor) are active for export and import traffic between India and Bangladesh (Map 11.1). The Broad Gauge (BG) connections are Gede (India)-Darsana (Bangladesh), Petrapole (India) – Benapole (Bangladesh) and Singhabad (India) – Rohanpur (Bangladesh), while the Meter Gauge (MG) connection is Radhikapur (India) – Birol (Bangladesh). The other meter gauge connection, Mahishasan (India) – Shahbazpur (Bangladesh), has not been in use in recent years. Now, Indian rail wagons are pulled by Bangladeshi locomotives only over short distance inside Bangladesh, where transshipment takes place. Present rating (43.7 KN per meter) of Jamuna Bridge does not allow Indian fully loaded wagons to pass through although a dual gauge railway network exists up to Joydebpur (near Dhaka). Bangladesh Railway (BR) wagons do not cross the Indian border because these cannot be connected to Indian rolling stock without reducing the efficiency of the trains. India and Bangladesh wagons have different coupling and breaking systems. Furthermore, lack of coordination between gauge conversion in Indian Railway (IR) and dualisation in BR is also killing the prospect of uninterrupted intercountry movement in the future.

Map 11.2: Location in South Asia Subregional Economic Cooperation Transport Sector (Bangladesh, Nepal and Bhutan)



Source: Prepared by author based on a map of SASEC Project, ADB (2004).

At present, goods movement between India and Pakistan by rail does not take place. The two countries broke off most of the ties in 2001 after India blamed Pakistan for probable support to an armed attack on the federal parliament in New Delhi. But at present passenger as well as goods movement between India and Pakistan are taking place. The *Samjhauta* (Friendship) Express, twice-weekly train connecting Lahore with Atari inside India (opposite Wagah in Pakistan, where transfer takes place), resumed in January 2004 is the only passenger train running between India and Pakistan. After completing customs and immigration formalities in Atari, passengers take connections to other destination in India. An overnight train from Delhi arrives at Atari station and passengers await to get into the *Samjhauta* Express to take them to Lahore. On 15 February 2006 another rail link between India and Pakistan has been established along the Karachi-Khokrapur-Munabao-Jodhpur route. The service at present comprises a single train service per week with seven coaches. Significance volumes of freight traffic also currently moving from central India to Pakistan. This corridor is also significant from the point of view of accessibility of North Indian hinterlands which are potential sources of containerised cargo to the port of Karachi (SRMTS, 2006). The train service could have been more extensively used if efficient facilitation measures could be in place. For example, passengers from Lahore need to travel to Islamabad to get an Indian visa. If arrangement could be made to issue visa on arrival at Atari, many more passengers from Pakistan could have made use of the train service to visit India.

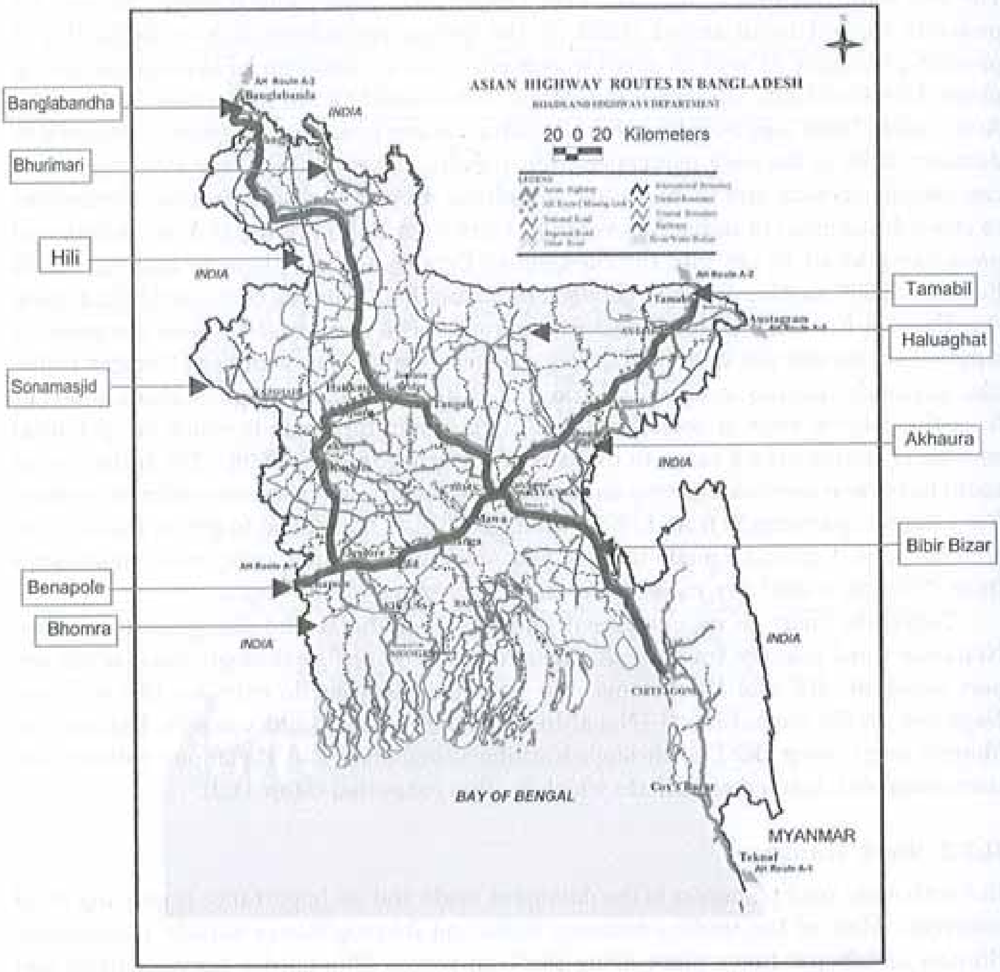
Currently, there is no agreement among Nepal, India and Bangladesh to allow Nepalese third country trade (both export and import) to go through Bangladesh sea port using the BR and IR systems. But excellent facilities do exist for this purpose. Nepalese traffic from Rauxal (Nepal-India border point) could come to Khulna (for Mongla port) using BG line through Kathihar-Singhabad and Rohanpur without any transshipment, instead of Kolkata which is often congested (Map 11.2).

11.2.2 Road Transport

In South Asia, road transport is the dominant mode and its importance is growing in all countries. Most of the trading between India and its neighbours namely Bangladesh, Bhutan and Nepal takes place along the land routes. The border between India and Bangladesh has ten road based check posts, and these are Banglabandha, Burimari, Hili, Sonamasjid, Benapole, Bhomra, Tamabil, Haluaghat, Akhaura and Bibir Bazar (Map 11.3). The facilities at Banglabandha are exclusively for Nepal-Bangladesh trading. All freight traffic by road to and from Bangladesh need transshipment at the border. Trucks from other neighbouring countries are not allowed to travel on the road networks of Bangladesh due to differences in the axle load limit which is 10.2 tons in India and 8.2 tons in Bangladesh (Subramanin, 2001). The Benapole (Bangladesh) – Petrapole (India) route carries the heaviest traffic by road, accounting for about 80.0 per cent (in terms of value) of India's export to Bangladesh. Currently, around 200 to 300 trucks are moving daily via Benapole – Petrapole border point. India also does not allow Bangladeshi trucks to travel to India.

The trade agreement between India and Nepal has a list of 22 border posts for the movement of goods between the two countries, out of which 15 are authorised for transit traffic (ADB, 2006). Out of these, only six are consistently being used. These are (on the

Map 11.3: Road Based Border Crossing Point of Bangladesh with Neighbour Country



Source: Prepared by author based on RHD GIS data base and LGED Digital Thana base map.

Nepali side from West to East) Dhangadhi, Nepalganj, Bhairahawa, Birganj, Biratnagar and Kakarvitta (also known as Kakarbhitta). Birgunj, Bhairahawa and Biratnagar represent between themselves 80-85 per cent of the total international traffic of Nepal.

India allows trucks from Nepal and Bhutan to operate on designated transit routes within India. Indian trucks are allowed anywhere into Nepal but are given a limit of 72 hours to return to India. Nepalese truck needs permit for every trip to India with a validity of three months.

India allows "Kakorvitta (Nepal)-Panitanki (India)-Fulbari (India)-Banglabandha (Bangladesh)" corridor for only bilateral trade between Nepal and Bangladesh. Currently, the level of traffic in this route is very low (less than 4 trucks per weak). This route could also have given the eastern part of Nepal easier access to Mongla ports in Bangladesh as an alternative route to the Kolkata port, which is often congested. But this would need India's transit agreement for Nepal to use this corridor for third country trade.

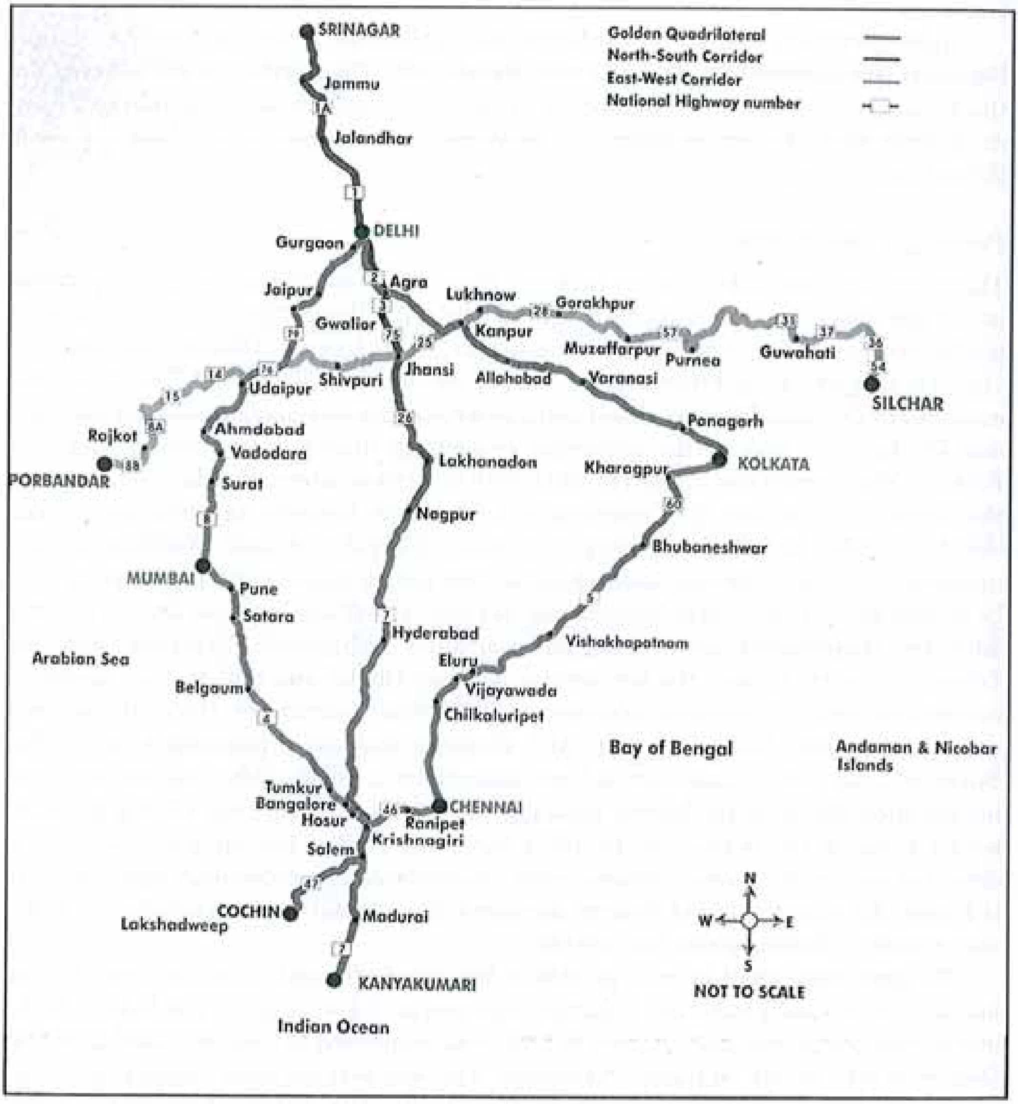
India permitted Bhutan to use Phuntsholing (Bhutan) – Changrabandha (India)-Burimari (Bangladesh) for its trade with Bangladesh. This corridor is not allowed for third country trade, although Bhutanese third country trade faces congestion problems at Kolkata port. Bhutanese buses are, however, allowed upto certain towns in west Bengal and Assam.

Passenger Movements

There are two established routes between Bangladesh and India along which direct passenger buses are operating on a regular basis. Another route is in the process of getting recognised for a formal agreement to start direct services. Dhaka to Kolkata and vice versa direct bus operation started in 1999 and has been doing well. Two buses run each way daily, except Sunday. Scheduled bus services are also playing between Agartala and Dhaka with most of the passenger originating from Agartala being bound for Kolkata. This service was started in 2003, with one bus or alternative days returning to the origin the next day, thus ensuring a daily service between Agartala and Dhaka (SRMTS, 2006). But it is a loosing concern at this point of time. Negotiations are underway between India and Bangladesh to allow Indian passengers a double entry visa by Bangladesh to make Dhaka Agartala bus operation a profitable business. On 10 February 2005, two Bangladeshi private transport companies –"Shayamoli Paribahan" and "SR Travels" – jointly started the bus service between Dhaka and Shiliguri in Assam in cooperation with private sector operators of TATA Sumo microbuses. Under the present arrangement, one Air-Conditioned (AC) 40-seater bus carry passengers up to the Burimari land port in Lalmonirhat from Kamalapur in Dhaka. After the customs and immigration checks at the border, passengers travel to Shiliguri from Chengrabandha border point on the Indian side by TATA Sumo microbuses. Despite the absence of a direct bus service, the efforts of private sector bus operators have been highly appreciated. It is hoped that once the travel demand increases, governments of Bangladesh and India may consider allowing direct bus services.

No goods movement by road is allowed between India and Pakistan. Cross-border bus services between India and Pakistan were suspended since 1947. The Lahore-Delhi bus service which had been started in 1999 was suspended in January 2002 after the December 2001 attack on India's Parliament. This was because India accused Pakistan-based militant group's involvement in the attack. The Lahore-Delhi bus service, however, resumed operation from July 2003. Two buses move in either direction per week. The landmark fortnightly bus service between India and Pakistan administrated Kashmir was launched on 7 April 2005, for the first time in nearly 60 years. The Cross-Kashmir bus service links Srinagar in Indian-administered Kashmir with Muzaffarabad in the Pakistani-controlled sector. Only 19 passengers travelled on the first bus from the Indian side following militant threats of violence and a rebel attack on a guest house in which the travellers had been lodged. Very recently, Indian and Pakistani leaders agreed to launch another bus service between Lahore and Amritsar. The final date for launching will be announced very soon. It was decided that at the beginning only one bus in a week would run between Lahore and Amritsar.

Map 11.4: India's Plan for High Density Corridor (13252 km, four to six lane) by 2008



Source: Prepared by author based on a map downloaded from http://en.wikipedia.org/wiki/image: National.hughway-network-map.png.

Developments of Major Highways

Both the governments of India and Pakistan have however taken up programmes for extensive development of road infrastructure at the national level. India has taken up a plan (Map 11.4) to develop about 13252 km of national highways by 2008, which are of dual carriage way standard having 4 to 6 lanes. These highways will cover the following corridors:

i. Golden quadrilateral connecting the four major cities, namely, Kolkata, Delhi, Mumbai and Chennai.

ii. North-South corridor to connect Srinagar with Kanyakumari.

iii. East-west corridor to link Silchar with Porbandar.

These road networks when completed will facilitate faster movement of roads transport between Bangladesh and Pakistan.

Pakistan's ambitious plan includes linking Karachi, Lahore, Islamabad and Peshawar by major national highways which are of 4 to 6 lanes dual carriage ways standards. Once these networks are completed, faster movement by road between Peshawar in Pakistan and Bangladesh through India would be possible.

11.2.3 Inland Water Transport

Among the South Asian Countries, inland water transport links prevail only between India and Bangladesh and it has great potential for development since it is the cheapest mode of transportation. Indian transit traffic and indo-Bangladesh bilateral traffic move along this IWT routes under the protocol on "Inland Water Transit and Trade" of October 1999, which is derived from the provision of the "Trade Agreement between Bangladesh and India" dated 4 October 1980. This is the only transit facility for India through Bangladesh for serving the requirements of North-East Indian states. But the IWT routes are highly under utilised. According to Bangladesh Inland Water Transport Authority (BIWTA) sources, in the year 2002-03, Indian transit traffic was 7,600 tons and bilateral traffic was 209,435 tons, of which 58.4 per cent were carried by Bangladeshi vessels and 41.6 per cent by Indian vessels. Some of the problems that might be contributing to low level of IWT use may include difficulties of round the year navigation along certain major routes due to draft limitation, lack of sufficient ports of call, absences of night navigation facilities along the entire route, etc. Moreover, the Inland Water Transit and Trade Protocol was expired on 3 October 2001. Bangladesh is presently agreeing to one, two and three month extension, while India would like a renewal for five years. As a consequence of this short extension, the transit operators are facing the risk of any time protocol expiry. So large and long term investments are not taking place in this mode of transport. This situation might have also contributed to the reduction of traffic along IWT routes between India and Bangladesh.

11.2.4 Cross-Border Facilitations Problems

Besides Physical links, considerable difficulties exist at the land border crossing among South Asian countries. The basic constraints are the lack of efficient customs operations, including lack of transparency of procedures for inspection, informal payments and inadequate preparation of customs document by the shipper, etc. An unusually long time is taken for scrutiny, checking and completion of documents and completion of formalities with banks. Banking facilities are inadequate; medical, communication, warehousing security and fire fighting facilities are deficient; way and side amenities are absent. For want of adequate truck terminals, vehicles are parked on the road creating acute congestion. In most of the border points, there is only one exit both for passengers and goods creating considerable inconvenience for the users. Other major problems at specific border crossing points are indicated below.

At Rauxal (India)

About 3200 out bound and 4500 in bound vehicles are processed between India and Nepal each day through this point (SRMTS, 2005). All inspections, export and import, take place in the customs examination yard which has a small area (1.23 acres), located immediately adjacent to the border that can accommodate only 15 vehicles at one time. Trucks typically require one day for the full procedures, although most of this time is spent queuing. The inspections and document examinations themselves take only two hours (SRMTS, 2006).

At Benapole (Bangladesh)

Indian truck move across the Bangladesh territory at Benapole and after unloading the trucks return to India. The typical waiting time at the Benapole land port truck parking yard is 2-3 days, though the delay of up to 15 days has also been observed, particularly if the cargo requires special type of storage or handling (SRMTS, 2006).

At Darsana (Bangladesh)

At Darsana, the rakes delivered by India are marshalled and reassembled into trains set accordingly to their individual destinations within Bangladesh. Average dwell time for a wagon at Darsana is about two days because of logistic problems. Moreover, permissible rake length in BR system (30 BCX wagons) is less than the IR system (33 BCX wagons) due to shorter passing loop length which is 1,850 meter in BR system. As a result, 3 BCX wagons are left at the yard from each Indian rake. Later, a new rake is formed by the left out wagons from 10 Indian rakes. This process contributes to increasing the average dwell time.

At Banglabandha (Bangladesh)

Bangladeshi trucks are not allowed to enter India and Nepalese trucks are not allowed to enter Bangladesh. All customs inspections, cargo transfers and other process must presently be conducted either in no-man's-land or on the public highway. Presently, when Bangladeshi customs officers are required, they must be summoned from Panchagarh, some 58 km away.

At Fulbari (India)

Cross-border movement is not allowed until either Bangladeshi truck for receiving Nepalese imports has arrived on the Bangladeshi side or a Nepali truck for receiving Bangladeshi exports has arrived on the Indian side. Delays occur most frequently due to non-arrival of either the Bangladeshi truck or Nepali truck. The maximum delay is up to two days. Indian Customs make cursory inspections of incoming and outgoing trucks and conduct paperwork examinations at a small post on the far side of the border gate. There are no facilities for unloading cargo other than manual labour. Indian customs officer, normally informed two hours in advance of a conveys arrival, is summoned from Fulbari customs Station, 2.5 km from the border.

11.3 EXPERIENCE OF TRANSPORT COOPERATION ELSEWHERE

A review of transport cooperation elsewhere in the world revealed that wide ranges of experiences are available. While Europe has been very successful in achieving real transport integration, the experiences elsewhere have been mixed. The experience of transport cooperation at the subregional level in Asia has generally been quite satisfactory, except in the South Asian subregion. Indicated below is a brief overview of the various initiatives.

11.3.1 UN-ESCAP's Initiatives

In order to promote regional cooperation among member countries, United Nations Economic and Social Commission for Asia and the Pacific (UN-ESCAP), earlier known as ECAFE, took one of the pioneering initiatives in 1959 through the Asian Highway (AH) project involving initially 15 countries. The Trans Asian Railway (TAR) project, launched one year later in 1960, further strengthened the initiative. Both the projects, however, lost their initial vigour during the 1970s and the 1980s due to various political and economic hindrances as well as war like situation that was prevailing in the region during that period. In 1992, the two projects were merged and a new element – facilitation of land transport movement was incorporated into an umbrella project named "Asian Land Transport Infrastructure Development (ALTID)" to pursue the regional cooperation in transport. The formation of Bay of Bengal Initiative for Multisectoral Technical and Economic Cooperation (BIMSTEC) has created further opportunity to operationalise the southern corridor of ALTID, which connects Bangladesh, China, India, Iran, Malaysia, Myanmar, Nepal, Pakistan, Singapore, Sri Lanka, Thailand and Turkey (Sobhan, 2000). The countries of South Asia have already identified their AH and TAR links to establish subregional connectivity. Now the emphasis should be on operationalisation of the identified links and their further strengthen to carry regional/subregional traffic.

11.3.2 ASEAN Subregion

The Association of South East Asian Nations (ASEAN) adopted a long-term vision (Vision, 2020) for an integrated and harmonised Trans-ASEAN transportation network. To achieve this vision, the ASEAN Framework Agreement on the Facilitation of Goods in Transit entered into force in October 2000.

The Fifth ASEAN Transport Ministers Meeting, held in 1999, also agreed to the development of the ASEAN highway network which was subsequently built on the AH framework and includes 23 routes covering some 38,400 km of highways. This subregional initiative may be viewed as important building blocks for realising the ALTID goal of fully integrated Trans-Asian transportation network with efficient interface with other regions.

11.3.3 GMS Subregion

At the initiative of the Asian Development Bank (ADB), and with active involvement of the six participating countries namely, Cambodia, People's Republic of China, Lao PDR, Myanmar, Thailand and Vietnam, the Greater Mekong Subregion (GMS) programme was launched in 1992. Subsequently, three sets of transport subsectoral network for roads, railways and inland waterways were adopted for development by the six GMS countries.

Realising that the infrastructure development is only part of the solution for efficient international movement of goods and people, the GMS countries also took the initiatives to simplify and streamline cross-border regulations/procedures. The implementation of the draft framework agreement for the facilitation of the cross-border movement of goods and people in the GMS has already been initiated and is expected to be fully in place by 2005-06.

11.3.4 ECO Subregion

The Economic Cooperation Organization (ECO), comprising the five countries of Central Asia as well as Turkey, Pakistan, Iran and Afghanistan, adopted the Almaty Outline Plan for Transport Sector Development in 1993 and the Programme of Action in 1998 for the ECO Decade of Transport and Communication (1998-2007). In the context of transport development in that subregion, considerable progress was made towards connecting the road networks of Central Asian republics with the network of Iran, Pakistan and Turkey. The Transit Transport Framework Agreement (TTFA), signed by the five Central Asian Member countries of ECO in 1998, is another important development towards improving land transport facilitation measures at the subregional level. The Transport and Communication Ministers meeting of ECO countries, held in Islamabad in 2000, adopted eight protocols in support of the above Framework Agreement. Subsequently, to further improve the facilitation measures at the border crossing and to introduce multimodal transport operation in the subregion, the ECO secretariat, in collaboration with UN-ESCAP and UNCTAD, implemented another project funded by the Islamic Development Bank (IDB).

11.3.5 Initiatives in Europe

The Declaration on the Construction of Main International Traffic Arteries of September 1950, adopted under the aegis of the United Nations Economic Commission for Europe (UNECE), provided an important regional framework for the post-war development of European transport networks. The European Agreement on Main International Traffic Arteries (AGR) of 1975, the European Agreement on Main International Railway Lines (AGC) of 1985 and the European Agreement on Main Inland Waterways of International Importance (AGN) of 1996 defined the E-network for road, rail and inland waterways respectively. These agreements provided a legally binding framework for coordination and cooperation in the development of such networks in Europe. In addition, the European Agreement on Important International Combined Transport Lines and Related Installations (AGTC) of 1991, which became effective in 1993, provided the legal framework for the development of multimodal transport. All these transport infrastructure agreements in Europe are being complemented by a host of trade and transport facilitation agreements and conventions. Most of the European countries have either signed or acceded to these agreements and conventions, which ensure that national transport networks of individual countries are now both technically and functionally integrated.

11.3.6 Initiatives in Africa

The initiatives for promoting integration of surface transportation at the regional and subregional levels were not confined to Europe and Asia. A case in point is the 1996 Southern African Development Community (SADC) Protocol on Transport, Communications and Meteorology. One of the strategic goals of this wide-ranging protocol was the integration of regional transport and communications networks, to be facilitated by the implementation of compatible policies, legislation, rules, standards and procedures.

UN Economic Commission for Africa (ECA) also identified within the framework of the Transport and Communication Decade of Africa, the regional network of Trans African Highways and Railways. Efforts were also underway towards the development of an interlinked surface transportation system among the countries of this continent. ECA also adopted a map showing the networks of Trans African Highways and feeder roads to the network, as well as links to the railways.

11.3.7 Initiatives in Latin America (Mercosur)

Mercosur was established in 1991 as a trade bloc of four developing countries of Latin America comprising Argentina, Brazil, Paraguay and Uruguay, and started functioning from January 1995. Approximately 90.0 per cent of traffic in the bloc travels by road transportation which is relatively superior to that of other modes (Zinn, 1999). Mercosur countries have a railway network sufficiently extensive to be an alternative to road transportation, but its use had been very limited owing to a number of problems related to infrastructure, including lack of standardisation of railway gauges. However, initiatives were taken by a private company, which operates railways in both Brazil and Argentina, to link northern Brazil to ports on the Pacific in Chile by using road-railers, a hybrid of road and railway technology. The road-railers have both truck and rail wheels so that they can be easily converted from a road carrier to a rail wagon and vice versa.

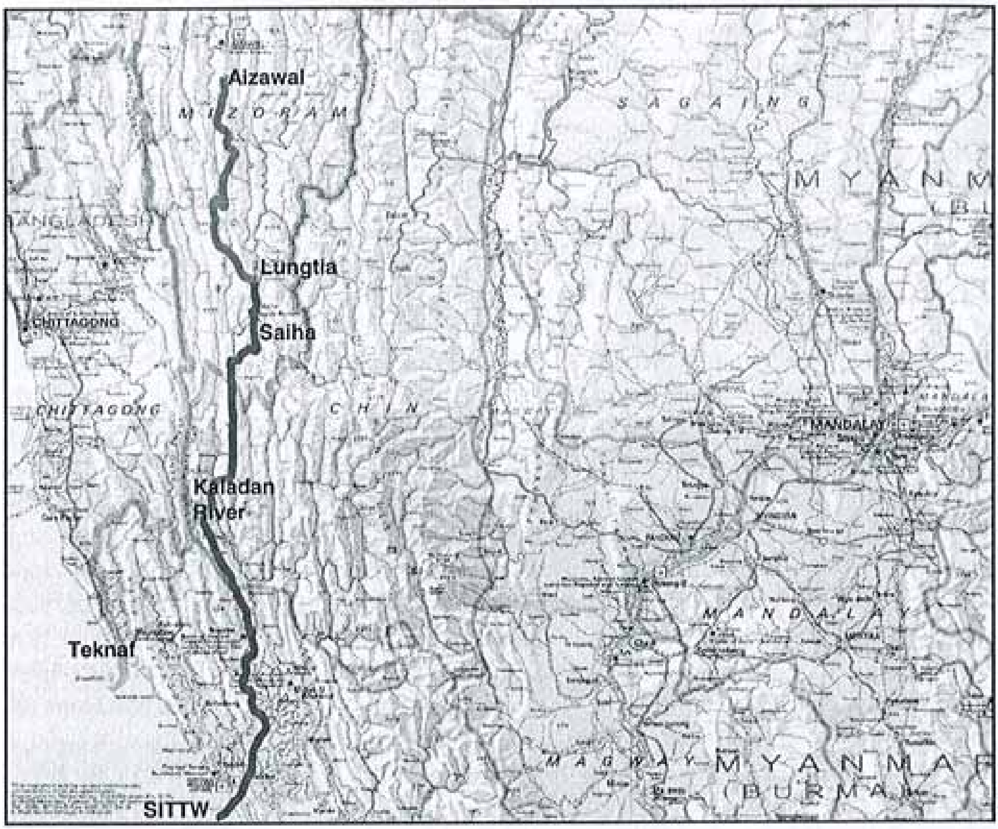
11.4 WHY TRANSPORT COOPERATION IS SO ESSENTIAL IN SOUTH ASIA?

In the absence of effective transport cooperation, countries of South Asia are loosing heavily on many fronts. Indicated below are some of the consequences of non-cooperation.

11.4.1 Movement Between NE-India and Mainland India

- The shipment of Assam tea to Europe along its traditional route through Chittagong is not possible, since it is not covered by the current bilateral agreement between Bangladesh and India. As a result, the transportation cost includes a trucking route of more than 1,400 kilometres from Assam to Kolkata Port through the land corridor termed the "chicken neck" between Bangladesh and Nepal (Verghese, 1996) (Map 11.2). The traditional route for Assamese tea via Chittagong port could have reduced the journey for export shipments by almost 60.0 per cent (Subramanin, 2001).

Map 11.5: New Delhi-Yangon Cooperation (Kaladan Project)



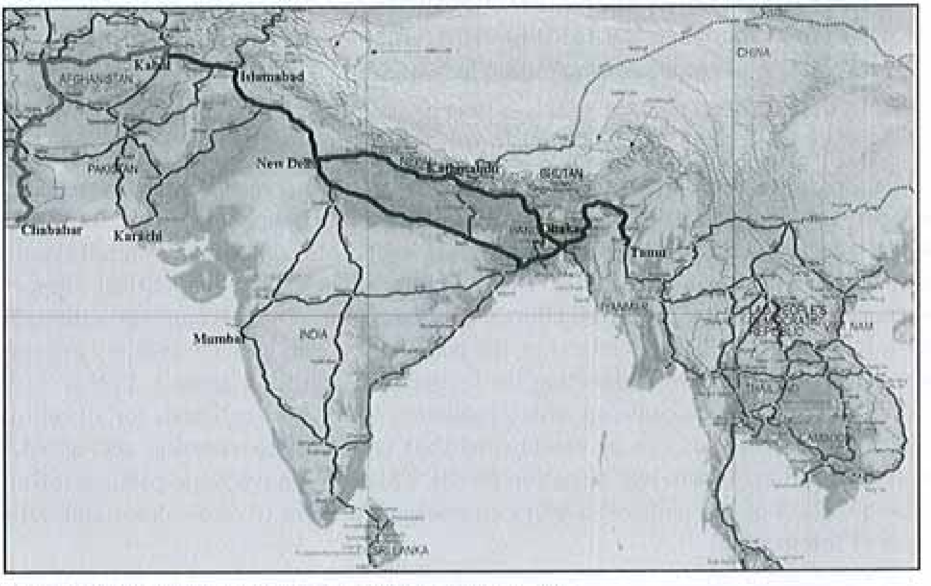
Source: Prepared by author based on a map for Myanmar, Printed by Nelles Verlag GMBH, D-80935 Munchen, Germany.

- The southern border of Tripura state is only 75 km from Chittagong port. But since access to Chittagong port is not allowed under any agreement between Bangladesh and India, goods from Agartala are required to travel a distance of 1,645 km to reach Kolkata, against a direct distance of 350 km across Bangladesh (Rahmatullah, 2004).
- Due to lack of cooperation between India and Bangladesh no transit facilities are allowed for NE Indian states to mainland India. New Delhi and Yangon are, therefore, currently implementing the Kaladan project that will revive an old historic port at Sittwe on the Western coast of Myanmar and link it by Kaladan river and road to southern Mizoram (Map 11.5). This Kaladan project will provide India a much needed alternative route to access the North-East India by going around Bangladesh territory. But this alternative is going to be quiet expensive route for India.

11.4.2 Movement Between Nepal and Bangladesh

Although India has allowed a route between Bangladesh and Nepal across the "Chicken Neck" for bilateral trade yet goods are required to be transshipped at Banglabandha border point. Since this route cannot be used for third country trade, Nepal's export and import traffic uses Kolkata port, which is often congested compared to Bangladesh seaport of Mongla, which has a direct broad gauge link with Rauxal (Nepal border) (Map 11.2). But this route cannot be used for either intercountry or third country trade of Nepal, as India has not agreed to it as yet.

Map 11.6: New Delhi-Tehran Cooperation through Iranian Port Chaubahar



Source: UN-ESCAP, Asian Highway Route Map (2004), Bangkok.

11.4.3 Movement among Bangladesh, India and Pakistan

- Bangladesh has its own development interest in North-East India and vice versa (Das, 2001). Scarcity of mineral resources, except natural gas, has been major problem for the development of Bangladesh. Northeast India with its huge mineral resource base can fill this vacuum. Moreover, the complementary nature of the hill economies of North-East India, their agro forest resource base and hydro-power potentials can be of much help for the development of Bangladesh. In fact, the resource structure of North-East India and the demand structure of Bangladesh are such that a free trade between them is likely to reinforce the development efforts in both sides for the border.
- It takes 45 days to transport a container from Delhi to Dhaka, because the container first moves to Tughlakabad ICD in New Delhi, then to Mumbai (India) and Singapore. From Singapore, the container is moved by feeder ship to Chittagong port, and then to Dhaka by rail. According to a reliable estimate, the

distance of around 2,000 kilometres between Dhaka and Delhi could have been covered in two to three days by rail (Subramanin, 2001).

- The distance between Dhaka and Lahore has also increased from 2,300 km to 7,162 km after 1947, because overland movement across India is not allowed (Rahmatullah, 2004). Transport cooperation among countries of South Asia could restore movement along shorter routes.

11.4.4 Movement Between India and Pakistan

- Since Pakistan has been denying facilities for overland trade between India and Afghanistan, New Delhi and Teheran are cooperating in the development of a transport corridor from India to Afghanistan and Central Asia through Iranian port of Chaubahar (Map 11.6). This will become the key corridor to rapid expansion of economic cooperation between New Delhi, Kabul, and Central Asia.
- In the process, Pakistan will lose the opportunity of earning a huge transit fee in foreign currency, if Indian goods were allowed to pass through Pakistan territory.

A quick analysis of the various impacts or cost of non-cooperation revealed that these are very high and all South Asian countries are incurring this loss. To integrate the transport system and establish transport cooperation, political commitment and understanding between countries is crucial. In order to mobilise the political support for transport integration, a concerted effort would be required throughout the subregion to ascertain, from the political leadership, the policymakers and the civil society in general, the real causes which are obstructing the transport integration process. In this context, it would be necessary to come up with a realistic estimate of such costs for all countries of South Asia so that it can be established that transport cooperation among SAARC countries could bring win-win situation for all. This could have some positive influence on the mind set of the political leaders and persuade them to come closer and support transport integration.

11.5 RECENT INITIATIVES OF TRANSPORT INTEGRATION IN SOUTH ASIA

So far 4 major organisations have taken the initiative to promote transport integration in South Asia. These are UNESCAP, WB, ADB and SAARC Secretariat. The details are as follows.

11.5.1 Implementation of ALTID

As indicated earlier in Section 11.3 of this paper, ESCAP took one of the pioneering efforts in promoting transport cooperation in Asia through it's two famous projects, the Asian Highway (1959) and the Trans Asian Railway (1960). In 1992 both these projects were brought under one umbrella of the ALTID project. Except Bhutan and Maldives, five SAARC countries are members of ALTID, and all of them have identified their highway and railway links which are forming parts of the AH and TAR networks. ESCAP had already taken further initiatives to formalise and standardise these links through signing of agreements. The main hurdle which is still to be resolved is the operationalisation of the AH and the TAR in South Asia to allow uninterrupted intercountry movement. Joint efforts backed by political support are essential to resolve these issues.

11.5.2 The World Bank (WB) Initiative

The World Bank initiated a transport corridor study for the South Asia region in early 1998 to identify key trade and transport corridors; document bottlenecks and other corridor problems from a user perspective; evaluate potential corridor improvements through a cost benefit framework; and proposed interventions that would improve corridor performance. The study scope included all the principle trade and transport corridors among Bangladesh, Bhutan, East and NE India, and Nepal. This study was known as South Asia Regional Development Initiative (SARDI).

Out of 19 major corridors, the project team finally selected six priority corridors for more detailed analysis. Information were compiled on traffic flows, time, costs and losses incurred in transit, delay faced and other major constraints for each crossing. The selected corridors were:

i. Kathmandu to Kolkata via Birganj
ii. Kathmandu to Kolkata/Bangladesh via Biratnagar
iii. Nepal/Bihar to Bangladesh via Jamuna Bridge
iv. Kolkata to Dhaka via Jessore
v. Guwahati to Kolkata via Shiliguri; and
vi. Guwahati to Dhaka/Chittagong.

The study concluded that the obstacles to effective transport networks in SARDI region pose a tremendous challenge. The costs of the bottlenecks to consumers and producers were in the range of 3.0 to 10.0 per cent of the value of goods. Some of the key actions recommended were to opening access of NE India to Chittagong port, and reduction/elimination of transshipment of cargoes from foreign vehicles to local vehicles at the borders. The study also suggested a number of policy interventions, but due to lack of political commitment from countries concerned, little progress could be achieved in enhancing intra-regional trade flows, and almost no progress in respect of the above mentioned transport related issues.

11.5.3 The Asian Development Bank (ADB) Initiative

Recognising that regional cooperation involving all 7 countries of SAARC was making slow progress, the idea of subregional cooperation among a few countries was mooted in 1996 in the name of "South Asia Growth Quadrangle (SAGQ)." The ninth SAARC Summit held in Male in 1997 approved the concept and the group consisting Bangladesh, Bhutan, India and Nepal became known as the SAGQ countries. In order to promote cooperation among SAGQ countries, ADB launched the South Asia Subregional Economic Cooperation (SASEC) programme in 2001. The Working Group on Transport, headed by the Secretary, Ministry of Physical Planning and Works of Nepal, had its third meeting in Bangkok in May 2005.

Out of 21 corridors initially identified, the "Subregional Corridor Operational Efficiency Study" of SASEC selected six corridors, involving all 3-modes, for detailed analysis. The corridors were:

i. Kathmandu-Birganj/Raxaul-Kolkata/Haldia Road/Rail Corridor
ii. Kolkata-Petrapole/Benapole-Dhaka Road Corridor

iii. Kolkata-Gede/Darsana – Ishawardi-Dhaka/Chittagong Rail Corridor
iv. Kathmandu-Kakarvitta – Banglabandha-Mongla or Chittagong
v. Kolkata – Sundarban – Narayanganj-Brahmaputra River-Assam Inland Waterway Corridor
vi. Thimphu/Paro-Phuentsuoling/Jaigaon-Kolkata/Haldia Road Corridor.

The Study identified the choke points, physical conditions, operational and institutional impediments, possible solutions and made recommendations for each of the corridors (SASEC, 2005). The study also reviewed and analysed the current customs procedures, the transit protocols or agreements and then suggested some amendments to the Protocols. Economic benefits that could be accrued to the countries, if the recommendations are fully implemented, were calculated as well.

It is to be observed now as to how much of these recommendations are picked up by the respective member countries of SASEC for implementation and their real life impact.

11.5.4 SAARC Secretariat's Initiative

To follow up on the decisions of the 12th SAARC summit held in Islamabad in 2004, the Secretariat in Kathmandu undertook "SAARC Regional Multimodal Transport Study (SRMTS)" identified the major transport corridors and analysed the physical and non-physical constraints along these corridors and at the border crossing points, as well as to determine the institutional weaknesses which are obstructing smooth movement of freight and passenger. Supported by ADB, the study roughly estimated the potential transport demand of both intra and interregional traffic along the corridors and assessed the adequacy of the infrastructure facilities to handle the future traffic, and identified the facilities and arrangements which are required to be expanded or upgraded.

The SRMTS covered both passenger and freight traffic between SAARC countries along road, rail and IWT networks. The study also focused on ports and shipping, land ports, and civil aviation. The SRMTS was carried out in two phases. Under Phase I, Country Transport Connectivity (CTC) reports were prepared by National Consultants. In order to address the special problems of NE India's access to the sea, country teams of Bangladesh and India discussed jointly the issue and suggested solution.

Under Phase II, the finding of Phase I was reviewed, redefined, synthesised and a regional "road map" prepared, containing recommendations to address various physical, non-physical, institutional and procedural constraints, for implementation in the short term (2006-2010), in the medium term (up to 2015) and in the long term up to 2020. Phase 1 of study (SRMTS) started in August 2005, and the Draft final report of phase II was submitted by the Regional consultants to the SAARC secretariat in early June 2006.

11.5.5 SACEPS Initiatives

It was observed that one of the major elements which was obstructing transport cooperation in South Asia in the past has been the *Political Constraints*. In order to address this issue which will be complementary to SAARC initiative, South Asia Centre for Policy Studies (SACEPS) has taken an initiative to involve the political leaders and the civil society in all the South Asian countries to discuss the issues involved in *Political Constrains* and how these would be resolved. Under the SACEPS programme, a series of dialogue will be organised involving political leaders and civil society in all South Asian countries through which attempt will be made to ascertain the type and nature of political constraints and how these could be addressed to benefit all the countries of south Asia, so that it is a win-win for all.

11.6 HOW TO ADDRESS THE PROBLEMS?

Virtually, all the constraints to improved transport cooperation in South Asia, as indicated above in Section 11.5, are political. Thus, the key to transport cooperation lies in a change in political mind set for achieving effective transport cooperation in South Asia; some policy changes are also needed as indicated below.

11.6.1 Strong Political Commitment Essential

The Islamabad Summit declaration in January 2004, seeking to strengthen transportation, transit and communication links across the region as well as harmonisation of standards and simplification of custom procedures, indicates a renewed political commitment to improve connectivity across the SAARC countries. The challenge to the SAARC governments will be to operationalise these commitments by dismantling the political as much as the infrastructural barriers to improve communications.

Civil society in South Asia as well as the business community can play a proactive role in ascertaining to why political leaderships in different countries cannot come closer to establish transport connectivity and operationalise the system for uninterrupted movement across the subregion. These initiatives could provide enough materials to the civil society and the business community to press the governments of SAARC countries to honour the commitments made at Islamabad. The series of dialogues involving the civil society and the political leaders could go a long way in addressing the political constraints and work strategies which could be acceptable to the political leadership to resolve the differences.

In addition, a comprehensive study of the "costs and benefits of cooperation in the transport sector between countries of South Asia" or in other words, a study on "cost of non-cooperation in transport" should be undertaken and the findings widely disseminated for awareness creation among political leaderships and people in general, so that transport cooperation issues could be pursued based on facts and figures.

11.6.2 Major Policy Changes Needed

In order to make transport cooperation viable, the following policy changes and studies are necessary:

i. Trade surplus countries could consider investing in trade deficit countries under decentralised production system to generate even flows as well as to contribute to reducing trade gaps; and

ii. Bangladesh and Pakistan should take advantage of their unique geographical location, and sell transport services; i.e. "trade in services" by allowing Indian traffic to pass across their respective countries, which could provide a stable source of foreign exchange earning for transit countries.

In the case of Bangladesh, it needs to change its perspective on issues of transport connectivity with India. The problems should be viewed from the opportunities provided to both sides to improve connectivity with neighbours and widening economic opportunities for the region. So far, manpower export was providing Bangladesh with largest net export earning. Bangladesh should now aim to become a major exporter of transport services to India. Bangladesh shall view its territory as a productive asset to connect East Asia to South Asia with a view to transform Bangladesh into a Singapore of the land routes. This would greatly help to reduce large and growing trade gap with India.

Bangladesh should therefore "trade in services" and export its transport services to India. This would create such an environment in Bangladesh which would facilitate attracting significant FDI and donor assistance for both upgrading and expanding capacity in infrastructure as well as carrying capacity.

Due to its unique geographical location, Bangladesh could become a "transport hub" for the subregion comprising NE India, Nepal and Bhutan. Opening up access through Chittagong Port could provide incentive to exploit natural resources in NE India to mutual benefit.

11.6.3 Coordination in Transport Development

Since the participation of India in 1947 and following India- Pakistan war in 1965, development of transport system in the South Asian countries has been considered only as a national issue and did not taken into account the cross-border issues of compatibility, uniformity of standards, infrastructure and equipment design, which are vital for promoting movement of goods and people across national boundaries. In this regard, following areas need urgent attention so that transport infrastructure does not stand on the way to smooth intercountry movement.

Coordinated Development of Rail Network

India Railway (IR) is making a concerted effort to convert its network from meter gauge (1.00m) to broad gauge (1.68m), and Bangladesh Railway (BR) is currently undertaking some conversions of meter gauge to dual gauge. In order to ensure smooth traffic movement by railway between various countries of South Africa, there is a need to coordinate the conversion programme of IR and BR. The coupling and breaking systems, load capacity of the tracks and bridges, wagon size and capacity, passing loop and rake lengths, signalling systems, etc. will also need to be standardised. To be able to face the competition from road transport, it would also be essential to achieve significant improvements in rail operation.

Fully loaded Indian wagons are not allowed at present to cross the Jamuna Bridge, as the bridge has a lower rating (43.7 KN per meter). Initiatives are already underway for re-rating the Jamuna Bridge to 60 KN per meter so that direct freight train movement between Dhaka and Kolkata becomes possible.

Till such a time that the Gauge conversion has been effectively undertaken, movements of goods in containers could be encouraged without any delay. These containers could be carried by both BG and MG. BR could pick up containers from Kolkata and carry upto BG/MG transshipment point, which could be established near Ishawardi, and subsequently by MG to any point in NE India and vice-versa. Arrangements for border crossing of containers can be worked out through discussion.

Prospects of Road Transport

For the movement of high value and perishable goods, trucks will continue to have a dominated role if not an exclusive one. To this end, the road infrastructures need to be upgraded from current 2 lanes (7.3 meter) to 4 or 6 lanes dual carriage ways. While both India and Pakistan have taken massive programme to upgrade their major Asian Highway network to dual carriage, Bangladesh is still to follow the trend. Again, Bangladesh roads are built to an Axle load limit of 8.2 tons per rear axle compared to 10.2 tons in Bhutan, India and Nepal. Although Bangladesh has recently adopted 10 tons axle load limit, yet it will take quiet sometime to upgrade its road infrastructures. It would, therefore, be a bit premature to open Bangladesh roads to any substantial movement of international traffic till its infrastructures are upgraded. In view of this constraint all subregional movement of goods, preferably only high value and perishable goods by road across Bangladesh, should be containerised and carried by multi-axle truck-trailers, instead of normal trucks (Rahmatullah, 2004).

As part of enhancing export of "transport services," Bangladesh should also consider providing bus services between Agartala and Kolkata and between Kolkata and NE India. These services could be provided by Bangladesh's private sector Luxury bus operators. Bus services could also be introduced between Dhaka and destinations like Shillong and Guwahati by private sector Luxury bus operators on 50:50 basis (Rahmatullah, 2005).

Using Full Potential of IWT

Inland water transport could play a very prominent role in transporting low value bulk cargoes that move between Kolkata and Northeast India including Tripura state. It is a mode of transport where no transshipment at the border crossing is involved and its charges are the lowest per ton km of freight. Even then it is still at a disadvantage because of its low travel speed, in the range of 50 to 80 km per day due to limited night navigation and limited drafts on certain routes in the dry seasons. Lack of sufficient ports of call also discourages movement of intercountry trade by IWT. Allowing transshipment to truck at Ashuganj for onward carriage of cargo to NE India, including Agartala, may make IWT a viable alternative mode of transport. The abovementioned issues need to be jointly looked into by both the governments of Bangladesh and India with a view to making water transport really competitive for low value bulk cargo, with efficient logistic linkages to provide door-to-door services.

Corridor Studies for Physical Integration

While efforts are underway to bring in a change in the mind set of politicians so that they support the full integration of the transport system in South Asia, in line with Islamabad Summit decision of 2004, some ground work should continue to identify both physical and non-physical bottlenecks in the transport system of South Asia. Under UNESCAP's ALTID project, major AH and TAR links between South Asian countries, as well as the facilitation measures required to be in place at border, have already been identified. These should be implemented on priority bases. Meanwhile, SAARC Secretariat supported by ADB has taken another initiative to identify, among others, some major corridors which need improvement. These initiatives should be pursued with strong commitment.

11.6.4 Facilitation of International Traffic

In line with European experience, UNESCAP resolution 48/11 of April 1992 urged member governments to accede to seven international land transport facilitation conventions (UN-ESCAP, 1992). Meanwhile, as an interim measure, a number of subregional groups have started adopting some Transit Transport Framework Agreements (TTFAs). Important provisions from the abovementioned international conventions are being included in the protocols of these TTFAs.

In addition, it would also be essential to remove inefficiencies associated with documentation and procedures involved in border crossing such as customs inspection, excessive documentation and multiple signature requirements, lack of transparency, informal payments, etc. Human resources development to deal with trade and transport facilitation issues as well as customs management practices also needs to be emphasised.

Facilitation of international traffic covers movement of both goods and passengers. As such, these have been addressed separately.

Movement of Passengers

In order to facilitate movement of passengers between South Asian countries, it is essential to simplify the visa requirements. All the countries could in fact consider adopting practices already in use between India and Nepal, where visa requirement has been completely abolished. In the interim period, visas may be issued free of charge on arrival, at the port of entry, leading finally to the abolition of visa requirement. Currently, Sri Lanka is issuing "visas on arrival." Nepal has also introduced this system for some of the SAARC countries.

Nationals of SAARC countries should be provided with dedicated quick entry and exit channels in all member states, as has been introduced in Sri Lanka. Bangladesh and India may also like to agree to establish a "Bangladesh consulate office" at Guwahati or Shillong to facilitate issuance of visa for movement between NE India and Bangladesh. Bangladesh Consulate Office at Agartala serves mostly the needs of Tripura, Mizoram and Manipur States.

Movement of Goods

As indicated earlier, as an interim measures, South Asian countries may consider adopting certain Transit Transport Framework Agreements (TTFAs). The ASEAN, Economic Cooperation of Organisation (ECO) of Central Asian countries as well as Greater Mekong Sub-region (GMS) countries have already gone for such arrangements. Measures envisaged in TTFAs such as mutual recognition of driving permit and vehicle registration, the issuance of multiple entry visas to transport operators and harmonised customs documents and procedures would minimise delay at border crossing and benefit the transporters and traders.

11.6.5 Introduction of Multimodal Transport Operation

In the context of globalisation, reliable, competitive and time bound door-to-door services can be ensured only under Multimodal Transport (MMT) operations which need to be introduced for efficient trading within South Asia. For effective introduction of MMT and provision of efficient logistic services, it would be necessary to organise short and long term training programmes for transport operators and freight forwarders to promote the concept of MMT operations and its implementation in practice. Supportive legislation may have to be adopted for introduction of MMT operations among countries of South Asia. Supporting infrastructures, in the form of well-equipped Inland Container Depots (ICDs), shall have to be established at strategic locations in addition to efficient transshipment facilities at transfer points to enable smooth movement of containers under the multimodal transport system, from the premises of the shippers to the premises of the consignees.

11.7 CONCLUSIONS

The South Asian countries, given their physical and cultural proximity and shared history and heritage, form a natural area for integration. Most of these countries once formed part of an integrated economy, and yet they probably constitute one of the less "internally connected" subregions in the world today.

The integration of the South Asian transport networks, in fact, would largely involve a reintegration of existing infrastructures, requiring minimum commitment of economic resources. In order to ensure that all South Asian countries benefit from such integration, attention needs to be given to the question of more balanced trade flows among these countries based on the development of greater complementarities among their economies. Increasing joint ventures among the entrepreneurs of these countries can help achieve this objective. In this respect, there is an immediate need for private and public sector collaboration within a multilateral framework.

National transport systems are within the exclusive jurisdiction of sovereign governments and their integration can be achieved only when the national governments show a strong political commitment to the goal of a more integrated South Asian community in general and an integrated South Asian transport system in particular. In this context, it would, however, be desirable to ascertain the real dimensions of the political constraints and reservations which are obstructing integration of the transport system, so that dialogues could be organised involving the entire civil society in each of the South Asian countries to find a solution which could be acceptable to the politicians. To this end, a process of awareness creation about the mutual benefit of transport integration, or cost of non-cooperation among countries based on a comprehensive study referred to earlier, could go a long way in persuading the political leadership about the importance of transport integration.

While the full integration of national networks, similar to Trans-European Transport Network, should remain a long-term goal, the South Asian countries have to establish first, an efficient level of cross-border transport systems among themselves. Unless progress is made in this direction soon, the South Asian subregion will become the missing link in an otherwise integrated regional and world transport network, not to speak of the lost opportunities in terms of exploiting their full economic potentials and a fuller participation in the global economy.

Finally, it may be said that it is time now for concerted efforts to be made by all stakeholders, the governments, the private sector and the civil society at large to bring about a change in the political mindset of the leaders, so that a long-lasting solution can emerge.

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Chapter 12

POVERTY SITUATION IN SOUTH ASIA: A NEED FOR AN EMPOWERMENT APPROACH

12.1 INTRODUCTION

This paper starts by describing the important mileposts of the global march through which poverty has become the central and the consensual theme of global development discourse. Then it critically examines the evolution of the ongoing discourse on poverty among the different South Asian countries collectively under the banner of SAARC first and then secondly the individual poverty discourse by each country within the framework of their own Poverty Reduction Strategy Papers (PRSPs).

Before examining individually the PRSPs of those South Asian Countries (Sri Lanka, Nepal, Pakistan and Bangladesh), which have accepted that framework, the paper tries to present a general comparative study about the latest poverty profile now prevailing in these four South Asian countries. We have also included India in our analysis because of its obvious overwhelming importance in South Asia, although it is not following the donor-driven PRSP framework. The paper also tries to provide in brief the common and uncommon aspects of the poverty reduction strategies initiated by the four South Asian Countries: Sri Lanka, Nepal, Bangladesh and Pakistan. The paper briefly concludes by pointing out the fundamental political constraint, which will have to be solved before any programme of poverty eradication becomes successful in South Asia.

12.2 POVERTY DISCOURSE: INTERNATIONAL MILESTONES

Poverty has slowly turned into the central focus of the International development discourse in the last decade of the previous century. The international mileposts of the last decade, through which "Poverty" had acquired this status, have been well described in the Bretton Woods (BW) institutions documents. Just for a reminder let me present a few selected highlights of them in brief:

- In 1995 International Community in their "Copenhagen Declaration" agreed to address key social development issues.

- In 1996 Development Assistance Committee (DAC) published "Strategy Twenty One" which called for a global effort to reach International Development Goals.
- World Bank (WB) and International Monetary Fund (IMF) approved the Heavily Indebted Poor Countries (HIPC) Initiative for comprehensive debt relief in their annual meetings of 1996.
- In the Cologne Summit held in 1999 the G8 Group declared support for a deeper debt-relief within a framework of poverty reduction.
- In the same year, the IMF and WB decided to base their debt relief and concessional lending on so-called national Poverty Reduction Strategy Papers (PRSPs) prepared by the respective loan recipient countries which have to be approved and finalised only after the endorsement of the board of directors of the BW institutions.
- The IMF replaced the Enhanced Structural Adjustment Facility (ESAF) -- it's concessional loan facility-with the Poverty Reduction and Growth Facility (PRGF) in 1999, which targeted poverty reduction as an objective.
- The WB introduced Poverty Reduction Support Credit (PRSC) in 2001 to support low-income countries in implementing their poverty reduction goals on the basis of the approved PRSPs.
- One hundred and eighty nine countries came together at the UN Millennium Summit held in 2000 and pledged to halve the poverty in their respective countries within a specified time period.
- Thus at last the UN system, bilateral donors and the IFIs all moved to align their assistance programmes in support of poverty reduction and the MDGs. (World Bank, 2000; Ahmed, 2002).

12.3 POVERTY DISCOURSE: SOUTH ASIAN PERSPECTIVE

As an active participant in the global discourse on poverty, the South Asian countries, both collectively and individually, had also turned poverty the centrepiece of all their development programmes. Five countries of South Asia had already embarked in the process of developing their PRSPs. They are Sri Lanka, Nepal, Pakistan, Bangladesh and Bhutan. The largest country in South Asia India, although has not yet embraced itself the recent donor driven PRSP approach, yet she also had started addressing the issue of poverty in as early as 1970 by launching the so-called *Garibi Hatao* movement under the regime of Indira Gandhi. The central strategic goal of the current Tenth Five Year Plan (2002-2007) of India is also "poverty eradication."

However, the history of formal poverty discourse in South Asia on a collective and regional basis starts from the year 1991. In November 1992, for the first time an Independent South Asian Commission for Poverty Alleviation (ISACPA) was constituted as a follow up of an initiative taken in the Colombo SAARC Summit held in 1991. ISACPA at that time had been assigned the following TOR on behalf of the highest authorities i.e. the Heads of the States of SAARC:

- To diagnose what went wrong with past attempts at poverty alleviation?

- To draw the positive lessons from the ground where the poor have been mobilised to contribute to economic growth and human development.
- To identify the critical elements in a coherent overall strategy of poverty alleviation in South Asia (SAARC, 2004).

The first report produced in 1992 by the then ISACPA identified quite a few structural constraints against previous attempts to eradicate poverty in this region. The report starts with the recognition that South Asia is caught in a "low economic growth and poverty reproduction syndrome." The report also identifies certain negative forces that perpetuate this "poverty reproduction syndrome." These are as follows:

- Population growth is identified as an important factor that whittles away a part of the low economic growth.
- In all the South Asian countries there are some outlying mountains, valleys and hills, remote areas and places where cost effective poverty alleviation programmes are difficult to implement. So these areas are continuing as chronically poor areas.
- There is a problem of growing foreign debt burden for the whole region, which has many direct and indirect negative implications for poverty.
- The report views the emerging global economic environment as more adverse for the poor. It argues that current forms of globalisation are opening up opportunities for few and posing threat for many.
- The report also points out that the developed countries are not opening up and the Western regional blocs often create new problems against the legitimate development efforts of South Asian countries.

Along with these negative points the report also recognised that at least some good results for the poor were coming out from the indigenous agricultural development and the strategy of enhancing food security (SAARC, 1992).

In the light of the above diagnostics of poverty some non-traditional recommendations were put forward in the 1992 report of the then SAARC nominated ISACPA. It suggested that agricultural development and food security must continue for their relatively greater direct positive impact on the lives of the low-income groups.

The report also pointed out that government's involvement in the development process was too much high and it should be replaced by poor people's participation in the development process.[1]

For that the report recommended to mobilise and empower the poor socially, economically, culturally and politically. A strategy of forming Community Based Organisations (CBOs) and mobilising the poor was also launched in various SAARC countries on a pilot basis. It was coordinated under a cross-country pilot project called "South Asia Poverty Alleviation Programme (SAPAP)." It may be mentioned here that the SAPAP experiences were neither uniformly bad nor uniformly good.[2]

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[1] It is noteworthy that the report does not suggest simplistically to replace the state sector with the private sector! It suggested replacing overdeveloped state with various forms of organisations where poor people have easy access and right to participate.

[2] While describing the experiences of his visit to the SAPAP project in the Andhra Prodesh of India the Co-Chair of the ISACPA 2003 Dr. Kamal Siddiqui noted that "It was very successful in Andhra Prodesh" but at the same

The authors of the 1991 report were not hopeful to attract foreign investment from outside the region to boost up growth and employment because of the lack of necessary physical and social infrastructure in the South Asian region. Rather they were more apprehensive of the potentiality of brain drain or/and reverse flow of resources.

However, before these non-traditional recommendations of the 1992 ISACPA were completely implemented, tested and evaluated, the changed external and internal situation created a new compulsion to reconsider it's non-traditional empowerment approach towards poverty alleviation. The heads of states in Kathmandu SAARC Summit of 2002, proposed for a rethinking, reconstituted the old ISACPA and entrusted a new commission to prepare a new report outlining a new Poverty Reduction Strategy (PRS) attuned to the new international realities of the new millennium, which has been already described in detail in the previous section of this paper.

Naturally the question arose: what specific changes have occurred in South Asia and the world during the 1990s that created the necessity of a revised new strategy? Some of the major changes during the 1990s, along with the set of new recommendations, have been summarised in the latest ISACPA 2003 report. Among the list of changes first comes the item of trade liberalisation. South Asia has become further liberalised. Average Tariff has declined from 65.0 per cent in the late 1980s to about 30.0 per cent at the end of the 1990s. However, it should be noted that even after the extensive reduction in the tariff rate (more than 50.0 per cent decline!) the share of export of South Asia in the global export has increased meagrely, from 0.6 per cent to only 0.9 per cent between the late 1980s and the late 1990s. However, it is also true that most of this incremental export was not of primary kind, they were mostly labour intensive manufactures which brought about at least some positive diversification in the old structure of the south Asian export to other countries.

Another major change had occurred in the field of domestic foreign investment in the South Asian region. The FDI virtually rose almost eight times during this decade! However, its distribution was highly skewed in favour of India.

Besides all these changes, the remittances earned by migrant workers have also increased much to become a critical source of both foreign exchange and personal income in many countries of South Asia.

New technological breakthrough had also occurred, especially in the ICT sector in South Asia. The telephone mainlines per thousand people has more than trebled in the region between 1983 and 2000.

According to the ISACPA Report 2003, these positive opportunities of an outward looking South Asia probably created a new hope for exploiting the opportunities of the ongoing asymmetrical globalisation for the development of the whole region. At the same time, the BW institutions also came forward with their new PRSP approach towards development assistance and all other international agencies had begun to align their development initiatives with it. These internal and external factors together created a powerful push as well as an attractive pull for reconsidering the old set of policies of the ISACPA – 92 emphasising "domestic empowerment of the poor."

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time he identified the SAPAP project in Kishoreganj of Bangladesh as a case of failure and according to Dr. Siddiqui the failure was due to wrong targeting. He remarked, "It was not targeted to the poor, it was targeted to the entire population. As it happens in such a situation the advantages are reaped by the more powerful" (CPD, 2004).

The New 2003 report ultimately suggested three strategic priorities: "mobilising the power of the poor," "prudent macroeconomics" and "mainstreaming the informal sector." The various policies and programmes under these three strategic blocs have been elaborated in the ISACPA report of 2003. These reflect the following partial departures from the old strategy of 1992:

- The new approach recognised that the fruits of globalisation are unequally shared between the poor and the rich but it also accepted it as a reality. It also saw a future prospect of having a greater share of the benefit arising from this asymmetrical process by increasing efficiency and productivity of the backward regions and the countries as a whole. However, the new approach especially emphasised rural development so that fruits of globalisation may not remain concentrated in the urban areas.
- The new approach also emphasised regional cooperation in the field of trade and investment and urged the South Asian countries to fight unitedly against the developed countries for better market access, increased aid, increased debt relief and reduced tariff.
- The new report calls forth for a prudent macroeconomic policy in order to ensure higher growth as well as stability. This actually covers a set of policies more in line with that of BW institutions.
- The new approach also recognises that liberalisation and deregulation may have various negative fall outs for the poor but these, according to the new strategy, are to be accepted as given reality. Thus, what is required is not to try to stop or reverse liberalisation but to accompany some safety net and social protection measures to compensate the short-term losers.
- The report also calls forth for effective education and improvement of socioeconomic indicators along with the reforms for better investment climate.
- According to the report, this type of social improvement and the accompanying safety-net measures would be sufficient to ensure higher participation of the poor in the growth process.
- Particular policies have also been put forward in the new report for supporting the informal sector labourers e.g. development of skill and literacy of them, ensuring a minimum level of wage, health and safety measures for them, maternity benefits and child care, insurance against old age, illness, etc.
- Various macro policies such as preferential tax and tariff treatment of the informal sector, technology and market support for them, promulgating new laws for them to make their entry into the formal sector easier and incorporating them in the official statistics are also suggested to promote the informal sector where majority of the poor are employed or self-employed.
- For empowering people at the grassroot level, the report proposes for improving local level democracy by delegating real power to local bodies, holding regular free and fair elections at local level and correcting the under representation of the under-classes in these local bodies.

One of the co-authors of ISACPA 2003 report Dr Hossain Zillur Rahman pointed out in a later discussion on the report that South Asia is different from East-Asia in the sense that in the case of the East-Asia development was mainly driven by policies from above whereas in the case of South Asia development is relatively more driven by social initiatives or mobilisations at the ground level. In this sense leadership structures, participation opportunities and organisations matter relatively more in South Asia. Good policies may not be enough since more often they are not backed by committed leadership and/or implementing agencies. Thus, according to him the key future challenge against any poverty alleviation programme in South Asia lies in the field of "Implementation[3]" (CPD, 2004).

The ISACPA 2003 report identified the key future challenges ahead in the three fields of macro economy (mainly various types of resource gaps and uncertainties), society and culture (mainly the various gaps in values and organisations) and governance (mainly political and institutional gaps). The new report did not try to question the policies of the BW institutions directly; rather it tried to argue that the abovementioned constraints often make many a good policies bad or worse because of their implementation failures.

Perhaps in one respect the authors of the 2003 report were somewhat nearer to the tone and spirit of their predecessors and quite legitimately diagnose the two fundamental internal and external constraints against poverty alleviation in a language, which largely coincides with the tone of the older report. At page 34 of the new report while discussing about "leadership and organisation," they wrote:

> Organisations here refer to those for the poor such as LGO, NGO, CSOs and those of the poor such as CBOs. It is obvious that without developing a strong leadership from among the poor at the grassroot level, and strengthening organizations related to them, the South Asian reality will continue to be top-down and not much progress forthcoming either in pro-poor policy formulation or it's implementation. (SAARC, 2003, p.34)

And at page 35 of the new report some common and popular criticisms were also hurled against the International Donors. The major among them are: "unfair conditionality of the donors," "disregarding of local specificities by the donors," "over reliance of the donors on the expatriate consultants" and "uncoordinated and disjointed moves of the donors." After saying all these things the new report went a little bit further and added the following especial critique of WB and IMF:

Standardized policy packages pursued by IMF and WB have been seen by many as aggravating poverty rather than it's amelioration [Ibid, P.35].

12.4 SOCIOECONOMIC PROFILE OF THE COUNTRIES IN SOUTH ASIA

In this section we want to introduce a broad picture of the contemporary socioeconomic status of the five South Asian countries. This will help us to get an overall idea about the incidence of both income and human poverty in South Asia with the help of available comparable statistical information. Two other small countries of South Asia namely

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[3] In the same dialogue where this novel approach was presented some eminent scholars had pointed out that there actually exists a dialectical relationship between "Policies" and "Initiatives." It is true that a good policy cannot thrive without a proper initiative, but it is also true that a good initiative can thrive and develop only if good policies are there to protect and support it! [CPD, 2004]

Maldives and Bhutan had not been included in this analysis mainly because of their extreme small size in terms of both population and area.

Tables 12.1, 12.2 and 12.3, Tables 12.4 and 12.5, Table 12.6 and Table 12.7 deal with four different important aspects of income/human poverty. The concrete statistical indicators are respectively head count ratio of poverty and absolute number of poor in each country, human development index of each country, growth rate of per capita income of each country and measures of relative inequality in each country. We also tried our best to present the chosen indicator's value for at least two different points of time so that one can also have an idea about the direction and level of changes of these variables in the respective countries for the specific reference periods on which data are available.

12.4.1 Poverty

Tables 12.1 and 12.2 show the change in the level of the head count ratio of income poverty between 1990 and 2003 for the five South Asian countries. For ensuring inter-country comparability of the data, we have used two uniform international poverty line PPP incomes across all the countries.[4] Of the two uniform poverty line incomes: the first one is the lower poverty line income defined as the PPP 1 dollar a day income and the second is an upper poverty line income of PPP 2 dollars a day. Using both these lower and upper poverty lines, HCRs and absolute magnitude of the poor were calculated for both 1990 and 2003 for all the five countries of South Asia.

TABLE 12.1

US Dollar 1-a-Day Poverty Index and Magnitude of Poor in South Asian Countries, 1990 and 2003

Country	Poverty Index: 1990[a]		Poverty Index: 2003[b]	
	HCR	Magnitude [m.]	HCR	Magnitude [m.]
Nepal	44.1	7.9	23.8	5.8
Sri Lanka	3.8	0.6	1.0	0.2
Pakistan	47.8	51.6	19.7	29.2
Bangladesh	34.0	36.9	30.3	41.8
India	42.1	351.2	30.7	326.7
Total	41.3	448.4	29.0	403.8

Source: [a]WB, Povcalnet Data base and WB, World Development Indicators Online for 1990 Poverty Estimates. [b]ADB Staff Estimates for 2003. [ADB, 2004]

It should also be noted that poverty estimation for a common reference year for all five countries was not always possible because of the unavoidable problem of non synchronisation of the HIESs of the different countries. In fact, the latest poverty figures of the year 2003 could be calculated directly from HIES only for the two countries, India and Nepal, which really have their own, HIES for that year. For having an estimation of comparable figures for the three other South Asian Countries, the standard method of interpolation and extrapolation was used[5] (ADB, 2004).

[4] The author is fully aware of the conceptual shortcoming of defining poverty in this absolute one-dimensional manner devoid of the historical-moral dimensions but this approach was taken for its operational advantage.

[5] For a detail description of the method used, please see Chen and Ravallion, 2004.

TABLE 12.2

US Dollar 2-a-Day Poverty Index and Magnitude of Poor in South Asian Countries, 1990 and 2003

Country	Poverty Index: 1990[a]		Poverty Index: 2003[b]	
	HCR	Magnitude [m.]	HCR	Magnitude [m.]
Nepal	83.8	15.2	65.0	16.03
Sri Lanka	40.6	6.6	24.3	4.7
Pakistan	87.9	94.9	72.6	107.7
Bangladesh	85.5	92.9	79.5	109.7
India	86.1	718.9	78.0	830.0
Total	85.5	928.5	76.6	1068.2

Source: a. WB, Povcalnet Data base and WB, World Development Indicators Online for 1990 Poverty Estimates.
b. ADB Staff Estimates for 2003. [ADB, 2004].

We have also presented another separate Table 12.3 depicting the trends of national HCR of poverty for each of the five countries by using national estimates and definitions. This table uses country specific poverty line incomes as defined in the specific national poverty studies to estimate HCR of poverty and on the basis of those estimates it shows country wise changes in poverty during the periods for which national estimates were made. In general, we have used the main Planning Document and/or the PRSP of the Government to derive the national figures. This table is important because it shows the national official perception about the changes in the poverty level in the respective countries.

Table 12.1 shows that according to the internationally hegemonic definition of poverty dollar-a day, poverty was highest in Pakistan (47.8 per cent in 1990) and it was lowest in Sri Lanka (only 3.8 per cent in 1990). On the other hand, in the year 2003 highest poverty incidence could be found in both Bangladesh and India (30.3 per cent and 30.7 per cent respectively). The lowest incidence of poverty in South Asia, according to the latest available figure, is found in Sri Lanka again (1 per cent only). Thus if we rank the five countries in terms of HCR (head count ratio of poverty) on the basis of the latest figures available (i.e. 2003), we have the respective order from high to low as India, Bangladesh, Nepal, Pakistan and Sri Lanka. However, if we rank the same countries according to the pace of poverty reduction, then the best and the quickest reducer of HCR during 1990-2003 becomes Sri Lanka (73.6 per cent reduction!) and the worst performer in South Asia is Bangladesh (Only 10.8 per cent reduction).

However, because of differential size of the population the highest absolute number of poor belongs to India (351.2 million in 1990) and the lowest number of poor actually live in Sri Lanka (Only 6.2 million in 1990). In Bangladesh, Pakistan and Nepal the numbers are 41.8 million, 29.3 million and 5.9 million respectively (Table 12.1). Again, if we look at the pace of poverty reduction in terms of reduction in the absolute number of the poor during 1990-2003, we find the quickest reducer of the absolute number of the poor in South Asia is Sri Lanka (almost 80.0 per cent decline!). The worst performer is unfortunately Bangladesh, which is the only country in South Asia where the number of absolute poor has increased by 13.0 per cent during 1990-2003. The ranks of other countries in South Asia from best to worse in this respect are respectively Pakistan (44.0 per cent decrease), Nepal (27.0 per cent decrease) and India (7.0 per cent decrease).

TABLE 12.3

National Poverty Estimates from the Official PRSP/Plan Document for Different South Asian Countries

Country	Document Reference	National Poverty Estimate for a Selected Past Year	Available Poverty Estimate for the Most Recent Year	Target Poverty Estimate in the Target Year
Nepal	Government of Nepal (2003). The Tenth Plan: Poverty Reduction Strategy Paper, 2002–2007. May. Planning Commission, His Majesti's Nepal 5.	42.0 per cent in 1996	38.0 per cent in 2000/01	33.0 per cent (for lower 4.3% growth) or 30.0 per cent (for normal 6.2% growth) in 2006/07
Sri Lanka	Government of Sri Lanka. (2002). Regaining Sri Lanka: Vision and Strategy for Accelerated Development. December. Sri Lanka.	31.0 per cent in 1985 (extreme poverty line)	25.0 per cent in 1995	20.0 per cent in 2005 and also Halving extreme poverty rates by 2010 (i.e.12.5%)
Pakistan	Government of Pakistan (2003). Accelerating Economic Growth and Reducing Poverty: The Road Ahead (Poverty Reduction Strategy Paper). December. Ministry of Finance. Pakistan.	29.1 per cent in 1986/87	32.1 per cent in 2000/01	16.0 per cent in 2015 as envisaged by the MDG
Bangladesh	Government of Bangladesh. (2005). Unlocking the Potentials: National Strategy for Accelerated Poverty Reduction, October. General Economic Division, Planning Commission, Dhaka. Bangladesh.	58.8 per cent in 19901 [using HIES unit-record method or 49.7 per cent. [Using longer-term grouped distribution data]	49.8 in 2000 [Using HIES unit-record method] Or, 40.2 per cent [Using HIES longer-term grouped distribution data]	25.0 per cent or 20.0 per cent in 2015
India	Government of India. (2002). Tenth Five Year Plan 2002-2007. December. Planning Commission, India	54.8 per cent in 1973/74	26.0 per cent in 1999/2000	21.0 per cent by 2007 and 11.0 per cent by 2012.

However, if we look into the Table 12.2 where both the level and the trends of poverty are shown by using a different upper poverty line (PPP 2$ a day), we do not find any significant changes in the rankings in the performance of South Asian countries. In terms of HCR the ranks from higher to lower in 1990 were Pakistan (87.9 per cent), India (86.1 per cent), Bangladesh (85.5 per cent), Nepal (83.8 per cent) and Sri Lanka (40.6 per cent). In terms of pace of poverty reduction during 1990-2003 the best performer was as before Sri Lanka and the worst is Bangladesh. The picture made according to the upper poverty line also shows that during 1990-2003 the absolute number of poor had increased in all these South Asian countries except Sri Lanka (30.0 per cent decrease!). The number of moderately poor had increased respectively by 18.0

per cent in Bangladesh, by 15.0 per cent in India, by 14.0 per cent in Pakistan and by only 6.0 per cent in Nepal.

Table 12.3 shows the officially accepted national perception of poverty levels and their trends in the five South Asian countries. Since the reference period differs from country to country, so we could only compare the pace of poverty reduction among these countries. From that perspective it seems that the quickest reducer of HCR was India. During the reference period of 1973/74-2002, national HCR had reduced each year on average by 1.1 percentage point. On the same basis, the lowest pace was shown by Pakistan where actually during the reference period of 1986/87-2000, on average, national HCR actually increased by 0.2 percentage point every year. The rate of reduction of the national HCR for Nepal was, on average, 1 percentage point per year during the period of 1996-2000. For Bangladesh the same was, on average, 0.9 percentage point per year for the period between 1990 and 2000. For Sri Lanka it was only 0.6 percentage point per year during the period of 1985-95.

Thus, international comparable data shows that from 1990 to until now the dynamic performance of Sri Lanka and Pakistan seems to be relatively better in South Asia with respect to the incidence of income poverty. And in all counts the worst performer is seemed to be Bangladesh. However, national data shows a different picture and according to the available officially recognised national poverty data it seems that India has the highest pace of reducing national HCR in South Asia. Then come respectively Nepal, Bangladesh, Sri Lanka and Pakistan. This conflicting picture only reveals that how difficult it is to have a consensus picture of the poverty estimate in any country.

12.4.2 Human Development Index

Table 12.4 presents the levels and ranks of HDI for all the South Asian countries for four different points of time: 1990, 1995, 2000 and 2003. From the table it is observed that at the beginning i.e. in 1990 Sri Lanka occupied the first position among the South Asian countries and 86th position among the countries of the world. The other countries in South Asia about which we are discussing here e.g. Pakistan, India, Nepal and Bangladesh have been occupying respectively the second, third, fourth and fifth position with respect to their levels of human development in 1990. However, within next thirteen years this rank order had changed due to the uneven rate of progress in the value of the HDI across the countries of South Asia.

TABLE 12.4

HDI Values and Ranks of South Asian Countries (1990-2003)

Year	Bangladesh		India		Pakistan		Sri Lanka		Nepal	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank
1990	0.189	147	0.309	134	0.311	132	0.663	86	0.170	152
1995	0.371	147	0.451	139	0.453	138	0.716	90	0.351	152
2000	0.478	145	0.577	124	0.499	138	0.741	89	0.490	142
2003	0.520	139	0.602	127	0.527	135	0.751	93	0.526	136

Source: UNDP, Human Development Report, Different Issues.

The HDI value had been increasing unevenly across these countries. The highest rate of increase in HDI occurred in the case of Nepal (209.0 per cent). The rate of progress achieved by Bangladesh was also enviable (188.0 per cent). India and Pakistan both countries had experienced a moderate rate of improvement in their Human Development Indices during 1990-2003, 95.0 per cent and 69.0 per cent respectively. But the rate of improvement was, however, insignificant in the case of Sri Lanka i.e. only 14.0 per cent. Perhaps this is due to the high base year value of the HDI of Sri Lanka.

After these changes we find, in the year 2000, Sri Lanka to be still the best performer with respect to human development. But Bangladesh, in spite of the high rate of growth in its HDI, had gone down to the last position in South Asia from its previous fourth position in 1990. On the other hand, Nepal graduated up to the fourth position from its previous rank of fifth. India's position also improved and became second whereas Pakistan got down from the second position to the third position.

Table 12.5 depicts the trend of the indicator *"GNP Rank minus HDI Rank"* which shows us whether the concerned countries had performed relatively better in terms of human development than that of economic growth from the perspective of the corresponding years achieved global standard. Accordingly, the countries which had been relatively more successfully going up in the HDI ranking than in the per capita GNP ranking during the period of 1990-2003 should reflect this achievement in their ability to turn their negative score into positive and if positive in the beginning then attaining still more higher levels at the end year of 2003. The table interestingly shows that for three South Asian countries actually the positive score has been transformed into negative. The degree of deterioration was highest for India (-20), then Bangladesh (-16) and then Pakistan (-12). In the case of Sri Lanka also the positive score at the beginning decreased by the highest amount of 27 but it still remains positive. In the case of Nepal only the positive score remained unchanged.

TABLE 12.5

GDP per capita (ppp US$) Rank Minus HDI Rank Figures for South Asian Countries: 1990-2003

Country	GNP Rank minus HDI Rank[a]	
	1990	2003
Sri Lanka	44	(+) 17
Nepal	15	(+) 15
Pakistan	7	(-) 5
India	11	(-) 9
Bangladesh	15	(-) 1

Note: [a]A positive score indicates that HDI ranking is higher than the GNP ranking and a negative score indicates the reverse.

Source: UNDP (1992 and 2005).

All these findings can be summarised by saying that in South Asia during the period of 1990-2003 all the countries, except Nepal, showed a mismatch between their progress in the GNP ranking and the HDI ranking.

12.4.3 Economic Growth

Table 12.6 presents the comparative picture of economic growth for the five South Asian countries for the two decades of 1980s and 1990s.

In the 1980s the topmost performer was Pakistan with a growth rate of 6.3 per cent. And the worst performer was Sri Lanka. In the 1980s the average growth rate for the whole South Asia was as high as 5.7 per cent and only two countries out of five had growth rates above that average. They were respectively Pakistan (6.2 per cent) and India (5.8 per cent). In the 1980s the below average performers were respectively Sri Lanka (4.0 per cent), Bangladesh (4.3 per cent) and Nepal (4.6 per cent).

TABLE 12.6

Trends in Overall GDP and Per Capita Growth

Country	Overall GDP Growth[a]		Per Capita GDP Growth[b]
	1980-90	1990-99	1990-99
Bangladesh	4.3	4.8	3.1
India	5.8	6.1	4.1
Nepal	4.6	4.8	2.3
Pakistan	6.3	4.0	1.3
Sri Lanka	4.0	5.3	4.0
South Asia	5.7	5.7	3.4

Source: [a]WB (2001); [b]UNDP (2001).

But in the 1990s the worst performer was Pakistan, which had experienced a decline in the growth rate from 6.3 per cent in the previous decade to a level of only 4.0 per cent. And India became the best performer in the 1990s with a growth rate of 6.1 per cent. However, the South Asian average growth rate had remained in the same level as it was in the 1980s. Actually the growth rates of all the countries of South Asia had increased during the 1990s, except Pakistan. The rate of acceleration in the growth rate was highest for Sri Lanka (almost a 30.0 per cent increase). Then come respectively Bangladesh (almost 12.0 per cent improvement), India (5.7 per cent improvement) and Nepal (4.3 per cent improvement).

12.4.4 Inequality

Table 12.7 presents the available measures of inequality for the different South Asian countries. The table shows that the Gini Index for inequality of either income or consumption was highest in India (36.7) during 1995-97. Those of Nepal, Sri Lanka and Bangladesh were also quite high, respectively 36.7, 34.4 and 33.6. In Pakistan the Gini Index value was 31.2. In general, Gini measure of inequality shows relatively small variation across South Asian countries.

But the most alarming trend is the trend of rising inequality in almost all the countries of South Asia. The ratio of income/consumption share of the richest 20.0 per cent to poorest 20.0 per cent, another index of inequality, shows that this ratio varies from 4.0 in Bangladesh to 5.0 in India and the time trend shows rising inequality in all of the South Asian countries, except Pakistan.

TABLE 12.7

Income/Consumption Inequality

Country	Gini Index (%)	Ratio of Income or Consumption Share of Richest 20% to Poorest 20%	
	1995-97[a]	1980-94[b]	1995-97[a]
Bangladesh	33.6	4.0	4.9
India	37.8	5.0	5.7
Nepal	36.7	4.3	5.9
Pakistan	31.2	4.7	4.3
Sri Lanka	34.4	4.4	5.3

Source: [a]UNDP, (1999); [b]UNDP (2002).

In general, we find that in spite of acceleration in the economic growth in most of the countries of South Asia (with the exception of Pakistan) in the recent period, there occurred no significant decline in income poverty. This is perhaps because the poor people of these countries of South Asia obviously did not have adequate opportunity to participate in the incremental growth processes of their respective countries. That is why we find rising inequality in the ratio of consumption/income share of the richest 20.0 per cent to poorest 20.0 per cent in all South Asian countries (except Pakistan) in spite of the growing momentum of growth. But even in Pakistan where inequality seems to have decreased, poverty seems to have actually increased more adversely. Perhaps it was because of a combination of lower growth rate and an insignificant decline in inequality.

12.5 COMMON DEVELOPMENT EXPERIENCES OF THE SOUTH ASIAN COUNTRIES

Thus, the economic indicators are generally not bright at all for the countries of South Asia. However, the social indicators as reflected in the trend of HDI show quite significant achievements by almost all the countries (except Sri Lanka, but its HDI rank was already quite high from quite a long time ago). Perhaps one way of explaining this apparent paradox will be to look into more details of the qualitative content of the social outcomes and indicators of each country as well as into their major socioeconomic policy regimes. Perhaps in this context it will not be irrelevant to quote from The *HDR in South Asia 2003* which interestingly notes the following commonalities of development experiences of the South Asian countries:

- Increasing inequalities of income in all the economies of region.
- A deceleration of employment generation compared to previous periods.
- Either stagnation or increase in the levels of poverty as defined by the head count ratio of poverty.
- The relative decline in the manufacturing, especially in the small-scale sector.
- Quality and terms and conditions of employment have in general deteriorated in all the South Asian countries.

- All the countries of South Asia over time converged more or less to a common set of policies under the framework of so-called SAP sponsored by the BW institutions.[6]

12.6 PRSP: IDEAL FEATURES, MUNDANE REALITY AND THE FUNDAMENTAL CRITIQUE

IMF paper defines PRSP as essentially *"a road map prepared by countries themselves to help them better target public policies in support of poverty reduction"* (Brian, Blett, and Plant, 2002). The four essential and common elements of the PRSP are:

- A description of the participatory process used in preparing them.
- A poverty diagnosis: includes identification of major obstacles to poverty reduction and growth.
- Targets, indicators and monitoring system.
- Priority public actions that countries are committed to undertake within budget constraint.

Generally PRSPs should cover a three-year period and be in consonance with the widely accepted long-term MDGs.[7] According to the BW institutions, the following five common basic principles are to be followed in any ideal PRSP:

i. Country-driven: With governments leading the process and broad-based participation in the adoption and monitoring of the resulting strategy.

ii. Results-oriented: Identifying desired outcomes and planning the road map towards them.

iii. Comprehensive: Must take the multidimensional nature of poverty.

iv. Long-term in approach: Must recognise the depth and the complexity of some of the required long-term changes.

v. Based on Partnership: Between governments, actors in civil society, the private sector and the donor community.

PRSP in general follows the old neo-liberal model of economic development based on the so-called "Washington Consensus." Besides this old wine, what is new in the PRSP bottle is its specific time bounded focus on the poverty reducing goals instead of the old emphasis on simple economic growth. It also pays explicit attention to a set of education and health related human development goals as envisaged in the MDGs.

In a recent report titled "Poverty Reduction Strategy Papers – Progress in Implementation" prepared by the IMF and IDA in September 2003, it was reported that:

- The total number of PRSPs has reached 32 as of in mid-July 2003. Another 21 countries have embarked on the PRSP process after having finalised their IPRSPs.

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6 *HDR in South Asia 2003* notes, "From the 1980s onwards, all of them (South Asian Countries) moved, to varying degrees, to a strategy of development based on export-orientation, liberalisation and privatisation based on the market-based economic paradigm. The process could be said to have started in South Asia with the Sri Lankan Government of Jayawardene moving towards liberalization and dismantling of the earlier universal food security system in the late 1970s and the early 1980s." [p. 46]

7 But there are a few exceptions too e.g. Nepal has a PRSP submitted to the donors and side by side there exists the traditional Tenth Five Year Plan sharing overlapped years with the PRSP !

- The average length of PRSPs has increased steadily, from under 70 pages in 2000 to over 190 pages in 2003. Although length in-itself is not an issue but at least in some cases it can exacerbate the problem of focus and make the priority issues appear more diffuse.
- The time gap between the IPRSP and the full-fledged PRSP has been becoming too long in many cases. For the 22 IPRSPs the average time elapsed since their IPRSPs were finalised stands at around 26 months.

12.6.1 The Issue of Domestic Ownership

The most novel as well as the most controversial feature of the PRSPs is its high rhetoric of so-called "Domestic Ownership and Poor Peoples' Participation." IMF board explicitly recognises that mere conditionality cannot ensure ownership and without ownership a reform programme is neither credible nor effective.[8] However, common sense says that the most natural way to establish domestic ownership of the PRSP should be to allow the countries to formulate their own policies independently first and then negotiate over it. But this procedure was not actually followed by the BW organisations (Lipumbo, 2001).

The degree of domestic participation in the process of formulating the PRSP may vary from country to country, but there is always a pre-eminent role of especially WB in that process and the PRSP cannot be launched unless the board of directors of the BW institutions finally approves it. A WB paper has described the following three important procedural steps prior to the finalisation of PRSPs:

i. WB and IMF must meet with country authorities to discuss the emerging strategy. These views must be shared with other development partners and civil society.
ii. The country will send the final strategy to the executive boards of WB and IMF.
iii. Before placing it in the boards Joint Assessment Report of WB and IMF will be made and put before the board (WB, 2000).

The procedure described above implies a peculiar kind of "domestic ownership" of the PRSPs. Helleiner (2000) defines such an "ownership" from the point of view of IMF by quoting an unidentified official of a donor agency to Tanzania as saying, "*Ownership exists when they do what we want them to do but they do so voluntarily.*"

However, WB claims that they only provide policy inputs to help their domestic "development partners" to formulate their own PRSP. In reality there is an agreed division of labour in this job of providing policy inputs between the two BW sister organisations.

WB has a comparative advantage in providing policy inputs in the areas of "poverty assessments," "designing of sectoral strategies," "institutional reforms" and "social safety net" policies.

[8] The executive Board, at it's March 2001 meeting to review conditionality, agreed that ownership is "essential to the successful and sustained implementation of a programme of economic policies" and that "conditionality can not compensate for a lack of programme ownership" [Public Information Notice No. 01/28, March, 2001, please see IMF, December, 2001, p. 3.].

Whereas IMF has comparative advantage in the fields of "macroeconomic," "exchange rate" and "tax policies."

Both IMF and WB provide common policy inputs in the fields of "fiscal management," "budget transparency" and "tax-custom administration" (Brian and Klugman, 2002).[9]

If BW institutions were providing simple policy advice without any conditional strings attached to them then there would have been not so much objection about its negative effect on the "domestic ownership" of those superimposed policies chosen and incorporated in the PRSP. All the concerned countries would have agreed that each country has freely chosen from the proposed set of policies without any apprehension of economic loss and thus it has not affected the domestic commitment and/or ownership of these policies. But unfortunately BW policy advice in many cases takes the form of "conditionality" attached to some kind of concessional aid facilities (e.g. PRGF credit of IMF and PRS credit by WB).

IMF based PRGF credit especially contains three types of conditions:

i. The first set of conditions pertains to the "prior action" conditionality. Under them IMF imposes "prior action" conditions which have to be undertaken in order to become qualified for IMF credit. This is primarily used against those countries where the past track record is bad or commitment to policy reforms is doubtful.

ii. There are also "outcome conditions" which are often termed as "performance conditions." Under them usually certain quantitative measures of performance are set which have to be met within a specified time limit in order to either receive the fund or for the continuation of the fund flow! Often "Floating Tranche" method is followed so that the country is forced to meet the set target in order to get the next instalment of the fund.

iii. There are also occasional "program review exercises" carried out by the donor agency to have a broad macro judgment about the overall success/failure of the aid recipient country. On the basis of that there may be "waiver" of the above two conditions if the IMF board approves that. Conversely, if the board is not happy then even after fulfilling all the performance conditions aid may not continue[10] (IMF, 2002).

Features of IMF conditionality described above actually do not fit with the concepts of "Free Partnership" and/or "Free Offer." It rather fits more with a new concept called "Throffer," a concept that was first proposed by Taylor (1982) while analysing the attributes of a unequal "Power Relation." According to Taylor in a situation of power relation between A and B, "A" has power over "B" if "A" can affect the incentives facing "B" in such a way that it is rational for "B" to do something he would not otherwise have

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[9] Ames Brian of IMF team and Jeni Klugman of WB led the PRSP review exercise jointly in 2002. The report is titled "Review of the PRSP Approach – Early Experience with IPRSPs and Full PRSPs."

[10] The IMF board may stop aid flow simply because they are not happy with the macro policies of the aid recipient country! In an official paper on IMF conditionality it is explicitly stated, "... meeting all the performance conditions is not always sufficient for continued access to Fund resources. Where purchase is also conditioned on completion of a program review, the completion of the review may also depend on the satisfactory progress in broader policy areas, as set out in the program documentation" (IMF, January, 2002, p. 17).

chosen to do. Generally "A" affects the incentives facing "B" mainly through the offer of a reward, the threat of a penalty, or some combination of a threat and an offer, which Taylor actually calls "Throffer." Pranab Bardhan mentions a chilling example of a "Throffer" in the film The Godfather e.g., "I'm gonna make him an offer he can't refuse!" (Bardhan, 2005)

The response of IMF to the above critique is quite simple. In an article titled, "Reconciling Conditionality and Country Ownership" published in the June 2002 issue of the IMF journal, Finance and Development, the authors wrote:

> The IMF is mandated by its charter to extend temporary financial assistance to its member countries facing BOP difficulties *under adequate safeguards*. It has to have assurances that will be repaid.
>
> IMF loan recipients do not possess internationally valuable collateral against which they could obtain private loans. In the absence of collateral, private loan contracts typically include various forms of covenants designed to protect the lender and prohibit the borrower from taking actions that could reduce the probability of repayment. IMF conditionality can be viewed as a complex covenant written into the loan agreement. It thus serves, in a sense, as a substitute for collateral (Mohosin and Sharma, 2002).

The paper also honestly points out to some very pertinent problems arising out of the particular features of IMF conditionality. These are:

i. IMF conditionality springs from assessing the macroeconomic imbalances or structural deficiencies that led to macroeconomic problems and then negotiating an agreement with country authorities that will address them. There can be broadly two kinds of disagreements in this respect: (a) Disagreement regarding the diagnosis of the cause of the problem; and (b) Disagreement regarding the policy instruments to fight the causes of the problem.

ii. In the late 1970s and the early 1980s IMF was heavily criticised for being interested only in narrow outcomes (BOP) and relatively unconcerned about growth. IMF then responded in cooperation with the WB by including policy conditions to remove structural impediments to growth and constraints against efficient resource allocation. As a result, the number of structural conditions has increased substantially, going from an average of 3 in the late 1980s to 15 in the late 1990s. But the macroeconomic performance related conditions have remained more or less stable during 1980-2000. This shift in the conditionality package in favour of the so-called "Second Generation Policies" has made the IMF reform programme more controversial and has evoked more severe criticisms from the domestic quarter! The author himself wrote:

> It is now widely acknowledged that the expansion of structural conditions left limited scope for domestic policy choices, thereby potentially reducing country ownership.

iii. The value of IMF conditionality even when agreed upon will largely depend upon the countries authorities commitment to these conditionalities.

iv. Unlike private borrowing where the lender deals with a single firm or single borrower, here IMF has to deal with the country as a whole, which is an agency of multiple stakeholders.

v. IMF lends to individual member country each of whom is sovereign, thus in the event of default IMF cannot go to any international court.

vi. Since penalties have limited credibility because they are unlikely to be enforced, so departure is easy.

12.7 THE COMMONALITIES AND NON COMMONALITIES OF THE SOUTH ASIAN POVERTY REDUCTION STRATEGIES

12.7.1 Commonness

The South Asian economies have many common social, political and economic features. The most salient among them are:

- Highly unequal distribution of physical, financial and human assets.
- High political instability originating from various kinds of ethnic or communal conflicts and regional or economic disparity.
- A strong dualism between organised and unorganised sector.
- The continuing significance of the agricultural sector as a major source of employment.
- The early emergence of a large service sector as one of the largest employers, often acting as the last refuge of the unemployed poor.
- A large segment of the assetless poor engaged in self-employment based low productivity micro activities.
- A historically inherited lack of trust towards India by its neighbours.

In the previous introductory discussion it was also pointed how poverty reduction had become the centrepiece of the development discourse all over the world in the last decade of the previous century. South Asia was also a part of that process. The IFI sponsored PRSP exercise was undertaken by at least four South Asian countries in the late 1990s.

Before that almost all of them had been following the BW sponsored reform agendas known as the "*Structural Adjustment Policy*" for quite a long time. The PRSPs of the four South Asian countries actually did not make any decisive break with their ongoing old reform processes. All the three documents of Sri Lanka, Nepal and Pakistan had explicitly recognised this truth in their documents. Although the Bangladesh document did not explicitly recognise this truth but are actually continuing to follow the old unfinished or remaining reform agendas of the BW institutions in the name of PRSP or separately outside PRSP! The only country India that had not undertaken an exercise in PRSP yet is also presently following the same reform agendas but a little bit slowly because of perhaps unfavourable political pressures from the left as well as the inner strength of their national economy to withstand international pressures and dictates.

However, if we look at broadly at the evolving macroeconomic framework of the South Asian countries, we may safely say that by the turn of the century most of the economies of South Asia had either initiated or completed the following macroeconomic reforms in their economies:

- Substantial reduction of state control in terms of administered prices and regulation of economic activities.
- Reduction of taxes in general with a special emphasis on import tax.
- In order to reduce fiscal deficit the general policy was to cut public expenditure, especially the subsidies to farmers and SOEs.
- Increasing the domestic prices of utilities, oil/gas and the user fees of various kinds of social/public services.
- Liberalising foreign trade, allowing entry of foreign commodities and capital into the domestic market without any restriction.
- Financial Liberalisation and freeing the interest rate as well as reducing subsidised targeted credits.
- Movement toward market determined exchange rates.
- Liberalising the capital account i.e. easing rules for FDI, access to foreign commercial borrowing by the domestic firms.[11]

All the four PRSPs of South Asia (Sri Lanka, Nepal, Bangladesh and Pakistan) have also more or less aligned their poverty reduction targets with the MDGs, which are to be achieved within 2015. These commonly accepted MDGs all over the developing countries are also applicable to all the South Asian PRSPs. In brief they are:

i. Eradicate extreme poverty and hunger. reducing by half the population in poverty by 2015.
ii. Achieve universal primary education.
iii. Promote gender equality: eliminate gender disparity in primary and secondary education.
iv. Reduce child mortality: reduce by two-thirds under 5-child mortality.
v. Improve maternal health: reduce by three quarters maternal mortality ratio.
vi. Combat HIV/AIDS, Malaria and other diseases.
vii. Ensure environmental sustainability: reduce by half proportion of people without access to safe water.
viii. Develop a partnership of development.

A detailed discussion on the status of MDG goals in the different countries of South Asia is available in the "Report of the Independent South Asian commission on Poverty Alleviation: Road Map Towards a Poverty Free South Asia." The main conclusion that follows from their discussion is that except Sri Lanka none of the countries of South Asia would be able to achieve the MDGs by 2015 if the current pace of poverty reduction continues and the PRSPs remain confined within a "Business as Usual" mode. It has been further calculated out that by current trends, the MDG target date for South Asia would be 2025 instead of 2015.

All the four PRSPs under this discussion had actually failed to address the basic issues of unequal ownership of different kinds of assets and have remained confined to the old macroeconomic framework inherited from the SAP reform process. However, all

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11 For a detail list of country wise reforms along these lines please see *HDR in South Asia 2003.*

of them commonly share the new rhetoric of "Pro Poor Growth" but each of them fails to lay down any kind of concrete structural measures for doing so. At best these PRSPs chalk out some concrete goals, programmes and projects for their respective countries in the fields of "*human resource development*," "*safety net programmes*" and a few "*institutional measures* aimed at achieving good governance" in the light of the accepted MDGs. But all such moves will require a massive transfer of resources from the rich biased sectors to the pro poor sectors. Without that such goals ought to remain mere pious wishes. But this is contingent upon the character of the ruling classes of these countries and that again is largely constrained by the existing political balance of power in these countries.

12.8 TRADITIONAL GOALS WITH UNCOMMON PROGRAMMES

12.8.1 High Growth Rate

All the four PRSPs want to accelerate their present growth rates. The goal of Bangladesh is to raise the growth rate of real GDP from 5.5 per cent in FY2004 to 6.5 per cent in FY2006. Nepal wants to ensure at least 6.2 per cent growth of real GDP in order to reduce poverty significantly through generation of employment. Sri Lanka had set a target of doubling its current growth rate and achieve a long term growth rate of 10.0 per cent. And Pakistan aspires for increasing the real GDP growth rate to 5.1 per cent in the FY2003 and to raise it to a level of 6.2 per cent by FY2008. These different growth targets are then used to project corresponding macro scenarios for each country respectively depicting the behaviour of broad macro variables like rates of investment, savings, government expenditures, foreign aid, inflation rates, employment, etc.

12.8.2 Human Resource Development

All the PRSPs aim for investing in the human resources of their countries. In Bangladesh the main mechanism of investing for human resource development would be increase in the budgetary expenditure in the health and education sector. The two issues of "quality of the health/education service" and the "paucity of fund" were recognised explicitly in the PRSP of Bangladesh. Arguments were presented in favour of involving NGOs and CBOs for better accountability of teachers/doctors and thereby ensuring better quality services from them. It was also suggested to increase current public spending in the education sector from the present level of 2.2 per cent of GDP to a level of 4.4 per cent! In Nepal also elaborate plans were drawn for both health and education sectors with a much greater emphasis on increasing adult literacy to the level of 63.0 per cent with the help of CBOs and NGOs. In Pakistan the main goal in the education sector is to ensure the implementation of the ongoing project of Education Sector Reforms Action Plan (2001-2005) embedded in the country PRSP. This would require tentatively an increase in public spending on education from 1.8 per cent in 2001/02 to 2.5 per cent of GDP by 2007/08. In the health sector the main aim was to fight certain diseases like TB, Roll Back Malaria, Hepatitis B, Polio, HIV and Aids. A programme to immunise children against six communicable diseases and a new community based maternal and child health programme are also going to be implemented. For Sri Lanka the main issue in the field of investing in human resources was to reduce regional and class disparity through enhancing the quality of both education and health services uniformly across the country/classes. Sri Lankan PRSP has also set the relatively higher target of reaching universal secondary school enrolment by the year 2010. In the health sector also Sri Lanka aims to ensure better quality services by introducing more modern superior technology and automation in its public health centres.

12.8.3 Safety Net Provisions

All the four PRSPs have their own designs of safety net programmes. Bangladesh had designed a four fold approach towards its safety net programme aimed at especially those sections of the population who face poverty due to some shocks emanating from natural disaster, sudden changes in the market price, change in the government policy, retrenchment policy, etc. These programmes include food/cash support to the vulnerable, micro credit to the poor, especially to the women, building local infrastructure and thereby creating new employment scope for the vulnerable groups and providing redemption fees for the retrenched workers of the SOEs.

In Nepal the safety net programmes consist of a large number of target group oriented expenditure/transfer by the Government. The delivery mechanism is however dependent on the NGOs, CBOs and local government.

In Pakistan micro finance bank has been established to serve the drowning poor. Besides that other social safety nets for the vulnerable groups currently available in Pakistan include Workers Welfare Fund (WWF), Food Support Programme, Social Security, Employees Old Age Benefit (EOAB), Pakistan Bait-ul-Mal (PBM) and Zakat Fund. The poverty reduction strategy of Pakistan especially aims to strengthen the existing mechanism of cash transfers through Zakat and the social protection system of EOBI and health care through Employees Social Security Institutions (ESSIs).

In Sri Lanka the main issue is to reform the "Samudri," the largest welfare programme of Sri Lanka in order to ensure better targeting, lesser leakage and increased efficiency.

12.8.4 Good Governance

All the four PRSPs recognise at least in words the necessity of good governance as well as increasing the voice and participation of the poor to ensure a greater agency role of the poor in the over all process of poverty eradication.

In this regard the position of the Bangladeshi PRSP is quite explicit. It suggests for promoting good governance through improving implementation capacity, promoting local governance, tackling corruption, enhancing access to justice for the poor and improving the service delivery mechanism. With regard to participation and empowerment the suggestion is, however, quite modest and urges for greater participation and empowerment of especially women and other disadvantaged and marginalised groups such as disabled, ethnic minorities, and the ecologically vulnerable.[12]

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[12] However, in the older version of the so-called IPRSP of Bangladesh there was a separate chapter head titled: "Policies and Institutions for Reducing Inequality." That chapter contained the following quite radical statement regarding the agency role of the poor: "*A faster pace of poverty reduction would require greater voices of the poor. Greater voices would be ensured through moving beyond the narrow domain of micro-empowerment measures such as access to credit. For greater agency role of the poor, measures would be taken for building*

The Nepalese PRSP proposes for increased decentralisation, civil service reforms, improved financial management and accountability and various anti-corruption measures for ensuring good governance. Nothing extra is said there for increasing the social mobilisation, participation and the voice of the poorer classes of the society. However, the Nepalese PRSP explicitly recognises the necessity of providing equal access for women and children to social and economic infrastructure and income and employment opportunity so that they can participate in the mainstream growth process.

Improving governance and devolution is treated as one of the four pillars of the Pakistani PRSP. The elements of this pillar are respectively devolution, fiscal decentralisation, access to justice, police reforms, civil service reforms, pay and pension reform, capacity building, anti-corruption strategy, procurement reform, freedom of information, fiscal and financial transparency and strengthening statistics. As regards to the agency role of the poor, it confines itself to the suggestion of an enabling environment for community participation of the poor through the legal framework in the village and neighbourhood councils and Citizens Community Boards (CCBs).

12.9 CONCLUSION

If we reflect back again as a whole on the abovementioned brief analysis of the four South Asian PRSPs, we are again struck by the traditionalistic and almost similar way of thinking among their authors. This shows that none of them had gone beyond the "Business As Usual" mode of response towards the really very inscrutable problem of poverty.

Although the goals set in these PRSPs by their authors were quite ambitious, yet policies and programmes contained in them have rarely gone beyond the traditional market based paradigm of poverty eradication supplemented with a programme of human development and a few safety net projects. Even this type of traditional strategy for poverty eradication in these four countries is also not immune from severe governance problems that continue to exist in each of these countries. But as we all know that in the ultimate analysis the *"governance problem"* is a political problem and cannot be solved by producing written document like PRSPs, so there is left little hope regarding the success of these PRSP exercises in South Asia.

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institutions for the poor at sectoral, sub-national and national levels with emphasis on developing new institutional ways and means for their collective empowerment" [p. 51]. It is not accidental that not only this statement but also the whole chapter was purged out from the final PRSP document of Bangladesh!

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